TREASURY, RISK AND FINANCE PROFESSIONALS

The Association of Corporate Treasurers
Comments in Response to

Inquiry into private equity funds
Issued by the Treasury Select Committee,
March 2007

May 2007

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the end of these comments and on our website www.treasurers.org.

Contact details are also at the end of these comments.

We have canvassed the opinion of our members through our communications to members and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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Response

The ACT's view is that that private equity can enhance capital market efficiency and can widen the availability of capital, identify companies with significant growth potential and facilitate their transformation. We do not believe that there are material gaps in the current regulatory regime which would require substantial changes in the attitudes of policy makers. The Committee asked for specific written evidence in the following areas

The regulatory environment

»Is the current regulatory regime for private equity funds suitable? *It is our view that there is no need for a separate private equity regulatory regime and that oversight from the FSA under existing legislation and procedures remains the appropriate mechanism.*

»Is there sufficient transparency on the activities, objectives and structure of private equity funds for all relevant interested parties? *It is not clear whether transparency is being used in this context to address concerns that have merit – e.g. adherence to statutory disclosure regimes – or to seek to control legitimate investment and capital market transactions which other parties dislike or disapprove of. We consider that there is sufficient transparency in respect of the concerns that have merit*

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»Has there been evidence of excessive leverage in recent transactions and what systemic risks arise in consequence? *There is no definitive academic or professional agreement on what constitutes appropriate leverage for individual enterprises. Hence the question of 'excessive' is not an objective standard. In addition there is no evidence as to the impact of failed leverage on market risk. Some professional commentators – such as Standard and Poor's - have recently expressed their concerns on likely rising levels of corporate debt defaults; however current levels of corporate default remain at historic lows.*

» What are the effects of the current corporate status of private equity funds, including both their domicile and ownership structure? *Providing the regulatory regime to which they are subject has full access to the information it requires, there is no evidential reason to be concerned with domicile or ownership*

Taxation

»Is the current taxation regime for private equity funds and investee firms appropriate? *–We would expect the tax regime to be neutral between public or private enterprise owners/shareholders. The only we are aware of that the current tax regime is either inappropriate or overly favourable to private equity funds or investee firms is in respect of FA 1996 Sch 9 para 13 which HMRC might consider a constraint on the retirement of existing equity by existing management but which might **not** apply to private equity buyers.*

The economic context

»Are developments in the environment and structure of private equity affecting investments in the long-term? *There is no empirical evidence to suggest private equity ownership has a negative effect on 'long-term' investment. In fact the normal private equity model relies on a realisation of the investment either through a public flotation or trade sale in three to seven years. There is therefore every incentive on the private equity owners to ensure that their businesses remain viable in the longer term.*

»To what factors, including the current macroeconomic context and position in the economic cycle, is the current rise of private equity attributable? *Private equity is one example of increasingly wealthy investors seeking diversification in their portfolios beyond traditional equity and bond markets. To the extent that low interest rates have benefited corporate activity through a low real cost of post-tax debt, this is not confined to private equity investment*.

»What are the economic advantages and disadvantages of a firm being owned by private equity funds as opposed to being publicly listed? *There are considerable arguments deployed by proponents of both of these forms of investment to recommend their use. The ACT's view is that investors should be free to choose between competing forms of asset allocation based on their own investment criteria. Public and private merger and acquisition activity involving a particular approach to management and finance of a portfolio of companies is not a new phenomenon*

Conclusion

We have noted the recent moves by the BVCA and others to inquire into creating a code of conduct for private equity firms. We also noted – and responded to – the recent FSA discussion paper (dp06_06)regarding private equity and market risk. We would support moves to engage further with the private equity industry and its representatives through these discussions.

The Committee might however wish to consider the role of traditional 'buy and hold' instutional investors in the exercise of their fiduciary duites to their clients. It might appear that these institutions have nor been exercising their shareholder powers to encourage public company mangement to run their companies to best advantage in terms of the business strategies and the financing models. This seems to be evident in that private equity values companies at levels above those prevailing in the public markets.

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The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including The Treasurer magazine and the annual Treasurer's Handbook, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce, financial institutions and professional service firms.

Our guidelines on policy and technical matters are available at http://www.treasurers.org/technical/resources/manifestosept2006.pdf.

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