TRAVERS SMITH

Investment Funds

Update on ILPA Revised Principles

Institutional Limited Partners Association – Private Equity Principles

January 2011 saw the Institutional Limited Partners Association issuing a revised version of the "Private Equity Principles" (the "Guidelines"). The three guiding principles set out in the Guidelines – alignment of interest, governance and transparency – are unlikely to be contested by either the general partner ("GP") or limited partner ("LP") communities and indeed have been central to the way fund terms have developed over the last ten years or so.

The Guidelines are an attempt to improve lines of communication between the GP and LP communities and increase awareness of the objectives from both sides of the table when fund terms are being negotiated. The Guidelines have been recognised by both GPs and LPs as a useful tool in the negotiation of fund documentation but some concerns remain.

A central, but inevitable, area of concern is that the Guidelines cannot, and do not purport to, provide a suite of suggested terms which will be suitable in all situations. The dynamics of the relationship between a GP raising its tenth fund and its investors will be, and should be, different from the relationship between a first time GP and its investors. The Guidelines explicitly recognise this tension by stating that each fund should be considered "separately and holistically" – the negotiations over the proposed terms of a fund should take into account the specific circumstances of the fund-raising and the nature of the fund and its investment objectives.

Whilst the majority of GPs would support the aims of the Guidelines and the three guiding principles, the Guidelines provide specific recommendations and the devil is in the detail. GPs should not be afraid to challenge the recommendations set out in the Guidelines if they believe that they are not appropriate to the nature of their business – however, GPs will need to be aware of, and understand, the position taken by the Guidelines and will need to construct coherent arguments as to why certain of the principles should be dis-applied. It is no longer sufficient for a GP to support a position merely on the basis that it is "market" or reflects its previous practice – there needs to be a recognition that the Guidelines have changed the investing landscape and GPs will accordingly need to be more pro-active in their discussion of terms.

From an LP's point of view, it is clear (and expressly confirmed in the Guidelines) that the principles articulated in the Guidelines should not be used as a checklist when considering an investment in a fund – assessing terms merely according to their compliance with the Guidelines is unlikely to be a helpful approach. The Guidelines provide a useful benchmarking tool and highlight issues which a prospective investor would be well-advised to consider, but LPs need to constructively engage with GPs to understand the arguments being put forward by the GP supporting the terms which they propose.

Therefore, whilst the publication of the Guidelines has not heralded an era of collective bargaining by LPs, the provisions suggested by the Guidelines have been extensively discussed in recent fund-raisings. Given the challenging nature of the fund-raising market in the period since the Guidelines were first published, it is difficult to empirically quantify their impact however, the strength and relevance of the Guidelines may be tested when market conditions improve and the balance of power between GPs and LPs shifts.

Travers Smith LLP is a limited liability partnership registered in England and Wales under number OC 336962 and is regulated by the Solicitors Regulation Authority. The word "partner" is used to refer to a member of Travers Smith LLP. A list of the members of Travers Smith LLP is open to inspection at our registered office and principal place of business: 10 Snow Hill, London, EC1A 2AL. We are not authorised under the Financial Services and Markets Act 2000 but we are able, in certain circumstances, to offer a limited range of investment services because we are members of the Law Society of England and Wales and regulated by the Solicitors Regulation Authority. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide. The information in this document is intended to be of a general nature and is not a substitute for detailed legal advice.

For further information on these issues please contact the following partner in our Investment Funds Department or your usual contact at Travers Smith.

Travers Smith LLP

10 Snow Hill

London EC1A 2AL

T +44 (0)20 7295 3000

F +44 (0)20 7295 3500

Sam Kay

Partner, Head of Investment Funds

sam.kay@traversmith.com

+44 (0)20 7295 3334

© **Travers Smith LLP - January 2012**