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## Event Report

# Regulatory Practices and Global Private Equity Opportunities

JANUARY 29, 2010

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*In January a panel of distinguished private equity professionals spoke to members of the Columbia community on the outlook for regulatory reform across the globe in the wake of the financial crisis. This panel was part of Columbia Business School's 16<sup>th</sup> Annual Private Equity and Venture Capital Conference. Panelists included moderator David Carey, senior writer for The Deal, LLC; Steven Davidoff, associate professor of law at University of Connecticut Law School; Micah Green, partner at regulatory advisory group Patton Boggs; and Kirk Radke, partner at law firm Kirkland & Ellis.*

The discussion began with a synopsis of Washington's regulatory response to the financial crisis. "Following the \$750 billion bailout, there was always going to be a pound of flesh in return," said Micah Green. "TARP evolved into an equity purchase program; [Treasury Secretary Henry] Paulson told larger banks they would volunteer, and the Administration simultaneously called this a bailout (coincident with AIG events)." Mr. Green also noted that several trillion dollars went to various financial institutions, while many Americans lost their jobs and others fell behind on mortgages. Subsequently, banks are repaying their borrowed funds, but there is huge headline risk relating to executive compensation.

Both Mr. Green and Kirk Radke condemned this regulatory response. Mr. Green noted the Administration felt the need to respond to the events outlined above via the Volker proposal currently under debate, which is designed to limit risk. The problem, according to Mr. Radke, is "the PE industry had almost zero systemic risk associated with its activities." The issue for PE players now is how to make policymakers and the public understand the real risk profile of the industry and the benefit the industry provides in terms of jobs and economic growth. The industry's challenge will be getting those messages out, which would be difficult in normal times but is even more so now.

To counter, Steven Davidoff warned, “We must be aware we’re in a dynamic environment. Banks are changing their business model and pulling back on private equity and hedge fund investments. People are pissed and it’s clear that regulatory subsidies are going to banks. Private equity is an easy villain.”

Turning to Europe, the panel’s reaction was soundly negative on the Rasmussen Regulations—regulations proposed by Poul Nyrup Rasmussen, president of the Party of European Socialists, to limit European financial institutions’ investments in private equity. David Carey asked the panel if the Rasmussen Regulations were protectionist. Mr. Radke felt U.S. alternative asset managers will be at a disadvantage in competing for deals and funds in Europe if they are unwilling to explicitly register their trading strategies under the proposed law. Professor Davidoff, however, thought Rasmussen was still “fighting the last battle” and that in building regulatory fences the region is creating barriers to entry that will eventually harm Europe. From his public policy perch, Mr. Green noted, “The regulatory environment is extraordinary. There will be regulatory competition [eventually] because people want to be financial centers, but the whole world is regulating now.” The panel was unanimous in acknowledging that the risk of implementation of these regulations is real.

Mr. Carey brought up the regulatory backlash against “windfall” private equity profits in parts of Asia. Specifically, he mentioned South Korea’s bringing criminal charges against the private equity shop Lonestar and the recent \$650 million tax assessment the Australian government put on TPG Partners.

This is clearly a concern for the industry. Generally speaking, the risk is that a PE firm enters into a great transaction that has met all rules, and then the rules change. Mr. Radke warned, “There will be marginal transactions that don’t get done because of this. But, over time, people will work their way through it.” Continuing to pound home the notion that there is very little regulatory competition across the globe, Mr. Green claimed, “There’s a risk of this problem in the U.S., so it’s not just an offshore problem. Populism poses an additional risk even in the U.S.”

Professor Davidoff challenged the other panelists, however, defending the Australian government. “Australia had some ambiguity in tax laws, so the issue is whether TPG is tax dodging or whether the law is unclear,” he said. “These cases add clarity to the process, but there is political anger clouding that clarity currently. There may be a future once law becomes more settled.” Thus, the risk of sudden regulatory change will lessen over time.

According to Professor Davidoff, sovereign wealth funds with tremendous amounts of capital and interests in building their economies, not just their balance sheets, are adding further complications to the regulatory environment. PE funds are consequently in a hurry “to establish a flag” before they are boxed out by governments and nationals who will be able to dominate the industry. Firms need an actual physical presence on location so they will be able to raise funds down the line. They are attempting to create this presence along with business and fund-raising connections before national regulatory regimes are fully established, hoping regulators will leave the status quo in place in most cases. Professor Davidoff went on to say, “You can’t just scale up Blackstone’s model and export it to China. You’re dealing with a government, not with citizens and companies. The Chinese government is not our friend and will benefit at our expense if they can.”

To conclude the session, panelists offered their assessments on the future of private equity regimes at home and abroad. The panel agreed that the next several weeks will provide clarity in the U.S., focusing particularly on the Senate.

Democrat Senator Chris Dodd, chairman of the Senate Banking Committee, is currently negotiating directly with Republican Senator Richard Shelby to hammer out a bipartisan package on banking reform that could explicitly affect the private equity industry. Mr. Green feels that Congress will pass substantial regulatory reform and that the global reaction to that legislation will be very telling. He notes that nations cannot regulate markets in a jurisdiction-centric manner, so there is a high likelihood that there will be more coordinated regulatory efforts going forward.

Professor Davidoff added that PE firms were smart in mid-decade with their covenant-light deals with banks. The banks, in turn, were smart to pass these deals on to investors through securitization. In response, it is natural for Congress to force banks to keep some part of securitization on their balance sheets. This will hit PE firms, as banks will be less willing to finance leveraged-buy-out deals when they cannot unload the liabilities through securitization. “This appears to be a global development,” Professor Davidoff concluded.

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