

Under the Microscope: The Critical Issues

Proskauer's Private Funds Group Analyses Key Trends Affecting Fund Managers

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April 17, 2018 (London) – Providing a comprehensive analysis of the critical issues affecting European private funds, Proskauer hosted a seminar analyzing market trends and a wide range of topics important to fund managers, including what UK managers need to be thinking about if they are fundraising during or after Brexit, an update on international tax and European tax development, global initiatives, such as the BEPS project, U.S. tax reform and its potential impact on fund managers, and an analysis of the current U.S. regulatory environment and what European fund managers need to be aware of. Presenters included Nigel van Zyl, Mary Kuusisto, Catherine Sear, Kate Simpson, David Tegeler and John Verwey.

With reported raised capital in excess of \$453 billion in 2017, Proskauer's private funds lawyers looked back at the last two years to decipher what trends have emerged and how terms have evolved in the European fundraising market. "2017 was another stand-out year for fundraisings, and by analysing data available from our innovative terms portal, and by monitoring key trends we were able to provide an analysis of the innovation in key terms and issues impacting the GP-LP dynamic." said Nigel van Zyl, partner and head of Proskauer's European Private Funds Group in London.

The Proskauer team reviewed and analyzed 32 key terms of nearly 60 European-focussed buyout funds raised between July 2016 and December 2017. The data was analyzed on both an aggregate basis and broken down into four fund size groups: <€250M, <€250M - <€750M, <€750M - <€2B and >€2B to assess whether the trends in any terms differ between fund sizes.

Key trends observed in 2017 included:

- **Narrowing the gross to net IRR spread** – GPs have continued to focus on narrowing the spread between their gross and net IRRs including by introducing

provisions in their LPAs to help them to achieve this. Some of these include more effective and broader recycling rights; deploying more capital prior to commencing the investment period of a successor fund; the ability to deploy greater amounts of follow-on capital after the investment period; and the use of extended bridge facilities.

- **Innovation in the waterfalls** – Several European GPs raising funds in 2016/2017 refined and innovated their waterfalls to provide investors with: choices between ‘whole fund’ and ‘deal-by deal’ with lower management fees; hybrid waterfalls with some carry paid on a ‘whole fund’ basis and some paid on a ‘deal-by-deal’ basis; and carry ratchets where carry increases to as high as 30% provided certain benchmarks are achieved.
- **Platform extensions** – In 2016/2017 we saw a number of European based fund managers who historically only offered one fund product expanding their platforms to offer adjacent products such as small-cap funds or debt funds, typically funds with different strategies to the main buyout fund product but where a number of synergies and efficiencies exist between the new products and the existing fund products.
- **Continued demand for co-investment** – The demand for co-investment from investors continued in 2016/2017. GPs therefore, because of this demand, have started exploring the possibility of, and in some cases charging fees and or carried interest, on co-investment arrangements. GPs have been giving more thought to how co-investment arrangements should be structured to harness such demand in efficient and innovative ways such as the raising of ‘top-up’ or ‘overflow’ funds, or more informal ‘preferred co-investment clubs’ for larger or strategic investors.
- **Continued success of ‘emerging’ managers** – Several teams starting, spinning out on to, or coming together on new platforms had successful fundraisings, particularly in the lower mid and mid market.
- **GP Commitment** – There continued to be a demand for GPs to increase the amount they invest in their own funds, and many GPs wanted to commit greater amounts to their funds than they had done in prior funds. This demand or desire for increased GP commitment has made GPs consider more innovative means of funding their co-investment.
- **Transparency & Disclosure** – Partly driven by SEC activism and by investor demand, GPs revised and reconsidered their LPA terms to ensure that their LPAs expressly address such points as: what fees and expenses paid by portfolio companies to affiliates of the GP, including operating partners and industrial advisers are not set-off against management fees; how broken deal costs are apportioned between fund vehicles and co-investment vehicles and the one-time

payment of the present value of monitoring fees. In addition, investors demand for the disclosure and reporting of any such fee payments continued to increase with many GPs volunteering to provide reports to investors in the form of the ILPA Fee Reporting Template or similar reporting arrangements.

- **Continued tightening of the tax environment** - Partly driven by the OECD BEPs project and partly driven by governments looking to increase tax revenues there has been an increased focus on the tax provisions in LPAs and side letters and more due diligence done by investors during the legal negotiations on how GPs propose to respond to and structure their investments in portfolio companies

Related Professionals

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