

Submission to the Walker Working Group on behalf of BBC Pension Trust, BP Investment Management, London Pensions Fund Authority, Wellcome Trust, and Universities Superannuation Scheme Ltd

Dear Sir David

We the undersigned Limited Partners, representing some of the largest pension funds and Charitable Trust funds in the UK¹, welcome the opportunity to respond to the issues raised in the Walker consultation. An increasing proportion of our funds are being allocated to alternative asset classes such as private equity, in which we currently have in excess of £6 billion in aggregate commitments.

As global investors, we attach considerable importance to ensuring the profile and reputation of all our investments are managed effectively and we are pleased to see the industry respond – albeit somewhat belatedly – to the criticisms levelled against it.

That said, we are disappointed that the composition of the working group did not include any representation from Limited Partners (LP). A General Partners' (GP) led document with no representation from Limited Partners is open to accusations of vested interests, which could undermine confidence in the eventual findings and recommendations. We also believe that the consultation and the issues addressed would have benefited from gauging the views of a larger group of investors from the UK, Europe and overseas at the outset of the process.

Our starting point is that we recognise the clear advantages of the private equity business model and the benefits to investors. However, we believe these advantages need to be explained more proactively whilst at the same time addressing the lack of transparency surrounding many of the industry's activities. Many of the Consultation's recommendations go some way to addressing the inadequacies in information flows from industry practitioners but there are areas which require further action.

Disclosure by Private Equity owned companies

We support the concept of appropriate reporting by large privately held companies where such reporting does not impact negatively on the performance of the company, reduce its strategic time horizons, or require the disclosure of confidential information. It is our view that effective reporting provides investors and other interested parties with a better understanding of the long-term prospects of companies.

The challenge will be to avoid boiler plate reporting and we would therefore suggest that standard setting and monitoring - in terms of reporting - should form part of the proposed Private Equity oversight body's remit. This is an extension of the remit outlined on page 41 of the consultation document for the creation of a group of trustees to monitor the recommended guidelines. In addition, we recommend that this group should be composed of, inter alia, representatives from both LPs and GPs.

Many large companies are in a position where their activities are open to the scrutiny of a range of stakeholders, and should respond to calls for transparency irrespective of their

¹ The following Dutch parties were also consulted in drawing up this response: ABP Pension Fund, PGGM Pension Fund and Alinvest; total private equity investments around Euro 12 bn

ownership structures. Hence, voluntary disclosure of additional information on the broad range of issues outlined in the consultation document is, we believe, in the interests of Private Equity owned companies. In addition, we would also recommend that private equity owned companies be encouraged to report against the Turnbull Guidance on internal controls which, although setting out best practice for UK listed companies, should be considered by all organisations seeking to improve their performance. It should be noted that the Turnbull Guidance has spread well beyond quoted companies and been adopted by the public and voluntary sectors as it is both good practice and makes good business sense to control and mitigate risk, regardless of the form of ownership of the business.

Although we agree that the thresholds, as outlined, are appropriate for enhanced reporting by private equity companies, we are also of the view that such disclosure should be expected of other privately held companies. The government should consider the creation of a level playing field *vis á vis* other privately held companies and even non-UK domiciled companies listed on the UK stock exchange by providing similar guidelines.

Outside directors

We believe that this idea either needs significant further development or should be reconsidered. It is unclear what benefit the inclusion of these appointments will have in the running of Private Equity company boards in terms of responsibilities to wider stakeholder groups from either an LP or an external stakeholder perspective. As LPs we expect, and indeed are confident, that GPs will already be appointing individuals with appropriate external expertise to the board where it is required. As highlighted in the report, the Companies Act already requires directors of all companies as part of their duties to have regard to external stakeholders to promote the success of the company for the benefit of its members as a whole.

The signatories agree that the primary concern should be to ensure that appropriate experience and capabilities are represented around the boardroom as opposed to setting any blueprint for the composition of boards of portfolio companies.

GP / LP communications

This is the area in which we have most concern regarding the lack of prior consultation. Indeed, we would question the statement that LPs are generally happy with the level of reporting between LPs and GPs. The information flows between GPs and LPs seem to be very much dependent on size of investment and we are therefore concerned about an asymmetry of information flows. Most LPs are happy with certain aspects of reporting, but there are areas where there could be significant improvements:

- As highlighted on Page 31 of the consultation document, there are clear concerns regarding the disclosure of the internal fees GPs charge to companies. There is a significant lack of transparency around these fees, which are partly drawn from the returns of the LPs. Also, significant additional fee income generated by GPs from portfolio companies may cause a misalignment of interest between GPs and LPs, as it may give the GPs the incentive to focus on short-term fee generation, instead of long-term value creation. Examples of such fees are upfront deal fees, monitoring fees, and exit fees.
- In addition, LPs would welcome standardised performance data to permit comparisons between funds and to assess the impact of various performance drivers, for example EBITDA growth. These data are not expected to be public, but if GPs reported in the same way using the same metrics LPs would have greater clarity as to performance. Ideally that information should be revealed in a pro-forma format which would enable easier comparison of performance of funds with a similar focus. We would call on the

sector representative bodies to work with LPs to develop KPIs for such comparable data.

- At portfolio company level, we recommend that GPs apply the industry guidelines on valuation and reporting in a more consistent manner.

Although we recognise that public disclosure of limited partners should be restricted to categorisation of investors, we do not see any reason not to disclose identities of limited partners to other potential limited partners. On the contrary, we would find it useful as part of our due diligence processes prior to investment.

Generic Communication

We generally welcome the recommendations outlined in this section but would also suggest that a reference is made to how the GPs manage their growth and the risks associated with that growth.

We would recommend that another area which needs further consideration is the reporting of how GPs are equipped to deal with risk in the investee companies – i.e. loss of key managers, failure to meet business targets, or fraud, etc.

We also believe that monitoring of generic communication should be part of the remit of the proposed oversight body.

Other issues

We would also like to correct a misconception highlighted on Page 28 of the consultation document: LPs are not "*only interested in performance*". Whilst performance is obviously important, LPs are also interested in investing in a responsible manner, one in which will not lead to activities or investments that could create a reputational risk for the investors.

Indeed, we would encourage GPs to consider the wider social and environmental implications of their activities. One framework which may be useful for such considerations is the UN's Principles of Responsible Investment.

It is also considered that the consultation process should result in detailed guidance to enable GPs to understand fully what is expected of them in terms of compliance with the recommendations made by the review.

Finally, we believe that the government and the sector's representative bodies should work strenuously to encourage the adoption of similar standards of good practice in other markets around the world, to ensure that a level playing field is created and the reputation of private equity is enhanced at a global level.

Yours sincerely,

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