

UPDATE

Mourant Ozannes Fund Transactions Conference 2018

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To be prepared is half the victory. This year's conference focussed on the need for funds to plan ahead, establish values and build a practical and tailored governance structure at the outset in order to mitigate risk and be able to take advantage of social, political and regulatory change.

The annual Mourant Ozannes Fund Transactions Conference was held on 24 May 2018 at One Moorgate Place in London.

Once again, we would like to thank our panellists for taking part and for sharing their insight and experience with our clients and colleagues in the global funds industry. Here is a brief summary of the topics covered for those unable to attend:

Panel One: Private Funds & Individual Incentives – General Trends & Issues

While the dust may currently be settling somewhat, recent regulatory change has had significant impact on the structuring of investment manager remuneration and incentivisation plans, both across carry/co-investment structures for closed ended funds, as well as performance fee structuring for open-ended funds. The UK's remuneration regulations and changing tax rules on disguised investment management fees, carried interest and non-domiciled individuals create an increasingly complex landscape for managers to navigate. This has led to increasingly complex arrangements for larger managers, but for smaller houses often opting for more basic solutions.

The industry has seen an increase in the use of deferral plans and an enormous range of good, bad and neutral leaver scenarios, together with judicial activism in this area. Further judicial development in this area is likely, and is an interesting space to watch. It was noted that, in the future, the judiciary may introduce public law concepts of proportionality and consistency to this area; perhaps even a right to be heard before making a decision on a leaver's status.

The English courts have emphasised the importance of procedure when making decisions regarding leaver status. Such decisions, and the factors taken into consideration when making those decisions, should be carefully documented in case the conclusion reached is later subjected to scrutiny. Some victories, both in litigation and in arbitration have been pyrrhic, where enforcement following a decision can be difficult in practice. Accordingly, care around choice of governing law and forum for enforcement is critical.

Lasting impressions: When structuring incentive arrangements, keeping things simple and consistent creates fewer delivery and enforceability issues over time. Good governance and procedures are essential when exercising contractual discretions in this area, and governance may extend to imposing consistent accounting practices on individual partners in order to mitigate corporate risk and avoid disputes.

Panel Two: Governance

The panel was united in the view that well-aligned governance is essential to investment, creating a competitive advantage over peer firms and even a 'governance premium' in a sale context. Conversely, a lack of, or inappropriate, governance can take value out of a business, where there needs to be an element of 'horses for courses'.

The panellists' experience was that effective governance starts from the top down. Investors should establish clear goals and then structure boards which are able to implement those goals and also to monitor and enforce the objectives of the business. This approach increases alignment and engagement across all levels of the business, with the company's culture then being experienced in practice. Research was shared, showing that well designed governance enabled better business decisions – and that this was also becoming a key element of due diligence.

The panellists also shared their view that private equity houses were increasingly looking to bring people with varied skill sets onto their boards (which have historically been homogeneous and narrowly defined), with good governance interpreted more widely from a stakeholder perspective being crucial to the proper management of risk, and diversity essential to the ability to capitalise on opportunities.

Technology was seen both as a challenge and an advantage to governance. On one hand, new technologies provide a number of interesting tools for funds which are useful, for example, in the context of distribution and investor communication. Increased transparency was also regarded as beneficial, though the downside of transparency is that it subjects businesses to the risk of hacking and cyber attack. In addition, new technologies can make businesses more complex (and therefore costly) to run, can lead to a dangerous level of inter-dependence within an industry, and are subject to increasing regulation.

The interplay between good governance and regulation is interesting, with important and valuable ideas (such as data protection) sometimes being translated into over-complicated and prescriptive legislation, the practical downsides of which can easily outweigh the intended benefits. In this area, the panel discussed the importance of simplicity and disclosure requirements, noting that the 'blunt instrument' gender pay gap reporting requirement has led boards to consider their internal structuring in more detail; an extremely valuable development.

Lasting impressions: Regulatory change is driven by social change, and regulatory change creates behavioural change in the industry; for better or for worse. The necessity of good governance is increasingly recognised and, as an illustration, the introduction of governance reporting obligations on larger private companies from 2019 reflects a sea change as to how governance will be approached.

Panel Three: Getting Behind the Stories

This very thought-provoking panel involved the discussion of a number of recent headlines ranging from the EU's attitude towards Britain as Brexit looms closer, to protectionism issues involving Russian oligarchs being denied visas and to a data harvesting scandal.

The industry's experience of Brexit was mixed. While one panellist noted that Brexit has not changed what makes private equity houses successful, and has therefore had little impact to date, an FX expert responded that Brexit has already destroyed the value of Sterling – and has not even happened yet.

The conversation moved to the impact of 'interventionist' government policies on the industry, noting that this was not confined to the UK and was being seen across the globe. One panellist shared the view that private equity was becoming wary of certain transactions which could be blocked if seen to contravene the current protectionist policy of the US. The industry has also seen an increase in break fees being included in first drafts of transaction documents where any kind of regulatory risk is perceived. The importance of effective governance was again noted here, with selection of the right people to sit on boards being key to understanding and reacting to political pressures and change.

Governance was also regarded as key when considering the danger of reputational risk where a business comes under the media's spotlight, particularly where a febrile environment can lead to contagion across sectors and geographies. The private equity industry's concern with reputation has led to increased reputational due diligence on proposed transactions and the normalisation of crisis management experience in the boardroom.

Lasting impressions: The current 'tsunami' of regulation is blocking investment in creative ideas within the City of London and that investment is needed for the UK to find its place in the world post-Brexit. Well-structured boards and vehicles will help businesses make the right decisions to respond to political and social pressures and to survive scandals.

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