

	<h2>Eleventh Annual Private Equity Forum</h2>
	<p><i>Raising a Private Equity Fund</i></p> <ul style="list-style-type: none">• Governance provisions: Key Person and other terms• Economic provisions: Carried Interest, Clawbacks and Management Fees• Institutional Limited Partners Association: Private Equity Principles <p>Glenn R. Sarno & David J. Schwartz July 12, 2010</p>

	<p><u>Notice</u></p> <p>These materials are for educational and illustrative purposes only and do not constitute legal, tax, regulatory or accounting advice. All statistical information used herein was derived from publicly available sources.</p>
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	<h2>Fundraising Generally</h2>
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	<h2>Fundraising Today</h2>
	<p><i>Where we were last year</i></p> <ul style="list-style-type: none"> ▪ 2009 proved to be a very challenging year for fund sponsors. ▪ Fundraising totals globally showed sharp declines. <ul style="list-style-type: none"> ▪ The marketplace, especially in the earlier part of 2009, was marked by the illiquidity of many investors, which put pressure on some general partners to defer drawdowns, created the need for expedited secondary transactions and caused defaults by some limited partners (although less than originally anticipated). ▪ These conditions resulted in an imbalance between supply and demand forces in the marketplace, putting pressure on sponsors to readjust the pricing of the terms of private equity funds.
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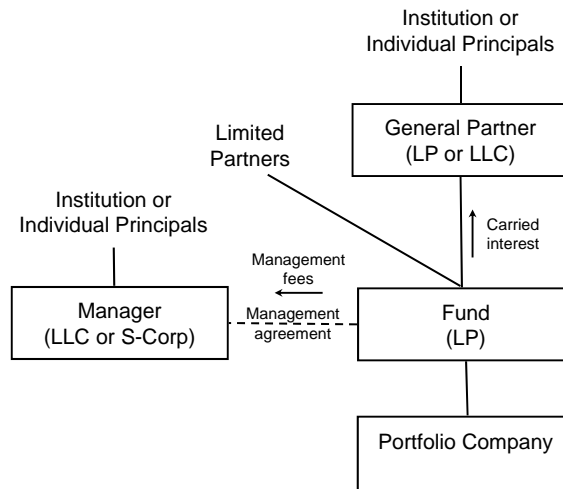
	<h2 style="text-align: center;">Fundraising Today (continued)</h2>
	<p><i>The fundraising environment appears poised to pick up some momentum.</i></p> <ul style="list-style-type: none"> ▪ More sponsors are launching new fundraisings. <ul style="list-style-type: none"> ▪ This is driven by a need to replenish available capital commitments and a desire to act upon investment opportunities created by perceived mispricings of companies under current market conditions. ▪ Funds offered by quality sponsors that were launched in 2009 are finalizing negotiations and helping to set the market for terms.
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	<h2 style="text-align: center;">Other Investment Trends</h2>
	<p><i>Are we headed in the right direction?</i></p> <p>Investor Outlook</p> <ul style="list-style-type: none"> ▪ According to a December 2009 survey, 51% of investors were slated to invest more capital to private equity in 2010 than in the year before, and only 8% of investors anticipated a reduction in private equity investing. <p>Deal Activity</p> <ul style="list-style-type: none"> ▪ Q1 announcements for new deals was \$26.6B, which was higher than any of the first three quarters of 2009. <ul style="list-style-type: none"> ▪ Small deals are dominating the deal volume, with investments in middle market companies making up 85% of the deal flow during first quarter of 2010. <p>Exits</p> <ul style="list-style-type: none"> ▪ Announcements for exits in Q1 2010 had a total value of \$25.6B. <ul style="list-style-type: none"> ▪ The continuing availability of exit opportunities will be crucial as funds strive to provide their limited partners with needed returns and more capital to recycle into new investments and vehicles.
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	Other Investment Trends (continued)
	<ul style="list-style-type: none">▪ In light of the relatively positive factors discussed, and given the extremely low levels of financial sponsor deal volume and fundraising activity in 2009, one would hope that private equity activity has nowhere to go but up. ▪ Successfully closing investors into funds requires:<ul style="list-style-type: none">▪ a more differentiated product offering (especially for first time funds),▪ enhanced and protracted diligence, and▪ more extensive negotiation of terms.
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	<p style="text-align: center;">Overview of Basic Structure and Certain Key Terms</p>
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A Simple Fund Structure



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The Fund

- “Blind Pool” investment vehicle
- Structured as a limited partnership
 - Tax pass-through
 - Limited liability

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	<h2 style="text-align: center;">The General Partner</h2>
	<ul style="list-style-type: none"> ▪ Ultimate management control over fund <ul style="list-style-type: none"> ▪ But may delegate to Manager (except buy/sell decisions) ▪ Unlimited liability ▪ Single-purpose vehicle (separate GPs for Fund I, II, III...) ▪ Generally structured as a limited partnership ▪ Ownership different for institutionally sponsored funds vs. boutiques
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	<h2 style="text-align: center;">The Manager</h2>
	<ul style="list-style-type: none"> ▪ The real “business” of the fund sponsor <ul style="list-style-type: none"> ▪ Employees, real estate, corporate goodwill are here ▪ Finds, negotiates, manages investments ▪ Receives a management fee ▪ Can manage more than one fund ▪ In boutique funds, generally structured as an LP or LLC ▪ In institutional funds, sometimes a separate subsidiary or division of the firm serves as the Manager
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	<h2>Key Person Termination</h2>
	<ul style="list-style-type: none">▪ Provision protects the Limited Partners in the event that Mr. or Ms. Big, or a certain number of Principals, leaves the Manager▪ Terminates Investment Period or Fund?▪ Automatic suspension?
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	<h2>No Fault Termination</h2>
	<ul style="list-style-type: none">▪ Provision allows the Limited Partners to vote to terminate the Investment Period (or, in some funds, to force the Fund to wind up) for any or no reason▪ Generally a percentage vote large enough (<i>e.g.</i>, 80% or 85% in interest) so that no one or two Limited Partners can force a decision on the majority of the Limited Partners
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	<h2 style="text-align: center;">General Partner Removal</h2>
	<ul style="list-style-type: none"> ▪ If a court has determined that the General Partner engaged in certain conduct (<i>e.g.</i>, conviction of a fraud or felony, material violation of the limited partnership agreement, etc.), the Limited Partners may vote to remove ▪ Generally 66-2/3% in interest required to remove ▪ No-Fault General Partner removal/ divorce – higher percentage (80-85%)
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	<h2 style="text-align: center;">Management Fee</h2>
	<ul style="list-style-type: none"> ▪ During the Investment Period, generally a fixed percentage of total Capital Commitments, paid on a semi-annual or quarterly basis; there are some variations ▪ After the Investment Period, generally a fixed percentage of total invested capital; there are some variations (write-offs, write-downs, successor funds) ▪ Reductions for other fees: directors' fees; transaction fees; monitoring fees; advisory fees; break-up fees
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	<h2 style="text-align: center;">Organizational Expenses</h2>
	<ul style="list-style-type: none"> ▪ The Fund pays all legal and other expenses incurred in connection with the formation of the Fund, generally capped at a percentage of Capital Commitments or a flat dollar amount ▪ The Manager will bear any organizational expenses in excess of the stated cap, through a 100% offset against the Management Fee ▪ Similarly, placement fees are typically borne by the Manager through a 100% offset against the Management Fee
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	<h2 style="text-align: center;">Other Expenses</h2>
	<ul style="list-style-type: none"> ▪ The Manager will pay all normal operating expenses incidental to the provision of the day-to-day administrative services to the Fund (<i>e.g.</i>, rent, utilities, salaries of the Principals and the other employees) ▪ The Fund will pay: all costs, expenses and liabilities in connection with its operations, including: fees, costs and expenses related to the purchase, holding and sale of portfolio investments (to the extent not reimbursed); expenses incurred in connection with transactions not consummated; insurance premiums; taxes; fees and expenses of accountants, counsel and consultants; costs and expenses of the Advisory Committee and the annual meeting; litigation expenses; and other extraordinary expenses
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	<h2 style="text-align: center;">Sample Distribution Waterfall</h2>
	<ul style="list-style-type: none"> ▪ <u>First</u>: 100% to the Limited Partners to return capital on realized deals, capital for [net] unrealized loss deals and management fees and other fund expenses allocable to such amounts ▪ <u>Second</u>: 8% preferred return - 100% to the Limited Partners to give them an 8% return on those amounts ▪ <u>Third</u>: GP catch-up - 100% to the General Partner to "catch up" to the 80/20 deal ▪ <u>Fourth</u>: 80/20 split - 80% to the Limited Partners and 20% to the General Partner ▪ European model: more likely to return all contributed capital prior to carried interest
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	<h2 style="text-align: center;">General Partner Clawback</h2>
	<ul style="list-style-type: none"> ▪ Protects the 80/20 deal ▪ If at the end of the Fund it is determined that the General Partner has received more than 20% of the profits, then it must return the amount of any over distributions (generally on an after-tax basis) ▪ Interim clawback (?) ▪ Guarantee of clawback is typically several, not joint and several
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	<h2>LP Clawback</h2>
	<ul style="list-style-type: none">▪ Under certain circumstances, the General Partner may require the Partners to return distributions for the purpose of satisfying any Fund obligations or liabilities▪ Often limited by time and/or amount

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	<h2>Institutional Limited Partners Association's Private Equity Principles</h2>

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	<h2 style="text-align: center;">ILPA and its Principles</h2>
	<ul style="list-style-type: none"> • The Institutional Limited Partners Association (“ILPA”) is a trade association of over 215 private equity institutional member organizations that collectively manage roughly \$1 trillion in commitments to private equity funds around the world. • Published on September 8, 2009, the ILPA Principles (the “Principles”) detail recommended best practices in order to better align general partner and limited partner interests (see Course Book for a copy of the Principles). <ul style="list-style-type: none"> • 119 member organizations have already publicly endorsed the Principles. • Some of the Principles deviate significantly from current “at market” fund terms. • In other respects, the Principles already reflect terms that are at or close to market.
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	<h2 style="text-align: center;">The ILPA Principles</h2>
	<p>In response to a perceived shift in negotiating leverage, groups of institutional investors have disseminated what they perceive as best practices for private equity fund terms and operations.</p> <p><u>The Principles’ Table of Contents</u></p> <ul style="list-style-type: none"> • ILPA Private Equity Principles • Best Practices in Private Equity Partnerships <ul style="list-style-type: none"> • Alignment of Interest • Governance • Transparency • Private Equity Preferred Terms <ul style="list-style-type: none"> • Alignment of Interest, Governance and Transparency • Limited Partner Advisory Committee <ul style="list-style-type: none"> • Formation, Meeting Protocol, Duties and Member Responsibilities
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	<h2 style="text-align: center;">The ILPA Principles (continued)</h2>
	<p>Some of the Principles' terms that seek to "push" or in some cases, "confirm" the market include:</p> <ul style="list-style-type: none"> • Management fee reductions; • A shift from the deal-by-deal carried interest distribution model to an aggregate or whole of fund distribution approach (best practice); • Enhanced deal-by-deal model; • Tough claw-back terms and interim reporting of potential liabilities, including very significant escrows (starting at 30%) and joint and several liability of the general partner and its principals; • Lower of cost or FMV valuations; return of all contributed contributions for fees and expenses instead of pro rata; • No "current income distinctions"; • Cash funding of the manager's investment in a fund, rather than the more tax-efficient method of funding by way of waiver of management fees;
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	<h2 style="text-align: center;">The ILPA Principles (continued)</h2>
	<ul style="list-style-type: none"> • Termination of the general partner for cause upon a preliminary determination, rather than upon a final and non-appealable court decision; • No modification of fiduciary duties or allowance of actions in general partner's self interest; avoiding conflict waivers; presenting all conflicts to the limited partner advisory committee (the "LPAC"); • Have fund maintain independent counsel available to the LPAC; • Extension of term in one-year increments only; • 100% crediting of transaction and other advisory fees to the fund (although 80% is probably the current market norm);
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	<h3 style="text-align: center;">The ILPA Principles (continued)</h3>
	<ul style="list-style-type: none"> • 50% or more step down of management fees upon the formation of another fund; • Narrowly drafted investment objectives to forestall style drift; • Automatic suspension of the investment period in the event of “key man” departures; • “No fault” divorce by super majority vote; and • Termination of the investment period by majority vote (although a super majority vote is still often required).
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	<h3 style="text-align: center;">The ILPA Principles (continued)</h3>
	<p>Enhanced Transparency</p> <ul style="list-style-type: none"> • Notifications of government actions or legal proceedings versus the sponsor, personnel changes, etc. • Enhanced reporting and certification by the general partner, sponsor and auditors. • Seek standardization of information to be provided in annual, quarterly and portfolio company reports. <p>Due Diligence</p> <ul style="list-style-type: none"> • Disclosure of general partner profit-sharing splits as well as individual commitment amounts by the partners.
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	<h2>The ILPA Principles (continued)</h2>
	<p><i>LPAC Procedures</i></p> <ul style="list-style-type: none"> • Some noteworthy suggested protocols include: <ul style="list-style-type: none"> • Requirement for twice a year meetings • “In camera” sessions • Limited partners maintaining right to convene meetings and add agenda items • Limited partners requiring the general partner to send consents or amendments to the broader limited partner base for vote • Notifications of all limited partners of actions of the LPAC • Auditors should be required to attend the year-end LPAC meeting • LPAC should have legal counsel at the expense of the fund or general partner • Maintaining detailed voting records
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	<h2>The ILPA Principles (continued)</h2>
	<p><i>LPAC Duties</i></p> <ul style="list-style-type: none"> • Suggested items the general partner should discuss with the LPAC: <ul style="list-style-type: none"> • Auditors • Operations • Compliance • Partnership expenses • Fees and carried interest calculation • Human resources • Strategy • New business initiatives • Valuation of portfolio companies
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	<h2 style="text-align: center;">ILPA Endorsers</h2>
	<p>These funds have publicly endorsed the Principles:</p> <ul style="list-style-type: none"> • AlpInvest Partners • Avenue Capital • Collier Capital • HarbourVest Partners • Northleaf Capital Partners • Terra Firma Capital Partners

	<h2 style="text-align: center;">ILPA Endorsers (continued)</h2>
	<p>These investors have publicly endorsed the Principles:</p> <ul style="list-style-type: none"> • Abu Dhabi Investment Authority • CalPERS • CalSTRS • Canada Pension Plan Investment Board • GIC Special Investments • Los Angeles City Employees Retirement System • MetLife • NYC Employees' Retirement System • NYS Common Retirement Fund • Robert Wood Johnson Foundation • Teacher Retirement System of Texas

	<h2 style="text-align: center;">The Impact of the Principles</h2>
	<p><i>Evidence of Changing Terms</i></p> <p>Certain sponsors have determined to voluntarily adopt some of the Principles, such as:</p> <ul style="list-style-type: none"> ▪ An interim clawback reporting; ▪ Mark-to-market procedure; ▪ More transparency on fund operations to the LPAC; ▪ Increased portfolio and transaction fees offsets; ▪ Enhanced investment limitations; ▪ Changing the trigger upon a “key man” event to an automatic termination of the investment period unless the limited partners affirmatively vote to continue the investment period; ▪ Tightening exclusivity terms regarding investments outside of the fund; and
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	<h2 style="text-align: center;">The Impact of the Principles (continued)</h2>
	<ul style="list-style-type: none"> ▪ Management Fee reductions <ul style="list-style-type: none"> ▪ Some large sponsors are said to have recently made concessions to or are renegotiating terms. ▪ Lowering of commitment levels for fee breaks on tiered management fees. ▪ Offering investors greater options on how to pay management fees (<i>i.e.</i>, different rates on invested vs. committed capital for different periods of time).
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	<h2 style="text-align: center;">The Impact of the Principles (continued)</h2>
	<p><i>How will the Principles impact the future of private equity fund terms?</i></p> <ul style="list-style-type: none"> • The Principles frame discussions between limited partners and general partners going forward. • First time funds may pay particular attention to the Principles. • Some general partners feel they have followed these practices for a while now and feel they should get recognition for their level of governance and transparency. • To a large extent, these guidelines aggregate many of the items that the investor community has been trying to obtain in negotiations over many years. • Limited partners have refocused not just on the straightforward economics of funds such as the management fee, carried interest formula and management fee offset, but also on non-economic terms.

	<h2 style="text-align: center;">The Impact of the Principles (continued)</h2>
	<ul style="list-style-type: none"> • Investors ask whether firms are in line with the Principles. • Perceived shift in the relations between buyout funds and clients (market vs. ILPA driven?). • Going forward, will firms adopt more or all of the Principles to stay competitive?