Private equity funds seeking to increasingly attract US-based capital should take care to familiarise themselves with the different habits of international investors.

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Asset managers and private equity firms that have historically raised private equity funds from investors in the Gulf region are now seeking capital from international and, in particular, US investors in an effort to obtain desirable longer-term capital. But there are some key contrasts between marketing funds to in-region and international investors.

CHANGING TERMS

Investors outside the Gulf region frequently seek investor-friendly fund terms. In addition to competitive fee structures, international investors now expect many of the following:

● Alignment of interest. International investors seek fund terms designed to ensure appropriate alignment of interest between the asset manager and the investors. These include: the equity interest of the asset manager in the fund; the deal team’s share of fees and carried interest; and no exemptions from fiduciary duties.

● Termination and removal triggers. International investors now insist on termination and removal rights, such as: no-fault termination of the fund or commitment period; key-man suspension of the commitment period; and, for-fault removal of the asset manager/general partner.

● Investment and borrowing restrictions. Although limited partners have no role in the management of private equity funds, they are seeking limits on the asset manager’s discretionary powers. International investors may insist on restrictions with respect to: diversification; industry, geography and asset type; affiliated and follow-on transactions; and borrowing.

● Clawbacks. Private equity funds typically provide for the “clawback” of carried interest distributions that require the asset manager to return any profits that exceed its agreed-upon profit split at the end of the partnership term. International investors are increasingly seeking to reinforce these protections.

● Disclosure and reporting. A fund’s offering materials should include disclosure of the fund’s asset manager and its background. International investors also require periodic financial and other disclosure during the life of the fund, including: track record; investment team; conflicts of interest; and reporting to investors.

● Limited partner advisory committee. International investors expect a fund to have an advisory committee composed of representatives of limited partners. The role of the advisory committee is to resolve conflicts of interest and consult with the asset manager. Increasingly, international investors require the advisory committee to approve the methodology for portfolio company valuations and review fund expenses and carried-interest calculations.

KNOW YOUR RIGHTS

There are also legal and regulatory considerations to take into account. Raising funds internationally creates obligations under the securities laws and practical consequences in the countries where the offering is made or where the investors are located. Basic requirements of US and UK securities laws include:

● Exemptions from registration/authorisation. Within the US, all offers and sales of securities (including the sale of shares or interests in a private investment fund) must be registered with the Securities and Exchange Commission unless an exemption from registration is available.

In the UK, communication of a “financial promotion” (including an opportunity to invest in shares or interests in a private investment fund) must either be made through an “authorised person” or pursuant to an applicable exemption – otherwise it can be a criminal offence.

In both cases, exemptions are often available, but they are typically subject to detailed conditions and restrictions, with which the asset manager must comply.

● Inaccurate or incomplete disclosure. If a fund’s offering materials contain any untrue statement of a material fact or omit to state a material fact which results in the offering materials being misleading, the asset manager may be subject to civil and criminal liability in the US or other countries with similar anti-fraud laws.

Asset managers in the Middle East are poised to build on their track records to raise funds from international investors. Before circulating initial documents, such as term sheets, or even approaching investors, asset managers should be aware of regulatory and disclosure requirements and should have a general familiarity with market practices regarding fund terms.

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