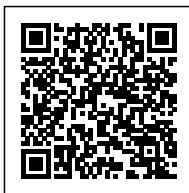


REGULATION OF PRIVATE EQUITY IN EUROPE - SJ BERWIN

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In late February, the European private equity industry was given an opportunity to present its views to the European Union on the regulatory framework which should apply to it in the future.

In front of an audience that included many strong supporters of the private equity model, industry participants and academics pointed out that private equity does not pose systemic risk and should not be put into the same regulatory basket as businesses that do.

They presented a compelling defence of the industry's business model, and submitted a detailed review of existing regulation in Europe – which demonstrated that there are already extensive rules covering most aspects of the way private equity and venture capital fund managers do business.

But, recognising the need for some change, the industry's leaders also promised to work with politicians and law-makers to establish a pan-European oversight regime for a unified, principles-based rule book.

That was a very significant promise, and one which sits well with the recommendations of another influential report published this past month – a European Commission (EC) taskforce suggests the creation of a European body to oversee policy and issue risk warnings to national regulators, and it specifically endorses the value of private sector regulation.

Recientemente, las sociedades de capital riesgo han presentado a la Unión Europea la visión que tienen sobre la envergadura e índole del marco regulador en el que deberían operar en el futuro. Los líderes de esta industria han presentado una convincente defensa de su modelo económico; no obstante, reconocen la necesidad de introducir algunos cambios. Sin embargo, comenta Carlos Pazos, socio director de la oficina madrileña de SJ Berwin, el punto clave estará en que alguien escuche. La regulación de la industria se ha puesto en prejuicio y rivalidad partidista y esto eclipsará los racionales argumentos presentados.

But the critical question is whether anyone was listening. It is clear that private equity regulation has become intensely political, and – as important European elections loom, including of the current EC President José Manuel Barroso – there is a risk that prejudice and party political rivalry will overshadow the rational arguments presented. Poul Nyrup Rasmussen, President of the Party of European Socialists in the European Parliament and architect of a report calling for greater regulation of private equity and hedge funds last year, repeated that nothing short of a hard line response from the EC will satisfy him and his colleagues. His response might substantiate what some industry commentators now point out: what matters is perception and image, not reality. And for many politicians the perception and image appears to already be fixed.

That view may be too pessimistic. Charlie McCreevy, the Internal Markets Commissioner, made it clear that he does intend to bring forward more regulation of private equity, and will produce new rules by the end of April 2009. But he has also laid out six 'lessons' which would guide his approach to that task. Mr McCreevy believes that the concerns about private equity are very different to those about other players in the financial services industry. The concern, he argues, focuses on debt levels in portfolio companies and the management of wider relationships.

The starting point for any new rules should be existing regulation and oversight, and an understanding that investors in private equity funds are sophisticated (mainly institutional) players who could undertake their own due diligence and negotiate their own terms. The first line of defence against excessive leverage should be at the source: banks should be required to manage their exposure to private equity.

McCreevy also pointed out that most concerns about private equity were not unique to it but applied to many other businesses.

The view that private equity is one of the causes of the current financial crisis, even if stated by the influential Mr Rasmussen, does seem to be a minority one. Most people also recognise that patient, intelligent capital is exactly what many businesses need at the moment, and that private equity firms are well placed to provide it.

An industry which now speaks with a coherent single voice has offered a constructive dialogue to address legitimate concerns, and is astute enough to know that more regulation is clearly on the way and needs to shape it rather than reject it. Those could prove to be the right ingredients for a system of regulation which is appropriate and proportionate. It is not just the private equity community which should hope that the optimists are proved right – Europe's economy should hope so too.

A very real risk remains, however, that what emerges from this process will be inappropriate, burdensome and stifling for private equity in Europe.

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