market intelligence

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Private Equity

Post-Brexit investor confidence returning

Simpson Thacher & Bartlett lead the global interview panel

North America • Asia-Pacific • Europe • Latin America
Investment hotspots • Cross-border challenges • Keynote deals • Shareholder activism

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market intelligence

Welcome to GTDT: *Market Intelligence*.

This is the fourth annual issue focusing on global private equity markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

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William E Curbow is a partner at Simpson Thacher & Bartlett LLP in the firm's corporate department, where he focuses on mergers and acquisitions. He represented Vodafone in the US$130 billion sale of its 45 per cent stake in Verizon Wireless to Verizon Communications – the third-largest M&A transaction in history.

Here, Curbow, fellow Simpson Thacher partners Atif Azher and Peter H Gilman, and corporate associates Fred de Albuquerque and Audra Cohen, look at developments in private equity markets worldwide.

GLOBAL TRENDS

BILL CURBOW, ATIF AZHER, PETER H GILMAN, FRED DE ALBUQUERQUE AND AUDRA COHEN OF SIMPSON THACHER & BARTLETT LLP

During the first half of 2017, global mergers and acquisitions deal volume measured in dollars increased from 2016 levels despite a decrease in overall activity levels. Global deal volume increased to US$1.49 trillion, an 8.4 per cent increase relative to US$1.38 trillion from the first half of 2016, according to Mergermarket. Meanwhile, worldwide deal activity levels trailed behind at 12 per cent compared to the first half of 2016, with 8,052 deals announced versus 9,169 deals. Following a period of uncertain macroeconomic conditions in Europe surrounding Britain's referendum to exit the European Union, investor confidence in the region has rebounded, while M&A deal activity in the Americas and Asia declined over the first half of 2017 relative to the same period last year. There has also been a continued global increase in announced 'mega-deals' with values greater than US$10 billion.

According to Mergermarket, 17 mega-deals have been announced since the beginning of 2017, worth a total of US$375 billion, versus 14 such deals during the first half of 2016. Private equity deals accounted for US$406 billion in global deal activity, which constitutes a 16.1 per cent increase in value relative to the first half of 2016, according to Bloomberg. In addition, according to Dealogic, global financial sponsor investments accounted for 8.6 per cent of total M&A, the highest percentage for the first half of a calendar year since 2013, when it reached 11.7 per cent. According to Mergermarket, private equity exit activity also increased in the first half of 2017 relative to the same period in 2016. In the former period, private equity sponsors achieved US$254 billion in exits with 1,106 deals, up 19.4 per cent from the first half of 2016 (Mergermarket).

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Americas

M&A deal volume in the Americas totalled US$703 billion in the first half of 2017, reflecting a decrease of 17.8 per cent from the first half of 2016 (Bloomberg). According to Bloomberg, the United States continues to drive M&A activity in the Americas, accounting for 85.7 per cent of the region's total. However, US-based transactions only reached US$602 billion, representing a 22.4 per cent decrease over the same period last year. According to Dealogic, the first half of 2017 represented the lowest level of M&A volume in the US for the period since the first half of 2013. Private equity activity has also declined as compared to 2016, with total deal value of US$275 billion in the first half of 2017 for US-based targets, representing an 18 per cent decrease relative to the second half of 2016, and a 12 per cent decrease compared to the first half of 2016, according to data supplied by Pitchbook. Small investments and add-on acquisitions continued to be major private equity trends in the first half of 2017, with Pitchbook reporting deals below US$25 million and add-on acquisitions accounting for about 42 per cent and 64 per cent of all US buyout activity during the period, respectively. The information technology sector continues to remain popular among financial sponsors, accounting for 19 per cent of private equity deals in the first half of 2017, whereas the energy sector made up just 4 per cent of all private equity deals. Notwithstanding the global increase in exit activity, US private equity exit volume decreased from 2016 levels to US$85.8 billion over 470 deals in the first half of 2017, and overall exit value is on track to be down 46.5 per cent this year if the pace continues (Pitchbook). Notable private equity transactions in the Americas in the first half of 2017 include: the US$6.9 billion acquisition of Staples, Inc by Sycamore Partners, the US$5.1 billion acquisition of West Corporation by Apollo Global Management and the US$5 billion acquisition of PAREXEL International Corporation by Pamplona Capital Management.

Europe, Middle East and Africa

Despite political uncertainty in Europe early in the year surrounding Britain's decision to exit the European Union, M&A deal volume in Europe, the Middle East and Africa (EMEA) increased significantly in the first half of 2017, totalling US$430.2 billion – a 30.4 per cent increase from the first half of 2016 (Bloomberg). According to Bloomberg, the United Kingdom, France and Spain were EMEA's most acquisitive countries, accounting for about 52.6 per cent of its total deal volume with a value of US$226.6 billion. EMEA private equity deal flow accounted for US$114.3 billion in the first half of 2017, a 40.5 per cent increase from the first half of 2016, and the number of private equity deals in the region also increased by 5.5 per cent over the same period (Bloomberg). Notably, the US$11.8 billion pending acquisition of certain Bradford & Bingley assets by a consortium consisting of Prudential PLC and The Blackstone Group LP Ltd contributed to the increase in private equity activity in the region.

Asia-Pacific

Announced M&A deal volume in the Asia-Pacific totalled US$407 billion in the first half of 2017, which represented a 34 per cent decrease from comparable deal volume in the first half of 2016, according to Bloomberg. Japan experienced its lowest first-half M&A deal volume in a decade, amounting to US$14.4 billion and representing a 53.5 per cent decrease as compared to the first half of 2016, according to Mergermarket. Overall, China M&A activity continued to dominate the region's transaction activity but slowed from the same period in 2016 with US$134 billion in deal volume, a 23.8 per cent decrease over the same period last year (Mergermarket). Increased scrutiny of capital outflow by Chinese regulators contributed to a decrease in Chinese outbound M&A volume, which only reached US$64.3 billion during the first half of 2017, a 49 per cent decline compared to the same period last year (Thomson Reuters). Private equity activity in the Asia-Pacific in the first half of 2017 was valued at US$85.8 billion, which represents a 13.5 per cent increase as compared to the first half of 2016, according to Bloomberg. In particular, Japan-targeted buy-side financial sponsor activity continued to rise, reaching US$6.2 billion, marking the highest first-half volume on record since 2012, according to Thomson Reuters.

Peter H Gilman

Fred De Albuquerque

Audra Cohen

Debt financing markets

Financial sponsors generally found ready access to debt financing over the first half of 2017. Leveraged buyout loan issuances increased to US$51 billion, up 27 per cent from US$40 billion in the first half of 2016. In comparison, overall M&A leveraged loan volume was US$133 billion in the first half of 2017, compared to US$141 billion recorded in the same period in 2016 (Thomson Reuters). Over the first six months of 2017, median debt-to-EBITDA multiples for private equity investments increased to approximately 5.9x as compared to 5.4x over the course of 2016, while equity-to-EBITDA multiples fell from 5.4x to 4.6x over the same periods. Overall valuation-to-EBITDA multiples midway through 2017 came in at approximately 10.5x, down from 10.7x over the previous year. The increase in debt-to-EBITDA multiples occurred despite two interest rate hikes by the US Federal Reserve in the first half of 2017 and was likely influenced in part by high-yield bond spreads reaching a three-year low in 2017.

Steady first half in private equity fundraising

Global private equity fundraising had a strong first half this year, with aggregate capital raised in the first quarter up 3.1 per cent from the first quarter of 2016 and 1.7 per cent from the second quarter of 2016, according to Preqin. Fundraising by recognised, top-performing sponsors has remained strong and reflects continued consolidation within the private equity fundraising market in favour of such established sponsors with proven track records, and a substantial majority of capital raised over the past year by private equity funds represents 're-ups' by existing limited partners.

Competition among private equity funds has increased as the number of funds in the market has increased in recent months, reaching 1,998 funds at the beginning of the third quarter of 2017, as compared to 1,720 in the third quarter of 2016, and the amount of capital targeted by private equity funds has increased over 50 per cent from the same period in 2016, rising from US$447 billion at the beginning of the third quarter of 2016 to US$676 billion at the beginning of the third quarter of 2017, according to Preqin.

Global macroeconomic uncertainty and difficult economic and political conditions in certain regions have caused a number of private equity firms to increase the pace of fundraising and have shifted fundraising dynamics in favour of North America, with over 50 per cent of the funds targeting investment opportunities in North America, according to Preqin. Additionally, there has been a continued focus on private equity fundraising in relation to strategic relationships and alternative fundraising strategies.

Outlook for the second half of 2017

Overall, global private equity activity saw a relatively steady first half in 2017 despite a decrease in activity in the United States. However, there is uncertainty as to whether such activity will continue to increase in the second half of 2017 as it is contingent upon US private equity activity levels rebounding. In general, sustained high valuations and fewer quality targets are likely to maintain high competition among potential investors, including both private equity sponsors and strategic buyers, while political, economic and regulatory uncertainty may temper deal flow as dealmakers wait to see whether the new administration in the United States will undertake tax reform or rollback of financial regulations. Meanwhile, robust debt financing markets and lower high-yield credit spreads are helping to buoy investment activity and private equity sponsors continue to maintain record levels of dry powder to deploy. If valuations remain high and competition among potential buyers remains strong, we expect private equity firms will continue to turn towards creative methods of deploying capital aside from traditional buyouts, including partnerships with strategic sellers, minority preferred investments, add-on acquisitions and joint ventures. On the fundraising side, commentators are generally optimistic that private equity fundraising will continue to grow, in part because of increased fund sizes and an influx of new investors, including sovereign wealth funds participating in fundraisings.

PRIVATE EQUITY IN THE

UNITED STATES

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Mr Curbow represented the Vodafone Group in the US$130 billion sale of its 45 per cent stake in Verizon Wireless to Verizon Communications. Other clients include L-3 Communications, Crestwood Midstream Partners and First Reserve.

Azher's clients have included Hellman & Friedman, Silver Lake Partners, Blackstone, TPG, KKR, Carlyle and Riverwood Capital.

Gilman has represented a number of the world's leading sponsors in a wide range of alternative investment matters, including Alinda, Blackstone, Centerbridge, KKR, Lexington Partners, Oaktree, Silver Lake and Providence.

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Bill Curbow

GTDT: What trends are you seeing in overall activity levels for private equity buyouts and investments in your jurisdiction during the past year or so?

Bill Curbow, Atif Azher, Peter H Gilman, Fred de Albuquerque and Audra Cohen: Over the first half of 2017, M&A activity levels in the United States dropped 22.4 per cent year over year to US$602 billion worth of deals, according to Bloomberg. Private equity activity in the US has also declined from 2016 levels. According to data supplied by PitchBook, through the first half of the year, US$275 billion in private equity deals has occurred in the US, representing an approximate 12 per cent decrease over the same period last year and an 18 per cent decline relative to the second half of 2016. Although fund sizes have continued to grow in 2017, the number of private equity mega deals in the US has slowed – there have been just five deals over US$2.5 billion in the first half of 2017 compared to 20 over the course of 2016.

GTDT: Looking at types of investments and transactions, are private equity firms continuing to pursue straight buyouts or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being considered?

BC, AA, PHG, FdA & AC: In part because valuations remain at relatively elevated levels, private equity sponsors continue to look for creative ways to deploy their capital. For example, we have seen sponsors engage in partnerships with strategic sellers, minority preferred investments, add-on acquisitions and joint ventures. Despite the slowdown in activity as a whole by sponsors, add-on acquisitions and small investments remain a popular avenue to deploy capital in the United States, with Pitchbook reporting add-on acquisitions and deals below US$25 million and accounting for about 64 per cent and 42 per cent of all US private equity buyout activity during the period, respectively.

GTDT: What were the recent keynote deals? And what made them stand out?

BC, AA, PHG, FdA & AC: Notable private equity transactions in the Americas in the first half of 2017 include the US$6.9 billion acquisition of Staples, Inc by Sycamore Partners, the US$5.1 billion acquisition of West Corporation by Apollo Global Management and the US$5 billion acquisition of PAREXEL International Corporation by Pamplona Capital Management. These buyouts, while large, are notably smaller than some of the mega deals of recent years.

GTDT: Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? Are those challenges evolving?

BC, AA, PHG, FdA & AC: Significant cross-border private equity activity is atypical. Many large-cap sponsors have stand-alone region-focused funds, such as Asia-focused funds, that have fund mandates to make investments in particular geographic regions. It is more common for non-US private equity sponsors, such as European funds or Asian funds, to look to the United States for potential investment opportunities.

Atif Azher

The primary challenges to cross-border investments revolve around financing, tax considerations, regulatory compliance and securities laws limitations. In addition, US sponsors seeking to sell portfolio companies to non-US buyers or considering other transactions involving sales to foreign acquirers should be aware of the possibility of review by the Committee on Foreign Investment in the United States (CFIUS), a multi-agency committee authorised to review transactions that could result in foreign control over US businesses for potential impact on US national security. CFIUS has the authority to negotiate and implement agreements to mitigate any national security risks raised by such transactions. Absent a mitigation agreement, CFIUS can recommend that the President suspend, prohibit or unwind a transaction. A CFIUS review can add delays and meaningful uncertainty to transactions depending on the nature of the target business and the identity of the foreign acquirer. In transactions involving sales of portfolio companies that are in sensitive industries or that handle sensitive data and, in each case, that implicate national security concerns, sponsors will be prudent to consider proposing reverse termination fees or pre-emptive divestitures, to discuss possible mitigation measures and to build political support. Since 2012, acquisitions involving Chinese acquirers have been the most reviewed transactions pursuant to the CFIUS review process. Given the new administration's avowed trade policies and anti-China rhetoric, as well as heightened tensions around North Korea, many practitioners are already experiencing even tougher scrutiny of inbound investments from Chinese buyers and expect this trend to continue. While the regulatory and other challenges in cross-border sponsor exits and other transactions, including CFIUS review, are often manageable in many contexts, they increase the level of resources required and may otherwise complicate the process for executing such transactions.

GTDT: What are some of the current themes and practices in financing for transactions? Have there been any notable developments in the availability of debt financing or the terms of financing for buyers over the past year or so?

BC, AA, PHG, FdA & AC: The most notable development or trend related to financing in the United States over the past couple of years has been the increased acknowledgment by regulated financial institutions of guidelines promulgated by the Federal Reserve and the Office of the Comptroller of Currency. Despite the current regulatory environment and a period of notable macroeconomic volatility, dealmakers have been able to find relatively attractive pricing and availability of credit for transactions involving high-quality assets. Overall, the debt financing markets in the US have remained open, with sponsors finding ready access to debt financing in the first half of 2017. Median debt-to-EBITDA multiples for private equity investments during the first half of the year increased to approximately 5.9x as compared to 5.4x in 2016, and valuation-to-EBITDA multiples have decreased from approximately 10.7x to 10.5x over the same period. As a result, we have seen an uptick in the average percentage of deal price being covered by debt financing in US private equity transactions. The increase in debt-to-EBITDA multiples occurred despite two interest rate hikes by the US Federal Reserve in the first half of 2017 and was likely

Peter H Gilman

influenced in part by high-yield bond spreads reaching a three-year low in 2017.

GTDT: How has the legal, regulatory and policy landscape changed during the past few years in your jurisdiction?

BC, AA, PHG, FdA & AC: As a result of the passage of the Dodd-Frank Act in 2010, most private equity firms are now required to register with the Securities and Exchange Commission (SEC) as investment advisers. The new administration in the United States has indicated a desire to roll back certain aspects of the Dodd-Frank Act, but has not enacted legislation doing so. The Act imposes extensive compliance obligations for the industry. In addition, in recent years, the SEC has focused on examining private equity firms with the goal of, among other things, promoting compliance with certain provisions of the Investment Advisers Act that the SEC deems of particular importance. In recent years, certain private equity industry practices have not only received significant attention from the SEC, but in certain cases have also led to enforcement actions against private equity fund advisers. Areas that the SEC continues to highlight as being of particular concern include:

- allocation of expenses (including for the compensation of operating partners, senior advisers, consultants and employees of private equity fund advisers or their affiliates (including seconded employees) for providing services (other than advisory services) to funds or portfolio companies (or both) as well as for payment of a private equity fund adviser's regulatory compliance expenses) to funds or portfolio companies, or both, and disclosure of 'hidden' fees. In addition, full allocation of broken deal expenses to funds instead of allocating a portion of such expenses to separate accounts, co-investors or co-investment vehicles, in each case without pre-commitment disclosure and consent from investors;
- receipt and disclosure by private equity firms of transaction-based compensation or other fees or compensation from funds or portfolio companies, or both, which is outside of the typical management fee or carried interest structure (eg, an acceleration of monitoring fees and compensation for the provision of brokerage services in connection with the acquisition and disposition of portfolio companies without being registered as a broker-dealer);
- allocation of investment opportunities by private equity sponsors among investment vehicles and funds that they manage;
- allocation of co-investment opportunities;
- disclosure of conflicts of interest to investors, including those arising out of the outside business activities of a private equity firm's employees and directors; and
- receipt of service provider discounts by private equity firms that are not given to the funds or portfolio companies.

The 'broken windows' approach to regulatory enforcement embraced by the SEC during the Obama administration put pressure on private equity firms to provide robust pre-commitment disclosure of, and obtain consent for, conflicts of interest, and to adopt and enforce sound compliance policies and procedures to mitigate such conflicts of interest. Although SEC officials in

Fred de Albuquerque

the new administration have articulated a desire to shift away from the broken windows enforcement approach, it remains too early to determine how the tone at the SEC will translate into specific policy and enforcement changes. In practice, it is unlikely that compliance systems developed over the past few years will be dismantled and we continue to believe that larger established private equity firms that have such systems and resources in place will continue to be better positioned to absorb the incremental costs and compliance burdens associated with today's regulatory landscape.

The JOBS Act and the SEC significantly amended certain aspects of the regulation governing the private offering and sale of securities (including limited partner interests in private equity funds) that are designed to permit greater flexibility for issuers. Despite these recent improvements and the adoption of Rule 506(c) permitting the use of general solicitation and general advertising in private placements, the conditions imposed by the SEC and the heightened compliance obligations (eg, enhanced verification) and costs associated with relying on Rule 506(c) imposed on private equity funds create a burdensome process, making it unlikely that private equity funds will seek to utilise these new rules in any meaningful way in their current form. In addition, the SEC adopted bad actor disqualification provisions in Rule 506(d) under which issuers are prohibited from relying on the Rule 506 safe harbour (regardless of whether the proposed offering involves a general solicitation) if the issuer or any other 'covered person' was subject to a 'disqualifying event' that occurred on or after 23 September 2013, which have in some cases significantly affected the ability of private equity firms to conduct private placements.

Over the past several years, the US Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) have sought to limit the ability of US corporations to engage in 'inversion' transactions (ie, transactions in which a US corporation converts into, or is acquired by, a foreign corporation). They have done so by issuing legal guidance and regulations under several provisions of the US Internal Revenue Code (the Code) to expand the class of outbound acquisitions of domestic corporations subject to the 'anti-inversion' rules of the Code and limit certain tax benefits previously available to US corporations that successfully complete an inversion transaction. If the anti-inversion rules of the Code apply, they can result in significant additional taxes being imposed on the inverted structure and, in the worst case scenario, the foreign acquirer being treated as a US corporation for US federal income tax purposes. The Treasury Department and IRS took these steps in response to a perceived surge in such acquisitions, which the Treasury Department maintains are tax-motivated.

In April 2016, the Treasury Department and IRS issued final and temporary regulations that further expand the application of the anti-inversion rules and reduce the tax benefits from inversion transactions (including by restricting the ability of so-called serial inverters to continue to acquire US corporations without being subject to the anti-inversion rules). Additionally, in October 2016, the Treasury Department and IRS issued final and temporary regulations addressing the US federal income tax treatment of debt between certain related parties (related-party debt). For US federal income tax purposes, the regulations generally limit interest deductions by (i) treating related-party debt as equity if such debt is issued in connection with certain transactions and (ii) imposing threshold documentation requirements for such related-party debt in the case of interests issued on or after 1 January 2019. These regulations were motivated in part by the perceived overleveraging of US entities in the cross-border context (including in inverted structures).

The tax rules announced to date are likely to affect many planned, pending and future transactions, including those involving private equity sponsors' portfolio companies and other investments. Further, the rules applicable to these areas will likely remain the subject of legislative and regulatory attention, and further changes on these subjects are expected.

GTDT: What are the current attitudes towards private equity among policymakers and the public? Has there been any noteworthy resistance to private equity buyouts by target boards or shareholders? Does shareholder activism play a significant role in your jurisdiction, and if so, how has it impacted private equity M&A?

BC, AA, PHG, FdA & AC: While negative attitudes concerning private equity buyouts seem to have waned over the past few years, shareholder activism associated with mergers and acquisitions activity has become increasingly prominent – irrespective of whether there is any private equity involvement. As a result, private equity sponsors seeking to effect 'going private' transactions or investing alongside a strategic partner are becoming increasingly mindful of the investor relations aspects of such transactions and are evaluating the risks of potential shareholder activism as part of the 'mix' of factors in connection with effecting such transactions.

Although the new administration has indicated that it may roll back some of the regulatory requirements applicable to private equity firms, including the Dodd-Frank Act requirement that private equity firms must register with the SEC, the regulatory landscape largely remains unchanged as of the first half of 2017. However, with a number of prominent private equity names serving in cabinet and other roles in the new administration, some people in the industry are expecting that regulators will take a more relaxed approach to oversight of financial sponsors. As a result of the uncertain regulatory landscape, some financial sponsors have taken a 'wait and see' approach during the first half of 2017 with respect to their investment activity.

GTDT: What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

BC, AA, PHG, FdA & AC: Sponsor exits were mixed in the first half of 2017, continuing the modest slowdown in exit activity seen in 2016 relative to the record levels of exit activity in 2015. According to data supplied by Mergermarket, sponsors executed 337 exits in the United States, accounting for approximately US$83.97 billion in the first half of 2017 and representing no change in exit volume as compared to the latter half of 2016 and a 4 per cent decrease in total exit value. The business-to-business sector dominated the private equity exit landscape, with 31 per cent of all total exit value achieved during the period, according to Pitchbook.

Following a slowdown in the first half of 2016, the US initial public offering (IPO) market has continued to rebound thus far in 2017. At halfway through the year, the 2017 overall IPO market has raised more capital than all of 2016, and IPOs with private equity backing saw increased volume for the fifth straight quarter (Renaissance Capital). The IPO market for private-equity-backed listings was highly active in the first half of 2017, with 27 completed listings raising an aggregate of approximately US$10.3 billion, according to Renaissance Capital. The largest private-equity-backed IPO was the offering by Altice USA, a spin-off of Altice NV, with private equity backing, which raised approximately US$1.9 billion.

Audra Cohen

Other notable private equity exits during the first half of the year included the sale by Quadrangle Group and Thomas H Lee Partners of West Corporation to Apollo Global Management for approximately US$5.1 billion and the sale by Onex Corporation of USI Holdings Corporation for approximately US$4.3 billion. Both of these transactions showcase the trend of sponsors electing secondary buyouts over corporate acquisitions. Secondary buyouts constituted 49 per cent of private-equity-backed exits in the first half of 2017, according to Pitchbook.

GTDT: Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

BC, AA, PHG, FdA & AC: Global private equity fundraising increased slightly in the second quarter of 2017 as compared to the second quarter of 2016 (with aggregate capital raised up to US$121 billion from US$119 billion according to Preqin), with fundraising by established, top-performing sponsors at the upper end of the private equity market continuing to remain strong. This reflects a

"Certain large US pension funds have significantly curtailed allocations to third-party fund managers."

continuation of the trend witnessed in recent years towards consolidation and the 'flight to quality', where larger established sponsors with proven track records are having considerable success raising large private equity funds on favourable terms, while first-time funds and sponsors without proven track records continue to find it challenging to compete in today's environment.

The recovery in the private equity fundraising market over the past few years has been substantial as private equity has continued to rebound following the global financial crisis. However, the benefits of such recovery have been disproportionately captured by established sponsors with proven track records. With US$121 billion in aggregate capital raised, according to Preqin, the second quarter of 2017 is the fifth quarter in the past seven quarters during which private equity fundraising exceeded US$100 billion. Moreover, competition among private equity funds has continued to increase as the number of private equity funds in the market has increased in recent quarters, reaching 1,998 funds in market at the beginning of the third quarter of 2017 according to Preqin (as compared to 1,720 in the third quarter of 2016) while the amount of capital targeted by private equity funds has increased by just over 50 per cent from US$447 billion at the beginning of the third quarter of 2016 to US$676 billion at the beginning of the third quarter of 2017.

Global macroeconomic uncertainty and difficult economic and political conditions in certain regions have caused a number of private equity firms to increase the pace of fundraising and have shifted fundraising dynamics in favour of North America, with over 50 per cent of the funds in market targeting investment opportunities in North America according to Preqin. Moreover, as of the end of the second quarter of 2017, the 1,027 North America-focused funds in the market represented a little more than half of the total number of private equity funds in the market and 51 per cent of aggregate capital targeted, according to Preqin. In addition, as of the end of the second quarter of 2017, there were 350 Europe-focused funds in market, targeting US$98 billion in capital commitments. As of the end of the second quarter of 2017, there were only 241 funds in the market with a primary focus on other parts of the world, seeking to raise US$42 billion in capital commitments. According to Preqin, as of the end of the second quarter of 2017, 52 per cent of institutional investors were seeking to make new capital commitments to Europe-focused private equity funds in the next 12 months (decreasing 1 per cent from 53 per cent in the second quarter of 2016) and 50 per cent of investors were seeking to make new capital commitments to North America-focused private equity funds.

Institutional limited partners are continuing to place increased emphasis on consistent track records and stability, tending to make larger commitments to fewer private equity funds, and established top quartile sponsors have continued to be able to raise larger funds in shorter periods of time and capture a greater share of the overall private equity fundraising market (particularly among North American, Asian and European sponsors). A substantial majority of capital raised over the past year by private equity funds represents 're-ups' from existing limited partners.

High pricing levels of assets and low interest rates have contributed to the substantial exits and distributions to limited partners over the past few years and have enhanced private equity fundraising for many sponsors as investors seek to redeploy those distributions into new private equity funds. Many institutional investors have also increased their overall portfolio allocation to the private equity asset class. The amount of capital distributed by private equity funds to investors in recent years has been significantly more than the amount of capital called from investors. As of May 2017, according to Preqin, dry powder held by private equity funds was estimated to have reached US$906 billion, an increase of over US$80 billion from December 2016.

There has also been a continued focus on strategic relationships and alternative fundraising strategies, including customised separate account arrangements, co-investment arrangements and multi-strategy (umbrella) arrangements, and new product development (eg, a number of established sponsors have raised longer life, lower risk and return funds in asset classes like private equity and real estate). Finally, certain large US pension funds have significantly curtailed allocations to third-party fund managers in an effort to consolidate their relationships among a smaller group of high-quality fund managers, further increasing competition among sponsors for institutional limited partner capital.

GTDT: Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your jurisdiction?

BC, AA, PHG, FdA & AC: While fundraising in today's environment has become less episodic and more resource-intensive, with fund structures, terms and marketing timelines customised to most effectively address the business objectives of the sponsor, below is a simplified framework and timeline for a typical private equity fundraising.

In most cases, the typical fundraising will begin with the preparation and distribution of a private placement memorandum to investors, which includes important information about the sponsor and the fund, including a term sheet setting forth the key terms of the fund and the offering of interests, along with additional disclosure information pertaining to the fund. Many private equity funds are structured as Delaware limited partnerships, but the structure and jurisdiction of the fund will depend largely on the sponsor and the asset class, geographic focus and anticipated investor base of the fund. It is not uncommon for private equity funds to be organised in jurisdictions outside of the United States (eg, the Cayman Islands). Legal counsel will also work closely with the sponsor as part of the fundraising to prepare the draft limited partnership agreement, investment management agreement, subscription agreement and related fund documents, which are the definitive agreements governing the operation of a private equity fund. Key contractual points in the fund documents will vary on a case-by-case basis, but often include economic arrangements (eg, management fees and carried interest), tax structuring provisions and minimisation covenants, investment allocation provisions, limited liability protections, standards of care, governance rights, co-investment arrangements and allocations of expenses. Increased regulatory scrutiny has resulted in a change in how marketing and offering documents are prepared. Drafting fund documents is now a resource and time-intensive exercise as pages and pages of granular disclosure are often added to these documents and more frequent updates to the documents are often made throughout fundraising in an effort to increase transparency.

Following delivery of the fund documents to investors, counsel and the sponsor will work closely with investors to resolve any questions or comments, and once a critical mass of investors' subscriptions has been secured, the fund will hold an initial closing. Fundraising timelines in private equity can vary significantly depending on the sponsor involved and the type and size of fund being raised, running anywhere from a few months to a few years. Once an initial closing has been held, a private equity fund will typically be permitted to hold subsequent closings over a period of 12 to 18 months. As the regulation of private equity funds continues to increase, it remains very important for sponsors to work closely with counsel to ensure that all necessary steps are taken to permit marketing in each jurisdiction in which fund interests are to be marketed.

GTDT: How closely are private equity sponsors supervised in your jurisdiction? Does this supervision impact the day-to-day business?

BC, AA, PHG, FdA & AC: Private equity firms are subject to substantial regulation and supervision in the United States, and the regulatory environment in which private equity firms operate is becoming increasingly complex. The regulation and supervision of private equity firms not only affects the manner in which interests in private equity funds are marketed and sold to investors, but also the day-to-day business and operations of private equity firms themselves.

The principal laws and regulations applicable to private equity firms affecting their day-to-day business and operations include: the Securities Act of 1933 (affecting the manner in which private equity funds market and sell interests to investors), the Securities Exchange Act of 1934 (affecting ongoing reporting obligations and placing practical limitations on the number of investors in private equity funds), the Advisers Act (imposing substantive regulations and reporting provisions on many private equity fund advisers), the Investment Company Act of 1940 (establishing certain eligibility requirements and limitations on investors in private equity funds), the Commodity Exchange Act (regulating the ownership of commodities by private equity funds) and the Employee Retirement Income Security Act of 1974 (imposing restrictions and onerous fiduciary requirements on private equity funds deemed to hold 'plan assets').

"The regulatory environment in which private equity firms operate is becoming increasingly complex."

Since the SEC gained oversight of the industry under the Dodd-Frank Act five years ago, the regulatory and public scrutiny of private equity firms has increased significantly. The SEC is finding more regulatory lapses among private equity firms, particularly related to expenses and expense allocation, conflicts of interest and other disclosure matters. The increased focus on private equity firms by the SEC, which we expect to continue in the foreseeable future, and the varying areas of concern the SEC emphasises from time to time, have resulted in increased compliance burdens for private equity fund sponsors and impact both the day-to-day conduct of a private equity sponsor's business and the formation, marketing and management of private equity funds. Private equity firms with dedicated compliance, investor relations and the administrative resources necessary to manage the increased regulatory and compliance burdens in addition to investor demands in today's competitive fundraising environment are likely to continue to enjoy an advantage in the future.

GTDT: What effect has the AIFMD had on fundraising in your jurisdiction?

BC, AA, PHG, FdA & AC: The AIFMD, as transposed into national law within the member states of the European Union, has imposed significant requirements on non-EU fund managers that market private equity funds to professional investors within the EU. One of the central aims of the AIFMD is to harmonise the regulation of fund managers across Europe; however, until non-EU fund managers are able to become authorised and benefit from the harmonised regime, non-EU fund managers are limited to marketing their funds on the basis of 'private placement' or local requirements. There is no requirement for EU member states to offer private placement to non-EU fund managers and where it is permitted, the member state is free to impose requirements more stringent than the minimum required under the AIFMD. As it stands, some member states do not allow any marketing by non-EU fund managers and of those that do allow it, some 'gold-plate' the standards imposed by the AIFMD. In practice, the patchwork of private placement regimes across EU member states has caused uncertainty for many non-EU fund managers regarding their ability to market to investors in the EU and has, in practice, hindered their ability to raise capital in Europe.

The AIFMD has meaningfully increased the compliance burdens and costs associated with private equity firms marketing alternative investment funds to non-retail investors in the EU, resulting in a number of US private equity funds, particularly smaller firms that do not have the necessary compliance and fundraising infrastructure in place, deciding not to market in Europe to avoid the additional regulatory burdens and costs imposed by the AIFMD. For example, while the registration and approval process in certain member states where private placements are permitted has settled into a predictable pattern, there remains legal uncertainty as to the meaning of key terms, such as what constitutes 'marketing' (and therefore what constitutes 'pre-marketing') and 'reverse solicitation'. In addition, minimum transparency requirements under the AIFMD (eg, annual reports, periodic alternative investment fund and alternative investment fund manager (AIFM) reports, pre-investment disclosure to investors, notification in respect of control of non-listed companies) create ongoing administrative and compliance burdens for non-EU fund managers and result in significant additional costs. The application process for marketing by non-EU fund managers (where it is allowed) varies across Europe with some member states only requiring an email notification in a prescribed form and others requiring approval of a more extensive application prior to marketing. However, unlike in the past, in member states where approval is required, the process now takes (on average) only a couple of months.

The increased regulation imposed by the AIFMD, together with a broader trend towards increasing scrutiny and regulation of private equity firms, has compelled many private fund managers to adopt more systematic and integrated compliance operations as part of their overall fundraising activities. We believe that larger established managers that either have the systems and resources in place or that can readily adapt to these requirements are better placed to absorb the incremental costs and compliance burdens associated with the AIFMD. Managers of larger funds should therefore enjoy a competitive advantage among their peers as smaller firms will likely feel a disproportionate impact on their businesses as a result of the AIFMD. The result of this relative disadvantage may be the rise of hosted solutions, where an authorised EU manager offers to manage an EU fund and delegate portfolio management to the non-EU manager. The 'passport' option and the 'hosted' solution are increasingly considered common, but whether they take hold across the industry remains to be seen. As a consequence of Britain's decision to exit the European Union (Brexit), there is a higher level of scrutiny on arrangements that provide access to the European market, including hosted AIFM platforms.

While private placement, with all its pitfalls, has become familiar and can be a workable marketing strategy for US private equity sponsors seeking to raise capital from investors in the EU, it remains critical for such sponsors to work closely with legal counsel to establish a 'marketing roadmap' in the EU that is tailored to the sponsor's intended marketing activities and investor base,

THE INSIDE TRACK

What factors make private equity practice in your jurisdiction unique?

The United States has blazed a trail in private equity practice over the decades. For example, the United States markets developed both private and public leveraged buyouts in which a significant amount of the purchase price is paid with the proceeds of new debt. As funds are constantly innovating and adapting to changing market conditions, groundbreaking private equity transactions require sophisticated guidance and creative solutions from legal advisers.

Overall, the United States continues to rank as the top market for private equity, reflecting the depth (in terms of size and liquidity) of its capital market and an ingrained culture of innovation. The United States is home to many of the world's most successful and well-established private equity firms, which have traditionally raised the largest buyout 'mega' funds. Historically, United States-focused fundraising has surpassed that of all other regions for private equity investment. As the traditional base of private equity, the United States has attracted the lion's share of capital over the years, and 2017 has been no different. Through the years, the private equity industry has matured and the experience of fund managers have broadened such that investors continue to view the United States as an attractive jurisdiction for their investment.

What should a client consider when choosing counsel for a complex private equity transaction in your jurisdiction?

The main consideration in selecting a legal adviser is depth of experience in the private equity sector and a creative and commercial approach to problem-solving. Practical experience combined with industry acumen are critical to advising complex transactions dealing with fund formation, minority investments, mergers and acquisitions, financing solutions and exit transactions.

In addition, counsel should have insight into the needs of every participant in private equity transactions, such as private equity sponsors, senior bank lenders, subordinated and bridge lenders, tax advisers, management and financial investors and underwriters. As such, a client would benefit from counsel that offers cross-practice excellence (eg, finance and banking practice areas that provide advice to private equity clients on financing solutions at all levels of the capital structure).

What interesting or unusual issues have you come across in matters that you have recently worked on?

In the first half of 2017, we saw sponsors and other dealmakers assessing cross-border transactions pay closer attention to CFIUS risk and measures designed to mitigate CFIUS risk. Given the new administration's avowed trade policies and increased protectionism, as well as diplomatic tensions involving North Korea, many practitioners have seen increasing scrutiny of inbound investments, particularly from Chinese buyers, and expect this trend to continue. For example, the President recently issued an executive order blocking the proposed US$1.3 billion sale of Lattice Semiconductor Corp to affiliates of Canyon Bridge Capital Partners, a private equity firm managed by US nationals whose investors include several Chinese state-owned enterprises. Consequently, in recent cross-border transactions, and in particular in transactions involving sales of portfolio companies that are in sensitive industries or possess sensitive data or technology and that implicate national security concerns, we have seen some sponsors consider or utilise creative mechanisms for allocating CFIUS risk, including negotiating pre-emptive divestitures of certain assets or specific termination fees tied to CFIUS approval (or both). In addition, we have seen some foreign buyers structure deals as minority or passive investments, rather than acquisitions of control, which may, in certain cases, have been done in an effort to avoid or mitigate CFIUS risk.

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and to work with counsel to understand how the private placement regimes and local requirements differ across the EU.

Regulatory compliance is no longer simply a cost of doing business, but rather an integral part of any private equity sponsor's global marketing programme. Fund managers that do not have the resources and counsel necessary to address the additional regulatory and compliance obligations arising out of the AIFMD may find it increasingly difficult to comply with the AIFMD and market funds in the EU, which is likely to have an ongoing and significant impact on fundraising by US private equity firms.

GTDT: What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment potentially changing in the near future?

BC, AA, PHG, FdA & AC: US tax rules are very complex and tax matters play an important role in both fund formation and the structure of underlying fund investments. Tax issues that have been given particular focus recently include:

- the implementation of new due diligence, information reporting and withholding rules pursuant to the Foreign Account Tax Compliance Act;

- possible changes in the taxation of carried interest;
- the proper tax treatment (including deductibility) of monitoring fees paid by underlying portfolio companies to a private equity fund's investment adviser; and
- the new partnership audit rules that may impose liability for adjustments to a partnership's tax returns on the partnership itself. Consultation with dedicated tax advisers with respect to specific transactions and issues is highly recommended.

Special consideration is given to structuring the carried interest, such that it is treated as a partnership allocation eligible for taxation on a flow-through basis. It is sometimes desirable to separate the general partner (namely, the recipient of the carried interest) and the investment manager (namely, the recipient of the management fee) into separate entities for state tax and other purposes.

Legislation has been introduced in Congress that, if enacted, would result in carried interest distributions that are currently subject to favourable capital gains tax treatment being subject to higher rates of United States federal income tax than are currently in effect. Whether such legislation will be enacted (or in what ultimate form) remains uncertain. In addition, the new administration has publicly stated that a top legislative priority is significant reform of the Code, including significant changes to the taxation of business entities. There is substantial lack of clarity around both the timing and details of any such tax reform.

GTDT: Looking ahead, what can we expect? What might be the main themes in the next 12 months for both private equity M&A and fundraising?

BC, AA, PHG, FdA & AC: Overall, US private equity deal flow slowed in the first half 2017 as compared to the same period in 2016. Practitioners are hoping that debt financing markets hold firm as buyers of multinational businesses are increasingly scrutinising how any acquired assets will perform in a potentially more volatile macro-environment going forward. We believe that valuations for highly sought-after targets for sale may continue to be propped up by strong competition. However, corporate buyers may choose to wait out periods of economic and regulatory uncertainty and high valuations. US private equity funds on the other hand are sitting on a record amount of deployable capital, having raised more than US$121 billion in the second quarter of 2017 alone. In addition, we expect to see a continued trend towards add-on acquisitions and smaller deals as sponsors work more closely with industry executives to find transactions with synergies to build portfolio company value.

We also expect that the trends and developments witnessed in the first half of 2017 with respect to fund formation will continue as the consolidation in the private equity industry continues. Competition for investor capital among private equity funds will continue to increase, with alternative fundraising strategies continuing to play a substantial role. Likewise, established sponsors with proven track records and the ability to absorb incremental burdens associated with today's continued scrutiny and enhanced regulation of the private equity industry should continue to enjoy a competitive advantage.

In conclusion, the current mix of factors makes it difficult to predict whether private equity sponsor activity will trend upward in the remainder of 2017. High levels of dry powder combined with easy access to debt financing is likely to drive dealmaking. However, overall volume may be tempered by fewer quality targets coming to market and the continued trend of smaller add-on, or strategic, acquisitions by portfolio companies. Political, economic and regulatory uncertainty may also temper deal flow as dealmakers wait to see whether the Trump administration will undertake tax reform or rollback of financial regulations, including parts of the Dodd-Frank Act. Each of these factors creates uncertainty for the direction of private equity deal activity in the remainder of 2017.

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