

British Airways Pension Investment Management Limited

11th Floor
Met Building
22 Percy Street
London W1T 2BU
Tel +44 (0)20 7908 5800
Fax +44 (0)20 7908 5898

12 January 2011

Online Submission to the European Securities & Markets Authority: Call for Evidence – Implementing Measures on the Alternative Investment Fund Managers Directive

British Airways Pension Investment Management Limited ("BAPIML") has been investing in private equity funds on behalf of the British Airways Pension Schemes for many years. Our private equity portfolio currently comprises almost 100 private equity funds. It includes participations in funds that invest in the EU, which are managed by EU-domiciled private equity firms, and funds that invest outside the EU, which are managed by non-EU domiciled private equity firms. The management of our private equity portfolio will be directly impacted by the implementation of the AIFMD.

We welcome the opportunity to respond to ESMA's call for evidence on the Implementing Measures on the Alternative Investment Fund Managers Directive. Although this is a wide-ranging Directive, our comments and observations are purely from the perspective of an institutional investor in private equity funds.

Issue 1 – Article 3 Exemptions

On the issue of determining the value of assets under management for a private equity manager, you might wish to consider linking the definition to the value of assets on which fees are charged: this would then accurately reflect the changes as funds are raised and realized and "commitments" of assets under management rise and fall. This would also help address how to incorporate the impact of any fund-level leverage (extremely rare though that is in private equity).

Issue 2 – Article 9 Initial capital and own funds

Our observation is that in private equity the relevance of "own funds" really only comes into effect should carried interest have been paid out during the life of a fund which has no, or inadequate, limited partner ("LP") protection in the form of escrow and/or interim/or end of life true-up provisions. So perhaps the way to address this issue is to require private equity funds to contain such LP protections.

In addition, we believe that the cost of professional indemnity insurance in respect of the management of a private equity firm should not be borne out of the assets of a private equity fund. We recognize that it may be difficult to separate the insurance policy covering the management of the firm from that which covers the individuals of the private equity firm in respect of their role on the boards of investments. We do not believe, however, that this should be an insurmountable issue: it may be addressed, for example, by some suitable apportionment of the cost of the insurance between the fund and the firm.

British Airways Pension Investment Management Limited

Issue 3 – Article 12 General principles

On the issue of ensuring investors are treated fairly perhaps this would be addressed if all private equity fund limited partnership agreements contained a Most Favoured Nation (“MFN”) provision.

Issue 9 – Article 19 Valuation

As an investor in unquoted, highly-illiquid assets we are very conscious of the limitations of applying any sort of market value methodology to non-marketable assets. We recognize, however, that over the years much work has been done in Europe and the US on the interim valuation of unquoted companies in private equity funds. Overall, we think that in the mainstream of private equity, most funds have a fairly systematic and well-documented approach to valuation which is robustly audited by the accounting industry and overseen by LP advisory boards. Consequently, we believe that requiring private equity funds to adhere to an industry-standard guideline on valuation (such as the International Private Equity and Venture Capital (IPEVC) valuation guidelines, or the Fair Value Basis of Valuation as recommended in the GIPS Private Equity Valuation Principles) would be an appropriate approach to take.

It would be beneficial if the valuation principles to be followed were stated by the General Partner (“GP”) of the fund from the outset. It would also be beneficial if the detailed methodology used were provided by the GP to its LPs on an annual basis. It would also be beneficial for all private equity funds to have an LP advisory board.

Issue 13 – Depositary functions

Given the nature of private equity funds and their investments there doesn’t seem to be any single entity which would be best placed to act as depositary. Consequently, perhaps consideration should be given to splitting the depositary function for a private equity fund between a legal firm and a fund administration/accounting firm.

Issue 19 – Article 4 Definition of leverage

Where a private equity fund has a borrowing facility in place, which it makes use of on a temporary basis to ensure greater efficiency, from the LPs’ perspective, in managing the draw down of commitments, it would be helpful to have clarification that this would not be regarded as the fund being levered.

Issue 20 – Article 22 Annual report

In considering your advice to the Commission on this (and indeed various related issues) you may find it helpful to know that, under the auspices of the BVCA, a working group comprising LPs and GPs was set up in June 2010. I am a member of this group which is working to identify areas of good practice in private equity. The whole issue of transparency and reporting by GPs to LPs is one of several matters we are covering. Over recent months we have had robust, but constructive, discussions and have made good progress on reaching agreement on what constitutes good practice in reporting and disclosure to investors. At the relevant stage in your deliberations on transparency we would be very happy should you wish to consult with this group on these matters.

The work of this group has also addressed the issue of LP protections which would be relevant to Issue 2. It is also supportive of the view that funds should have LP advisory boards.

British Airways Pension Investment Management Limited

Issue 21 – Article 23 Disclosure to investors

Our observation is that it is difficult to see how the Level 1 text would apply to a private equity fund, given such funds are not normally levered.

Issue 24 – Article 40 Co-operation arrangements between European competent authorities and the authorities of third countries

For most experienced professional investors in private equity funds, it is critical to investing prudently and well to be able to invest in funds managed by non-EU managers that invest in non-EU investments. So, for example, investing in high-quality US venture funds is a fundamental component of many experienced institutional investors' private equity strategy.

While it may be reasonable to think that many of the very large non-EU managers will seek to become covered by the third country passport regime, it is equally reasonable to think that very many smaller and specialist managers will, for perfectly valid reasons, not. We do not believe that such managers should be considered to be in any way "unsuitable" simply because they choose not to become part of the passport regime. Similarly, being part of the passport regime would not automatically mean a GP would satisfy the more detailed requirements of an institutional investor's due diligence process.

The implementation of Article 40 would seem to pose quite a challenge: on the one hand it appears to allow the marketing of a non-EU fund, by a non-EU manager, to EU professional investors (though only in the territory of the non-EU manager), without a passport; yet on the other hand, it would seem to require that, even in such a situation, the non-EU manager must still comply with various aspects of the Directive.

From a professional investor's perspective, we would feel quite comfortable if the application of Article 40 to private equity (which for us includes venture capital, growth equity and buy outs) simply required that the non-EU manager be registered with the relevant regulatory authority in its own country. So, for example, for us it would be sufficient to be able to verify (as a small part of our wider due diligence) that the US manager of any US venture fund we approached, while we were in the US, were registered with the SEC.

Contact Details:

Gillian Brown, Head of Private Equity, BAPIML
gillian.brown@bapensions.com