Walker Guidelines for Enhanced Disclosure by Portfolio Companies and Private Equity Firms published

On 20 November 2007, Sir David Walker published his final Guidelines on disclosure and transparency in the private equity industry. The Guidelines, which are a voluntary set of rules intended to be implemented on a 'comply or explain' basis, require greater disclosure by large private equity firms and their portfolio companies, as well as industry-wide data collection and dissemination. The main points to consider in the Guidelines are as follows:

Who is covered by the Guidelines?

The Guidelines cover firms 'authorised by the FSA' that manage or advise investment funds that 'own or control' (or have the designated capability to own or control) one or more UK 'portfolio companies'. It also covers the portfolio companies themselves. To be caught a portfolio company must (i) generate more than 50% of its revenues in the UK, (ii) employ more than 1,000 full time equivalent UK employees and (iii) pass a size threshold of £300 million in terms of market capitalisation plus acquisition premium (for a publicly quoted company which has been taken private) or £500 million in terms of enterprise value (for a company acquired in a secondary or non-market transaction).

Sir David Walker estimates only 65 companies will be caught by these requirements.

Private Equity Firms

Annual Review

Each private equity firm owning a company which meets the thresholds set out above should publish an annual review accessible on its website or ensure regular updating of its website covering:

- how the FSA-authorised entity fits into the firm of which it is a part, its history and investment approach (including investment holding periods), illustrated by case studies where possible;
- a commitment to conform to the Guidelines and promote conformity by portfolio companies owned by the fund, its leadership and conflict of interest arrangements; and
- a description of its UK portfolio companies, and a categorisation of its limited partners by type and geographic location.

The firm should ensure that reports to limited partners follow established guidelines in monitoring, reporting and valuing existing investments, such as the international guidelines published by the EVCA.

Data input by a private equity firm to the industry association

The firm should provide to the BVCA, on a confidential basis, data for the previous calendar year which covers: the amounts raised in funds which may invest in UK portfolio companies, acquisitions and disposals of portfolio companies by transaction value, estimates of aggregate fee payments to professional advisers and other services associated with the establishment and management of their funds and, for exits from UK portfolio companies, firms should support the preparation of industry-wide attribution analysis which will indicate the major sources of the returns generated by private equity.

Portfolio Companies

Enhanced disclosure

Portfolio companies are subject to enhanced disclosure, broadly similar to the requirements for quoted companies contained in the Companies Act 2006. The enhanced reporting will require the inclusion in the annual report and accounts of:

- a business review which includes the information required by section 417(5) of the Companies Act 2006 (which usually applies to quoted companies). The review must therefore identify trends and factors affecting the business, provide information about environmental matters, details of the company's employees, social and community issues, and information about persons with whom the company has contractual or other arrangements which are essential to the company's business;

- a financial review covering risk management objectives and policies in the light of the principal financial risks and uncertainties facing the company, including those relating to leverage; and

- identification of the private equity fund owner and the senior executives or advisers responsible for overseeing the company, and the composition of the board, identifying executives, representatives and other directors brought in to add industry experience.

The annual report and accounts should be published on the company's website within 6 months of the year end, and a summary mid-year update should be published on its website within 3 months of the half-year containing a brief account of any major developments in the company.

The Guidelines emphasise that such reporting should focus on substance rather than form and on the economic reality of a company or group rather than its legal structure.

Data input by a portfolio company to the industry association

Portfolio companies should provide to the BVCA data, for the previous calendar year, on trading performance, employment, capital structure, investment in working and fixed capital, expenditure on research and development and any other data as the BVCA may request.

Responsibility to employees at times of significant strategic change

Private equity firms should commit to ensure timely and effective communication with employees, either directly or through the relevant portfolio company. If a portfolio company encounters difficulties "that leave the equity with little or no value" the private equity firm should be attentive not only to the full discharge of fiduciary obligations to its limited partners but also to facilitating the process of transition "as far as practicable to do so".

These Guidelines are really designed to allay some of the public perceptions about private equity firms failing to treat employees with sensitivity, particularly at times of significant change in the businesses where they are employed. The Report states that "... it is of key importance that private equity firms be alert to such concerns and approach the discharge of the commitment sought under the relevant guidelines in ways that dispel any continuing misperception as well as achieving the substance of effective employee communication."

Comply or explain principle

Conformity with the Guidelines should be on a comply or explain basis. Where an explanation is given for 'non-compliance', this should be posted alongside other related relevant disclosures on the website of the private equity firm or portfolio company.

BVCA

The Report proposes that the BVCA will be responsible for:

- collating the data provided by the portfolio companies and private equity firms (as outlined above); and

- monitoring compliance with the Guidelines. In a separate announcement the BVCA has appointed Sir Mike Rake to check that private equity firms are conforming to the "comply or explain" principle and to keep the Guidelines under review.

If you would like more information on any of the topics discussed in this Note, or on what you should do to prepare for the changes, please contact your usual contact at the firm.

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December 2007

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