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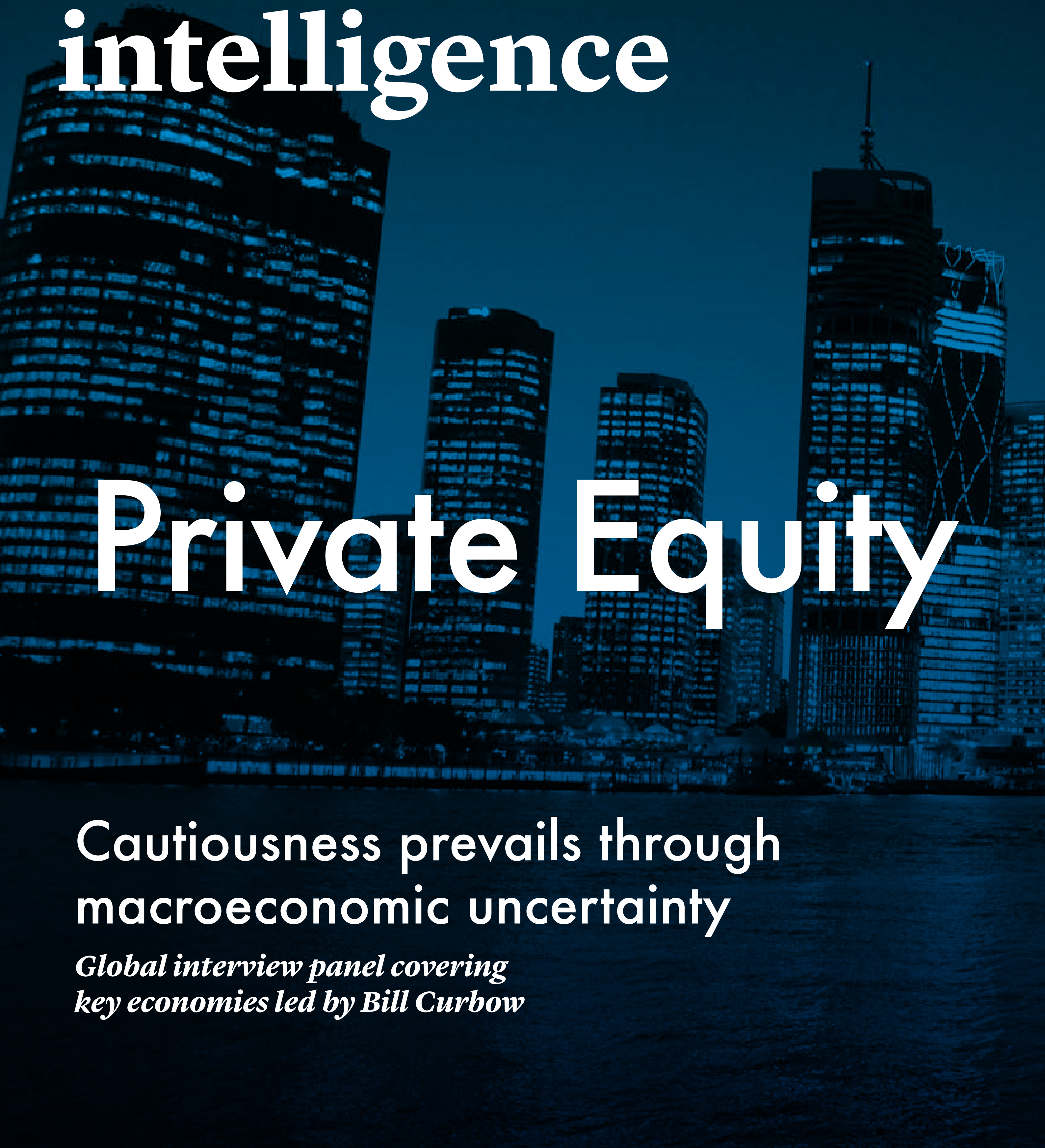
GETTING THE DEAL THROUGH

market intelligence



Private Equity

Cautiousness prevails through macroeconomic uncertainty

Global interview panel covering key economies led by Bill Curbow

Regulatory developments • Major cases • Big Data • 2016 trends
Europe • North America • Asia-Pacific • Latin America

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market intelligence

Welcome to *GTDT: Market Intelligence*.

This is the third 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.

Market Intelligence is available in print and online at www.gettingthedealthrough.com/intelligence

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In this issue

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

Global mergers and acquisitions activity levels dropped from the record-breaking levels of 2015 in the first half of 2016. Deal volume decreased to US$1.71 trillion, an 18 per cent drop relative to US$2.09 trillion over the first half of the prior year, according to Dealogic. This represented the lowest level for the period since the first half of 2013. Worldwide deal activity levels also trailed about 10.5 per cent compared to the first half of 2015, with 18,651 deals announced versus 20,854 during the same period last year. Uncertain macro-economic conditions, including Britain's referendum to exit from the European Union, contributed to volatile equity markets and tightened financing markets and have presented significant hurdles for potential transactions. According to Dealogic, fewer deals were withdrawn in the first half of 2016 (down 9 per cent year-over-year) but many of those were mega-deals, valued in the US$10 billion-plus range. As a result, withdrawn transactions amounted to US$606 billion of value, more than double the US$233 billion during the same period last year. The period also featured a drop-off in newly announced mega-deals. Only 16 of such deals were announced in the first half of 2016, only five of which were valued over US$20 billion, as compared to 24 mega-deals that were announced in the first half of 2015, nine of which climbed above US$20 billion. Global private equity deals accounted for US$335.9 billion in deal activity, which constitutes a 6.3 per cent decrease relative to the first half of 2015, according to Bloomberg. Private equity exit activity slowed considerably in the first half of 2016. According to Mergermarket, in the first half of 2016, private equity sponsors achieved US$185.6 billion in exits with 1,006 deals, down 15.3 per cent from the first half of 2015. Technology led all sectors by number of private equity exits, accounting for approximately 23 per cent, while the consumer sector dominated total exit value at approximately 28 per cent, according to PitchBook.

Americas

M&A deal volume announced in the Americas totalled approximately US$964.2 billion in the first half of 2016, reflecting a decrease of 12.3 per cent from the first half of 2015. According to Bloomberg, the United States continues to drive M&A activity in the region as US-based transactions totalled approximately US$739.1 billion, representing an approximately 7.4 per cent decrease over the same period last year. US private equity activity has remained relatively flat thus far as compared to 2015, with total deal value of approximately US$298 billion in the first half of 2016, representing a 12 per cent decline relative to the back half of 2015 and a slight increase over the same period last year, according to PitchBook. Small investments and add-on acquisitions were major trends in the first half of 2016, with PitchBook reporting deals below US$25 million and add-on acquisitions accounting for about 48 per cent and 64 per cent of all private equity buyout activity during the period, respectively. As private equity activity has slackened, every sector has experienced a decline in overall volume other than information technology, with 261 closed transactions through the first half of the year. Notable private equity transactions in the Americas in the first half of 2016 include: the US$15 billion acquisition of ADT Security Services, Inc by a consortium of investors including affiliates of Apollo Global Management; the US$13.9 billion acquisition of Keurig Green Mountain by affiliates of JAB Holding Company, Mondelez International and BDT Capital Partners; and the acquisition of Multiplan, Inc by affiliates of GIC, Hellman & Friedman and Leonard Green & Partners, LP, which was reported by Preqin as one of the three largest private equity deals of the year thus far.

Europe, Middle East and Africa

Announced M&A deal volume in Europe, the Middle East and Africa (EMEA) totalled approximately US$315.3 billion in the first half of 2016, a 25.2 per cent decrease in deal volume from the first half of 2015. According to Bloomberg, the United Kingdom, France and Germany remained EMEA's most acquisitive regions, accounting for about 59.7 per cent of its total deal volume with US$226.4 billion in value. UK deal activity fell 58 per cent as compared to the first half of last year, recording 638 deals worth US$58.2 billion, the lowest deal value since 2010, according to Mergermarket. According to Bloomberg, EMEA private equity deal flow accounted for US$74.8 billion in the first half of 2016, an approximate 27 per cent decrease from the first half of 2015, although the number of private equity deals in the region increased by 3.7 per cent over the same period. Private equity firms have been particularly reticent to invest in the UK market, with buyouts of UK companies amounting to only US$4.9 billion over the first half of the year – 75.4 per cent less than over the first half of 2015, according to Mergermarket.

Asia-Pacific

The announced M&A deal volume in Asia-Pacific totalled approximately US$612.2 billion in the first half of 2016, which represented an approximate 3.4 per cent decrease from comparable deal volume in the first half of 2015, according to Bloomberg. Despite the general slowdown in the region, Japan experienced a notable increase in M&A activity levels in the first half of 2016. Announced M&A deal volume in Japan totalled approximately US$30.7 billion, representing an approximately 68 per cent increase as compared to the first half of 2015, according to Mergermarket. Overall, China M&A activity continued to dominate the region's transaction activity with US$197.3 billion in deal volume – a 15.7 per cent increase over the same period last year. Outbound M&A volume in China reached US$135 billion, surpassing any China outbound annual record, according to Dealogic. Private equity activity in Asia-Pacific in the first half of 2016 was valued at approximately

US$74.6 billion, which represents a nearly 16 per cent increase as compared to the first half of 2015, according to Bloomberg.

Debt financing markets

Debt financing markets in the United States experienced some choppiness over the first quarter of 2016, but conditions steadily improved during the second quarter. Over the first six months, median debt-to-EBITDA multiples for private equity investments fell to approximately 5.5x as compared to 5.8x during the same period in 2015, while equity-to-EBITDA multiples went from 4.5x to 5.8x. Overall valuation-to-EBITDA multiples midway through 2016 came in at approximately 11.3x, up from 10.3x over the previous year. The overall decrease in median debt levels can be attributed in part to a challenging regulatory environment affecting many providers of debt financing for M&A transactions, as well as the tighter debt financing markets during the first quarter. In addition, external economic shocks may be affecting the desire to operate at a baseline that includes less debt.

Strong first half in private equity fundraising

Global private equity fundraising had a strong first half of 2016, with aggregate capital raised in the first quarter up 21 per cent from the first quarter of 2015 and 44 per cent from the second quarter of 2015 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.

Competition among private equity funds has increased as the number of private equity funds in market has increased in recent quarters, reaching 1,720 funds in market at the beginning of the third quarter of 2016 according to Preqin (as compared to 1,529 in the third quarter of 2015), while the amount of capital targeted by private equity funds has remained relatively stable (decreasing only 6 per cent from US$477 billion in the third quarter of 2015 to US$447 billion at the beginning of the third quarter of 2016 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 and Europe, with Europe-focused private equity funds having the strongest overall half of the year since 2008. Additionally, there has been a continued focus in private equity fundraising on strategic relationships and alternative fundraising strategies.

Outlook for second half of 2016

Overall, private equity activity opened the year to a relatively slow start, due in part to market volatility, weak debt financing markets and global economic and political factors. Deal professionals remain cautious as to whether private equity buyout activity will improve in the second half of 2016 as there are several headwinds impacting the industry, including macroeconomic uncertainty, the US presidential election in the autumn and potential impending fallout from Brexit. We note that one positive factor has been improving debt financing markets over the course of the year, which may help to buoy investment activity so long as valuations remain at the levels seen earlier in the year. We expect that private equity fundraising will continue to be affected by competition for limited partner capital and sponsors continuing to adapt to the heightened regulations applicable to private equity firms. We believe this will result in further separation within the private equity fundraising market in favour of established sponsors with proven track records and the fundraising and compliance resources necessary to successfully raise capital in today's environment.

Bill Curbow

PRIVATE EQUITY IN THE UNITED STATES

Bill Curbow, Atif Azher and Peter H Gilman are partners and Fred de Albuquerque and Audra Cohen are corporate associates at Simpson Thacher and Bartlett LLP. They have wide-ranging experience in M&A and private equity matters, acting for clients including large multinationals, Fortune 500 companies and smaller and closely held private companies, as well as financial advisers, boards of directors and special committees.

Curbow recently 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.

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

Bill Curbow, Atif Azher, Peter H Gilman, Fred de Albuquerque and Audra Cohen: Mergers and acquisitions activity levels over the first half of 2016 dropped from the record-breaking levels of 2015 to US$1.32 trillion of deals, according to Mergermarket. However, despite the global drop in M&A activity, private equity activity in the US has so far remained relatively flat as compared to 2015. According to PitchBook, through the first half of the year, US$298 billion in private equity deals have occurred in the US, representing a slight increase over the same period last year and a 12 per cent decline relative to the back half of 2015. Megafund formation and private equity transactions of over US$5 billion have been less frequent compared to last year, as sponsors have favoured mid-level funding and strategic 'add-on' acquisitions.

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 joint ventures, 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 seek to provide acquisition financing to large strategic companies in connection with strategic company acquisitions. Despite the slowdown in activity as a whole by sponsors, add-on acquisitions remain a popular avenue to deploy capital in the United States. According to PitchBook, in the first half of 2016, the number of 'add-on' investments by private equity sponsors had risen to 64 per cent of all control investments, continuing the steady increase from 43 per cent back in 2006.

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

BC, AA, PHG, FdA & AC: Notable deals in the United States included the US$15 billion leveraged buyout of ADT Security Systems by Apollo Global Management and the US$13.9 billion acquisition of Keurig Green Mountain by JAB Holding Company, Mondelez International and BDT Capital Partners. The leveraged buyouts of both ADT and Keurig Green are notable because they show that, despite current valuations, sponsors are prepared to, and will, deploy large amounts of capital for certain businesses and that lenders will provide sizeable credit financing for large LBOs.

Does private equity M&A tend to be cross-border? Tell us about some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal.

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, to look to the United States for potential investment opportunities.

The primary challenges to cross-border investments revolve around financing, tax considerations, regulatory compliance and securities laws limitations. One issue for US sponsors seeking to sell their portfolio companies to non-US buyers is the potential review by the Committee on Foreign Investment in the United States (CFIUS). A meaningful CFIUS review can add potential delays and uncertainty to such a transaction. Since 2012, acquisitions involving Chinese acquirors have been the most reviewed transactions pursuant to a CFIUS review process. Despite the recent approval of many high-profile acquisitions involving non-US acquirors, CFIUS review should be a factor for sponsors to consider when negotiating transactions involving sales to foreign acquirors. 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 negotiate reverse termination fees or pre-emptive divestitures, discuss possible mitigation measures and build political support. While these regulatory challenges are usually manageable, they increase the level of resources or otherwise complicate the process for execution in such cross-border sponsor exits.

What are 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 OCC. 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 experienced some choppiness over the first quarter of 2016, but conditions steadily improved during the second quarter. Median debt-to-EBITDA multiples for private equity investments during the first half of the year fell to approximately 5.5x as compared to 5.8x during the same period in 2015,

although valuation-to-EBITDA multiples have increased from approximately 10.3x to 11.3x over the same period. As a result, we have seen an uptick in the average percentage of deal price being covered by equity financing in US private equity transactions. The decrease in median debt percentages was likely influenced by market realities for debt financing in the first quarter of 2016, as well as dealmakers' continuing desire to operate at a baseline that includes less debt moving forward amid concerns about continued macroeconomic uncertainty.

How has the legal and policy landscape changed during the past few years in your country?

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 SEC as investment advisers. With this regulatory shift there are now more extensive compliance obligations for the industry. In addition, since then, the SEC has been scrutinising the private equity industry with the goal of, among other things, promoting compliance with certain provisions of the Investment Advisers Act of 1940 (the Advisers Act) that the SEC deems of particular importance. Recently, certain commonplace private equity industry practices have not only received significant attention from the SEC on examination, but in certain cases have also led to SEC enforcement actions against private equity fund advisers. Areas that the SEC has highlighted to be of particular concern include, among others:

- allocation of expenses (including for the compensation of operating partners, senior advisors, 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, as well as for payment of a private equity fund adviser's regulatory compliance expenses) to funds or portfolio companies, or both. Plus full allocation of broken deal expenses to funds instead of separate accounts, co-investors or co-investment vehicles, in each case without pre-commitment disclosure and consent from investors;
- receipt 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) without pre-commitment disclosure and consent from investors;
- receipt by private equity firms of 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 the 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 firms' employees and directors;
- receipt of service provider discounts by private equity firms that are not given to the funds or portfolio companies without pre-commitment disclosure and consent from investors;
- failure to fully allocate transaction fees from portfolio companies to management fee paying funds to offset such management fees without

> *"Overall, US private equity deal flow slowed in the first half of 2016 as compared to the end of 2015."*

pre-commitment disclosure and consent from investors; and

- allocation of interest from a loan to the private equity fund adviser only to the private equity fund adviser without pre-commitment disclosure and consent from investors.

The SEC's 'broken windows' approach to regulatory enforcement has 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 interests. We 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 such increased scrutiny.

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 (whether or not 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 – namely, 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 (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.

Most recently, in April of 2016, the Treasury Department and the 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 'serial inverters' to continue to acquire US corporations without being subject to the anti-inversion rules). Additionally, on the same day that these regulations were issued, the Treasury Department and the IRS also issued proposed regulations addressing the US federal income tax treatment of debt between certain related parties, which were intended to reduce certain tax benefits from related-party leverage. Although these proposed regulations were motivated in part by the perceived over-leveraging of US entities in the cross-border context (including in inverted structures), the rules are not limited to inverted corporate groups and may apply even if the debt is between US entities.

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. Furthermore, the rules applicable to these areas will likely remain the subject of legislative and regulatory attention, and further changes on these subjects are expected.

What are the attitudes to 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 country?

BC, AA, PHG, FdA & AC: While negative attitudes concerning private equity buyouts seems to have waned over the last 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.

At the same time, policymakers are continuing their enhanced focus on the private equity industry with examination and enforcement activities remaining a top priority. While we can expect to see an uptick in examination and enforcement activities by both the SEC and other regulatory bodies, some SEC officials have reported that the cases against private equity firms could take years to build, and might be less severe than some fear.

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 trended downward in the first half of 2016, following several years of rocketing exit activity during which many sponsors reaped the benefits of a high valuation environment. Recently, valuations have come down slightly and sponsors, as a whole, are holding a higher proportion of relatively new inventory as compared to the past two years. According to PitchBook, sponsors executed 459 exits accounting for approximately US$113 billion in the first half of 2016, representing a 28 per cent decline in exit volume as compared to the latter half of 2015 and a 47 per cent decrease in total exit value. The consumer sector dominated the private equity exit landscape, with 28 per cent of all total exit value achieved during the period.

The first quarter of 2016 was the first quarter since the beginning of 2009 during which no private equity portfolio companies listed on public exchanges in the US. The second quarter of 2016 saw a welcome rebound in the IPO market for PE-backed listings, with 10 completed listings raising an aggregate of US$3.1 billion, according to Pitchbook. The largest PE-backed IPO was the offering by US Foods, a former portfolio company of KKR & Co LP and Clayton, Dubilier & Rice LLC, which raised approximately US$1.2 billion.

Other notable private equity exits during the first half of the year included the sale by Bain Capital LLC of Blue Coat Systems to Symantec Corp. for approximately US$4.7 billion (although Bain Capital reinvested approximately US$750 million in the combined company) and the sale by Madison Dearborn Partners of Sage Products to Stryker Corp for approximately US$2.8 billion. Both of these transactions showcase the trend of sponsors favouring corporate acquirers rather than peers in private equity when it comes to selling high-quality assets. Corporate acquisitions constituted more than half of the 459 PE-backed exits in the first half of 2016, according to Pitchbook.

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 by 44 per cent in the second quarter of 2016 as compared to the second quarter of 2015 (with aggregate capital raised up to US$101 billion from US$70 billion according to Preqin) as fundraising by established, top-performing sponsors at the upper end of the private equity market remained strong. This reflects a 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$101 billion in aggregate capital raised, according to Preqin, the second quarter of 2016 is only the fourth quarter since the fourth quarter of 2008 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 1,720 funds in market at the beginning of the third quarter of 2016 according to Preqin (as compared to 1,529 in the third quarter of 2015) while the amount of capital targeted by private equity funds has remained relatively stable (decreasing only 6 per cent from US$477 billion in the third quarter of 2015 to US$447 billion at the beginning of the third quarter of 2016 according to Preqin).

Global macroeconomic uncertainty and difficult economic and political conditions in certain regions have caused a number of private equity firms to

> *"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."*


Peter H Gilman

increase the pace of fundraising and have shifted fundraising dynamics in favour of North America and Europe. Europe-focused private equity funds had the strongest overall half of the year since 2008, with a number of European mega-buyout funds returning to the market in 2016. Moreover, as of the end of the second quarter of 2016, the approximately 846 North America-focused funds in market represented nearly half of the total number of private equity funds in market and 45 per cent of aggregate capital targeted according to Preqin. In addition, as of the end of the second quarter of 2016, there were 325 Europe-focused funds in market, targeting US$109 billion in capital commitments. While, as of the end of the second quarter of 2016, there were 327 Asia-focused funds in market, such funds were seeking only a total of US$94 billion in capital commitments. As of the end of the second quarter of 2016, there were only 173 funds in market with a primary focus on other parts of the world, seeking to raise US$26 billion in capital commitments. According to Preqin, as of the end of the second quarter of 2016, 56 per cent of institutional investors were seeking to make new capital commitments to Europe-focused private equity funds in the next 12 months (up from 50 per cent in the second quarter of 2015) and 48 per cent of investors were seeking to make new capital commitments to North America-focused private equity funds. However, the impact of Brexit remains uncertain and may influence investors' opinion towards investing in Europe going forward.

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 and European sponsors).

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 June 2016, according to Preqin, dry powder held by private equity funds was estimated to have reached US$818 billion up from US$745 billion in December 2015.

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.

What are the timelines, structures, and the key contractual points in a typical fundraising? What are the most significant legal issues specific to your country?

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. It should be noted that 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 such documents and more frequent updates to such 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.


Fred de Albuquerque

How closely are private equity sponsors supervised in your country? 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 affects not only 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, among others: 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

Audra Cohen

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').

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 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.

What effects 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 EU, 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 'reverse solicitation'. In addition, minimum transparency requirements under the AIFMD (eg, annual reports, periodic reports, pre-investment disclosure to investors, notification in respect of control of non-listed companies, etc) 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

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 (LBOs) 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 megafunds. 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 2016 has been no different. In the first half of 2016, we saw private equity funds focusing on the United States and North America raise more than US$115 billion. Through the years, the private equity industry has matured and the experience of fund managers has 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 transaction in your jurisdiction?

The main consideration in selecting a legal adviser is depth of experience in the private equity sector. 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).

Bill Curbow, Atif Azher, Peter H Gilman, Fred de Albuquerque and Audra Cohen
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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. Larger managers 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.

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, 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.

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

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 as of late include:

- the implementation of new due diligence, information reporting and withholding rules

pursuant to the Foreign Account Tax Compliance Act, commonly referred to as FATCA;
- possible changes in the taxation of carried interest (as further described below); and
- the proper tax treatment (including deductibility) of monitoring fees paid by underlying portfolio companies to a private equity fund's investment adviser. 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. The Obama administration has indicated that it supports the adoption of this legislation or legislation that similarly changes the treatment of carried interest for United States federal income tax purposes. Whether such legislation will be enacted (or in what ultimate form) remains uncertain.

Looking ahead, what can we expect? What will be the main themes over the coming year?

BC, AA, PHG, FdA & AC: Overall, US private equity deal flow slowed in the first half of 2016 as compared to the end of 2015. 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 lower-growth, 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 among potential buyers – many corporates still hold significant cash stores coming off a decade of conservative corporate spending, and US private equity funds are sitting on a record amount of deployable capital, having raised more than US$115 billion in the first half of 2016 alone. In addition, we expect to see a continued trend towards add-on acquisitions, 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 2016 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 second half of 2016. Significant corrections in asset valuations could lead to more completed transactions, particularly for assets with solid long-term prospects. However, overall volume may be tempered by continued movement towards smaller add-on, or strategic, acquisitions by portfolio companies. Moreover, fallout from Brexit will likely continue to cause US dealmakers to exercise caution in pursuing cross-border transactions or transactions involving multinational companies with significant UK exposure. Each of these factors creates uncertainty for the direction of private equity deal activity in the second half of 2016.

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