EMPEA Guidelines

Key elements of legal and tax regimes optimal for the development of private equity

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EMPEA

Emerging Markets Private Equity Association

About EMPEA

The Emerging Markets Private Equity Association (EMPEA) is an independent, global membership association whose mission is to catalyze the development of private equity and venture capital industries in emerging markets. EMPEA's nearly 300 members share the belief that private equity can provide superior returns to investors, while creating significant value for companies, economies and communities in emerging markets. Our members include the leading institutional investors and private equity and venture capital fund managers across developing and developed markets. EMPEA leverages its unparalleled global industry network to deliver authoritative intelligence, promote best practices, and provide unique networking opportunities, giving our members a competitive edge for raising funds, making good investments and managing exits to achieve superior returns.

In support of its mission, EMPEA:

- Researches, analyzes and disseminates authoritative information on emerging markets private equity;
- Convenes meetings and conferences around the world to promote information exchange between leading fund managers and institutional investors;
- Offers professional development programs to enhance knowledge transfer; and,
- Collaborates with stakeholders from across the globe.

EMPEA's members represent nearly 60 countries and over US$1 trillion in assets under management.

For more information, please visit www.empea.org or call EMPEA at +1.202.333.8171.

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EMPEA Guidelines

Introduction

The Emerging Markets Private Equity Association (EMPEA) is an independent, global membership association whose mission is to promote the development of private equity and venture capital industries in emerging markets. Our 300 members include the leading institutional investors and private equity and venture capital fund managers across more than 60 developing and developed markets. EMPEA's members share the belief that private equity and venture capital are an important source of long-term financing for businesses in emerging markets.

By providing growing companies with operational expertise, governance enhancements and expanded strategic networks in addition to capital, private equity and venture capital investors can significantly impact business growth, elevate environmental and other industry standards, create jobs and improve access to services for underserved populations, thereby improving the overall quality of people's lives. Private equity and venture capital investors' success in individual emerging markets may also help attract other investors to undercapitalized economies.

Accordingly, EMPEA supports the development of legal and regulatory frameworks that address risks and encourage alignment of interests, but do not unintentionally restrict capital flows or limit investors' participation in opportunities they find attractive.

The EMPEA Guidelines are intended to identify those elements of legal and tax regimes that experience from other markets has demonstrated will help attract robust international and local private equity and venture capital investment. Given the core facets of the private equity model—active ownership, often of minority stakes, in private businesses seeking not only capital but also enhanced governance or more professionalized management, over a period of several years—private equity investors seek clarity and consistency around securities law and minority investor protections, as well as fair and equivalent treatment for all providers of capital regardless of mode of investment or country of origin. Additionally, as private equity funds are pooled vehicles comprising capital from investors spanning multiple jurisdictions, clear, consistent and internationally competitive tax treatment is also vital.

We envision the use of the Guidelines primarily by three groups: by regulators engaged in an assessment of their own regimes vis à vis practices in international markets; by private equity firms engaging in dialogue with regulators in their home markets; and, by investors in private equity funds seeking a framework for evaluating the legal and regulatory environments in individual markets.

The Guidelines are intended to serve as a general framework for constructive dialogue amongst all these stakeholders—policymakers, regulators and investors—and to thereby promote private equity and venture capital investment in emerging markets. Our hope is that engagement on these issues will result in thoughtful assessments of both best practices and opportunities for change.

Contents

The guidelines comprise 10 specific topics important to private investment and should be read in conjunction with the detail and supporting materials that follow. Additional information related to the Guidelines is available from EMPEA (www.empea.org).

EMPEA Guidelines

1. Effective, clear and flexible corporate and securities laws, with the ability to negotiate rights in capital structures.

Private equity investment will be more robust in markets with corporate and securities laws designed to provide liquidity to businesses and their investors, to foster fundraising through public offerings, to encourage local and international listings and to promote the development of local capital markets. Issues particular to private equity investment ideally addressed in such laws include (i) limited liability for investors who provide capital, but do not take an active role in the management of the investment vehicle, (ii) the ability to flexibly negotiate equity and debt interests in both corporate and partnership structures, (iii) mandatory disclosure of directors' and officers' conflicts of interest, (iv) directors' and officers' fiduciary duties, (v) reasonable protections for minority investors, and (vi) flexibility with respect to share repurchases, treasury shares and distributions of cash and other assets.

2. Conformity to international standards of business integrity and anti-corruption.

In addition to adopting international conventions and national legislation to combat corruption and money laundering, regulators should demonstrate effective enforcement and support a culture of business integrity, transparency and anti-corruption.

3. Clear, consistent and internationally competitive taxation.

Markets optimal for private equity investment also feature tax systems that promote the long-term growth of capital and allow foreign and domestic private equity investors to pool their capital in an investment vehicle. Key features of such tax systems minimize the risk of onerous treatment of foreign investors, e.g., protection from additional or double taxation at the level of the vehicle or on distributions by the vehicle as well as certainty with respect to the local tax liability. Tax filing obligations in such systems are not unnecessarily onerous and there are minimal delays in refunds of withholding tax where a country agrees not to exercise its taxing right in respect of payments to, or on disposals by, foreign investors.

4. Reliable and consistent approach to dispute resolution and enforcement.

Given that private equity investments often take the form of minority stakes with influence but not control, reliable, consistent, fair and efficient dispute resolution mechanisms are critical, including the recognition and enforcement of arbitral awards and foreign court judgments in accordance with international norms.

5. Non-discriminatory treatment of cross-border investment.

Flows of private equity capital are often international in nature, due to the pooled structure of most vehicles and the need to accommodate investors from multiple jurisdictions. Environments attracting robust private equity investment are therefore minimally discriminatory in terms of: foreign ownership of assets (i.e., only as necessary to protect legitimate national interests); investments abroad by domestic investors; fundraising and promotion by foreign private equity managers to institutional and other sophisticated investors within the country. Additionally, such regimes allow for currency convertibility at market-based or dependably managed rates of exchange and movements of currency in and out of the country, and provide for a fair and flexible means of allowing foreign expertise to operate locally.

6. Efficient, transparent and fair regulatory environment.

Private equity tends to thrive in markets where the regulatory regime is clear, efficient, transparent, independent and fair. In such markets, there are minimal restrictions on allocations to private equity as an asset class and regulation of the asset class itself is linked to identifiable policy objectives, such as the encouragement of appropriate standards of behaviour in the financial sector, the maintenance of stable financial markets, the discouragement of anti-competitive behaviour and other internationally recognized policy objectives.

7. Transparent and reliable rules for expropriation.

As expropriation poses a direct danger to the preservation of capital in an investment, private equity investors require very clear rules around the specific circumstances in which the state is permitted to expropriate private property and the way in which investors must be compensated when such expropriation occurs. Any such laws should be consistent with a country's multilateral and bilateral investment treaty obligations, as well as international norms.

8. Stable and fair framework for property rights.

A stable framework for property rights is pivotal to investment in privately held companies and assets, therefore investors seek a framework that provides: (i) an accessible and easily searchable means of (a) recording title to real property, mortgages, liens and other security interests and (b) obtaining basic information concerning local companies, (ii) a cost-effective means of transferring title to real property and shares in local companies and registering a security interest, and (iii) the protection of intellectual property rights.

9. Flexibility in insolvency proceedings and fairness for stakeholders.

Systems that best protect the interests of all stakeholders feature bankruptcy regimes that provide for (i) the appointment of independent administrators in bankruptcy proceedings, (ii) the recognition of the priority of secured creditors and other negotiated preferences and subordination arrangements, (iii) a fair means of proposing and approving restructuring initiatives, and (iv) the ability to challenge pre-insolvency transactions in a manner that accords with international norms.

10. Ability to contract freely, with minimum prescription by statute.

Markets with greater private equity investment afford private equity investors and their investee companies sufficient flexibility to execute their strategies efficiently, including allowing a business and its investors to contract freely, to freely negotiate the terms of loans, bonds, shares and other securities, and to choose foreign law to govern their contracts, with the goal of providing businesses and their investors with the freedom to implement transaction structures and instruments that incorporate best available practices for their industry.

The intended use of the EMPEA Guidelines is as a tool for more informed and constructive exchanges among private equity firms, their investors and regulators in both developed and developing markets. The supporting material that follows provides further clarification and detail on the Guidelines framework. Additional information related to the Guidelines is available from EMPEA (www.empea.org).

1. Effective, clear and flexible corporate and securities laws

Private equity investment will be more robust in markets with clear and concise corporate and securities laws that promote capital growth and encourage good corporate governance. Corporate and securities laws optimal for private equity investment are designed to provide liquidity to businesses and their investors, to foster fundraising through public offerings, to encourage local and international listings and to promote the development of local capital markets.

Issues particular to private equity investment preferably addressed in such laws include (i) limited liability for investors who provide capital, but do not take an active role in the management of the investment vehicle, (ii) the ability to flexibly negotiate equity and debt interests in both corporate and partnership structures, (iii) mandatory disclosure of directors' and officers' conflicts of interest, (iv) directors' and officers' fiduciary duties, (v) reasonable protections for minority investors, and (vi) flexibility with respect to share repurchases, treasury shares and distributions of cash and other assets. Recommended features include:

1.1 Promotion of liquidity

(a) Frameworks for that allow for public offerings, including international listings;

(b) The development of local capital markets; and,

(c) The freedom to transfer shares or other interests without significant restrictions or costs.

1.2 Limited liability for investors

(a) The limitation of liability for investors who provide capital but do not take an active role in the management of the investment vehicle; and,

(b) Different forms of legal entities, such as corporations, limited liability companies, limited partnerships, general partnerships and limited liability partnerships that allow for the limitation of liability and corporate or flow-through taxation.

1.3 Ability to flexibly negotiate equity and debt interests

(a) Different classes of equity securities and debt interests in both corporate and partnership structures, including preferred shares, whose rights can be freely defined and contractually defined partnership interests;

(b) Mandatory disclosure of directors' and officers' conflicts of interest; and,

(c) Directors' and officers' fiduciary duties.

1.4 Reasonable protections for minority investors

(a) The enforceability of customary minority protections embodied in constitutive documents, e.g., shareholders' agreements, regardless of their governing law;

(b) A mandatory tender offer for all shares following the direct or indirect acquisition of more than 50% of the shares of a public company;

(c) Well-defined and enforceable concert party rules;

(d) Reasonable processes to approve and implement corporate actions; and,

(e) Required timely preparation and adoption of financial statements and reporting of financial results.

1.5 Reasonable flexibility with respect to transfer and sale of shares and/or assets

(a) Allowances for share repurchases, treasury shares and distributions of cash and other assets; and,

(b) Clear and fair procedures for winding up legal entities that take account of the interests of all interested persons, including shareholders and creditors.

2. Conformity to international standards of business integrity and anti-corruption

In addition to adopting international conventions and national legislation to combat corruption and money laundering, regulators should demonstrate effective enforcement and support a culture of business integrity, transparency and anti-corruption.

To maintain a strong legal and contractual basis for commerce and investment, bribery and corruption must be combated at all levels, but most particularly in the judiciary, where failure in this respect erodes the rule of law and the basic tenets on which a successful economy are based. Specific recommendations in this regard include:

2.1 Conformity with international anti-corruption and integrity standards

EMPEA encourages formalized practices and procedures that conform to international conventions and standards, such as the OECD Anti-Bribery Convention, the OECD's 2009 Anti-Bribery Recommendations and the UN Convention against Corruption and other internationally recognized standards.[1]

2.2 Comprehensive enforcement regimes

Implementation of a comprehensive enforcement regime of anti-corruption laws and procedures that include clear and measurable standards, strategies and goals for business integrity and combating corruption, implemented by:

(a) Credible leadership and high-level support for enforcement;

(b) Centralised planning, strategy and accountability;

(c) Effective local devolution of plans for anti-corruption procedures and accountable monitoring (including a transparent chain of responsibility);

(d) Guidelines and benchmarks enforced by government at the local level; and,

(e) A periodic means of changing those responsible for enforcement (i.e., a 'changing of the guard' to enhance accountability).

2.3 Special attention to combating corruption within the judiciary

An anti-bribery regime should include comprehensive rules prohibiting the bribery of judges, bailiffs and other court officials, and such rules should be strictly and systematically enforced by the criminal justice system.

2.4 Public procurement rules

Public procurement rules should be consistent with international norms and should be adhered to in practice.

2.5 Whistle blowing

In addition, countries should consider a supportive approach to whistle blowing, including name and shame practices such as www.ipaidabribe.com.

1 OECD Anti-Bribery Convention; OECD 2009 Anti-Bribery Recommendations; UN Convention Against Corruption.

3. Clear, consistent and internationally competitive taxation

Markets optimal for private equity investment also feature tax systems that promote the long-term growth of capital and allow foreign and domestic private equity investors to pool their capital in an investment vehicle.

Key features of such tax systems minimize the risk of onerous treatment of foreign investors, e.g., protection from additional or double taxation at the level of the vehicle or on distributions by the vehicle as well as certainty with respect to the local tax liability. Tax filing obligations in such systems are not unnecessarily onerous and there are minimal delays in refunds of withholding tax where a country agrees not to exercise its taxing right in respect of payments to, or on disposals by, foreign investors. Specific aspects of tax systems that accommodate the private equity investment model include:

3.1 Flow through taxation of investment vehicles and certainty with respect to local tax liability

(a) In many jurisdictions, private equity investments are made through investment vehicles that are not themselves taxed, such as limited partnerships. Investors who are limited partners are taxed on their share of income and capital gains generated by the limited partnership (whether or not any distributions are made to limited partners).

(b) Allowing for such taxation avoids an element of double taxation of profits, thereby promoting specialized and professionally managed capital pools, providing diversification benefits to investors and providing certainty for investors with respect to taxation.

(c) It should be clear to foreign investors whether they are subject to local taxation in respect of any activity or investment (subject to any treaty relief), the applicable rates of taxation and the method of calculating the tax liability.

3.2 Limitation of the potential for double taxation of foreign investors

Measures that will reduce the likelihood of double taxation for foreign investors include:

(a) Application of anti-avoidance rules (e.g., anti-treaty shopping rules) in a manner that can be understood and predicted by private equity investors;

(b) A clear and consistently applied set of requirements for claiming treaty benefits and a streamlined process for foreign investors to claim withholding tax refunds or withholding tax exemptions, including avoiding the requirement that foreign investors with a multitude of beneficial owners (e.g., pension plans) produce unnecessarily extensive information about their ultimate beneficial owners in order to claim such refunds or exemptions;

(c) Not treating foreign investors as having a taxable presence in a country unless it is established that they are carrying on business in that country through a permanent establishment, as defined in the OECD Model Tax Convention and the Commentary to the Model Tax Convention;[1]

(d) Consistency with the OECD's interpretation in application of the provisions of their double tax treaties (e.g., in determining the source of capital gains and investment income so as to allow the proper functioning of the double taxation treaty network);[2]

(e) Establishing rates of withholding taxes on interest and dividends paid to foreign investors that are no higher than the OECD average;[3]

(f) Treatment of foreign-established and domestic-established limited partnerships as tax transparent vehicles for domestic tax purposes and for purposes of applicable double tax treaties;

(g) In cases where investments pass through a tax transparent vehicle located in a third country, application of the tax treaty between the country in which the investment is located and the foreign investor's country of residence; and,

(h) Attribution of capital gains and investment income arising from investments to the jurisdiction of the foreign investor rather than the jurisdiction in which assets are located, or where assets are managed (i.e., a safe harbour rule for income and capital gains arising from portfolio investments or as a result of investment managers' decisions made in the jurisdiction in which the assets are located).

1 OECD Model Convention with Respect to Taxes on Income and Capital, 2003; 2010 Update to the Model Tax Convention.
2 OECD Model Convention with Respect to Taxes on Income and Capital, 2003.
3 OECD Tax Database, Section C Corporate and capital income taxes.

3.3 Other tax issues for consideration

(a) Countries seeking to encourage private equity investment should assess whether domestic tax rules discourage or impede domestic investors from pooling their capital with foreign investors.

(b) Countries should assess whether foreign investors are subjected to taxation that is more burdensome than the taxation to which local investors in the same circumstances are subject;

(c) If a stamp duty regime applies, securities that are substantively similar in nature are ideally treated the same for stamp duty purposes so as to avoid creating a bias for or against the transfer of securities of a particular form;

Countries should also consider:

(d) Abolishing the taxation of unrealised gains and other forms of 'phantom income';

(e) Avoiding using import duties as a tool to reduce the price competitiveness of imported goods;

(f) Providing a stable and predictable duty regime to facilitate the accurate forecasting of supply and demand;

(g) Ensuring the existence of a comparatively competitive and user-friendly regime of corporate taxation;

(h) Ensuring that methods of assessment for corporate taxation are transparent, predictable and include standard reliefs;

(i) Ensuring that foreign investors can obtain binding tax rulings, which afford certainty in regard to the manner in which investments are taxed;

(j) Consistently applying 'transfer pricing' and other similar rules with respect to the deduction of royalties, interest, management fees and other deductible expenses incurred by portfolio companies;

(k) Not imposing significant import duties on equipment imported for the purpose of capital investment; and,

(l) Providing for depreciation and amortisation deductions for wasting assets, goodwill and intangibles in line with OECD norms.[4]

4 OECD Model Convention with Respect to Taxes on Income and Capital, 2003.

4. Reliable and consistent approach to dispute resolution and enforcement

Given that private equity investments often take the form of minority stakes with influence but not control, reliable, consistent, fair and efficient dispute resolution mechanisms are critical, including the recognition and enforcement of arbitral awards and foreign court judgments in accordance with international norms.

4.1 Reliable and fair mechanisms for dispute resolution, including arbitration

Legal systems should provide a reliable, predictable, fair and timely forum for dispute resolution in support of both the enforcement of contractual obligations and the rights of shareholders.

4.2 Recognition of arbitration proceedings and enforcement of local arbitral awards

Arbitration proceedings should be recognized and respected, and local arbitral awards enforceable. Parties to contracts governed by local or foreign law should be permitted to agree that disputes will be settled through arbitration, including in the local country or in a foreign jurisdiction.

(a) Legal systems should be arbitration-friendly, with arbitration laws that set out clear ground rules for arbitrations conducted within the jurisdiction, safeguarding the privacy of the proceedings and the autonomy of the tribunal's decision-making. A useful precedent for pro-arbitration legislation is the UNCITRAL Model Law on International Commercial Arbitration, which has been adopted by a number of arbitration-friendly countries.[1]

(b) Court interference in local arbitrations should be kept to an appropriate minimum. For example, it should be possible to call upon local courts to compel arbitration, or enforce orders for provisional relief, such as freezing injunctions.

(c) With respect to foreign arbitrations and court proceedings, interference should in general be avoided, unless this serves to support the foreign proceedings.

4.3 Recognition and enforceability of foreign court judgments and arbitral awards

(a) Legal systems preferably ensure that foreign court judgments or foreign arbitral awards can be enforced against assets located in the jurisdiction.

(b) Enforcement of foreign court judgments and arbitral awards generally should be based on treaty arrangements between states that provide for reciprocal recognition and enforcement of judgments or awards from other states. Conformity with internationally-recognized standards and conventions is strongly preferred. Countries should consider membership in the International Centre for Settlement of Investment Disputes (ICSID) and ratification of the 1958 New York Convention on Recognition and Enforcement of Arbitral Awards, both of which are addressed in greater detail in 4.6 and 4.7 below.

(c) Local courts' power to refuse enforcement of a foreign judgment or arbitral award should be limited to narrow grounds, avoiding reconsideration of the merits.

(d) Local arbitral awards should only be subject to challenge on narrow grounds, such as the award having been obtained by fraud.

(e) Countries should also consider the availability of effective mechanisms in practice, such as the ability to seize cash or assets, for the purpose of satisfying awards.

4.4 Consistent, predictable, transparent and efficient legal systems

Legal systems themselves are ideally consistent, predictable, transparent and efficient, with an effective system of courts, laws, politics and administrative practices with clear and stable rules for the handling of disputes. Experience shows that adequate resources need to be provided by the state in order to ensure an efficient judicial and administrative system.

Specifically, private equity investment will be more robust in countries with systems in which:

(a) Courts are independent from political interference and neutral, even where the state or a state-owned entity is party to a dispute;

(b) There is effective training of the judiciary and administrative staff, including, among other things, appropriate anti-corruption policies;

(c) Court procedures, including relevant appeals, are reasonably swift and mediation and out-of-court settlements are encouraged; and,

(d) Court systems are open and the reporting of rulings and judicial decisions are available to the public, some-

1 UNCITRAL Model Law on International Commercial Arbitration.

times made possible by either public or private funding for the creation of court reports and for their dissemination. Web-based solutions may be of assistance in this regard, but consideration should be given to whether publication in electronic form will ensure accessibility throughout the relevant country.

4.5 2005 Hague Convention on the Choice of Court Agreements

(a) Other than within Europe and in certain countries of the former Soviet Union, there are no multilateral treaties for the enforcement of foreign court judgments. The 2005 Hague Convention on the Choice of Court Agreements aims to change this by providing, amongst other things, that a judgment given by the chosen court in a contracting state must be recognised and enforced in principle in all other contracting states.[2]

Both the US and the European Union have signed the Convention, and ratification of the Hague Convention would be an extremely positive sign for a country. The Hague Convention requires two accessions or ratifications to enter into force.

4.6 International Centre for Settlement of Investment Disputes

If they have not already done so, countries should consider becoming members of ICSID (International Centre for Settlement of Investment Disputes) and signatories to the ICSID Convention.[3]

(a) Membership in ICSID and enforcement of its awards may send a positive signal to potential investors that their investment is protected by an effective dispute resolution mechanism. An arm of the World Bank, ICSID was created by the ICSID Convention, a multi-lateral treaty ratified by more than 140 states. ICSID has proven to be a successful body under whose rules and regulations disputes between contracting states and foreign investors from other contracting states can be resolved.

(b) The majority of disputes are referred to ICSID via bilateral or multilateral investment treaties, which require one state to create favourable conditions for investors from the other state(s), or via a state's national investment legislation.

(c) ICSID allows for more transparency and more public participation than most other forms of international commercial arbitration. It operates within an autonomous jurisdictional system: local courts cannot support or intervene directly. Awards cannot be challenged locally, but must be brought before a second ICSID panel, which is an ad hoc committee that hears annulment proceedings. An ICSID award is directly enforceable in a contracting state as if it were a local court judgment.

4.7 New York Convention on Recognition and Enforcement of Arbitral Awards

If they have not already done so, countries should consider ratifying the 1958 New York Convention on Recognition and Enforcement of Arbitral Awards.[4]

(a) The New York Convention is a pro-enforcement treaty that facilitates recognition and enforcement of foreign arbitral awards in countries that have ratified the Convention. It also restricts the grounds on which local courts can refuse enforcement by eliminating, for example, non-enforcement due to alleged errors of fact or law.

(b) The New York Convention is the main reason arbitral awards are more readily enforceable abroad than court judgments, making arbitration the prevailing method for resolution of international commercial disputes. Adopted by the UN in 1958, it has been ratified by more than 140 countries and is the law in most nations. Ratifying the New York Convention should indicate to potential foreign investors a country's desire to show that arbitral awards obtained elsewhere can be enforced against local assets.

(c) As noted in 4.7(b) above, ratifying the New York Convention alone will not make enforcement easier if effective practical mechanisms for enforcement do not form part of a country's legal regime. That said, a party is indisputably better off with a New York Convention-based right to enforcement. Without it, the party may need to sue on the foreign arbitral award as evidence of a debt, which is a cumbersome method of enforcement that is best avoided.

2 The Hague Conference on Private International Law, Hague Convention of 30 June 2005 on Choice of Court Agreements.
3 ICSID Convention, Regulations and Rules; List of ICSID Convention Signatories.
4 New York Convention (United Nations).

5. Non-discriminatory treatment of cross-border investment

Flows of private equity capital are often international in nature, due to the pooled structure of most vehicles and the need to accommodate investors from multiple jurisdictions.

Environments attracting robust private equity investment are therefore minimally discriminatory in terms of:

- Foreign ownership of assets (i.e., only as necessary to protect legitimate national interests);
- Investments abroad by domestic investors; and,
- Fundraising and promotion by foreign private equity managers to institutional and other sophisticated investors within the country.

Additionally, such regimes allow for currency convertibility at market-based or dependably managed rates of exchange and movements of currency in and out of the country, and provide for a fair and flexible means of allowing foreign expertise to operate locally.

5.1 Minimal restrictions on cross-border investment

EMPEA's primary concern for cross-border investment is to allow investors to determine the efficient allocation of capital without undue legal or regulatory restraints. While many aspects of that concern are reflected in the other Guidelines, this Guideline concerns cross-border investment, including restrictions on foreign ownership, restrictions on investments abroad, fundraising restrictions, currency convertibility (which includes the ability to freely repatriate funds) and the ability of a foreign investor to operate freely in another country.

5.2 Minimal restrictions on foreign ownership of assets

Countries seeking to encourage international and domestic private equity investment should place minimal limitations on foreign ownership of assets, including public companies.

(a) As a general matter, any restrictions should be clearly defined and limited to majority control of those assets that are reasonably critical to a country's national security.

(b) Where requirements for the disclosure of information by foreign investors are reasonably warranted for a country's national security, such requirements should be transparent and clear to foreign investors.

(c) Investment treaty obligations should have the force of law and be applicable to all government departments in a country. Where applicable, countries should comply with agreed conditions in respect of the World Trade Organisation and other international bodies that serve as the framework for the international economy.

5.3 Minimal restrictions on investments abroad by domestic investors

Countries may opt to restrict investments in private equity due to liquidity concerns or other issues applicable to the private equity industry as a whole, but, with respect to the regulations applicable to sophisticated investors, should not distinguish between private equity asset managers located domestically or abroad. Markets in which private equity is most robust allow sophisticated investors to choose the best managers for their investments regardless of where they are located.

5.4 Independently managed fundraising and promotion

Private equity managers who have taken appropriate advice and are complying with local law should be permitted to manage their own fundraising, particularly in respect of sophisticated investors.

(a) In many jurisdictions, a private placement exemption allows for private equity interests to be privately placed without the requirement to register locally or to use a local broker, or there being other onerous restrictions on fundraising.

(b) In some jurisdictions, hiring a local broker, custodian, depositary or valuation agent creates an additional expense for a private equity fund that is likely to impede the efficient allocation of capital.

5.5 Currency convertibility

A monetary and fiscal regime optimized for private investment of any kind, including private equity, provides for:

(a) A transparent and easy framework for the conversion of funds to local currency;

(b) Unrestricted convertibility of the local currency into foreign currency and the unrestricted repatriation of funds; or,

(c) If restrictions on convertibility are necessary, an efficient, swift and transparent means of conversion that does not discriminate against foreign investors.

(d) Rates of exchange should be market-based or transparent and dependably managed so that foreign investors are not at a disadvantage to their local counterparts.

5.6 Ability of foreign expertise to operate locally

An optimal visa and work permit regime for foreign employees is flexible, transparent and easy to use, and:

(a) Has minimal restrictions on foreign service providers, such as law firms and accountants, to promote the free exchange of information and expertise;

(b) Has a common set of statutory protections for foreign and domestic employees that strike a sensible balance between the rights of the employers and employees, including with regard to non-competition and non-solicit arrangements;

(c) Allows fund sponsors to incentivise their employees through employee stock incentive schemes, stock option plans, carried interest plans and similar arrangements;

(d) Allows foreigners holding work permits to maintain their visas when switching employers through a streamlined, simplified visa transfer process; and,

(e) Provides for the issuance of landing visas for business travelers on arrival.

6. Efficient, transparent and fair regulatory environment

Private equity will thrive in markets where the regulatory regime is clear, efficient, transparent, independent and fair. In such markets, there are minimal restrictions on allocations to private equity as an asset class and regulation of the asset class itself is linked to identifiable policy objectives, such as the encouragement of appropriate standards of behaviour in the financial sector, the maintenance of stable financial markets, the discouragement of anti-competitive behaviour and other internationally recognized policy objectives.

A country's regulatory regime can either facilitate an attractive investment environment or through lack of transparency and opportunities for arbitrary decision-making, create the conditions for an environment that limits growth and is conducive to corruption.

6.1 Conformity with international accounting standards

(a) Countries should consider adopt International Accounting Standards (IAS) or Generally Accepted Accounting Principles (GAAP) in conformity with international standards.[1]

6.2 Minimal use of regulatory requirements to restrict foreign investment

(a) As with foreign ownership restrictions, restrictions of foreign private equity investment should be clearly defined and limited to majority control of those assets that are reasonably critical to a country's national security.

(b) Where requirements for the disclosure of information by foreign investors are reasonably warranted for a country's national security, such requirements should be transparent and clear to foreign investors.

(c) Investment treaty obligations should have the force of law and be applicable to all government departments in a country. Where applicable, countries should comply with agreed conditions in respect of the World Trade Organisation and other international bodies that serve as the framework for the international economy.

6.3 Minimal restrictions on allocations by domestic investors to private equity funds

(a) Countries should not unduly restrict asset allocations to private equity or the ability of financial institutions to seed and/or sponsor private equity funds. Restrictions based on liquidity should be relative to the size of a given pool of investable assets and its liquidity constraints.

6.4 Minimal restrictions on investment strategies

(a) Countries should avoid unduly onerous regulatory restraints on private equity investment strategies. Any regulations applicable to investment strategies should:

(i) Allow for relative freedom of investment strategy for sophisticated investors; and,

(ii) Provide for appropriate valuation methodologies that take into account the illiquid nature of private equity assets.

6.5 Competition and anti-trust rules

(a) Competition and anti-trust regulations should be efficient, transparent and fair and feature transaction approval processes that are efficiently dealt with by a body independent of politicians.

(b) Decision makers and their staff involved in approval processes should be adequately trained to deal with the complexity of competition and anti-trust matters.

6.6 Minimal barriers to domestic credit markets

(a) Countries should minimise or remove formal or informal barriers to foreign investors' access to domestic sources of credit, including not only domestic commercial banks but also non-bank financial institutions and other alternative domestic sources of credit.

6.7 Efficient, fair and transparent sector level regulations

(a) As a general matter, a country's regulatory framework for a given industry should be efficient, transparent and fair, with limited amounts of discretion exercisable by regulators and clear principles to guide the exercise of any discretion and appeals procedure.

(b) In the financial sector, the regulatory framework should encourage appropriate standards of behaviour by participants in that sector, stable and liquid financial markets, and an appropriate balance between investor protections and business innovation and development.

1 International Accounting Standards; Financial Accounting Standards Board GAAP.

6.8 Open and transparent public appeals processes

(a) Public appeals processes should be efficient, transparent and fair. The existence of processes for public appeals, and their effectiveness and transparency, may have a significant effect on the quality and openness of regulatory frameworks and decision-making processes.

(b) Such processes may also result in regulatory, planning and licensing decisions relevant to an investment being subject to public challenge or review.

6.9 Availability of financial information

(a) To assess the financial risk of an investment, investors require access to complete and accurate financial information. Investors also seek monetary and fiscal regimes that are both transparent and predictable. Restrictions on the availability of such information make the assessment of risk more difficult and are an impediment to inward investment.

(b) Further, investor confidence is quickly undermined if financial data is not equally available to all interested persons or is unreliable.

(c) A country's monetary and fiscal policy must be both transparent and predictable. An investor will assess the merits of an investment on the basis of a particular fiscal and monetary environment; unexpected increases in interest rates or taxes will pose problems for inbound investment.

6.10 Efficient, transparent and fair licensing regimes

Licensing processes should not be used as an obstacle to investment or development of an industry. Instead, efficient licensing processes can be a selling point for a jurisdiction.

7. Transparent and reliable rules for expropriation

As expropriation poses a direct danger to the preservation of capital in an investment, private equity investors seek very clear rules around the specific circumstances in which the state is permitted to expropriate private property and the way in which investors must be compensated when such expropriation occurs. Any such laws should be consistent with a country's multilateral and bilateral investment treaty obligations, as well as international norms.

7.1 Minimal risk of expropriation

Expropriation by the state must be limited to justifiable instances of national security, public health and safety or other similar examples, consistent with international norms and investment treaty obligations.

7.2 Clear and fair rules

Expropriation must be based on transparent, explicit and well-defined terms and conditions.

(a) Private property should be enshrined as a constitutional right, and any encroachment on private property by the state, including by way of expropriation, should occur only where the state is permitted by law to do so.

(b) Expropriation should occur only where it is in the public interest, which has been pre-defined in a transparent and clear manner by the legislature.

(c) Expropriation should be non-discriminatory and based on rules that define the terms and conditions for the expropriation and the process to be followed, including the determination of the compensation.

7.3 Right to compensation

Investors should have a right to fair compensation in cases where expropriation occurs.

(a) The determination of fair compensation should be made by an independent party acceptable to both parties.

(b) Compensation for expropriation should not be calculated based on general and abstract conditions, but should take into account the individual context, including the actual loss, the loss of lawful gains, and the economic implications of the expropriation for the public interest.

(c) Fair compensation should not be limited to an asset's purchase price, but should also take into account reasonable damages incurred due to of the expropriation process itself.

7.4 Right to independent review

Investors should have a right to an independent review of any expropriation and any such review should be fair and timely.

(a) Investors subject to expropriation should be able to contest the legitimacy of the expropriation and the terms of the proposed compensation before a court or other independent judicial body.

(b) The state should not exercise any influence over bodies carrying out valuations, or over any judicial body assessing the legitimacy of the expropriation or the adequacy of compensation.

8. Stable and fair framework for property rights

A stable framework for property rights is pivotal to investment in privately held companies and assets, therefore investors seek a framework that provides: (i) an accessible and easily searchable means of (a) recording title to real property, mortgages, liens and other security interests and (b) obtaining basic information concerning local companies, (ii) a cost-effective means of transferring title to real property and shares in local companies and registering a security interest, and (iii) the protection of intellectual property rights.

In addition to a general acceptance of the legitimacy of the system of property rights at the highest levels of government, investors seek a framework that provides for complete and accurate information concerning property and securing title, including:

8.1 Clarity of property rights and efficient and prompt property rights enforcement

(a) Clarity of property rights and of co-ownership/shareholders' rights; and a degree of formality that encourages legal clarity and reduces the scope for disputes (e.g., requirement of a written instrument, or involvement of a notary);

(b) Enforcement of property and co-owners'/shareholders' rights, which should be efficient, prompt and cost-effective;

8.2 Effective systems for property registration

(a) An effective system of property registration that is accessible and/or public, at a cost and in a timescale that does not discourage transactions, and a similar system for providing basic information concerning local companies, limited partnerships and other legal entities;

(b) Reasonable and transparent costs of registering/transferring property, including stamp duty, registration fees and taxes;

8.3 Security interests

(a) Clarity with respect to the rights of the holders of security and a degree of ease in enforcing security interests; and,

(b) The ability of an offshore lender to secure its loans using local collateral, and have the ability to perfect and enforce that security interest in a manner that is equivalent to the means afforded to domestic lenders.

8.4 Intellectual property rights

(a) A stable and fair system of intellectual property rights that includes a high level of protection, efficiency of the registration process and an enforcement and dispute settlement mechanism for intellectual property;

(b) Signatory status of the country to the WTO TRIPs (Trade-Related aspects of Intellectual Property rights) agreement and national legislation for implementation; and,[1]

(c) Signatory status of the country to the Patent Cooperation Treaty for Inventions, the Madrid system for trademarks and Hague system for industrial design.[2]

1 World Trade Organisation, Trade Related Aspects of Intellectual Property Rights (TRIPS).
2 Patent Cooperation Treaty for Investments, World Intellectual Property Organisation; Madrid System for the International Registration of Marks, World Intellectual Property Organisation; Hague System for the International Registration of Industrial Designs, World Intellectual Property Organisation.

9. Flexibility in insolvency proceedings and fairness for stakeholders

A rational and predictable bankruptcy regime is essential for ensuring a level playing field for investors, both foreign and domestic. Systems that protect the interests of all stakeholders feature bankruptcy regimes that provide for (i) the appointment of independent administrators in bankruptcy proceedings, (ii) the recognition of the priority of secured creditors and other negotiated preferences and subordination arrangements, (iii) a fair means of proposing and approving restructuring initiatives, and (iv) the ability to challenge pre-insolvency transactions in a manner that accords with international norms. A suitable framework for bankruptcy will include:

9.1 A suitable framework for bankruptcy

A rational and predictable bankruptcy regime is essential for ensuring a level playing field for investors, both foreign and domestic. Countries should provide for a suitable framework for bankruptcy, including:

(a) Recognition of security and a clear distinction between different classes of creditors (e.g., secured, unsecured, preferential or subordinated, and those with fixed or floating charges);

(b) Rules to ensure a company's assets are not removed from the reach of creditors upon the onset of insolvency proceedings (e.g., the 'anti-deprivation principle' in English law) and a clear system of priority in distribution of assets on insolvency;

(c) Legal principles that ensure that an insolvency officeholder cannot disregard perfected security interests other than in cases of fraudulent transfers, transfers at undervalue or security interests granted within a preference period;

(d) *Pari passu* distribution for unsecured creditors;

(e) Limited liability for stakeholders in respect of a company's debts;

(f) A clear insolvency set-off regime; and

(g) The adoption of rules relating to financial collateral similar to the EU Financial Collateral Directive.[1]

9.2 Clear and reciprocal treatment of foreign creditors

(a) In respect of foreign creditors, countries should have a clear, reciprocal, system of rules for recognition of foreign insolvency procedures and officeholders (e.g., adoption of UNCITRAL Model Law); and,[2]

(b) Treat foreign creditors on an equal basis with domestic creditors.

9.3 Independent administrators and fair proceedings

(a) A country's bankruptcy procedures should provide for independent, regulated insolvency officeholders; and,

(b) To permit the preservation of the value of a business, at least one insolvency process that involves a moratorium on action by creditors, preventing enforcement of security or an action against an insolvent company except with the consent of the officeholder or court approval, such as administration under English law or Chapter 11 of the US Bankruptcy Code.[3]

9.4 Provisions for additional security for creditors and/or that accommodate restructuring situations

Countries should consider elements of other bankruptcy regimes that provide for additional security for creditors and/or more options in a restructuring situation, including:

(a) The concepts of fixed and floating charges;

(b) The ability for stakeholders to reorganise the capital structure through an insolvency procedure; and,

(c) The ability for secured creditors to have an element of control over insolvency processes in respect of their secured assets (e.g., by appointing a receiver of secured assets or by having a right to choose the insolvency appointee).

1 2002 EU Financial Collateral Directive (2002/47/EC); 2009 Amendment (2009/44/EC).

2 UNCITRAL Model Law on International Commercial Arbitration.

3 Title 11 - United States Bankruptcy Code.

10. Ability to contract freely, with minimum prescription by statute

Markets with greater private equity investment afford private equity investors and their investee companies sufficient flexibility to execute their strategies efficiently, including allowing a business and its investors to contract freely, to freely negotiate the terms of loans, bonds, shares and other securities, and to choose foreign law to govern their contracts, with the goal of providing businesses and their investors with the freedom to implement transaction structures and instruments that incorporate best available practices for their industry.

10.1 Freedom to implement a diverse range of transaction structures and instruments

(a) A country's legal and regulatory regime should be sufficiently flexible to allow businesses to execute their strategies, including their financial strategies, efficiently.

(b) Such business flexibility can be achieved through the ability to contract freely, without statutory limitations on the types of potential transaction structures, so that businesses can employ flexible and creative financial instruments, such as convertible bonds, preferred equity, financial leasing, mezzanine financing, warrants, put and call options and a variety of other instruments.

(c) Many of these instruments can assist local companies in raising the necessary capital without the founding shareholders giving up complete ownership and/or control.

10.2 Freedom to employ jurisdictional discretion

(a) Countries should also consider the merits of allowing companies to take advantage of successful corporate regimes and structures in other legal jurisdictions.

(b) Such flexibility allows for additional avenues of investing that may actively encourage new investors to take minority stakes or debt rather than equity positions.

(c) By allowing parties to choose foreign law to govern their contracts and elect to resolve their disputes in international courts or through international arbitration, countries promote not only inward investment but also the success of local companies in the global economy.

(d) Permitting foreign investors and local companies to take advantage of the protections found in the laws of jurisdictions whose courts and laws are universally recognised as investor-friendly will assist those companies in attracting capital and growing their businesses.

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