Guidelines for Disclosure and Transparency in Private Equity

November 2007

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PREFACE

1. I was asked at the end of February by the British Venture Capital Association and a group of major private equity firms to undertake an independent review of the adequacy of disclosure and transparency in private equity with a view to recommending a set of guidelines for conformity by the industry on a voluntary basis.

2. This report sets out guidelines for adoption on this basis by private equity firms authorised by the FSA and by UK portfolio companies owned by private equity funds. The principal focus is on larger private equity firms and their portfolio companies, and on enhancement of the data collection, processing and reporting undertaken on an industry-wide basis. I have been assisted in my work by an advisory group comprising:

Adrian Beecroft	Apax Partners
David Blitzer	Blackstone
Robert Easton	Carlyle (joined the group during the consultation process)
Anne Glover	Amadeus
Robin Hall	Cinven
Baroness Hogg	3i Group
Lord Hollick	KKR
William Jackson	Bridgepoint
Dwight Poler	Bain Capital
Sir Mike Rake	BT Group
Rod Selkirk	Hermes

   I have also drawn on advice and input from a wider group of large private equity firms including Charterhouse, CVC, Permira and TPG.

3. In July I published a consultative document that set out the principles underlying my intended approach to setting guidelines: an executive summary of main elements as envisaged in the July document is at Annex B below. Since July there has been a full consultative process drawing input from and involving discussion with private equity firms, accountancy, audit and law firms, with individual limited partners and limited partner associations, including the International Limited Partners Association (ILPA), with the British and the European Private Equity and Venture Capital Associations (BVCA and EVCA), with HM Treasury, the Department for Business, Enterprise and Regulatory Reform (DBERR), and the Financial Services Authority (FSA), with the TUC and the CBI and with other interested parties: a list of contacts during the consultative process is at Annex A.

4. This final report discusses the matters raised in the consultative process by reference to the questions posed in the July document (at Annex B); sets out guidelines on enhanced disclosure for private equity firms and portfolio companies; and makes recommendations for adoption by the BVCA in respect of data gathering, processing and reporting on an industry-wide basis and for the establishment of a review group

to keep the guidelines under review and to monitor conformity with them. For the purposes of this report and the guidelines, **portfolio companies** are large UK companies (as precisely defined in Chapter V(3)) acquired and controlled by private equity; and **private equity firms** are firms authorized by the FSA (as precisely defined in Chapter V(2)) that invest, or have the scope and capacity to invest, in UK portfolio companies.

5. My hope and expectation is that implementation of these guidelines and recommendations will mitigate many of the specific concerns about large-scale buyout activity that have emerged in the recent past and will provide for better understanding of how private equity operates and its contribution to UK economic performance in terms of employment, productivity, investment and growth.

6. I have been assisted by Andy Olding, on secondment from Ernst & Young, whose ability, energy and commitment was a significant support throughout the review process, and I am very grateful to him.

David Walker
20 November, 2007

SUMMARY OF GUIDELINES AND RECOMMENDATIONS

1. This summary sets out in abridged form the definitions, principal guidelines for enhanced reporting by UK portfolio companies and private equity firms and recommendations for initiative by the BVCA. For the purposes of conformity with the guidelines by portfolio companies and private equity firms on a comply or explain basis, and for implementation of the recommendations to the BVCA, the full texts respectively in Chapters V and VI have precedence over this summary, which is designed solely to provide a high-level overview.

Definitions

2. The guidelines apply exclusively to UK portfolio companies and private equity firms as defined below:

   A **private equity** firm for the purpose of these guidelines is a firm authorised by the FSA that is managing or advising funds that either own or control one or more UK companies or have a designated capability to engage in such investment activity in the future where the company or companies are covered by the enhanced reporting guidelines for portfolio companies.

   For the purpose of these guidelines, a **portfolio company** is a company:

   a) acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £300 million, more than 50% of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents
   b) acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction was in excess of £500 million, more than 50% of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents.

Content and timing of enhanced reporting by portfolio companies

3. A portfolio company should publish its annual report and accounts on its website within six months of the year-end and include:

   - the identity of the private equity fund or funds that own the company, the senior managers or advisers who have oversight of the fund or funds, and detail on the composition of its board
   - a business review that substantially conforms to the provisions of section 417 of the Companies Act 2006, including sub-section 5 that otherwise applies only to quoted companies, calling for an indication of main trends and factors likely to affect the future development, performance and position of the company's business and to include information on the company's employees, environmental matters and social and community issues

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

4. Portfolio companies should:

   a) publish a summary mid-year update no later than 3 months after mid-year giving a brief account of major developments in the company;

   b) provide data to the BVCA in support of its enlarged role in the gathering and aggregation of data and associated economic impact analysis.

5. **Communication by a private equity firm**

   A private equity firm should publish either in the form of an annual review or through regular updating of its website:

   - a description of its own structure and investment approach and of the UK companies in its portfolio, an indication of the leadership of the firm in the UK and confirmation that arrangements are in place to deal with conflicts of interest
   - a commitment to conform to the guidelines on a comply or explain basis
   - a categorisation of its limited partners by geography and by type.

6. Private equity firms should, in their reporting to limited partners, follow established guidelines, such as those published by EVCA, commit to follow established guidelines in the valuation of their assets; and should provide data to the BVCA in support of its enlarged role in data gathering and economic impact analysis, in part as the means of appropriately attributing private equity returns on an industry-wide basis respectively to financial structuring, market movements and operational improvement.

7. In particular at a time of strategic change, a private equity firm should ensure timely and effective communication with employees, either directly or through its portfolio company, as soon as confidentiality constraints are no longer applicable.

   Recommendations for initiative by the industry association

8. The BVCA is recommended to strengthen its capability in particular:

   - to represent more effectively the larger buyout end of private equity;
   - to undertake rigorous evidence-based analysis of the economic impact of private equity activity so that it becomes the recognised authoritative source of intelligence and analysis and a centre of excellence for the industry and
   - to engage proactively with private equity-like entities to promote their commitment to the guidelines, and with other private equity and professional groups to develop improved standards for fund performance measurement.

9. The BVCA should establish an independent guideline review and monitoring group with a majority of independent members under the leadership of an independent chairman to keep the guidelines under review and to monitor ongoing conformity with them by private equity firms and portfolio companies.

I. PRIVATE EQUITY: BACKGROUND AND CONTEXT

1. Private equity is the name loosely given to an industry which draws capital into specific funds, managed by management groups, which may be quoted or unquoted. Hitherto, quoted funds or management groups have been rare, but there have been several in the UK, and some US groups have recently sought to list. Private equity groups take stakes, often involving control or full ownership, in companies across a wide array of industries. The industry can be sub-divided into venture capital, typically invested in technology companies at an early stage of development (and where a group of investors may each take a relatively small stake); growth capital, typically invested in companies at critical points of expansion (and where an investor may take a stake of perhaps 20% of the equity); and buyouts, the largest and most high-profile part of the industry (where private equity funds take stakes, commonly involving control or full ownership, in companies whose size has increased substantially recently). The industry has developed on the basis of contractual arrangements (termed partnership agreements) between professional investors, the limited partners, and management groups, who are contracted to advise and manage the funds in which they are typically also investors. There is substantial variety in structure, organisation and areas of focus, but private equity firms in buyout business, the principal focus of this review, typically follow a relatively conventional strategic sequence of investing in, buying, improving and selling companies.

2. The UK is the largest market for private equity outside the United States, now with some 250 private equity companies directly authorised by the FSA and a significant number of others who are part of other authorised firms such as investment banks. A private equity firm requires FSA authorisation if it conducts a regulated activity (as defined in financial services legislation) in or from the UK, for example advice on or the management of investment for a private equity fund. But lines of demarcation based solely on geography are of limited relevance. Reflecting the cross-border nature of private equity business run from the UK, in the sense that the "mind" of the management in respect of their business in the UK, Continental Europe, the Middle East and Africa is UK-based, employment in private equity firms is typically from a wide spread of nationalities. Most of the funding of the largest UK-based private equity firms is raised from limited partners based outside the UK, and a significant share of the investments of such funds is abroad. Of the 20 largest private equity groups in the UK, 79% of new funding in the period 2004-2006 came from outside the UK and only 38% of their investment was in the UK. There is also increasingly significant activity on the part of entities such as sovereign wealth funds and principal investors who do not necessarily depend for their funding on investment from third parties. Although their investment approach may be substantially "private equity-like", their activities may not require specific authorisation by the FSA. All this means that the evolution of guidelines and standards for the industry has both a potentially significant international dimension and may also have relevance for a wider group beyond the immediate confines of the private equity industry, to be reviewed later in this report.

3. The core concept and model of private equity originated in the United States and took root in the UK in the late 1970s. The early focus in the UK, and subsequently in Continental Europe, was on investment in new ventures and the provision of growth capital, which is still the principal activity of many of private equity management companies in the UK. But in terms of the scale of transactions, buyout activity, which involves a change in ownership of the target company, is now the largest part of the industry. Most of that activity in terms of the number of transactions involves smaller and medium-sized companies, but deals involving large companies have recently come to much greater prominence, with some large private equity groups now substantially or wholly disengaged from venture and growth capital activity and mid-market buyouts. The main focus of this review is on these larger transactions and the private equity funds that undertake them, sometimes working in co-operation with other private equity funds in "club" deals.

4. Sources of capital for unlisted private equity funds are principally institutional investors who have the sophistication and ability to conduct extensive due diligence before deciding whether to commit funds. Retail access to this market is limited and is usually via listed private equity investment trusts or venture capital trusts. Institutional investors account for well over half of total investment in private equity funds, with the remainder sourced from sovereign government funds, endowments and wealthy individuals, often through family offices or investment vehicles for whom investment in private equity complements their allocation to listed equity and other asset classes, and whose participation in a fund is as limited partners. Limited partners share in the risks and benefits of the performance of companies in which the fund invests, but have no active day-to-day involvement in the management of the partnership once their capital is committed to a chosen fund managed by the general partners. They are attracted to private equity by the prospect of risk-adjusted returns that are typically, though not invariably, substantially in excess of those in listed equity markets. The formulation and execution of strategy for a fund is the responsibility of the general partner, for which the general partner receives an annual management fee, commonly 1.25 – 2.0 per cent (tending to vary inversely with the size of the fund) of funds committed, and a share or "carry", commonly 20 per cent, of profits made by the fund as a whole, after repayment of all fees and expenses, subject to achievement of a minimum hurdle level of return, commonly of around 8 per cent per annum. General partners are themselves invariably investors in their own new funds through co-investment and share the risk, though their proportionate share will typically be small.

5. A private equity fund with a focus on medium to large-scale acquisitions might typically have some 150 limited partners, in sharp contrast with the average of some 150,000 shareholders for a FTSE 100 company in the UK. All UK companies are required under companies legislation to file reports and accounts at Companies House, but required content and detail is materially less for private companies (including private companies that are not owned by private equity groups) than for those that are listed. Listed companies must also report more frequently and within a shorter timeframe than private companies.

6. The key ingredient in reporting by private equity portfolio companies is that by the general partner to the limited partners. Such reporting is governed by contractual relationship, set in place at the time of the limited partners' commitment to a fund, and normally involves, on a confidential basis, whatever content and frequency of information flow the limited partners may require. The limited partners hold an illiquid asset, their stake in the fund, and since neither it nor the fund's holding in a portfolio company is traded, there need be no inhibition on the information flow to limited partners in respect of which they are "natural" insiders. There is some secondary market activity in limited partner stakes, but it is limited in scale and does not materially detract from the contrast with listed company reporting as described here. The latter is necessarily public, to all shareholders simultaneously, given that their stock is liquid and tradeable in public markets, and is thus subject to substantial regulatory prescription as to both content and timing.

7. Not all private equity investment involves acquisition; it may involve taking a minority stake. Where acquisition is involved, it is through the four main channels of conversion of a listed into a private company; purchase of a subsidiary from another company which might be listed or private; purchase of a private company, possibly from its founders or a family; or a secondary transaction involving purchase from another private equity firm. The fund itself is the source of the equity element in the acquisition of portfolio companies, with the balance of financing, commonly involving substantial leverage, provided through banks and the debt market. A common pattern is for the credit exposure in initial bank participation in the provision of facilities to be substantially distributed to other market participants within a relatively short period after completion of the acquisition.

8. Listed companies typically have much less debt in their balance sheets, but comparisons between listed and private companies based on levels of debt are potentially misleading without analysis of the structure of debt. At any rate until the recent downturn in credit markets, leverage in private equity portfolio companies has commonly involved several layers below senior debt (debt that takes priority over all other debt sold by the issuer) and mezzanine debt (debt that is subordinate to senior debt), with the most subordinated debt involving few if any covenants, and thus involving higher risk for the lender. The precise composition of the capital structures used by private equity for the companies that they acquire is evolving over time, reflecting changing market conditions and financial innovation. A significant development in the structuring of larger transactions (at any rate before emergence of the very recent credit market pressures) has been the increasingly common use of non-amortising bullet debt, where no capital repayments will be made for a pre-agreed period, often around 8 years, after which a large payment falls due. Such debt has the benefit of allowing a company to use debt finance without having to eat into its short-term cash flow to make large repayments.

9. There are substantial differences in style, practice and performance among private equity firms and in the characteristics of individual portfolio companies. But there are also important common features. Private equity funds are typically raised with an

expected life of around 10 years, a term that is established in the partnership agreement at the outset and thus involves long-term investment commitment to the fund by the limited partners. The limited life of the fund means that the general partners might typically invest the capital committed during the first 5 years, allowing sufficient time to improve the performance of the portfolio companies and to arrange for their divestment before the end of the fund's normal life span. So the expected hold period for an individual portfolio company is normally well below 10 years, and most commonly in the range of 3 to 5 years before the general partner exits, by means of an initial public offering, sale to another private equity firm or to a strategic buyer. The larger private equity firms normally commit substantial resource to buyside research, often involving long periods of focussed research on particular prospects before any acquisition initiative is taken, with research typically concentrated in a limited number of sectors in which they have built industry specialism and expertise. Although the basis for comparison is at best imperfect, and is of only limited public policy interest, it is a relevant contrast with the partial or mistaken view that the private equity time horizon is invariably short that the average holding period by active investors in FTSE 100 stocks is substantially less than 1 year.

10. Successful business selection and financial structuring are typically material elements in the value added for their limited partners by private equity firms, with a combination of favourable stock market conditions (relevant for exit prices) and abundant credit availability giving a significant boost to these elements in private equity performance in the recent past. But a large, and frequently the largest, element has been achieved through introduction of strong management teams to implement a focussed strategy and improved operating efficiency in portfolio companies. A key differentiating feature of private equity is the direct alignment and short chain of communication between the general partner and the executive of the operating company, facilitating proactive and real-time convergence between shareholder interests and management. This contrasts with the attenuation and potential impairment of the agency relationship between owner and manager as a result of the formal structures that have been imposed in listed companies as the means of assuring appropriate accountability to a large group of public shareholders.

11. Despite the significant cross-border dimension, both the scale and the recent growth in private equity activity focussed on UK companies has been very substantial. The data and estimates below are drawn from the BVCA and the Centre for Management Buyout Research (CMBOR) at the University of Nottingham. In the 3-year period 2004-2006, employment in the UK in portfolio companies controlled or wholly owned by private equity rose to 1.2 million, more than 8% of UK private sector employment; buyouts of UK listed companies, from corporates and secondary transactions (that is, buyouts from other private equity firms) totalled £26 billion in 2006; total private equity investment in the UK totalled £43 billion over the period 2004-2006 and associated leverage might double or treble this equity investment in terms of total enterprise value; and IPOs and strategic sales of portfolio companies acquired earlier totalled £26 billion in this period.

12. This recent growth in private equity involves major features that are still comparatively novel in the UK environment. These include taking listed companies private, leading to a diminution in reporting and governance obligations, as well as the introduction of substantial leverage into the balance sheet of acquired portfolio companies. But the preoccupation of the main private equity firms with identifying opportunities and executing business in a fast-developing and attractive environment has not been matched by comparable attention to the wider public interests and concerns to which these developments have given rise. The questions raised in this report focus on the appropriate weight to be attached to these interests and concerns and how they might be addressed in particular:

    - in enhanced reporting by portfolio companies;
    - in fuller communication by major private equity firms;
    - and through more substantive reporting, interpretation and analysis in respect of the whole private equity industry.

13. These questions are focussed on the buyout end of private equity business and, by and large, do not arise in respect of venture and development capital, whose social and economic contribution has long been clearly recognised in the UK. The following Chapters accordingly relate principally to large-scale buyouts, to the private equity firms that engage in such activity and to the larger portfolio companies that are acquired by the funds that they advise or manage. Precise definitions of the categories of portfolio company and private equity firm that are covered by the guidelines are set out in Chapter V.

II. INPUT FROM THE CONSULTATION PROCESS

1. The principles and philosophy underlying the approach to the proposed guidelines were set out in the July document, of which the executive summary is reproduced at Annex B. The purpose of the current report is to review the approach proposed in July in the light of the consultation process and to set out in final form specific guidelines for the industry and recommendations for initiative by the industry association (respectively in Chapters V and VI). An abridged version of the principles and philosophy of the approach as set out in the July report is at Annex C.

2. The executive summary of the July document (Annex B) sought views on six groups of issues to be addressed in the consultative process:

   a) appropriate size thresholds for enhanced reporting by portfolio companies

   b) appropriate ingredients in such reporting

   c) the extent of public policy and other concerns about the prospective imbalance as between reporting by private equity portfolio companies and reporting by other large private companies

   d) appropriateness of the elements envisaged for inclusion in annual reviews as a key element in greater openness on the part of private equity firms

   e) coverage of the agenda for significantly enhanced data collection and analysis by the BVCA on an industry-wide basis

   f) an appropriate process for review of the guidelines.

3. Comments in the context of the consultation process have been generally supportive of the approach proposed in July, with widespread endorsement of the view that private equity needs to become more open and that this should be achievable without undermining the capability of the industry to generate exceptional economic performance. From both the consultation responses themselves and the opportunity for a substantial sequence of discussions with interested parties, five major themes stand out.

4. The first is general support for the view that the voluntary guidelines approach as envisaged here is preferable to primary legislation and the regulation that would necessarily be associated with it. The (minority) challenge to this view was on the basis that the disclosure (and other related issues) are too serious to be left to a voluntary approach, the supposition being that such an approach would not assure adequate conformity. The conclusion of the review is that this concern is currently misplaced and exaggerated. The main reasons relate to the strength that the guidelines approach should draw from recognition by the main industry participants of the merit of a workably practical and flexible regime that is capable of evolving over time with changing market conditions; because of the asymmetry that, while the voluntary guidelines can evolve, if necessary toward a more formal structure, there is little precedent for movement back toward a more flexible structure once black-letter provision reaches the statute book; and a principles-based guidelines approach is

more apt for such cross-border business, and may come to attract emulation as a workable approach that might be applicable elsewhere, whereas statute-based provision would inevitably give rise to concerns about extra-territoriality and would, as an unintended consequence, involve greater risk of geographic relocation of parts of the business.

5. Second, the proposal that conformity with the guidelines might be achieved (as in the case of quoted companies under the Combined Code) by either compliance or by explanation where compliance would be inappropriate is widely supported as a critical element of flexibility in the structure. It means that the guidelines can be drafted to be anchored in principle without need for building in complexity to accommodate a wide array of anticipated specific exceptions.

6. Third, the review process has highlighted that the content and timeliness of information flow to limited partners is regarded by most limited partners as fully sufficient and that, as professional investors, prospective or existing limited partners should be, and generally are, well-placed to identify and protect their interests through the negotiation and implementation of the terms of their contractual agreements with general partners. Some concerns have, however, been expressed in relation to the lack of standardisation in on-going reporting on the performance of existing funds and of their portfolio companies and, given rather greater emphasis, the need to achieve greater standardisation in the format and basis for presentation of track record when new funds are being raised.

7. Fourth, despite the importance attached to enhanced public reporting by both portfolio companies and private equity firms on an individual company or firm basis, the review process has brought into still sharper relief the priority of improved reporting by private equity on an industry-wide basis, above all as a means of promoting better understanding of how the industry operates and its actual and potential impact on the UK economy in particular in terms of employment, productivity, investment and successful growth.

8. Fifth, in respect of conformity with the guidelines, the July document envisaged that this would be assured by a combination of, on the one hand, the prospective closeness of critical scrutiny by the media, unions, politicians and government and, on the other, the enlightened self interest of private equity firms and their portfolio companies, and peer group pressure among them, to be seen to be "doing the right thing". But the consultation process revealed a widely-held view that a more explicit and independent monitoring process should be provided, not least as a means of building a database of experience of conformity through compliance or reasonable explanation and a proposed structure for institution of such a process is accordingly now included as a core recommendation to the BVCA (in Chapter VI).

9. Beyond these main themes underscored in the course of the consultation and review process, comments included more specific suggestions for modification of the July proposals, many of which have been incorporated in the guidelines and recommendations set out respectively in Chapters V and VI below. Reference should,

however, also be made to two specific areas where the consultation process and review generally (though not universally) supported the view in the July document: that no guidelines should be set in respect of board composition and corporate governance of portfolio companies beyond appropriate description in the annual report of board composition and experience; and that the compensation arrangements of senior executives of private equity firms are properly a matter of interest and concern for limited partners as owners but not a matter for accountability to other stakeholders or of wider public interest.

10. The following summary seeks to give the flavour (though not a comprehensive tally) of the more than 50 written submissions (and an extensive discussion process) summarising comments (not of course all pointing in the same direction) made by reference to the issues identified for attention in the July executive summary:

    a) *thresholds for enhanced reporting by portfolio companies* – that the threshold criterion in respect of employee numbers should be reduced below 1,000 (one proposal is that the threshold should apply wherever there are more than 250 employees, irrespective of other size criteria); and that a turnover criterion should be introduced so that only portfolio companies with a significant part of their activities in the UK should be brought into the enhanced reporting net

    b) *appropriate ingredients in such reporting* – that more explicit implementation guidance is needed in respect of such obligations; that all of the business review provisions in companies legislation should be extended beyond quoted companies to all large private companies; that needless overlap should be avoided where, for example in respect of public market debt or equity issuance, a company is already publishing information substantially beyond that required in UK companies legislation; that more time be allowed for publication of information newly required under the guidelines; and that the executives within the private equity firm who are responsible for oversight of the company on behalf of the controlling fund or funds should be identified

    c) *imbalance in reporting obligations* – that initiative is needed to mitigate or eliminate the imbalance vis à vis non-private equity portfolio companies and their owners as a result of conformity with the guidelines by private companies, a concern that acquired greater acuity during the review process in particular as a result of the prospectively increasing activity of sovereign wealth funds

    d) *elements in greater openness and enhanced reporting by private equity firms* - that critical balance needs to be found between, on the one hand, leaving substantial discretion to general partners as to the style of their reporting and, on the other, providing specificity as to content; that updated websites should be an alternative to publication of a discrete annual review, and that particular emphasis be placed on addressing employee concerns when portfolio company transactions are being implemented

    e) *industry-wide data gathering and reporting* – that greater priority and urgency be given to building an authoritative and respected reporting capability for the industry within a much larger and more proactive role for the BVCA

f) *review of the guidelines and monitoring of conformity* – that whereas the proposed approach to review of the guidelines was appropriate, an independent process (not envisaged in the July document) will be needed to monitor conformity with the guidelines (as discussed in paragraph 8 above).

11. Concern has been expressed that the provisions of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (referred to as TUPE) do not apply to private equity transactions. These regulations apply to business transfers (for example the transfer of a business's trade and assets) and are designed to safeguard the rights and obligations of the employees, for example, by providing protection for employees from dismissal for the sole or principal reason of the transfer itself, whilst still allowing a dismissal for a reason connected with the transfer where that reason is an economic, technical or organisational one entailing changes in the workforce. Where a business is acquired by means of a transfer of shares, the TUPE provisions do not apply since the contracts with the employees are maintained and remain with the entity that has been purchased and are subject to existing legislation applicable to the proper treatment of employees. Whilst the guidelines in this report do not seek to address the provisions of TUPE (a matter of employment legislation) they are explicitly attentive to the interests of employees, calling for enhanced disclosures by UK portfolio companies (as defined in Chapter V(3)), and a commitment by private equity firms to communicate and engage effectively with employees either directly or through their portfolio companies as further described later in this report.

12. In a closely related context, reference should also be made here to:

a) the recently-introduced obligation under the Takeover Code to make disclosures in respect of continuing employment, conditions of employment and pensions provision in a published offer document in support of an offer for a company quoted in the UK. This obligation reflects the requirements of the European Union Takeover Directive (2005) carried into legislation in the UK through Chapter 1 of Part 28 of the 2006 companies legislation; and

b) the obligation on all public and private companies in the UK that employ more than 100 employees, and more than 50 employees from April 2008, to conform to the Information and Consultation of Employees Regulations (made under the Employment Relations Act 2004) that set out the rights of employees to be informed and consulted on a regular basis on important developments that may affect their interests. The procedures are triggered by a formal request from employees or at the employer’s initiative by starting the process voluntarily.

13. The following Chapters provide an assessment of this process of consultation, discussion and reflection in terms of its implications for the guidelines and recommendations that are the final product of this review.

III. ASSESSMENT: PORTFOLIO COMPANIES AND PRIVATE EQUITY FIRMS

1. This final stage of the review rests on the propositions that private equity needs to become more open, that voluntary conformity with a framework of guidelines is the most practicable and preferred approach to achieving this, and that, separately from and additional to enhanced disclosure on the part of individual private equity firms and portfolio companies, priority should be given to promoting better understanding on an industry-wide basis of how private equity operates and of its potential contribution to the UK economy. In this context, the following paragraphs set out the concluding assessment of this review in relation to enhanced disclosures by portfolio companies and private equity firms on the basis of guidelines with which conformity will be by compliance or explanation. The emphasis throughout is on substance rather than form, on materiality rather than box-ticking, with the intention and expectation that private equity firms and portfolio companies will commit fully, not least given the reputational damage and public criticism that would be likely to follow from failure to conform.

Portfolio companies

2. In relation to the thresholds envisaged for categorisation of portfolio companies, concern was expressed that UK companies with most of their operations outside the UK would be brought, inappropriately, into reporting coverage in the absence of some additional test of UK significance. The relevant guideline accordingly specifies that only companies with more than half of their revenues generated in the UK will be brought into the net. With this adjustment to the threshold criteria (not modified since the July document in any other material respect) it is estimated that some 65 companies will be brought into enhanced reporting coverage. Given the materiality of the additional disclosure being sought from such portfolio companies (see below in respect of the application of relevant provisions in companies legislation) the guidelines do not modify the employee number (1,000) in the threshold criteria. This should, however, be re-examined in the proposed guideline review process. Any presumption that the threshold should be lowered by reference to employee numbers should be related to observed experience and the performance in this respect in companies immediately below the current threshold. The relevant guidelines are principally designed to be applicable to portfolio companies above the size threshold; but the expectation that the boards of companies owned by private equity should be closely attentive to other stakeholder interests, in particular those of employees, applies, not least as a matter of enlightened business interest, to all of the companies in a private equity firm's portfolio.

3. As to the content of enhanced disclosure by portfolio companies, the principal new element, consonant with the concern expressed in the consultation process that a clearer indication should be given to portfolio company boards as to what is expected, the guidelines call for a business review that substantially conforms to the provisions of Section 417 of the Companies Act 2006, including sub-section 5 (which is ordinarily applicable only to quoted companies) set out in full in Annex D. Although, as a matter of deliberate decision by Parliament, this statutory provision itself leaves scope for interpretation, in particular as to how detailed and full particular disclosures should be, the removal in respect of private equity portfolio companies of the

derogation available to all other non-quoted companies will call for a material increase in disclosures. Beyond this, no specific implementation guidance is being proposed in the context of this review. A major reason is that the relevant provisions of the 2006 legislation are new and are still being interpreted even by quoted companies, but additionally because other important specific obligations in respect of the rights of employees are already in place under the Information and Consultation of Employees Regulations 2004. In any event, and in particular in the light of the recent media, union and public focus on large-scale buyout activity, it seems a reasonable expectation that the boards of private equity portfolio companies, and the private equity firms whose funds are their owners, will see their own clear interests, and ultimately those of their limited partners, in ensuring effective communication with their employees in line with developing good practice. As higher standards of good practice in this respect emerge as part of the interpretation and bedding down of the business review provisions of the 2006 Act (in particular sub-section 5), and other relevant regulatory provisions, any company that is covered by these provisions that fails to conform at least to good practice will inevitably self-select for critical public scrutiny and risk of reputational damage

4. The guidelines also call for identification in a portfolio company's report and accounts (or otherwise accessibly on the company's website) of the fund (or funds) that own the company and of the senior managers in the private equity firm that have UK oversight of the company on behalf of the controlling fund (or funds).

5. Consistently with, and for the reasons described in the July document, the guidelines will not call for numerous disclosures that are in place and specifically appropriate for quoted companies such as quarterly earnings statements, nor do they include any specification as to corporate governance of portfolio companies beyond calling for a description in the annual report of the composition and relevant experience of the board.

6. As to the timing of enhanced disclosures, the guidelines provide that the report and accounts should be published no more than 6 months after the company year-end (a longer period than the 4 months envisaged in the July document and in line with the provision for AIM-listed companies) and that a summary mid-year update should be placed on the website no more than 3 months after mid-year (as against the delay of only 2 months envisaged earlier).

7. Portfolio companies will be expected to contribute data to the BVCA (or to a professional firm acting on its behalf) as input to the enhanced industry–wide data aggregation and analysis function that is to be undertaken as a key element in promoting better understanding of how private equity operates and its contribution to the UK economy (described more fully below).

Private equity firms

8. There is an understandable tendency on the part of private equity firms to be more sensitive as to disclosures about themselves than in respect of the portfolio

companies of their funds. A core reason is that while the relevant portfolio companies are rooted in the UK, their funds are both funded from and invested widely outside the UK, and it would seem neither practicable nor desirable to propose an enhanced disclosure framework for private equity firms that is exclusive to the UK. The concern in this review has accordingly been to identify a balance in two main respects. The first involves respect for the private characteristics of private equity activity which, in common with all private companies, in part flow from a conscious and deliberate election to avoid the constraints, prominently including comprehensive disclosure obligations, that bear on quoted companies; while providing for the degree of accountability which has become imperative for the perceived social legitimacy of private equity in the wake of the acquisition by private equity of rights of ownership and control of major UK companies that in some cases are seen to have iconic significance. The second, related but separate, is balance between the generic communication that a private equity firm might (and in some cases already does) make available to all stakeholders through its advisory or management capability in any of its geographic locations and communication initiative that is specifically sensitive to the UK environment.

9. In relation to enhanced disclosure on the investment approach of the firm and of the senior executive team with responsibility for UK portfolio companies, the guidelines call for either an annual review to be posted on the website or the maintenance of an up-to-date website, with other elements of disclosure essentially similar to those proposed in July. As in the case of portfolio companies, there is provision in the guidelines for substantial data input to be made to the BVCA as part of its newly-enlarged function of industry-wide data aggregation and analysis, but with provision that data regarded as sensitive might be contributed on a confidential basis. One element of special importance in this context is input to the attribution analysis to be undertaken by the BVCA on an industry-wide basis to identify the sources of value creation through portfolio companies that have been exited by private equity over a specified recent period.

10. Additionally to specification in the guidelines for enhanced public disclosure as described above, the guidelines call for private equity firms to commit to providing timely and effective communication with non-owner stakeholders, either directly or through the portfolio companies that they control. This commitment has special relevance for employees at the time of any significant transaction. The perception of inadequate sensitivity and attentiveness on the part of private equity firms or the boards of their portfolio companies in this area has in the past contributed to suspicion, and probably needless anxiety for employees given that, overall, the employment record of private equity appears to have been at least as positive as that of quoted companies. Against this background, 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 guideline in ways that dispel any continuing misperception as well as achieving the substance of effective employee communication. The primary focus here is on communication in respect of portfolio companies above the size

threshold, but the expectation is that private equity firms will be similarly attentive to employee (and other non-owner stakeholder) interests in all of the UK companies owned by the funds that they manage or advise.

11. Reference was made in the July document to the need for special consideration to be given where possible to the interests of employees and other non-owner stakeholders in a problem situation in which a portfolio company has encountered severe financial or other difficulty that threatens its viability. The fiduciary responsibility of the private equity firm is to the fund as owner of the portfolio company but, where the degree of distress is such that the equity stake has little or no value, a private equity firm should to the extent possible draw on its experience and capacity for influence to ensure that the process of transition is effected as smoothly as possible, and a guideline is included to this effect.

12. The content and timeliness of reporting by general partners is generally regarded by the limited partner community (with which there has been substantial contact during the review process) as satisfactory, a view reached by the FSA at the conclusion of its own recent consultation process. As experienced and professional investors (and generally regarded as professional clients or eligible counterparties under the FSA's categorisation of clients) it is for limited partners to be satisfied at the outset that the partnership agreement to which they commit in the context of a new fund provides for the information that they require and to ensure that they receive the information flow for which the agreement provides on an ongoing basis. Negotiation of the partnership agreement is a matter subject to private negotiation and not subject to the regulatory constraints of debt or equity issuance in public markets. It follows that situations may arise in which the general partner is not willing to satisfy all of the requirements of the potential limited partners during initial due diligence or through the life of the fund, in which case it will be for a limited partner to determine whether to commit to the fund on what it may regard as a suboptimal basis.

13. While the review process has found relatively little evidence of dissatisfaction on the part of limited partners in this respect, there is scope and need for somewhat greater standardisation (to converge on existing best practice) in the coverage of basic reporting both in the context of existing funds and in the marketing of new funds to the extent that this can be achieved without undermining the customised nature of specific partnership agreements. In respect of the former, reporting on existing funds, there is established guidance such as that of the EVCA (summarised at Annex E below) (covering matters such as commitments, drawdowns and distributions, fund and portfolio performances related party transactions and fees), and a guideline provides for private equity firms either to follow the EVCA guidance or to cover in their reporting all of the matters identified in that guidance. In respect of fund performance reporting, in particular in the marketing of new funds, progress toward greater standardisation will necessarily depend on further collaboration on a cross-border basis, recommended for the new agenda for the BVCA.

IV. ASSESSMENT: INDUSTRY ASSOCIATION INITIATIVE

1. Since its creation in 1983 the BVCA has played an important role in representation of the venture, development capital and middle market parts of the private equity industry, a role underpinned by substantial data collection and dissemination on a industry-wide basis in particular through its economic impact surveys. In the last few years, however, this capability has been eclipsed by the very rapid growth in large-scale buyout business which calls for important new initiative to complement the BVCA's historic focus hitherto.

2. Probably the principal deficiency or lacuna relevant to the commissioning of this review was that publicity in respect of the large buyout end of the industry had come to focus on the individual compensation of senior executives, often believed to reflect an egregious degree of asset-stripping, the imposition of excessive leverage on portfolio companies and disregard for employee interests. The public attitude to the large buyout end of private equity is still seriously tainted by these perceptions and it is essential for the focus to be shifted through improved understanding of the potential and actual contribution of private equity to real economic performance. Until this has been accomplished, the social and economic legitimacy of private equity will continue to be challenged. So it is a very welcome development that, alongside this review process, major firms in the industry and the BVCA have come to recognise the importance of prompt action to correct this damaging imbalance. Part of the required initiative is already in train both within the industry and in the strengthening in the scope and capability of the BVCA.

3. Recommendations for initiative by the BVCA (set out in detail in Chapter VI) are in three main areas: data-gathering, processing and analysis; the establishment of a guidelines review and monitoring capability; and proactive initiative to promote voluntary commitment to conformity with these guidelines by entities such as sovereign wealth funds or their UK affiliates and large private groups that use leverage in a similar way to private equity and which, though not private equity firms in the sense of requiring authorisation by the FSA, engage in private equity-like activity, and to promote international convergence in areas such as standards for fund performance reporting.

Industry-wide reporting and intelligence

4. The review process has brought into greater prominence the importance of the data-gathering, processing and analysis function that is called for on an industry-wide basis. While the enhanced disclosure requirements for private equity firms and their portfolio companies should help to dispel widespread concerns about the secretiveness and apparent insensitivity of private equity in particular situations, the major building block toward achieving wider acknowledgement of its social and economic legitimacy will be an enhanced understanding of how the large buyout end of the industry operates and its potential contribution to the economy. For this purpose, two major areas for focus will be the production of evidence-based analysis of the performance of private equity as measured in particular by growth in earnings, enterprise value and employment, eventually providing a database to be compared

with the performance of quoted companies in the same business sectors; and an analysis of the key elements in the delivery of private equity returns (generally known as attribution analysis), separating the respective contributions of leverage and financial structuring, of the growth in market multiples and market earnings in the relevant industry sector, and of strategic direction and operational management of the business.

5. A frequently-expressed concern is that private equity holding periods are typically too short for the long-term health of a portfolio company, which may be seen to be "sucked dry" at the point of exit. Recent sample survey work in relation to exits in both the United States and Europe do not support this view, but more comprehensive survey work is needed. Accordingly the BVCA's enhanced data and analytical initiative should extend to post-exit performance to assess the sustainability of initiatives taken to improve performance and growth of UK portfolio companies while they were in private equity ownership.

6. Building this enhanced data and analytical capability will be a substantial task, requiring new resource commitment in the form of an independent high quality input. It is essential that the data, and the process of aggregation and analysis that flows from it, should command respect for its integrity and professionalism. Analysis in many areas will unavoidably depend on subjective assessment, but the fact that sensitive elements of the relevant data to be provided by private equity firms will be on a confidential basis should mitigate any risk of distortion of judgements and data for competitive reasons. More widely, the opportunity is for the BVCA, with appropriate professional support from one or more accounting firms or other independent capability, to come to be respected as a centre of excellence in data dissemination, analysis and appraisal of private equity in a way that will be positive for the United Kingdom as a key "home base" for private equity activity.

7. This effort will be directed principally at promoting understanding of private equity. But the resulting analysis will permit benchmarking of private equity performance alongside that of quoted companies in the UK in comparable industry or business areas. If higher quality data and evidence-based analysis supports the preliminary indications of recent (limited) sample surveys, on the lines that private equity performance has been fairly consistently stronger in terms of growth in enterprise value, earnings and employment, this will be a major contribution to the public interest debate on the agency problem (as discussed in the July document). It should in particular promote higher quality analysis as to why private equity is frequently able to secure such better economic performance and what regulatory or other impediments stand in the way of enhanced performance by quoted companies. This debate centres in particular on the very direct alignment of interest achieved by private equity between ownership and management, an alignment that is at least attenuated in the case of quoted companies by the complexities of regulation designed to protect owners and the integrity of the public market.

Guidelines review and monitoring

8. The purpose has been to set guidelines that are appropriate and fit for purpose given the position of private equity in the wider social and business environment in the UK in late 2007. The fact that conformity with the guidelines will be achievable by explanation where compliance is inappropriate (for example, where compliance might risk competitive disadvantage) provides a potentially substantial degree of suppleness that will reduce the need for any revision of the guidelines in the short-term. But like the code of the Takeover Panel, the guidelines may need to be modified at some stage in the future and accordingly the BVCA is recommended (as envisaged in the July document) to institute an independently-led review process.

9. The July document did not, however, envisage installation of an explicit monitoring process, in the expectation that the keen interest of government, politicians, unions and the media, in addition to potential peer group pressure from within the industry, would ensure that no private equity firm or portfolio company would lightly fail to conform with the guidelines through either compliance or explanation. In deference to the widely-expressed view in the consultation process that this approach was insufficiently robust, the recommendation to the BVCA is to extend the remit of the guideline review to provide also an independent monitoring capability. To achieve its purpose, it is critically important that this new capability be, and be seen to be, independent. Equally, however, the intention is that its authority and effectiveness will be achieved in a light-touch way, deriving from a combination of its independence and influential capability to encourage peer group pressure and focus on potential damage where there is any recalcitrance, with need for recourse to any form of censure or sanction seen as rarely if ever likely to arise.

10. One proposition in the consultation process was that conformity with the guidelines should be enforced by the Financial Reporting Council. But the construction of and commitment to the guidelines reflect a voluntary initiative by the private equity industry and it would seem inconsistent with the spirit of this initiative for "ownership" of any part of the process to be ceded to a statutory body. This does, however, underscore the critical importance of the perceived independence and effectiveness of the recommended monitoring group.

11. A recommendation is made that the guidelines review and monitoring process should produce a brief annual report, the precise form and content to be determined in the light of observation and experience in the first year and on the basis of consultation with the Chairman and Council of the BVCA.

Two further areas for BVCA initiative

12. Considerable concern has been expressed that, by virtue of calling for materially higher standards of disclosure by private equity firms and portfolio companies, a distortion is being introduced that involves a potentially serious inequity in relation to entities that conduct their business on a "private equity-like" basis. The validity of such concern would seem to be greater the greater the similarity of the potentially competitive business model with the private equity model.

13. On this basis, principal investors such as sovereign wealth funds or their UK affiliates, large private groups that use leverage in a similar way to private equity and the principal investment capabilities of several major financial institutions most clearly fall into the "private equity-like" category. It is not within the scope of this review of private equity to bring them into the guidelines structure which has, in any event, been created to address concerns in relation to private equity activity which have not arisen to anything like the same degree in relation to the activities of other principal investors. But on the general principle that business and investment activities that are similar in substance if not in institutional form should be subject to broadly similar reporting and disclosure provisions, there is a clear case for exploration whether other principal investors who operate in a "private equity-like" manner might be ready to commit to observe the guidelines more or less fully, in part on the basis that it would be in their own interest to operate with the "good citizen" approbation that such commitment should attract.

14. Accordingly, as soon as the guidelines are in place, it would seem appropriate and desirable for the BVCA, after consultation with government in particular in respect of sovereign wealth funds, to identify the main investors in the "private equity-like" business category and to seek engagement with them with the object of securing their commitment to the guidelines (as already achieved in principle with the UK entity of one major sovereign wealth fund). The process of such engagement would probably be facilitated by creation of a special membership category within the BVCA.

15. In a second and unrelated area, the BVCA is recommended to take a proactive role in international discussion toward achieving convergence in defining standards for the reporting of fund performance in marketing or private placement documents prepared by the general partner. The Global Investment Performance Standards, administered by the CFA Institute, may provide a basis for convergence, and a recommendation for the BVCA to engage with this and any related initiative on behalf of the private equity industry is included in Chapter VI.

V. GUIDELINES FOR ENHANCED DISCLOSURE BY PORTFOLIO COMPANIES AND PRIVATE EQUITY FIRMS

1. **Conformity with each of 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 called for under these guidelines on the website of the private equity firm or portfolio company.

2. Definition of a **private equity firm** for the purpose of the guidelines:

   A firm authorised by the FSA that is managing or advising funds that either own or control one or more UK companies or have a designated capability to engage in such investment activity in the future where the company or companies are covered by the enhanced reporting guidelines for portfolio companies.

3. Definition of a **portfolio company** to be covered by enhanced reporting guidelines:

   A UK company

   a) acquired by one or more private equity firms in a public to private transaction where the market capitalisation together with the premium for acquisition of control was in excess of £300 million, more than 50% of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents
   b) acquired by one or more private equity firms in a secondary or other non-market transaction where enterprise value at the time of the transaction is in excess of £500 million, more than 50% of revenues were generated in the UK and UK employees totalled in excess of 1,000 full-time equivalents.

4. **Content of enhanced disclosure by a portfolio company**

   A portfolio company should include as part of its audited annual report and accounts the following enhanced disclosures, none of which call for disclosures beyond those specified for quoted companies in the Companies Act 2006 or other disclosure requirements applicable to quoted companies. Such reporting should throughout focus on substance rather than form and on the economic reality of a company or group rather than its legal structure.

   a) The report should identify the private equity fund or funds that own the company and the senior executives or advisers of the private equity firm in the UK who have oversight of the company on behalf of the fund or funds.
   b) The report should give detail on the composition of the board, identifying separately executives of the company, directors who are executives or representatives of the private equity firm and directors brought in from outside to add relevant industry or other experience.
   c) The report should include a business review that substantially conforms to the provisions of Section 417 of the Companies Act 2006 including sub-section 5 (which is ordinarily applicable only to quoted companies). Section 417 is reproduced at Annex D below, sub-section 5 provides:

"(5) In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include-

a) the main trends and factors likely to affect the future development, performance and position of the company's business; and

b) information about—

(i) environmental matters (including the impact of the company's business on the environment),

(ii) the company's employees, and

(iii) social and community issues,

including information about any policies of the company in relation to those matters and the effectiveness of those policies; and

c) subject to subsection (11), information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

If the review does not contain information of each kind mentioned in paragraphs (b)(i), (ii) and (iii) and (c), it must state which of those kinds of information it does not contain."

d) The financial review should cover risk management objectives and policies in the light of the principal financial risks and uncertainties facing the company, including those relating to leverage, with links to appropriate detail in the footnotes to the balance sheet and cash flow section of the financial statements.

e) To the extent that the guidelines at (b) and (c) above are met by existing market disclosures in respect of debt or equity issuance on public markets, this should be explained with the relevant material made accessible on the company's website; and where compliance with these guidelines, in particular in respect of any forward-looking statement, might involve conflict with other regulatory obligations, the reason for non-compliance should similarly be explained on the company website.

5. **Form and timing of public reporting by a portfolio company**

a) The audited report and accounts should be readily accessible on the company website;

b) The report and accounts should be made available no more than 6 months after the company year-end;

c) A summary mid-year update giving a brief account of major developments in the company (but not requiring updated financial statements) to be placed on the website no more than 3 months after mid-year.

6. **Data input by a portfolio company to the industry association**

As input for the enhanced role in data collection, processing and analysis to be undertaken on an industry-wide basis by the BVCA, portfolio companies should provide to the BVCA (or to a professional firm acting on its behalf) data for the previous calendar or company accounting year on:

- trading performance, including revenue and operating earnings
- employment
- capital structure
- investment in working and fixed capital and expenditure on research and development
- such other data as may be requested by the BVCA after due consultation and where this can be made available without imposing material further cost on the company.

7. **Communication by a private equity firm**

A private equity firm should publish an annual review accessible on its website or ensure regular updating of its website to communicate:

- a description of the way in which the FSA-authorised entity fits into the firm of which it is a part with an indication of the firm's history and investment approach, including investment holding periods, where possible illustrated with case studies
- a commitment to conform to the guidelines on a comply or explain basis and to promote conformity on the part of the portfolio companies owned by its fund or funds
- an indication of the leadership of the UK element of the firm, identifying the most senior members of the management or advisory team and confirmation that arrangements are in place to deal appropriately with conflicts of interest, in particular where it has a corporate advisory capability alongside its fiduciary responsibility for management of the fund or funds
- a description of UK portfolio companies in the private equity firm's portfolio
- a categorisation of the limited partners in the funds or funds that invest or have a designated capability to invest in companies that would be UK portfolio companies for the purposes of these guidelines, indicating separately a geographic breakdown between UK and overseas sources and a breakdown by type of investor, typically including pension funds, insurance companies, corporate investors, funds of funds, banks, government agencies, endowments of academic and other institutions, private individuals, and others.

8. **Reporting to limited partners**

In reporting to their limited partners on their interests in existing funds and for incorporation in partnership agreements for new funds, private equity firms should:

a) follow established guidelines such as those published by EVCA (or otherwise provide the coverage set out in such guidelines) for the reporting on and monitoring of existing investments in their funds, as to the frequency and form of reports covering fund reporting, a summary of each investment by the fund, detail of the limited partner's interest in the fund and details of management and other fees attributable to the general partner (a summary of the EVCA guidelines is at Annex E).

b) value investments in their funds using either valuation guidelines published by the International Private Equity and Venture Capital Board (IPEV) or those published by the Private Equity Industry Guidelines Group (PEIGG) or such other standardised guidelines as may be developed in future.

9. **Data input by private equity firms to the industry association**

Data to be provided on a confidential basis to an accounting firm (or other independent third party) appointed by the BVCA to cover:

a) In respect of the previous calendar year

- the amounts raised in funds with a designated capability to invest in UK portfolio companies
- acquisitions and disposals of portfolio companies and other UK companies by transaction value
- estimates of aggregate fee payments to other financial institutions and for legal, accounting, audit and other advisory services associated with the establishment and management of their funds
- such other data as the BVCA may require for the purposes of assessment of performance on an industry-wide basis, for example to capture any material change over time in the terms of trade between general partners and limited partners in their funds

b) In respect of exits from UK portfolio companies over at least the previous calendar year to support the preparation on an aggregate industry-wide basis of an attribution analysis designed to indicate the major sources of the returns generated by private equity. In broad terms, these are the ingredients in the total return attributable respectively to leverage and financial structuring, to growth in market multiples and market earnings in the relevant industry sector, and to strategic direction and operational management of the business. The relevant data, which will unavoidably involve important subjective assessment, will involve content and format at the outset as in Annex F to the guidelines, to be reviewed and refined as appropriate in the light of initial experience and discussion between

the BVCA, with the third-party professional firm engaged for this and related analysis, and the relevant private equity firms.

10. **Responsibility at a time of significant strategic change**

    A private equity firm should commit to ensure timely and effective communication with employees, either directly or through its portfolio company, in particular at the time of a strategic initiative or a transaction involving a portfolio company as soon as confidentiality constraints cease to be applicable. In the event that a portfolio company encounters difficulties that leave the equity with little or no value, the private equity firm should be attentive not only to full discharge of its fiduciary obligation to the limited partners but also to facilitating the process of transition as far as it is practicable to do so.

VI. RECOMMENDATIONS FOR INITIATIVE BY THE INDUSTRY ASSOCIATION

These recommendations for initiative by the BVCA cover:

- the BVCA's industry-wide reporting and intelligence function;
- the establishment of a guidelines review and monitoring capability
- for engagement with major investors and their associated entities or affiliates which, though "private equity-like", do not require authorisation by the FSA;
- and for engagement in discussion with relevant private equity groupings outside the UK in the development of common standards, in particular in respect of fund performance.

A. Reporting and intelligence

1. The BVCA should boost significantly its capability for the collection, processing and analysis of data submitted by private equity firms and portfolio companies. While the main focus of this report is, as indicated and defined at the outset, on the activities of large buyout firms and their portfolio companies, the BVCA's reporting and intelligence function covers the whole of the private equity industry, including venture and development capital. The recommendation here is that this overall capability should be boosted so that the BVCA becomes the recognised authoritative source of intelligence and analysis both of larger-scale and of venture and development capital private equity business based in the UK and a centre of excellence for the whole industry. It is recommended that, alongside the strengthening of the executive that is already in train, the BVCA should retain the services on a fee-paying basis of one or more professional firms to assist in this task as a means of quality input and assurance, as also for the assurance of confidentiality in respect of data that is provided exclusively for incorporation in an aggregation process.

2. This recommended enlargement and strengthening in the BVCA's data gathering, analytical and reporting capability will call for materially increased data input from portfolio companies covered by the enhanced reporting guidelines and from the private equity firms investing in those companies. Responsibility for the sourcing of specific data flows respectively as between private equity firms and portfolio companies should be determined by the BVCA on the basis of prior consultation, to include for the previous calendar year or portfolio company reporting period:

   - amounts raised in funds with designated scope to invest in portfolio companies in the UK
   - categorisation of limited partners by geography and by type
   - scale of acquisitions of UK portfolio companies by transaction size at the time of acquisition
   - trading performance of portfolio companies in terms of revenues and operating earnings
   - estimates of levels and changes in employment, new capital investment and research and development expenditure by portfolio companies

- aggregate fee payments by private equity firms and portfolio companies to other financial institutions and for legal, accounting and other advisory services
- such other data collection and analysis as may be required in support of a comprehensive evidence-based assessment capability on the performance and economic impact of private equity in the UK, with particular reference to employment, productivity, investment and innovation.

3. Data should be collected from private equity firms to support attribution analysis in respect of exits in at least the previous calendar year to provide on an industry-wide basis annually an assessment of percentages of total return over the holding period attributable to

   - leverage and financial structuring
   - growth in market multiples and market earnings in the relevant industry sector
   - strategic direction and operational management of the business.

4. It is recommended that the BVCA should publish an enlarged version of its economic impact and associated surveys to cover both the industry overall and giving separate data and analyses for

   - larger-scale private equity business to present an authoritative evidence-based account of the performance of the industry in the UK over the holding periods of portfolio companies and of the subsequent performance of former portfolio companies where exit by the fund or funds is to the public market by means of an IPO process.
   - venture and development capital, which will call for an increase in the sample sizes for data collection.

B. Guidelines review and monitoring

For the purposes of ensuring that the guidelines for disclosure by portfolio companies and private equity firms remain appropriate in the light of changing conditions and to monitor conformity with the guidelines, the BVCA should establish a Guidelines Review and Monitoring Group (the Group) with the following elements:

1. Terms of reference of the Group:

   a) to keep the guidelines under review and to make recommendations for changes when necessary to be implemented by the BVCA after due consultation to ensure that the guidelines remain appropriate in changing market and industry circumstances

   b) to review the extent of conformity with the guidelines, through compliance or explanation, on an ongoing basis

   c) to publish a brief annual report on the work of the Group

2. Composition of the Group:
   a) a Chairman with substantial experience but independent of private equity
   b) total size of 5 to include 2 executives of GPs or advisers to funds investing in portfolio companies covered by the guidelines
   c) 2 independent members additionally to the Chairman with substantial professional or business experience
   d) thus a majority of independents.

3. Appointment of the Group:
   a) to be appointed by the Chairman and Council of the BVCA on the advice of a Nominations Committee of the Council
   b) the Chairman of the Group to have a term of 3 years with provision for appropriate rotation of other members to ensure continuity
   c) the Chairman and members to be paid an appropriate fee.

4. Operations of the Group:

   The guidelines review and monitoring processes under paragraph 1 (a) and (b) above to be supported by an accounting firm appointed by and under the direction of the Group:

   a) undertaking data processing and assessment on the basis of initial self-assessment on conformity by private equity firms and portfolio companies
   b) appropriate spot-check sampling
   c) funded under budget provisions agreed between the Group and the Chairman and Council of the BVCA.

5. Conformity with the guidelines:

   On the basis that BVCA member firms commit to conform to the guidelines as a condition of membership, the Group would discuss in confidence with a private equity firm or portfolio company any case of non-conformity which it considered to be material. In the absence of commitment to early remedial action, the matter would be for discussion and determination of appropriate action between the Chairman of the Group and the Chairman of the BVCA and might, after due process, involve public disclosure and termination of membership of the BVCA.

C. Engagement with "private equity-like" entities

1. The BVCA should identify entities whose business, though not requiring authorisation by the FSA, is similar to that of the private equity firms covered by these guidelines, to include in particular the UK affiliates of sovereign wealth funds and other major principal or proprietary investors whose funding is not dependent on limited partners.

2. The BVCA should initiate discussion with such groups (where appropriate, in the case of sovereign wealth funds, after consultation with government) with the purpose of enlisting their voluntary undertaking to conform to the guidelines, on the basis that this will be in their own interest as a manifest of their commitment to established good practice as to disclosure and transparency in such business conducted in the UK.
3. The BVCA is recommended to create an appropriate category of membership to enable such entities to be associated appropriately with the activities of the association.

D Fund performance measurement.

The BVCA should participate proactively with private equity trade associations beyond the UK and with representatives of the domestic and international limited partner community to develop a methodology for the content and presentation of fund performance information with particular relevance for prospective future limited partners as well as those in existing funds. The Global Investment Performance Standards (GIPS) prepared under the auspices of the CFA Institute represent a possible approach on which the BVCA should engage during the impending five year review of GIPS. Any standard to emerge from this process should be incorporated in the guidelines in due course.

ANNEX A - ORGANISATIONS AND INDIVIDUALS CONTRIBUTING TO THE CONSULTATION PROCESS

Members of the Advisory Group

Adrian Beecroft	Apax Partners
David Blitzer	Blackstone
Robert Easton	Carlyle (joined the group during the consultation process)
Anne Glover	Amadeus
Robin Hall	Cinven
Baroness Hogg	3i Group
Lord Hollick	KKR
William Jackson	Bridgepoint
Dwight Poler	Bain Capital
Sir Mike Rake	BT Group
Rod Selkirk	Hermes

The following organisations participated in the review, either by submitting formal reports or in informal discussions throughout the course of the review.

3i Group
Association of British Insurers
Advent International
Association of Corporate Treasurers
Association of Investment Companies
Alchemy Partners
Allen & Overy
August Equity
Autorità Garante della Concorrenza e del Mercato
Apax Partners
Apollo Global Management
Bain Capital
Bank of Scotland
Barclays Private Equity
BBC Pension Trust
BC Partners
BP Investment Management
British Private Equity and Venture Capital Association
Candover
CalPERS
CalSTRS
The Carlyle Group
CASS Business School
Confederation of British Industry
CFA Institute
Chartered Institute of Management Accountants
Clayton, Dubilier & Rice
Close Brothers

Cognetas
CVC Capital Partners
Enterprise Ventures
Ernst & Young LLP
European Private Equity and Venture Capital Association
Financial Services Authority
Financial Reporting Council
Gazelle
GMB
Institute of Chartered Accountants in England and Wales
International Limited Partners Association
Investment Management Association
Industri Kapital
Institute of Economic Affairs
KPMG
Langholm Capital
Loan Market Association
Lloyds Development Capital
Legal and General Ventures
London Pension funds authority
Lyceum Capital
Montagu Private Equity
National Association of Pension Funds
Centre for Management Buyouts Research
Pantheon Private Equity
Parallel Private Equity
Pathway Capital Management
Permira
PPM Capital
PricewaterhouseCoopers
Private Equity Investors Association
Phoenix Equity Partners
SJ Berwin
Star Capital
SVG Capital
Three Delta
Tomorrow's Company
TPG Capital
Trades Union Congress
UK Investment Performance Committee
The UK Society of Investment Professionals
University Superannuation Scheme
The Wellcome Trust

An e-mail survey was sent to over 50 Limited Partners to seek their views on wide-ranging aspects of the relationship between GP and LP, and the International Limited Partnership Association hosted a webcast for 25 of its members as part of the review.

ANNEX B - EXECUTIVE SUMMARY (of the July 2007 Consultative Document)

1. This executive summary describes the broad approach that is envisaged: detailed guidelines will follow after the consultation process is complete. The focus of the review is on the need for greater openness in respect of buyout activity. The guidelines that will emerge from it are not addressed to the venture and growth capital parts of private equity business, which are widely respected as important sources and support for new enterprise and have given rise to neither the visibility gap nor critical concern that have come to be associated with buyouts.

2. A private equity fund with a focus on medium to large-scale acquisition might typically have some 150 limited partners, in sharp contrast with the average of some 150,000 shareholders for a FTSE 100 company in the UK. Reporting by listed companies is aimed principally at the interests of shareholders, a large group holding stock that is traded in public markets. In contrast, the interests of the very much smaller group of ultimate owners in private equity, who hold an illiquid stake in a fund that cannot be traded on a public market, do not in themselves call for public disclosure. This review finds that reporting arrangements between private equity firms (general partners) and investors (limited partners) in private equity funds are generally satisfactory, and few changes are proposed.

3. But reporting by listed companies is also the channel for addressing the legitimate interests in their policies and performance of stakeholder groups such as employees, suppliers and customers, as well as the public interest more widely. These interests have been inadequately informed by the buyout end of private equity. In particular, its rapid recent growth in scale and economic significance has outstripped its recognition of implicit contractual obligations to these constituencies over and above its explicit contractual relationships. As a result, the industry has come to be seen as needlessly secretive, feeding suspicion and, in some quarters, close to hostility. Much of the concern is exaggerated and risks obscuring the significantly positive economic contribution made by private equity.

4. There is thus a major transparency and accountability gap to be filled. The need is to identify the areas and reporting channels through which this can be done. But this does not call for the full array of obligations now imposed on listed companies, resistance to the burden of which appears to be a material influence in the growth of public to private buyout activity.

5. This need for greater openness and explanation cannot be met through any one channel, but calls for initiative and adaptation by three separate but related groups, namely:

   - **private equity portfolio companies**
   - **the general partners who manage private equity funds**
   - **the representative industry association.**

6. The approach envisaged for conformity with the **voluntary guidelines** is on a **comply** or explain basis in the expectation that buyout firms and portfolio companies will generally conform, with the added discipline, especially in the present environment, of external scrutiny by unions, politicians and the media, all of which can be confidently expected to play a part in seeking and smoking out explanation for any divergence from the guidelines. No other monitoring process is therefore proposed.

7. It is proposed that **portfolio companies** that were: formerly listed as FTSE 250 companies or where the equity consideration on acquisition exceeded £300 million or where the company has more than 1000 employees and an enterprise value in excess of £500 million should report to an enhanced standard beyond that required in the 2006 companies legislation.

   Views are invited as to whether these are the appropriate thresholds for enhanced reporting by portfolio companies.

   Main ingredients of such enhanced reporting would be:

   - filing of the annual report and financial statements on a company website within 4 months of the year-end as against the 9 months currently provided in companies legislation
   - the report to provide detail on the composition of the board, indicating separately executives of the company, board members who are executive of the general partner or fund and directors brought in from outside to add relevant industry or other experience
   - the narrative in the statements by the Chairman or CEO and in the board's operating review to refer to the company's values and approach to its reputation, with specific reference to employees, customers and suppliers and, as appropriate, the company's role in the wider community
   - financial reporting to cover balance sheet management, including links to the financial statements to describe the level, structure and conditionality of debt.
   - there should be a short interim statement not more than 2 months after the mid-year, but no requirement is envisaged for publication of quarterly earnings statements.

   Views are invited as to whether these are the appropriate ingredients in enhanced reporting by portfolio companies.

8. Such enhanced reporting is intended to apply to operating companies owned by private equity: standards for reporting by other private companies are outside the scope of this review, but the approach developed here may increasingly be seen as at least a benchmark for other large private companies.

   Does the prospective imbalance in reporting obligations as between private equity portfolio companies and other large private companies give rise to public policy or other concern? And, if so, how should this be addressed?

9. The guidelines will include a provision as to the approach that should be taken by the general partners or fund in a situation in which a portfolio company encounters severe business difficulty that threatens its survival. Generalisation is difficult because the circumstances of such (hopefully rare) situations will differ. But the proposal is for commitment by general partners that they would see it as their responsibility to assist in the transition to management by a creditor group as smoothly as possible along the lines provided in the Statement of Principles of INSOL (International Federation of Insolvency Professionals) on multi-creditor workouts.

10. **General partners** should publish an annual review, accessible on their website, which should become an important channel of communication on the values that inform their approach to business and the governance of their portfolio companies. This general communication should include:

    - an indication of the leadership team of the management company, identifying the most senior members of the general partner team or general partner advisory group
    - a commitment to conform to the proposed guidelines on a comply or explain basis
    - under the rubric of the values of the private equity firm and the general partners, the philosophy of their approach to employees and the working environment in their portfolio companies, to the handling of conflicts of interest that may arise and to corporate social responsibility
    - a broad indication of the performance record of their funds, with an attribution analysis to indicate how much of the value enhancement achieved on realisation and in the unrealised portfolio flows from financial structuring, from growth in the earnings multiple in the market in the industry sector, and from their strategic and operational management of the business.
    - a categorisation of the limited partners in their funds, indicating separately UK and overseas sources to include pension funds, insurance companies, corporate investors, funds of funds, banks, government agencies, endowments of academic and other institutions, private individuals and others.

11. Alongside communication through such annual reviews, private equity firms will be expected to be more accessible to specific enquiries from the media and more widely. Confidentiality concerns will constrain responses that can be given in some situations, but the line between openness and secretiveness should be drawn with much greater flexibility than hitherto, especially in respect of large transactions which, in the listed sector, would attract very full public presentation.

    Views are invited as to whether these should be the recommended elements for an annual review and for greater openness on the part of general partners.

12. **Industry-wide initiative and communication**: alongside enhanced reporting by portfolio companies, there is a major role for data collection, aggregation and dissemination on an authoritative industry-wide basis broadly to cover:

    - scale of funds raised
    - categorisation of limited partners by type and geography
    - scale of existing private equity portfolios and of recent buyout activity
    - leverage levels and debt structures, indicating the relative significance of covenants (or their absence)
    - estimates of levels and changes in employment and new capital investment by portfolio companies
    - aggregate performance measures for portfolio companies, including revenue and profit growth
    - estimates of aggregate performance measures for funds
    - estimates of aggregate fee payments by private equity management companies and by portfolio companies to other financial institutions and for legal, accounting, audit and other advisory services.

    All of this calls for substantial amounts of data but not all of it is clearly additive, and judgement will be required to make qualitative overall assessments in some areas, for example in providing an assessment of the overall performance of funds on an aggregate basis and, in another area, given the wide array of definitions of leverage ratios and types of covenant used in the industry. Hence the importance of investing resource in developing an authoritative and respected capability that avoids misleading aggregation of apples and pears and commands confidence within the industry as well as externally.

    Views are invited on the coverage of this data agenda and proposal for evidence-based analysis, keeping in mind the need to avoid undue reporting burdens on the industry.

13. The data should be drawn on in high quality evidence-based economic assessment, to be effectively and pro-actively deployed. The overall objective should be to create a centre of excellence for the private equity industry that should come to be seen and respected as such and, would thus make a major contribution to filling the void that currently exists in terms of credibility and authority. This will take time to build, but it is a high priority for the process to start now.

14. Beyond more effective communication, there will be need for the industry's representative body to institute arrangements to keep the proposed guidelines under review so that they can be adapted as priorities and changing circumstances require: a small group of trustees chaired by an independent outsider is envisaged for this purpose.

    Views are sought on the appropriate model for review of the guidelines on a timely, effective and authoritative basis.

15. Given the cross-border nature of private equity, there is a need for pro-active engagement with industry bodies beyond the UK, in particular in Continental Europe and North America, to promote the guidelines put in place in the UK as at least a reference benchmark.
16. All of this will require commitment of substantially increased resource to the industry's representative association, in particular from buyout firms.

ANNEX C - PRINCIPLES AND PHILOSOPHY
(abridged from the July Document)

1. The context for this enquiry is that a position that full disclosures and reporting to limited partners, the ultimate owners of private equity, are alone sufficient is no longer politically and otherwise sustainable, at least in respect of the largest portfolio companies. At the opposite end of the spectrum - what might be termed the stakeholder position - there is the view that the large portfolio company is a social institution with obligations to all who are affected by its activities. The definition of stakeholder is sometimes drawn narrowly to emphasise those who have contractual relationships with the company (employees, suppliers, customers) but is frequently expanded to embrace local or wider communities in which the company operates. In extreme form, composition of this latter group might include parties that have no commercial involvement with the company at all, though those concerned may have views as to what the company should do and how it should be organised.

2. Neither the view that reporting and disclosure in private equity should be to limited partners only nor the extreme stakeholder position would appear to be tenable. The questions accordingly become what are the persuasive arguments for a realistic and moderate version of the stakeholder position and what measures might be appropriate in response. The relevance of these questions has been underscored recently by the increasing diversity in patterns of ownership of large businesses. In the UK in the 1980s and 1990s it appeared that the listed company would soon become essentially the only form of large-scale business organisation as statutory corporations, mutuals and partnerships converted to listed status. But the trend has been reversed latterly, above all by private equity. It is also relevant to signal here that, although the immediate focus of this review is on private equity in the UK, there are important differences of at least nuance between American and European approaches to matters of law and regulation. An American perspective tends to adopt what may be characterised as a unilateral concept, whereas the European approach tends to be more sympathetic to the notion that ownership entails obligations as well as rights. These different assumptions and characteristics in relation to the nature of ownership are associated with different approaches to dispute resolution, with an American disposition to resolve contested issues by reference to texts and documents, and with readiness to litigate, and a European inclination to place greater emphasis on the social context of behaviour or transactions. Firms that operate cross-border, as all of the larger UK-based private equity management companies do, need to be sensitive to these differences.

3. The following criteria would seem to be the most apt for assessment of the weight to be attached to stakeholder interests beyond those of the limited partner as owner - legitimacy, integrity, and other contractual relationships.

4. Under **legitimacy**, in a modern economy business leadership represents the largest concentration of power that is not derived from or accountable to an elected body. In Europe, the social democratic view has historically been that the authority of business leaders needs to be legitimated politically through regulation and direct state control of the most important business activities. One characterisation of European experience in the past two decades is that social democracy in the business sense has

been forced into retreat as it became apparent that its preferred business model was inefficient at providing the goods and services that consumer and society wanted. The legitimacy of business authority, in short, has been established by its success in meeting the economic needs of stakeholders, particularly those of consumers. If this analysis is correct, then the source of business legitimacy is economic success, and the means of maintaining the undisturbed authority of business and business leaders is by clear and continuous demonstration of that success. On this approach, the legitimacy of authority, importantly including that of the leaders of private equity, is likely to be easiest to defend in a competitive market - where commercial success and the authority and rewards that go with it are the direct result of demonstrable superiority in meeting consumer needs. In contrast, the defence of such legitimacy is more difficult where competition is limited or effectively non-existent, which provides the justification for appropriate economic regulation of utilities and of firms that control natural monopolies in the field of infrastructure.

5. The **integrity** of the conduct of business controlled by private equity is, in the first instance, the responsibility of the principals, and especially of those who are actively engaged in management. The relevant question here is whether combination of contractual provisions and the general law are sufficient to ensure that private equity firms and portfolio companies are run by people of decency and integrity. What is meant by decency and integrity is more substantive than conformity with contractual provision or the law: it relates to a set of principles and values that cannot be encapsulated in a detailed set of rules. Standards of conduct are contagious, and any degree of malpractice in a particular business situation can have a negative effect on general expectations of what is and what is not normal business conduct and weaken the legitimacy of corporate structures as a whole. On the positive side, the promotion and demonstrable achievement of high standards of behaviour in all portfolio companies, extending beyond compliance with the law, should be powerfully supportive of private equity as a whole.

6. Apart from the contract between general partner and the limited partners, the private equity industry has, directly and indirectly, a wide array of **other contractual relationships**. Those with employees and suppliers are clearly partly explicit, for example, the contracts of employment or contractual terms of trade credit maintained by a portfolio company. But there are also important implicit contractual relationships, for example with employees who believe that the company is a good one in which to work, and with suppliers who value the continuity and depth of their relationship with the company. Such contractual relationships are implicit partly because explicit contracts cannot be sufficiently wide-ranging or anticipate every possible relevant contingency, and because the nature of the behaviour and relationships expected is often defined by the context rather than by the contract. It follows that the effective mechanism of enforcement of such implicit contracts is not legal process, but the requirements of the parties to go on doing business together. Of special importance in this context is that the increase in leverage commonly involved in a public to private transaction is likely to involve some increase in risk for wider

stakeholder groups, above all employees and suppliers, which underscores the importance of attentiveness to the implicit social contracts between a portfolio company and these groups. This does not mean that implicit contracts are merely what all stakeholders would like them to be. For example, the existence of implicit contractual commitments does not mean that jobs cannot be cut where this is necessary to continuing viability of a business. But it does mean that reasonable expectations as to behaviour in matters such as appropriate communication, including its style and timeliness, should not be disappointed. Part of the concern that gave rise to this review is a sense, rightly or wrongly, that some private equity portfolio companies may have acted in relation to employees in violation of such implicit contracts which, despite being implicit, are nonetheless regarded as real and substantive, with reliance reasonably placed upon them.

7 The widespread perception that private equity is insufficiently transparent feeds suspicion that its success is not of a kind that gives it legitimacy in the sense described above. There are also associated doubts about some aspect of its integrity, for example in the perception of "asset stripping" to the detriment of employees, suppliers and potentially other stakeholders, and that private equity is insensitive to the implicit contractual obligations that are seen to be more fully and dependably observed by listed companies - though this is probably not invariably the case in practice. In broad terms, the response would appear to lie in more effective disclosure of the business activity and performance that gives it legitimacy, in emphasis on the integrity of the business and of those responsible for directing it, and in underscoring the attentiveness of boards of portfolio companies to the conventions embodied in implicit contracts as described above and to matters of social responsibility.

ANNEX D - EXTRACT FROM COMPANIES ACT, 2006

Section 417 Contents of directors' report: business review

1. Unless the company is subject to the small companies' regime, the directors' report must contain a business review.

2. The purpose of the business review is to inform members of the company and help them assess how the directors have performed their duty under section 172 duty to promote the success of the company).

3. The business review must contain:

   a) a fair review of the company's business, and
   b) a description of the principal risks and uncertainties facing the company.

4. The review required is a balanced and comprehensive analysis of:

   a) the development and performance of the company's business during the financial year, and
   b) the position of the company's business at the end of that year, consistent with the size and complexity of the business.

5. In the case of a quoted company the business review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:

   a) the main trends and factors likely to affect the future development, performance and position of the company's business; and
   b) information about:
      i) environmental matters including the impact of the company's business on the environment,
      ii) the company's employees, and
      iii) social and community issues,

      including information about any policies of the company in relation to those matters and the effectiveness of those policies; and
   c) subject to subsection 11), information about persons with whom the company has contractual or other arrangements which are essential to the business of the company.

   If the review does not contain information of each kind mentioned in paragraphs b)i), ii) and iii) and c), it must state which of those kinds of information it does not contain.

6. The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:

   a) analysis using financial key performance indicators, and

b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.

"Key performance indicators" means factors by reference to which the development, performance or position of the company's business can be measured effectively.

7. Where a company qualifies as medium-sized in relation to a financial year see sections 465 to 467), the directors' report for the year need not comply with the requirements of subsection 6) so far as they relate to non-financial information.

8. The review must, where appropriate, include references to, and additional explanations of, amounts included in the company's annual accounts.

9. In relation to a group directors' report this section has effect as if the references to the company were references to the undertakings included in the consolidation.

10. Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.

11. Nothing in subsection 5)c) requires the disclosure of information about a person if the disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest.

ANNEX E - SUMMARY OF EVCA REPORTING GUIDELINES

The EVCA reporting guidelines set out recommendations that are intended to represent common practice on the contents of reports to investors in private equity funds. The guidelines do not include requirements as to the content of statutory accounts, but instead are designed to complement and enhance the requirements of European laws governing reports to investors.

The guidelines set out two levels of reporting: matters that are required for the General Partner to claim compliance with the guidelines, and a supplementary level of recommended practice. The table below sets out an abridged overview of the EVCA guidelines.

Section	Requirements	Recommendations
A. General considerations	The fund manager should observe the principles of relevance, transparency and consistency, and reporting should be in the fund's functional currency.	Combined statement of all vehicles comprising the fund.
B. Timing	Semi-annual reports, produced within 60 (half year) and 90 days (full year).	Quarterly fund reports, within 45 days, or 60 days for the audited full year accounts.
C. Fund reporting	Fund overview. Details of commitments, drawdowns and distributions. Changes to investment strategy, or fund manager's senior investment personnel. Current investments, new investments, follow-ons, realisations and investment valuation, at fair value Performance of fund (IRR and multiples). Details of any leverage applied to the fund. Cashflows between fund and investors, including their timing.	Value progression chart showing change in value of the fund analysed between total committed capital, cumulative distributions, residual fund value net of fees and carried interest. Potential drawdowns
D. Portfolio reporting	Detailed realisation summary by investment. Detailed summary of individual investments. Valuation of each investment explaining the application of the appropriate methodology. Explanation of significant events and issues. Historical profit and loss. Assessment of company's status compared to the expectation at the time of investment.	Historical profit / loss with comparison to budget / forecast for full year. Explanation of changes in valuation, names of syndication partners and co-investors, and exit plans.

Section	Requirements	Recommendations
E. Capital account	Capital account setting out details of changes in investors' equity and capital contributions over the period and from inception.	Cash flows detailing drawdowns and distributions for each investor.
F. Fees and carried interest	A clear statement of related party transactions, benefits and fees, and net management fees. Carried interest earned or paid for the period and since inception, together with the value of any potential clawback.	

ANNEX F - GUIDANCE FOR INPUT ON ATTRIBUTION ANALYSIS

Data input required from private equity firms in accordance with the guideline in Chapter V and the recommendation to the BVCA (in Chapter VI) to undertake attribution analysis in respect of exits from investment in UK portfolio companies in at least the previous calendar year

- enterprise value at entry and exit
- capital structure at entry and exit, with details of recapitalisations and dividends
- gross equity return over holding period
- trading performance over the holding period in terms of revenues and operating earnings

Summary methodology

To compute the attribution of returns, each portfolio company will first be matched as closely as possible to the appropriate country / sector stock market index. Thereafter, leverage will be matched to that of the benchmark, to calculate the returns on the investment as if it were leveraged to the same degree as the selected public comparator. The rise in the relevant stock market index over the holding period of the investment will indicate the amount of the returns generated by rises (or falls) in the overall market, with the remainder attributed to strategic and operational improvements delivered by the private equity firm and management of the portfolio company.

The object of this analysis is to identify the sources of the return generated by a private equity firm between acquisition of a portfolio company and the cash exit. The methodology will attribute the gross equity return of the investment between the categories outlined above and does not focus on the net return to the investor after deduction of any management fees and carried interest, a matter for reporting to limited partners in accordance with the EVCA or comparable guidelines.

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