

6 March 2007

Our ref: ICAEW Rep 14/07

Rebecca Jones  
Capital Markets Sector Manager  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS



THE INSTITUTE  
OF CHARTERED  
ACCOUNTANTS  
IN ENGLAND AND WALES

By email

Dear Ms Jones

### **PRIVATE EQUITY: A DISCUSSION OF RISK AND REGULATORY ENGAGEMENT**

The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the discussion paper *Private Equity: a discussion of risk and regulatory engagement* published by the Financial Services Authority in November 2006.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

The Institute's Corporate Finance Faculty is the largest body of professionals involved in corporate finance. Its 6,000 members include private equity firms as well as advisers and lenders to the private equity sector. In addition the Institute's new Financial Services Faculty will draw together professionals from across the financial services industry.

Please contact Katerina Joannou, Capital Markets Policy Manager, on 020 7920 8806 or at [katerina.joannou@icaew.com](mailto:katerina.joannou@icaew.com), should you wish to discuss any of the general points raised in this response.

Yours sincerely

Vera Sabeva  
Head, Corporate Finance Faculty  
T +44 (0)20 7920 8796  
E [vera.sabeva@icaew.com](mailto:vera.sabeva@icaew.com)

Chartered Accountants' Hall  
PO Box 433 Moorgate Place London EC2P 2BJ  
[www.icaew.com](http://www.icaew.com)

T +44 (0)20 7920 8100  
F +44 (0)20 7920 0547  
DX DX 877 London/City

## **GENERAL COMMENTS**

1. We welcome this opportunity for discussion and believe that informed debate is extremely valuable. We recognise that the FSA has to ensure that its scrutiny of changing markets gives it full coverage of its four statutory objectives.
2. In the case of private equity, it would appear to us that the main area of concern (given the limited relevance of private equity, except at the smaller VCT end, to consumers of regulated activities) relates to “maintaining confidence in the financial system”, particularly in respect of increased debt levels in major companies. However we agree that the concern about the complexity of debt finance structures and involvement with the public markets is confined to relatively few larger deals.

### **The importance of the private equity market**

3. We agree that private equity is “an important part of the financial markets that can significantly enhance capital market efficiency”. In the interest of free markets and competition the onus falls on individual sectors, where appropriate, to better communicate how they discharge corporate responsibility and demonstrate good governance. It should be recognised that safeguards such as corporate governance standards are in place to protect quoted company shareholders who have little direct influence on directors and may be of less relevance where there are no shareholders in such a weak position.
4. We support the FSA’s desire to “maintain the competitive position of the UK capital markets”. The drivers of competitiveness, such as economic conditions, a proportionate regulatory regime and a skilled workforce, also underpin the success of the private equity market. The private equity market and its stakeholders must be vigilant to future changes in these drivers.
5. We commend the FSA’s intention to establish a centre of excellence for alternative investments and believe the increased knowledge will help maintain the effectiveness of its regulatory approach. We also support the FSA’s proposal to engage with trade associations and experienced practitioners to understand the private equity market’s merits and risks. In turn, by way of board placements, private equity firms have a role in ensuring that companies develop and maintain appropriate skills and expertise to be able to deal with new, sometimes complex, financial structures and operational changes.

### **Risks and the regulatory approach**

6. Some of the risks identified are common to other markets and there needs to be recognition of the extent of mitigation achieved by way of private equity market practices and its implication for further mitigation required through regulation. The risk of unclear ownership of economic risk is, for example, one where more understanding and knowledge are probably needed to determine the appropriate regulatory approach.
7. We agree that the FSA’s regulatory regime must be “effective and proportionate”. We believe that a risk-based regulatory approach is appropriate and any additional procedures or future alterations to the current approach (e.g. additional surveying, monitoring of credit markets and data collection) should be based on the same principles and subject to rigorous cost benefit analysis.