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## Freedom of information concerns may be overblown

The reality is that the impact of the new legislation in the UK is unlikely to be as far-reaching as was originally feared, writes Brian Bollen

The UK's much-vaunted, and long-delayed, Freedom of Information Act, which came into effect on January 1 this year, looks like another example of the British government's ability to shoot itself in the foot.

Chris Hale, head of corporate at law firm Travis Smith, said: "I'm sure that when the Act was passing through Parliament, its effect on the private equity industry was not in the minds of those debating the provisions of the Bill. Unfortunately, parliamentary draftsmen these days tend to draft most legislation on an extremely wide basis and it is only later that the breadth of that legislation and its effects become apparent."

As the law of unintended consequences begins to operate, some private equity specialists claim that the Act could institutionalise a form of financial apartheid. This would be forced on the industry so it could protect itself from local authority pension funds, traditional investors in private equity vehicles, who may come under pressure from journalists seeking to disclose confidential details of transactions.

Faced with such a possibility, general partners look likely to begin excluding such investors from new investment opportunities, argue some industry experts. Taken to extremes, this would prevent local authority pension funds from buying into potentially stellar investments. This could in turn lead to underperformance and higher council and other taxes needed to make up the resultant shortfall. Ideologically pure perhaps, but a perverse outcome, nonetheless.

The impact on the industry is likely to be less severe. The broad consensus is that the possible implications of the Act are nowhere near as far-reaching and widespread as initially feared. Not least because, while the contribution that local authority pension funds make to private equity funds is growing, it remains a relatively modest figure.

George Anson, managing director at Harbour-Vest, a global private equity fund of funds investor, said: "Any impact will be purely at the margin. It's not going to change the landscape."

Moreover, as John Mackie, chief executive of the British Venture Capital Association, said, the relationship between investor and the individual fund manager is already highly transparent. "The pension funds, insurance companies and others who provide us with capital get all the information they



**Anson: 'Any impact will be purely at the margin.'**

want and need on a regular basis. The argument here is as to whether there is any benefit to anybody in that information being more widely available," said Mackie.

Hale said the three main implications are that a number of matters private equity houses have hitherto regarded as confidential might seep out into the public domain.

These are: 1) details of private equity fund performance; 2) valuations of companies in which private equity funds have invested; and 3) details of the charging structure which private equity funds agree with their investors.

Private equity investors do have legitimate concerns, he said, in the way that most businesses do, about information that is otherwise regarded as confidential being known to the world at large. "This information could help private equity investor competitors or competitors of their investee companies. None of this should be regarded as information they are seeking to hide in some untoward way. Fund performance statistics are different. If your fund has not been performing well, you understandably do not want its returns known at large. There is a strong case for saying that wider assessment of comparative

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returns of public equity fund managers is in the public interest and should be more broadly known."

But could the FOIA result in a traditional source of funds drying up? "It could certainly result in some public organisations which provide funds to private equity managers either being excluded from investing or not being offered co-investment opportunities," said Hale.

ECI, a private equity group, said it actively promotes full disclosure of performance to its investors and to those groups looking to make an investment in its funds. Indeed, it believes it is the first fund in the UK to comply with the industry-wide global industry performance standard for reporting results.

However, Mounir Guen, chief executive of MVision, a specialist in raising capital for private equity firms and other unquoted investment managers, said: "ECI, along with some of its LPs, has concerns about how such information from private equity portfolios will be used in the public domain. The published information we have seen has been at worst inaccurate or at best out of date.

"Even if the information could be verified, we question whether the particular attributes of private equity returns may result in the data being misleading or misunderstood.

"Some form of visibility is going to come into the market place, and there's nothing wrong with that. The underlying issue is what does it mean? What is the process for accessing that information and how deep does it go? Throwing out a top-line number doesn't necessarily give you any information. Visibility is good, but you have to worry about the interpretation of the data that is visible."

As UK local authority pension funds represent only a tiny component of the private equity funding base, any complication will only lead to their isolation, suggested Guen.

"The US has found ways to work round the problem, because the large private equity funds need the money", he said.

Because local authority money is only a marginal contributor here, it is not likely to be sufficient to make up for the possible damage caused by local authority involvement and the possible increased disclosure that might ensue.

"Investors already have access to everything: they know everything a GP is doing. But if that information is made public, you run the risk of giving away proprietary information and losing your competitive edge. You will affect performance, negatively, said Guen.

"If an investor is compelled to divulge information inappropriately, no-one is done any justice. You hurt the council. You hurt the other investors. You hurt the GP. You hurt all the employees of the portfolio company. What does it mean if you can't then invest with the top-tier groups? You'll miss out on the top-tier investment opportunities. In the current climate, can any pension fund anywhere in the UK be sanguine about that?"



**Guen: visibility is good but it's the interpretation that matters**

The message from the US industry is instructive, given that it has been having to cope with disclosure for longer than the UK.

The giant Californian pension fund Calpers claims to have been at the forefront of private equity disclosure in recent years. According to a spokesman, some of this has been voluntary, but in other instances it has been forced on it through legal action.

"There are two instances when Calpers has dealt with disclosure. The first was after the *San Jose Mercury News*, a California-based daily newspaper, filed a lawsuit against us to gain access to private equity fund returns and portfolio companies. The second is when the California First Amendment Coalition filed a lawsuit seeking information on fees paid to PE managers.

"Calpers does support transparency and disclosure where it is in the best interests of the public, but does not harm our investments. That being said, we do disclose rates of return quarterly on our PE funds and the fees paid to managers. We do not, however, disclose the portfolio companies that our PE managers invest in. We believe this is trade secret and gets at the heart of their unique investment strategy.

"Overall, this disclosure has had little impact to our PE portfolio. There are a handful of PE firms that won't do business with us and other public pension funds, but the impact is minimal. That being said, we are looking at what other US states have done to put in law what is public and what is not public in this area so we have clear guidance in the future."

Those on the ground on this side of the Atlantic certainly believe they can cope with the UK's own freedom of information legislation.

Duke de Grassi, the London-based managing director for Europe at Hamilton Lane, a private

equity asset management adviser, said: "We have seen some venture capital funds refuse to take in investors that may have FOIA issues. But overall I don't think investors are going to miss out on enough good investments to have a significant impact on their returns."

Anson echoes other concerns about uninformed, out-of-context reporting. "The cold numbers tell you nothing. A typical private equity fund has a 10-year life. In years one to four, it is investing. Then it starts realising its investments. It will be years eight to nine before you see whether it has been a success.

"Reporting information in years three and four will not tell you whether it's going to be a success. It's like reading a balance sheet: on its own, it tells you nothing about the health of a business.

"Most local authority private equity investments will look to be under water after five years; if you're prejudiced towards finding bad news, you'll find confirmation of your prejudices. This won't do the industry any good, and it won't do the pensioners any good", said Anson.

The BVCA's Mackie agrees that wider dissemination of information would probably hit both investee companies and their investors. But he suggests that the Act is "simply another part of the legislative framework within which we operate," around which they will have to negotiate.

Anson believes they have already come to grips with its impact. "We've adjusted our reporting, and our investors are happy without our business being jeopardised. We've made it clear what is disclosable and what is not.

"Where they request additional information, we ask them to sign a new confidentiality agreement. Everyone is behaving in an adult manner." But even he admits that it is early days yet. There is still an element of wait and see in all this, he said.



**Mackie: Act is simply another part of the legislative framework**