

Ethics Policies Pose Next Challenge For Private Equity Firms

By Laura Kreutzer

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Private equity firms devote plenty of time and attention to their investments, but many need to spend more time and attention on developing and sticking to formal ethics policies.

So said a panel of experts speaking about ethics at the Private Equity Analyst Conference in New York.

"Because we're in the business of capital formation, there are a number of people that aren't aware of their fiduciary duty and are embarrassed, because everyone assumes that you know what they're doing," said Pascal Levensohn, founder of Levensohn Venture Partners.

Levensohn has authored several white papers on best governance practices for venture capitalists and their portfolio companies as part of an effort to provide guidance to his industry peers.

Private equity and venture firms have plenty of ethical issues to grapple with in today's challenging fund-raising environment, including avoiding corruption when marketing their funds, developing policies governing their employees' public stock trades and addressing potential conflicts associated with cross-fund investing.

When London buyout shop BC Partners Ltd. wants to invest across two funds, the firm sets up a separate deal team for each fund to evaluate the prospective investment based on its value to that specific fund, according to Senior Partner James Rubin, who was also a panelist.

"The cases are presented by two different teams, so the investment committee is reminded that they have two separate [sets of] investors to think about," Rubin said.

New mark-to-market accounting rules have also generated concern among some limited partners about the potential for unethical behavior by general partners, according to Barry Gonder, general partner at Grove Street Advisors LLC.

"It's taken what was fairly tightly limited and given the general partner a huge amount of discretion in how they value things," Gonder said. "Those valuations have an impact on when the GP can take distributions of their carry."

Levensohn added that he thinks there is abuse occurring in the industry when it comes to mark-to-market valuations.

"I have seen other GPs carry the FAS 157 pressures internally into the board room and have seen it dominate the discussion over the structure of a specific financing so they can hide behind preferences and other [structures] of the investment schema which would give them an outcome that differs from the investment reality," he said.

Some firms question the price tag of developing and implementing formal ethics policies.

"There's always a cost to having more vigilance," said Susan Mangiero, president and chief executive of Pension Governance Inc., an independent research and analysis firm focused on corporate governance and risk management. "The question is who bears that cost? That's what we hear from managers. 'We're not interested in bearing the cost of X, Y and Z unless the investors will bear the cost of X, Y and Z.' [Then] the investors say 'I thought someone [else] along the food chain was bearing X, Y and Z.'"

More private equity and venture firms may want to bear that cost particularly as the investment

pace picks up.

"At a time like this when we seem to be coming out of a trough, you have to be very careful that standards are [not] being lowered," Rubin said. "It's important that those in the industry keep a close eye on what's going on as more capital goes out. When you're a hammer, everything looks like a nail."

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