Guidelines Monitoring GROUP

Private Equity Monitoring Group on Transparency and Disclosure

FEEDBACK STATEMENT: AMENDMENTS TO THE WALKER GUIDELINES

JULY 2014

GUIDELINES MONITORING GROUP

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GUIDELINES MONITORING GROUP

EXECUTIVE SUMMARY

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The Guidelines Monitoring Group (the "Group") has spent the past few months consulting on its proposed amendments to Sir David Walker's Guidelines for Disclosure and Transparency in Private Equity (the "Guidelines") and here we present our feedback and final advice.

As we near the seventh anniversary of the launch of the Guidelines, the Group is publishing, alongside this feedback statement, a revision to Part V and Annex D of the Guidelines which sets out the enhanced reporting requirements for portfolio companies and private equity firms. As well as monitoring the industry's compliance with the Guidelines, we have continuously reviewed how the Guidelines should evolve over time to ensure they remain relevant in the eyes of the industry's stakeholders as they underpin the industry's commitment to transparency. The amendments implement the Department of Business, Innovation and Skills' new narrative reporting regulations that came into effect in October last year.

The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (the "Strategic Report Regulations") necessitated amendments to the Guidelines as they removed the requirement for a business review in the directors' report – which was the foundation for the enhanced disclosure requirements for portfolio companies – and moved this content, with a few additions, to a new report called the strategic report. The revisions to Part V and Annex D of the Guidelines are therefore focused solely on the requirements for portfolio companies and the enhanced disclosures required to be comparable to quoted companies.

As part of the feedback process we invited comments on the proposed revisions from interested parties including private equity firms, portfolio companies, advisers and any other stakeholders. We received three written responses from accountancy firms and bodies, and through the BVCA, met with 26 firms to ensure the changes proposed were fully understood. The meetings also provided those firms with an opportunity to voice their views, including areas were the BVCA and the Group could assist with compliance. In addition, we discussed the objectives and benefits of the Guidelines and section 3 of this statement explains why they remain important for the private equity industry.

What is changing?

Firms covered by the Guidelines were appreciative of the need for change and further detail on the response to the consultation questions is set out in section 2. These amendments will further improve the quality of narrative reporting by portfolio companies in line with the good practice seen amongst constituents of the FTSE 350, our chosen benchmark.

Here we summarise the new requirements and changes to the Guidelines.

A strategic report
Portfolio companies have been disclosing additional information about their activities in their annual reports for the past six years and this business review has typically been presented in the directors' report. The changes in the UK now require this content to be placed in a strategic report that sits alongside the directors' report, both requiring approval from directors. The Guidelines have been amended to incorporate this change and include flexibility for non-UK companies so they can continue to include the content in a directors' report or equivalent in line with their applicable legal requirements. We have also recommended that companies consider the Financial Reporting Council's Guidance on the Strategic Report. This guidance has been well received and will assist preparers of the annual report.

Changes to content as a consequence of the new narrative reporting regulations	
Strategy and business model	We are incorporating the requirements in the Strategic Report Regulations that call for detail on a company's strategy and business model. The former was an implicit requirement of the Guidelines and expected as it better links elements of the annual report. The business model disclosure requires a clear explanation of what a business does and how it creates value. After discussion and presentation of model examples, firms agreed this was a relatively straightforward disclosure to implement.
Gender diversity	Portfolio companies will need to include specific metrics on gender diversity, setting out the number of people of each sex who were the directors, senior managers and employees of the company. We have included flexibility in the Guidelines to allow portfolio companies to determine how to define what a "senior manager" is, rather than adopting the fixed Companies Act 2006 definition which may not always lead to the most appropriate for the company.
Human rights issues	Portfolio companies will need to disclose their policy in respect of human rights matters and further detail on this area to the extent it is strategically important to the business. Where it is not, this disclosure can be omitted but this needs to be stated in the annual report.
Essential contracts	Detail on a portfolio company's contracts and other arrangements will no longer be required, however we expect this to be considered as part of the business model and assessment of principal risks when applicable.
Environmental matters – greenhouse gas emissions	The Group had concluded not to incorporate the additional disclosures concerning greenhouse gas emissions in the directors' report, which have now been implemented by quoted companies. On the whole, feedback received during the consultation process supported this approach although some firms were concerned it severed the link with quoted company reporting and therefore our benchmark. The Group is still of the view that the requirement will create an additional cost burden for portfolio companies and for some, may not add to the quality of the company's reporting or transparency about its operations. However, we do acknowledge that where this area is significant for portfolio companies they may wish to include this disclosure to ensure when benchmarked against comparable FTSE 350 companies, appropriate disclosures are in place. This has been added to the Guidelines although it is not a mandatory requirement. We will continue to monitor whether it should be included in the Guidelines in future years as practice develops.

Other changes to the Guidelines	
Statement of conformity with the Guidelines	The Group is implementing a requirement for a specific statement of conformity with the Guidelines in the annual report of the portfolio company. There was a minority of dissenting views from firms on this requirement, however on the whole firms were either very supportive or indifferent on whether portfolio companies ought to include such a statement. The Group continues to believe that portfolio companies and their directors are responsible for ensuring the enhanced reporting requirements are met. We believe this statement will contribute to higher standards of transparency in reporting as it comes at a time when directors of listed companies are revisiting and reshaping the content of annual reports to ensure they are "fair, balanced and understandable" – a new requirement for companies complying with the UK Corporate Governance Code. This requirement, coupled with the Strategic Report Regulations, is expected to act as a catalyst that increases the overall quality of reporting across the FTSE 350. Portfolio companies must follow suit to ensure we continue to meet our aim of reporting to the level seen by quoted companies.
Alternative Investment Fund Managers Directive ("AIFMD")	The Group decided not to amend the Guidelines for any of the applicable additional disclosure requirements included within the transparency provisions in the AIFMD. A table setting out the interaction between the two sets of requirements is included in the Guidelines. Firms that are covered by the AIFMD may find the Guidelines and examples of good practice reporting by portfolio companies as a useful source of guidance but are responsible for taking appropriate advice to ensure they are fully compliant with their obligations.

Next steps

The Group signalled its expectation that these changes would need to be implemented for accounting periods ending on or after 30 September 2014 – a year after they were implemented for quoted companies in the UK. The feedback received was supportive of this commencement date and alongside this statement and publication of the revised Guidelines, we are publishing a new edition of the good practice guide with PwC. This will help companies comply with the Guidelines by analysing the new requirements and also includes examples.

The Group would like to thank all those firms that participated in the consultation process and continues to welcome any additional feedback you have as we implement the changes to the Guidelines.

2 AMENDMENTS TO NARRATIVE REPORTING REQUIREMENTS FOR PORTFOLIO COMPANIES

2.1 Overview

This feedback statement should be read in conjunction with the consultation paper which outlined:

- the new requirements and how they compare to the existing Guidelines;
- initial expectations of what companies will need to disclose to comply with the new requirements;
- detail on when portfolio companies are expected to comply with the requirements; and
- the areas we sought views on as part of the consultation.

During the consultation process we invited comments on the proposed amendments from interested parties including private equity firms, portfolio companies, advisers and any other stakeholders. We received three written responses from accountancy firms and bodies, and through the BVCA, met with 26 firms to ensure the changes proposed were fully understood. The meetings also provided those firms with an opportunity to voice their views, including areas were the BVCA and the Group could assist with compliance. The firms met included six infrastructure or special situations managers, one investor and four non-BVCA members. In addition, we discussed the objectives and benefits of the Guidelines and section 3 of this statement explains why they remain important for the private equity industry.

Overall firms supported the changes proposed and requested that further guidance be provided to assist preparers in the first year of compliance. The following table summarises the enhanced reporting requirements portfolio companies will need to comply with and which of those are new.

Portfolio company narrative reporting requirements

Applicable to all UK companies[1]	■ Balanced and comprehensive analysis of development and performance during the year and position at the year end ■ Principal risks and uncertainties facing the company ■ Key performance indicators – financial ■ Key performance indicators – non-financial including environmental matters and employees	Existing requirements under the Guidelines	Companies Act 2006 requirements
Enhanced disclosures that are required by the Guidelines, including those normally applicable to quoted companies	■ **Strategy** ■ **Business model** ■ Trends and factors affecting future development, performance or position ■ Environmental matters ■ Employees ■ Social, community and **human rights issues** ■ **Gender diversity information**	The requirements highlighted are new, however disclosure on strategy has always been expected to achieve compliance.	
	■ Identity of private equity firm ■ Details on board composition ■ Financial review – position ■ Financial review – financial risks ■ **Statement of conformity with the Guidelines**		Guidelines-specific requirements

1 These are applicable to all companies (including private companies) except those eligible for the small companies' exemption. Medium-sized companies are also eligible for an exemption to provide non-financial information.

2.2 Response to consultation questions

Question 1: Do you agree with the proposed amendments to Part V Section 4 of the Guidelines relating to the enhanced reporting requirements for portfolio companies? If not, please set out your specific concerns and suggestions for an alternative approach.

General comments

Overall, firms understood the rationale for the changes and specific comments on key changes are set out further below. A common request was for examples of how quoted companies have been implementing the changes so that firms could better understand the benchmark and expectations.

Guidance

To support firms in implementing the changes the Group, along with PwC, is publishing a new edition of the good practice guide. This provides further information to help firms understand what is expected in terms of compliance and example disclosures. Successful implementation and compliance is aided by early engagement with portfolio companies and the Group and the BVCA will provide guidance on specific matters to assist companies.

Following feedback, we have also referenced the FRC's Guidance on the Strategic Report in the Guidelines. This guidance has been well received and will further assist portfolio companies when compiling their annual report. Section 4c)ii) of the Guidelines state:

> *When considering the level of detail and nature of information to be included in the review, the portfolio company should have regard to the guidance set in the Financial Reporting Council's Guidance on the Strategic Report.*

Non-UK companies

At times, the parent company preparing the group annual report may not be a UK company. As a consequence, these companies will not have to prepare a strategic report under the applicable legal framework in the non-UK country. The Group has therefore amended the Guidelines to make it clear that the content should be included in a strategic report when it is a UK company and in the directors' report or equivalent when it is a non-UK company. Section 4c)i) of the Guidelines states:

> *For a UK portfolio company, this review is required to be included in the strategic report under the Companies Act 2006. A non-UK portfolio company may include this review in a directors' report or equivalent in line with applicable legal requirements in the non-UK country.*

Strategy and business model

With respect of this change, firms were keen to see examples of how the requirements are being implemented in practice and our response is covered above. Some firms queried whether it was acceptable to set out areas such as the business model in narrative form rather than diagrammatically (as some quoted companies have done). Whilst the use of diagrams can aid the understanding of a company's business, narrative discussion would be acceptable as long as it was clear and well-articulated.

Gender diversity

The definition of a "senior manager" in the Companies Act 2006 is a person who "(a) has responsibility for planning, directing or controlling the activities of the company, or a strategically significant part of the company, and (a) is an employee of the company" *[s414C(9)]*. In respect of group report disclosures, "(a) the reference to the company in subsection (8)(c)(i) is to the parent company; and (b) the breakdown required by subsection (8)(c)(ii) must include the number of persons of each sex who were the directors of the undertakings included in the consolidation." *[s414C(10)]*.

Based on feedback received and how quoted companies are complying with this requirement in practice, we have included flexibility in the Guidelines to allow portfolio companies to determine how to define what a "senior manager" is rather than adopting the fixed Companies Act 2006 definition. The definition is subjective and inclusion of directors of subsidiary companies may not always lead to the most meaningful disclosure for the company. Section 4c)iv) of the Guidelines now the following guidance:

> *When preparing disclosures in respect of gender diversity under section 414C(8)c)(ii), a portfolio company may apply its own definition of "senior manager" that differs from the definition and requirement provided in sections 414C(9) and (10) as long as it clearly explained. A reconciliation to the disclosure using the statutory definition will not be required.*

Human rights issues

Firms agreed this area was of interest to stakeholders and commented on whether guidance was available to help portfolio companies assess the type of information expected. The Group will publish examples of what is being seen in practice (include statements where the disclosure is omitted) and companies should also refer to the FRC guidance.

Statement of conformity with the Guidelines

The Group is implementing a requirement for a specific statement of conformity with the Guidelines in the annual report of the portfolio company. Previously these statements have been provided by firms to the Group and the BVCA and this is the first time portfolio companies are being asked to confirm compliance. However we note that many portfolio companies already include this disclosure in their annual reports. Section 4f) states:

> *The report should include a statement by the directors of the portfolio company confirming compliance with the Guidelines or setting out explanations for areas of non-compliance.*

There was a minority of dissenting views from firms on this requirement, however on the whole firms were either very supportive or indifferent on whether portfolio companies ought to include such a statement. Those firms that agreed with the inclusion noted that it increases the responsibility and accountability of the directors of the portfolio company. It increases the visibility of the Walker reporting process across the management team and makes it easier for firms, as owners, to sign the conformity letters sent to the Group and BVCA.

The concerns raised were primarily centred on the view that this was the responsibility of the private equity firm as owners and not the directors of the company. Some firms felt this increased the burden placed on portfolio companies and may lead to additional costs and further briefings for some directors. Further clarification was requested on how compliance overall would be judged if the statement was not included and whether the non-inclusion of such a statement materially impacted transparency objectives.

The Group continues to believe that portfolio companies and their directors are responsible for ensuring the enhanced reporting requirements are met. We believe this statement will contribute to higher standards of transparency in reporting as it comes at a time when directors of listed companies are revisiting and reshaping the content of annual reports to ensure they are "fair, balanced and understandable" – a new requirement for companies complying with the UK Corporate Governance Code. This requirement, coupled with the Strategic Report Regulations, is expected to act as a catalyst that increases the overall quality of reporting across the FTSE 350. Portfolio companies must follow suit to ensure we continue to meet our aim of reporting to the level seen by quoted companies.

The Group does not expect this requirement to lead to additional costs as in practice these disclosures are reviewed by auditors of the portfolio companies, and guidance and extra support is available to assist with compliance. The good practice guide includes some examples of what portfolio companies are including in their annual reports and the impact on overall compliance will be judged on a case-by-case basis.

Question 2: Do you agree the proposed changes to the reporting requirements for Walker portfolio companies appropriately implement The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 in respect of the requirements relating to the Strategic Report?

Drafting points were suggested and have been incorporated into the final Guidelines. The Group has also narrowed down the specific reference for portfolio companies to follow to section 414C of the Companies Act 2006. The draft amendments referred to Chapter 4A of Part 15 of the Companies Act 2006 and many of the provisions in here are mandatorily applicable to companies that are required to prepare a strategic report.

Question 3: Do you agree with the Group's approach to implementing the requirements concerning greenhouse gas emissions in the directors' report? If not, please provide suggestions for an alternative approach.

The vast majority of firms agreed with the Group's decision not to incorporate the additional disclosures concerning greenhouse gas emissions in the directors' report, which have now been implemented by quoted companies. Some firms were concerned it severed the link between the Guidelines and the FTSE 350 and therefore our benchmark.

The Group is still of the view that the requirement will create an additional cost burden for portfolio companies and for some, may not add to the quality of the company's reporting or transparency about its operations. However, we do acknowledge that where this area is significant for portfolio companies they may wish to include this disclosure to ensure when benchmarked against comparable FTSE 350 companies, appropriate disclosures are in place. Indeed some portfolio companies already include this information in their annual reports or on their websites.

The Group has therefore added an addition to the Guidelines which recommends inclusion of disclosure on greenhouse gas emissions when significant, although this is not a mandatory requirement. Section 4c)iii) of the Guidelines states:

> *When preparing disclosures in respect of environmental matters under section 414C(7) b)(i), a portfolio company may, to the extent it is significant, include the disclosures concerning greenhouse gas emissions as set in Part 7 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. This is not a mandatory requirement of the Guidelines.*

We will continue to monitor whether it should be included in the Guidelines in future years as practice develops.

Question 4: Do you agree with the timeframe proposed for implementation of the amendments to the Guidelines?

The changes will impact portfolio companies with accounting periods ending on or after 30 September 2014. The vast majority of firms agreed with the timetable as portfolio companies covered by the Guidelines typically have December year-ends and this gives sufficient time to prepare for the changes. The proposed project plan for implementing the proposed amendments is set out below.

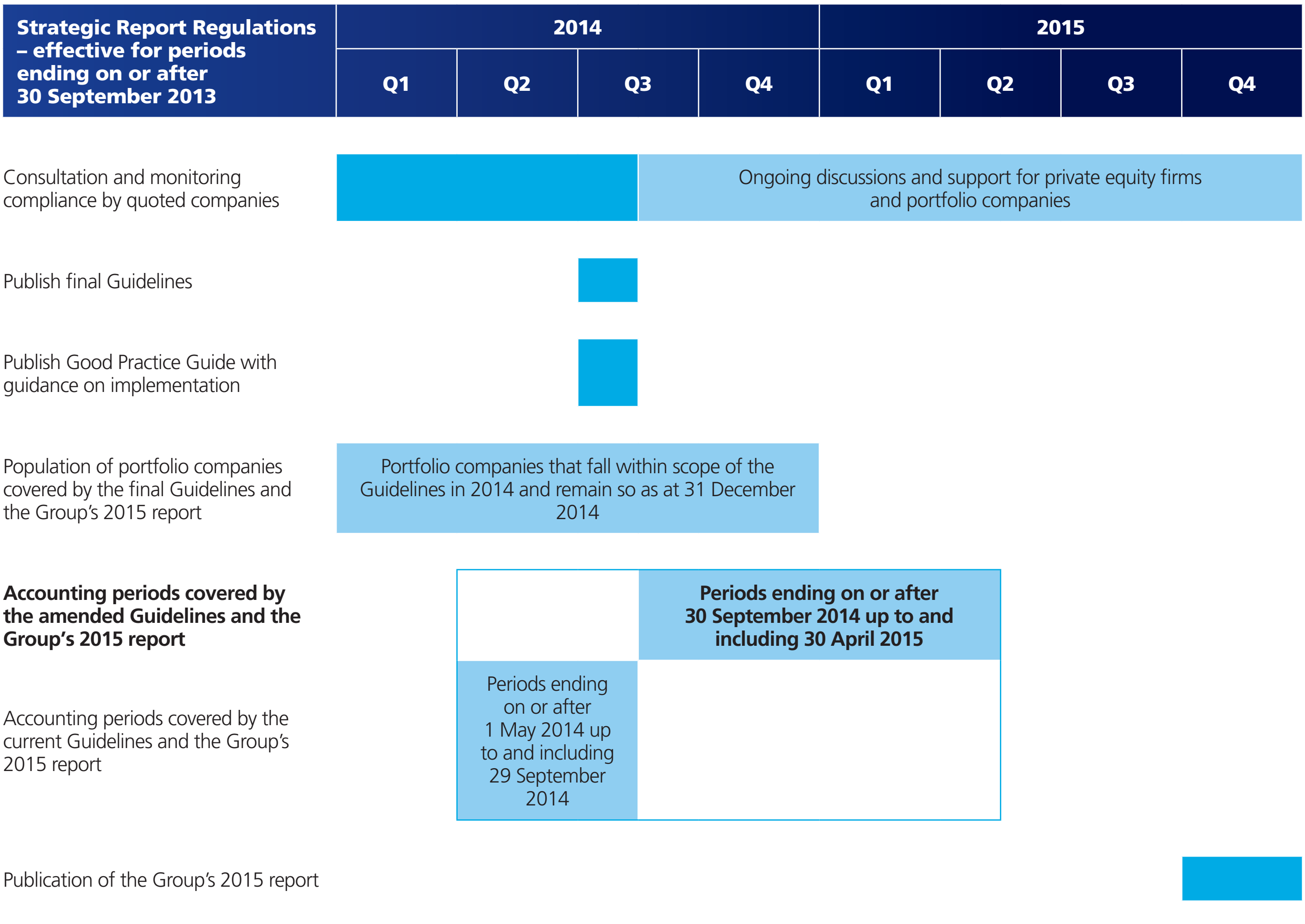
The scope of the Group's review in 2014

The extended requirements applicable to quoted companies in the strategic report (the business model, gender diversity and human rights matters) will therefore not apply to portfolio companies preparing annual reports that will be reviewed by the Group for its seventh report. The seventh report will be published in December 2014 and will cover accounting periods ending up to and including 30 April 2014. For those UK companies with accounting periods ending on or after 30 September 2013, a strategic report is required under company law and the Group will review this report to assess compliance with the current guidelines. Portfolio companies may voluntarily include the additional information if they wish and the Group will provide feedback.

The scope of the Group's review in 2015

The Group will report on the compliance of portfolio companies with the amended Guidelines in December 2015 and this will cover portfolio companies that fall within the scope of the Guidelines between 1 January 2014 and 31 December 2014 and the portfolio company must meet the threshold criteria set out in Part V of the Guidelines as at 31 December 2014.

The Group will monitor compliance of the annual reports of covered portfolio companies with accounting years ending up to and including 30 April 2015. This means that portfolio companies with accounting years ending on 1 May 2014 and up to 29 September 2014 will not be required to comply with the amended Guidelines but the Group would encourage portfolio companies to consider doing so.



The Group intends to be flexible in its approach to implementation and will support portfolio companies complying with the amended requirements in the first year of their application. The Group will discuss individual cases with portfolio companies and private equity firms.

THE IMPORTANCE OF THE WALKER GUIDELINES TO THE PRIVATE EQUITY INDUSTRY

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The Guidelines Monitoring Group was created in 2007 as an independent body to monitor the private equity industry's compliance with Sir David Walker's Guidelines for Disclosure and Transparency in Private Equity. This was in response to the increased scrutiny and negative publicity the private equity industry faced in 2007 from the media, trade unions and politicians, culminating in the Treasury Select Committee hearings.

Since then, the industry has embraced and adopted these Guidelines with over eighty portfolio companies currently providing additional disclosure voluntarily. Further detail and reports can be found on the Group's website and here we set out the objectives and benefits of the Guidelines to the private equity industry.

Objectives of the Guidelines

- To demonstrate the private equity industry's commitment to transparency of its activities.
- To provide data to support the private equity industry's contribution to the UK economy.

Benefits of the Guidelines

- The Guidelines provide a framework for the private equity industry to enhance stakeholders' understanding of our activities and address concerns about a lack of transparency in the industry. These stakeholders include government, regulators, media, employees, customers and the public more widely.
- The data published on the performance of portfolio companies supports the advocacy work the BVCA does on behalf of the private equity industry. It gives it the credibility and evidence it needs when discussing the industry's contribution to the broader economy in terms of employment, productivity, capital investment and growth. This in turn allows for more informed and proportionate decisions on policy and regulation by Government and regulators. It also provides a returns attribution analysis which quantifies the impact of strategic and operational plans implemented under private equity ownership as well as the impact of leverage.
- By publishing annual reports on portfolio company websites and including further disclosure on private equity firms' websites, the industry is able to demonstrate its commitment to transparency is real and here to stay.
- Enhanced reporting by portfolio companies and disclosures by private equity firms on their investment approach further demonstrates they are responsible owners and builders of businesses. The reputational impact benefits the portfolio company itself as well as its owner and the Guidelines support those portfolio companies with reporting ahead of a listing on a public market.
- The Guidelines are monitored by an independent body which further validates the private equity industry's transparency commitment.

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APPENDIX 1: DEFINITIONS AND LINKS TO DOCUMENTS

The Guidelines or Walker Guidelines	Guidelines for Disclosure and Transparency in Private Equity, November 2007 Sir David Walker's final guidance following an independent review in disclosure and transparency in the private equity industry. The consultation document and final guidelines are available at http://www.walker-gmg.co.uk/?section=10774
The Group	The Guidelines Monitoring Group The Group was created in 2007 as an independent body to monitor the private equity industry's compliance with the Guidelines. Further detail on the membership of the Group is available at http://www.walker-gmg.co.uk/?section=10769
Strategic Report Regulations	The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 The legislation is on the Government's website available at http://www.legislation.gov.uk/uksi/2013/1970/contents/made
FRC guidance	Final guidance on the Strategic Report published by the Financial Reporting Council This is available at https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Guidance-on-the-Strategic-Report.pdf
AIFM Regulations	The Alternative Investment Fund Managers Regulations 2013 HM Treasury's consultation and the AIFM Regulations are available at https://www.gov.uk/government/consultations/transposition-of-the-alternative-investment-fund-managers-directive--2
BVCA	The British Private Equity and Venture Capital Association

Reports published by the Guidelines Monitoring Group on its monitoring activities, the Q&A published in the Group's publication in July 2013 and the prior editions of the Good Practice Guide, prepared by PwC, are available on the Group's website accessible at http://www.walker-gmg.co.uk/?section=11664.

The BVCA Guide to Responsible Investment is available at http://www.bvca.co.uk/ResearchPublications/BVCAGuidetoResponsibleInvestment.aspx.

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