

OPALESQUE

PRIVATE EQUITY STRATEGIES

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Happy Spring! If you opted to download our new format, you'll see we've made some exciting changes to this month's issue. Going forward, we will be looking for ways to bring you new, and interactive content in the form of video, audio and interactive data snapshots. We also have additional content releases planned in an effort to make your reading experience richer and actionable. I hope you will share your own ideas and feedback with me about what you would like to see. Some of you already have, and these new features are a direct result of those conversations. Please keep them coming.

On to this month – we open with the launch of a new resource for GPs, LPs, and anyone involved with corporate finance. The Center for Audit Quality is working with faculty at Harvard Business School to craft case studies and videos designed to help spot corporate financial fraud.

In the Next Generation series, we report on the creation of a new academic and industry partnership the –Private Equity Research Consortium, which brings together professors from several business schools with industry professionals to build upon the body of academic research around private equity.

We bring back Tools of The Trade for a discussion with Shareholders Representative Services co-CEO Mark Vogel about a new partnership with Capital One Bank that aims to create a new market standard for deal parties on escrow and payment agent services.

Regs Watch will take a look at some recent shifts in people and priorities of international financial regulators.

Our Data Snapshot takes a look at the deep interdependence between pension funds and private equity with new analysis from the Private Equity Growth Capital Council (PEGCC).

In Movers and Shakers we talk with CEO and co-Founding Partner of Franklin Square Capital Partners, Michael Forman about nontraded business development companies, a structure of interest to private equity firms and investors alike.

And finally, as always, Quick Hits will look at recent fund news from around the globe. Happy reading.

Sincerely,
Bailey McCann
Editor
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Center for Audit Quality Establishes Case Library To Guard Against Financial Fraud

Bailey McCann
Private Equity Strategies

In the fight against financial reporting fraud, members of the financial reporting supply chain have a new tool to advance their fraud deterrence and detection capabilities. The Anti-Fraud Collaboration – the Center for Audit Quality (CAQ), Financial Executives International (FEI), The Institute of Internal Auditors (The IIA) and the National Association of Corporate Directors (NACD) – have published the “[Hollate Manufacturing Case Study](#),” a study of a potential material fraud at a fictitious public company in order to raise awareness of environments in which financial reporting fraud might flourish. The case study and a companion discussion guide provide a roadmap to help audit committees, financial executives, and internal and external auditors engage in interactive discussions on what could have been done to mitigate the risk of fraud.

“Historically, financial reporting fraud is the workplace fraud that has had the highest cost impact on public companies,” said CAQ Executive Director Cindy Fornelli, in an interview with Private Equity Strategies. “All parts of the supply chain need to have a healthy skepticism about what they see.”

To that end, this group of partners is working with Harvard Business School faculty to create a case library that walks investors and firms alike through indicators of financial fraud. The CAQ released a guidebook along the same lines earlier this year. All of the materials including video will be made available for free. The discussion manual will only be made available to professionals trained on the case study method in an effort to aid teaching programs.

“The second case will look at what you can do if you suspect that there is fraud taking place,” Fornelli says.

Video will also be a key component of the resource. The videos feature insight from Willis Emmons, Senior Lecturer and Director of the Christensen Center for Teaching and Learning at the Harvard Business School. The videos also feature V.G. Narayanan, Thomas D. Casserly, Jr., Professor of Business Administration at the Harvard Business School, leading a discussion of the Hollate Manufacturing Case Study.

In all, the [resource library](#) is designed to help both potential investors and employees in firms guard against fraud. The guide lists a number of recommendations including setting clear ethics guidelines and ensuring that there aren't incentives for fraud. It also notes that setting up options for whistleblowers could be advisable to give employees a means of reporting possible fraud.

Unable to view the video?
[Watch here.](#)

The inclusion of whistleblowers in the list of recommendations is notable in light of recent actions in the federal government and the third circuit court around whistleblowing. Some observers have noted that investigations and indeed prosecutions of financial fraud have dropped off since the early 2000s. However, there are some indications that may be changing.

According to the SEC, one of its biggest areas of fraud in 2012 was accounting. The regulator is also adding new technology to help officials analyze accounting reports. A recent [Forbes piece](#) also notes an uptick in the number of accounting re-statements, which have previously been indicators of fraud.

In March, the Third Circuit Court also reversed a decision to rule in favor of whistleblowers that report fraud with good faith intentions. While the rulings have been controversial, legal authors Debra S. Katz and Matthew LaGarde [write in the National Law Journal](#), that the court is actually on the right track in creating an environment in which whistleblowers feel protected in coming forward. In that piece, they argue that one of Sarbanes-Oxley's "most potent tools to prevent future economic catastrophes is its whistleblower provision."

"Financial reporting fraud has a profound negative impact on investors' confidence in public companies and the capital markets," says Fornelli, "we want to help people be able to see the red flags on their own."

*Video Source: CAQ

New Report From Ernst & Young Highlights Evolution in Private Equity Firm Operations In Response To New Demands:

A [new report](#), "Positioning for an upturn: The institutionalization of private equity operations" explores how a growing economy is creating new business opportunities for the private equity industry. Authored by Ernst & Young, the report which includes interactive graphics and video, looks at the changes in the operational structure of private equity firms in response to growing regulatory and investor demands. At the same time, the shift to more complex operations requires increased sophistication of talent and resources to keep pace with client needs and compliance regulations.

These shifts offer many members of the executive team, especially private equity chief financial officers (CFOs) and chief operating officers (COOs), an invaluable opportunity to increase their visibility and clout within their organizations.

"Nearly every firm is now faced with choosing the most effective tools, technologies and operational processes to support their people over the next several years," said Samer Ojeh, a principal in the Financial Services Office of Ernst & Young LLP. "Executives need to keep in mind an important facet: the transformation of an organization's operating model is not a process that will ever really be 'complete.'"



The Next Generation: Scholars Join on the Private Equity Research Consortium

By: Bailey McCann
Private Equity Strategies

Scholars from the Universities of Chicago, Oxford, North Carolina and Virginia have come together to launch the Private Equity Research Consortium (PERC). The goal of the consortium will be to bring together scholars and industry professionals to improve data on and understanding of private equity.

In our [January issue](#), we discussed similar, albeit single school efforts underway at Harvard Business School and the London Business School. Professors at both institutions lead their own research institutions on private equity, although it is unclear if they will work with the PERC or just alongside them.

PERC will be housed at the University of North Carolina Kenan-Flagler Business School. Funding for the corporation was provided by the UAI Foundation, a non-profit foundation devoted to supporting research in finance.

"Over the last two decades, private equity has grown to become an important part of the investment landscape, yet little is known about the industry. Historically, researchers who want to study private equity confront a major barrier: high-quality data," said Brown, Sarah Graham Kenan Distinguished Scholar and professor of finance at UNC Kenan-Flagler. "Our goal is to help remove that barrier." Portfolio management software company Burgiss, has also partnered with the consortium to provide support for data and research. James Bachman, Burgiss, director, will be the only private sector member of the five person advisory board.

Other board members include - Gregory W. Brown, University of North Carolina; Robert Harris, PERC director and University of Virginia; Tim Jenkinson, Oxford University, and Steven Kaplan, University of Chicago.

Qualified applicants may also request access to the data provided through the consortium. PERC will also be holding a conference this November at UNC-Chapel Hill.

Private Equity Magnate Steven Schwarzman Launches Chinese Scholarship Fund

According to a BBC report, Stephen Schwarzman has launched a \$300m scholarship program to send post-graduate students to study in China every year. The program aims to send approximately 200 students each year.

The initiative is backed by western private companies, \$100m of Schwarzman's own money and academic interests that hope to build bridges between the two countries going forward.

Tools Of The Trade: Deal Parties Capture Value With New Escrow & Paying Agent Service

By: Bailey McCann, Private Equity Strategies

Maximizing the value of M&A consideration set aside in escrow, often millions of dollars, has historically been an afterthought for parties hustling to get deals done. However, SRS | Shareholder Representative Services, a post-closing expert for private-company mergers and acquisitions, has re-engineered M&A escrow, paying agent and investment services in an effort to streamline the process. SRS partnered with Capital One Bank for the market-wide launch of Acquiom, the company's answer to M&A escrow services.

"Acquiom is focused on common M&A escrow and paying agent pain points that we've seen across more than 400 deals," said Mark Vogel, co-CEO of Shareholder Representative Services, in an interview with Private Equity Strategies.

Acquiom was designed from the ground up with input from hundreds of buyers and sellers to provide simple documentation, fast payments, reduced transaction costs and competitive interest rates on deposits. Through operational efficiencies and simplified forms, merger parties can save tens to hundreds of thousands of dollars per deal in transaction fees, spend less time on documentation of administrative matters, and benefit from streamlined disbursements.

"Shareholders can get paid the same day as the deal closes," Vogel says. Most payments can now go through wire transfer or electronic check rather than the more traditional process of mailing a paper check. "If you have a small shareholder, it doesn't make sense to go through the whole process of sending a check for \$200, especially when you can send a wire transfer."

Operationally, Acquiom will offer a single combined agreement for paying agent and escrow agent services, saving on paperwork. All deposits will go into an FDIC insured money market account. Tax reporting, escheatment compliance and lost shareholder services are also included at no cost.

According to Vogel, SRS partnered with Capital One on the product, which will be offering the service at no cost to its clients. "Capital one got it immediately," he says. "They are a bank focused on innovation, and they thought these services fixed key business challenges."

However, Vogel wants to make Acquiom more than a one off. "We built Acquiom to set a standard for the market." Currently, SRS has relationships with most major banks involved in these types of transactions. He also says they have plans to expand these and other services. "There are still plenty of problems to solve in the market, we plan to invest in solving them."

Regs Watch: Brief Updates on Changes in Regulation for Private Equity

As a journalists like me and lawyers have written ad nauseum, new and ever more regulations are in the pipeline for private equity and alternatives as a whole. Here we will hit on some of the cases of note and provide links to new guidance over the past month.

China NDRC Again Pushes for Control of Private Equity

The Chinese government is again urging local authorities to tighten their grip on private-equity firms. All private equity firms in the country must be registered by the end of June according to [MoneyBeat](#)

Can the SEC Demand Information From The China Arms of Accounting Firms?

The Cheung Kong Graduate School of Business, [asks](#) how far the SEC's reach extends when it comes to the international operations of large accounting firms like the Big 4. Professors argue that China has the right to decide on its own whether it will comply with US financial regulations.

Proposed German Regulation Could Drive Investors Away from REITs

According to a [recent article](#) in the Financial Times, Germany's REIT industry could face some significant challenges following a controversial decision by the country's financial regulator to deter investment in REITs from equity funds, and from countries restricting holdings of foreign funds. The decision would also raise costs for REITs that stay in operation.

Global Banking and Regulators Get Further Apart

A [controversial decision](#) by the US Fed to attempt to force the foreign subsidiaries of large US banks to hold more capital is drawing the ire of banks and investors alike who are already feeling a liquidity squeeze. The announcement has also pushed some European investors to threaten protectionist measures. The decision may also create bigger opportunities for non-bank lenders.

Changes to the UK financial services regulatory framework

The [UK's new Financial Conduct Authority](#), is now operational, along with a host of changes to the overall regulatory structure of that country. PE firms will now see a new supervisor in the space.

Oxford paper analyses effective mix of financial regulations

A [new paper](#) from Dimitrios Tsomocos of Saïd Business School, Oxford looks for the most effective mix of financial regulation in the wake of piling on by regulators in response to rolling international debt crises.

Private equity billionaire Wilbur Ross Argues For An End To Hourly Billing on Bankruptcy Filings

Wilbur Ross is tired of paying hourly for bankruptcy proceedings and is arguing for a push toward a "results based" system.

Law Firm, Greenberg Traurig, LLP Releases US Regulation Update

Attorneys for Greenberg Traurig have pulled together a [full list](#) of investment regulation changes effecting all types of investments and investment firms, not just PE.

Luxembourg Private Equity / Real Estate

Global law firm, Ogier [has released](#) a new update detailing the new landscape for private equity and real estate funds inside Luxembourg.

According to the report, Luxembourg's investment funds industry ranks as the largest EU fund domicile jurisdiction and the second largest fund domicile jurisdiction globally. After more than 30 years of development, total net assets under management of Luxembourg undertakings for collective investment and specialised investment funds stood at €2.157 trillion in January 2012.

Dodd-Frank Progress:



Movers and Shakers: BDCs Find New Life In Low Liquidity Environment

By: Bailey McCann
Private Equity Strategies

An ongoing story in the wake of 2008, is how hard it is for financially sound companies to gain access to credit after the crisis. Recently, hedge funds and private equity firms have stepped up their activities in non-bank lending, taking advantage of a growing pool of creditworthy companies who can't get loans. This is great news for accredited investors hungry for returns, who don't mind investing over a longer time horizon. Another way to invest in this space is through a business development company (BDC). BDCs have recently drawn the interest of private equity firms looking to diversify their business lines as well as investors familiar with specialty finance looking for new ways in.

There are two ways to structure a BDC – traded and nontraded. Traded entities basically act like publically traded private equity companies, giving a broader range of investors access to lucrative opportunity sets in debt and equity.

On the other end of the BDC spectrum are non-traded BDCs which work similarly to public BDCs in terms of offering access to debt and equity, but through a closed-end structure. The return from nontraded BDCs can be more attractive than their public cohorts, although they typically also come with a riskier investment profile. Nontraded BDCs are offered through independent broker-dealers.

In the immediate aftermath of 2008, BDCs hit a rough patch when the liquidity freeze hit everyone. But, in recent months the market for BDCs has picked up, with high profile announcements from the likes of Goldman Sachs, saying they planned to launch a BDC to invest in higher risk corporate debt and equity. The Goldman announcement was notable as they are the first bank to get into the BDC arena. Others in the non-traded space include big names in private equity as well, like KKR and Apollo.

BDCs are considered specialty finance operations, typically outside of the realm of banks in the classical sense. Private Equity Strategies spoke with Michael Forman, CEO of Franklin Square Capital Partners, which pioneered the nontraded BDC structure, about what this all means for investors.

Forman is a co-founding partner of Franklin Square, which is a sponsor and distributor of publicly registered alternative investment products. Franklin Square currently manages more than \$5bn in investor assets held in three BDCs. "We look at bringing true alternatives to non-institutional investors," Forman explains. "We distribute our product on a wholesale basis much like mutual funds, but through independent broker-dealers."

On the BDC side, Franklin Square's three funds focus primarily on corporate leveraged credit, energy and power. The firm works with GSO Capital Partners, a subsidiary of Blackstone as an investment advisor on its BDC funds. "We started working with GSO in 2008 before it was acquired by Blackstone. When the acquisition went through the entire team moved over, and we maintained our relationship with them as a sub-advisor," Forman says.

He explains that Franklin Square wanted to stay nontraded because it can be difficult to raise money in the public markets for BDCs like this. So far, fundraising on the nontraded side seems to be working out, according to sources familiar with the firm, – the FS Investment Corporation (FSIC) fund closed five months ago at approximately \$4.3bn. The FS Investment Corporation II (FSIC II) fund is at just under \$1bn, and the FS Energy & Power Fund (FSEP) is just over \$1bn. "We are in a continuous offering, so we raise money everyday," Forman says.



On the credit side, both FSIC and FSIC II invest in senior secured loans, unsecured debt, and equity. For investors, funds like this can bring diversity to credit positions. "These could be the long end of the bond ladder for example, and these investments are typically uncorrelated so you can get the benefit of that as well," he explains.

Once these opportunities are identified, education becomes the next hurdle for firms like Franklin Square. Forman says they spend a lot of time educating independent broker-dealers about BDCs, and what they can do for investors. Apart from being CEO, and sitting on the boards of his portfolio companies, he also leads the investment committees for the BDC funds. He says that bringing that knowledge into the education discussion can help broker-dealers better understand and explain products to investors.

"People are starting to understand BDCs, they see the opportunity. Educating our wholesalers and advisors is a cornerstone of what we do, and they appreciate that," Forman says.

Looking into the future, Franklin Square is working on a fourth fund as well as a liquidity event for FSIC. "I don't see huge drivers for growth in the US economy over the near term, but that lack of liquidity provides us with opportunities. We're going to be focused on performance and investing our capital wisely," he says.

Big Deal: Credit Suisse Sells Private Equity Unit To Blackstone

Credit Suisse Group AG has agreed to sell its private equity business to Blackstone Group, as the bank continues trying to find ways to restore the health of its balance sheet after the crisis. The unit has approximately \$9bn in assets under management.

Credit Suisse was advised by law firm Schulte, Roth & Zabel for the transaction and Blackstone involved senior leadership as well as counsel for its part. Blackstone President Tony James was also said to be involved in the deal.

Credit Suisse reported a jump in its first quarter profits already this year, by 1.30 billion Swiss francs (\$1.37 billion), up from 44 million francs a year before. The company said it was able to realize cost savings through consolidation.

Data Snapshot: Private Equity and Pension Funds

Bailey McCann
Private Equity Strategies

In our [last issue](#), we discussed the potential impact of institutional divestment around hot button issues like guns and climate change. In that piece, data showed that even if institutions like public pension funds are seeing returns from controversial investments, stigma around those investments and/or pending legislation, may in of itself prompt divestment even without a public outcry.

Now, the Private Equity Growth Capital Council (PEGCC), [has released](#) a new whitepaper detailing just how intertwined public pensions are with private equity and what that will mean for the industry. The report highlights the significant amount of capital pension funds commit to private equity and the financial gains they receive from the outperformance of these investments.

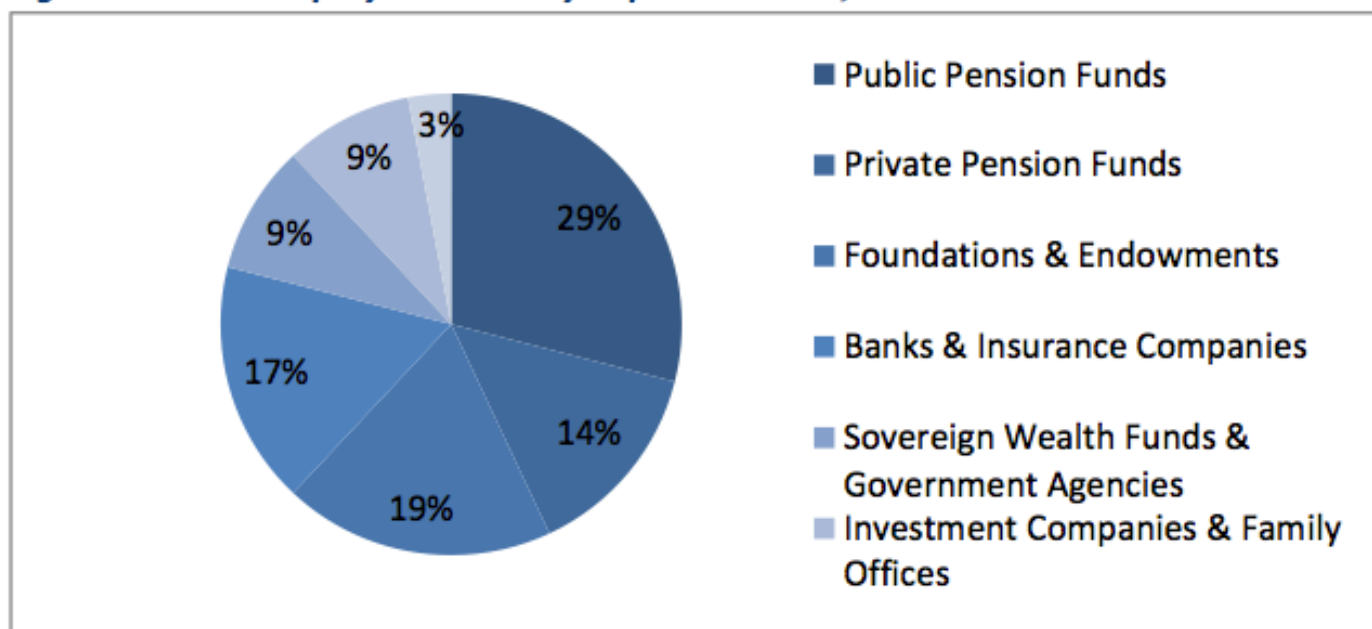
Despite losses from other investment strategies during the Great Recession, one bright spot for pensions is the superior performance of private equity funds, which helped buoy overall pension returns. The PEGCC research found that the median public pension portfolio received 8.8% in returns from private equity, compared to 3.7% in public equity and 5.7% in total portfolio returns, annually over the past ten years.

Overall, 60% of the funding available in pension funds comes from returns on investment – setting up a high-pressure situation for the directors of those funds when investments fail to return. The long-term structure of private equity investments can provide a buffer from episodic market corrections, but lengthy recessions like 2008 can depress returns.

Private equity too relies on investments from pension funds. Data in the paper shows that investments from public pensions account for 43% of all invested capital in private equity. According to the PEGCC, pensions are “essential to the private equity industry, just as private equity’s superior returns are vital to the financial health of pension funds.”

“Without private equity returns, public pension plans across the country would incur greater unfunded liability, possibly resulting in higher pension contributions by employees and a spike in taxes paid by local residents,” Bailey concluded.

Figure 1: Private Equity Investors by Capital Invested, 2001-2011



Source: Private Equity Growth Capital Council based on data from Preqin.

Quick Hits

Peter Dolan, Harvard endowment's chief of private equity and venture, leaves high-profile perch -- The Boston Globe is reporting that Peter Dolan left last week and the school has not commented on his future plans. Dolan has long been considered a PE heavy-weight.

Warburg Pincus invests in Polish cable company Inea -- the firm is eyeing big developments in a fibre-to-the-home-based network expansion. Warburg Pincus will be a strategic minority investor, but the deal itself is widely believed to be the biggest in Poland so far this year.

KPS Capital Partners buys Thilmany paper mills, the firm plans to combine both mills involved in the transaction to create one of the largest specialty paper mills in the country.

Aquiline Capital Partners Completes Acquisition of Equity Insurance Group -- Aquiline Capital Partners, a New York-based private equity firm investing in financial services, has completed the acquisition of Equity Insurance Group a market-leading specialist motor insurer based in the United Kingdom. It was purchased from Insurance Australia Group. Equity Insurance Group includes motor insurer Equity Red Star and Equity Syndicate Management Ltd., with its associated Syndicate 218 at Lloyd's, as well as the broking business Equity Direct Broking Limited.

Law firms Latham & Watkins and Joelson Wilson have landed roles on the Carlyle Group's investment in minicab company Addison Lee.

Texas Permanent School Fund, Austin, has hired Neuberger Berman Group for a \$900 million private equity strategic partnership.

MarketShare, has announced an \$38m investment led by growth equity firm FTV Capital and joined by existing investor Elevation Partners and other investors. The financing will be used to further enhance the company's state-of-the-art technology platform as well as to accelerate growth in markets worldwide.

Pamplona Capital in talks to buy Medical Park --- London-based private equity fund Pamplona Capital Management is in talks to buy a majority stake in Turkish hospitals group Medical Park, says a source close to the firm.

Events

Private Equity Investing In Apparel & Footwear Companies -- Winning Ways to Profit From The Power of Branding

May 2, 2103 - New York, NY
Hosted By: Capital Roundtable

Private Equity Investing In Healthy & Better Living Companies -- A Trillion-Dollar Market With Long-term Sustainable Growth

May 9, 2103- New York, NY
Hosted By: Capital Roundtable

Rigors of Being a P.E. Firm CFO -- How to Survive the Trials & Tribulations Best Practices for Overseeing Private Equity Administration & Compliance

May 30, 2103- New York, NY
Hosted By: Capital Roundtable

About the Editor: Bailey McCann is a reporter and analyst based in the US, with experience covering government, policy and regulatory issues in addition to her coverage of alternative investments. Prior to her work with Opalesque, she provided research and media intelligence for members of Congressional and White House offices, government contractors, and Fortune 500 companies. She has also reported on, and done policy analysis of state and local government issues. She may be reached directly at mccann@opalesque.com



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