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Skadden

Investment Management Alert

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Fee Reporting Template Unveiled by Institutional Limited Partners Association

On January 29, 2016, the Institutional Limited Partners Association (ILPA) unveiled its fee reporting template[1] (the Template) together with accompanying guidance (the Guidance). The Template has been produced based on feedback from more than 120 participants, including nearly 50 global limited partner (LP) groups, 25 general partner (GP) organizations and numerous industry trade bodies.

The stated intention of the Template is to enhance and standardize fee disclosure. However, while there is general agreement that having standardized reporting in the private equity industry benefits LPs, the costs and other implications of implementing such standards may reduce the adoption by GPs.

Perhaps to encourage GPs, in a recent industry forum in New York, Peter Freire (ILPA's chief executive) stressed how valuable proper self-regulation could be for the private equity industry to avoid further intervention by regulators. It is not clear that this argument will hold much sway with GPs. On the one hand, regulators have already begun to take action in relation to fees and expenses, while on the other, it is clear that it will take some time for the Template to be implemented even with substantial GP support (since it is only likely to apply to new funds).

Purpose

In its Guidance, ILPA states that it has prepared the Template with two distinct goals, to provide LPs with:

- the ability to monitor, aggregate and analyze their direct costs of participating in a private equity fund (a Fund); and
- a summary of the GP's sources of economics regarding the Fund and the investments made by the Fund.

The Template is intended to form part of a Fund's standard financial disclosures, with a recommendation that the information be provided on a quarterly basis. The Template itself is split into two tiers, in order to provide differentiated levels of reporting. Level 1 provides a high-level summary of the net asset value (NAV) of the Fund and the LP's interest, as well as the fees and expenses paid during the relevant period (grouped

[1] https://ilpa.org/best-practices/reporting-best-practices/for-consultation-ilpa-fee-reporting-template/

by type, *e.g.*, partnership expense for due diligence as well as advisory (or similar) fees that are typically offset against the GP's management fee). Level 2 provides more granular detail, breaking down the categories of fees paid or received, such as those fees received from portfolio companies.

The Guidance also makes clear that the Template is designed as a tool for standardizing the disclosure made by GPs in relation to fees, expenses and incentive allocation. It is not designed to verify the information, and metrics such as the waterfall structure are intentionally withheld from the Template. ILPA intends to issue separate guidance (in the form of a white paper and an appendix to the ILPA Private Equity Principles) to address limited partnership agreement (LPA) compliance.

Implementation

It is clear that ILPA has responded to some of the feedback received from GPs, in part because the Guidance makes clear to LPs that the Template cannot be applied in a one-size-fits-all approach. There is acknowledgement that the Template would need to be implemented on a scaled basis to reflect the different sizes and complexity of GPs — larger GPs should find it fairly straightforward to implement the Template, but smaller GPs and new managers may not have sufficient resources to pool all of the information required. The Guidance also states that the Template is intended for future funds — only where feasible would it be applied to current vintages.

ILPA advises that LPs should, when analyzing the fees charged by GPs to portfolio companies, consider the potential value of the services being provided by a GP rather than just the cost. Similarly, amounts paid by a portfolio company to a GP to reimburse it for amounts it has advanced do not constitute a revenue stream for the GP.

In a separate section, ILPA seems to have given fund of funds a relatively easy ride. There is a supplemental schedule for fund of funds to list the layers of fees and incentive allocations paid in relation to the fund's underlying holdings. However, the Guidance states that fund of funds will be "highly challenged" to provide the itemized content in that supplement. Since layers of fees are commonly perceived as a drawback to investing in fund of funds, GPs of fund of funds may be motivated to obtain the required information in order to report it to their own investors.

Changes to Fund Documentation

The values to be reported through the Template should still be calculated using the methodology agreed in a Fund's documentation and ILPA has not sought, through this medium, to make any changes to valuation policies or similar. However, the Template does include a recommended definition of "Related Parties" that ILPA is encouraging future PE funds to adopt. This definition is an attempt to ensure that all the fees that are directly or indirectly borne by LPs and, ultimately, paid to the GP or their staff or owners are disclosed, despite the varying definitions that have been used by GPs.

The Related Parties definition is, however, complicated and it is not immediately clear who is being targeted. There is, for example, a requirement to disclose fees paid by the Fund to professional services providers such as third-party lawyers, consultants and accountants who are "regularly engaged by portfolio companies" and that also provide advice or services to any "Related Person" or "Related Entity." This disclosure would not appear necessary to fulfill either of ILPA's stated goals.

Likely Impact

The introduction of standardized reporting should help LPs to analyze and compare their holdings in private equity funds. Despite the potential additional administrative burden that implementation of the Template may bring for some fund managers, the goal of standardizing data to enable easier comparison is understandable.

The Template has been released against a backdrop of increased scrutiny and attention to the fees paid, directly or indirectly, by LPs in private equity funds. Notably, the SEC has already taken action against a number of firms and, as a result, the disclosure made by GPs at the pre-investment stage has increased substantially. However, while the SEC's action has led GPs to be more transparent about the types of fees and expenses that may be borne by LPs, the Template could take this disclosure further by providing LPs with measurable data on the quantum of those fees. Given that GPs may not readily adopt the Template, it may be some time before LPs see real benefits.