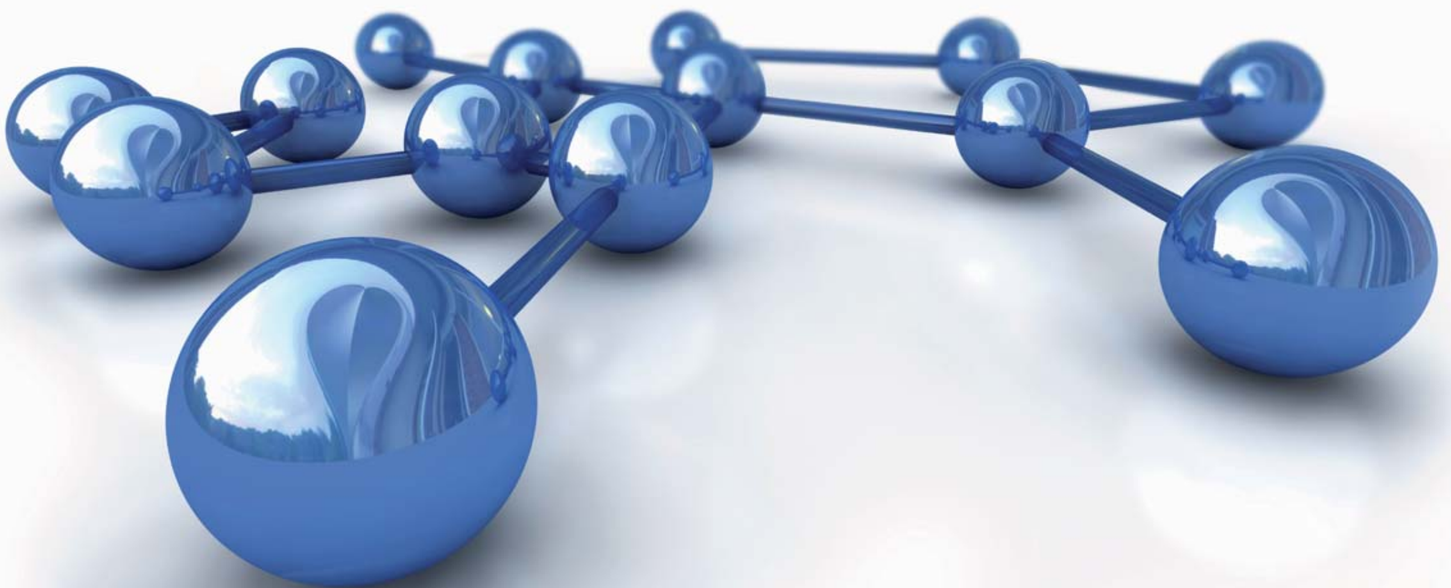
Preqin Research Report

Potential Effects of SEC Proposed Rule Release IA-2910 on the Private Equity Industry

August 2009



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Potential Effects of IA-2910
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Preqin Research Report:
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Overview

Preqin has produced this research report in order to assess the potential impact of the proposed changes in the private equity industry that would be brought about by the introduction of SEC proposed rule release IA-2910 relating to the introduction of Advisers Act Rule 206(4)-5. This report can be viewed on the SEC website at the following address:

http://sec.gov/rules/proposed/2009/ia-2910.pdf

In particular we were seeking to measure reaction to the following key points:

- Banning political contributions by investment advisors - i.e. private equity and other fund managers
- Banning the use of placement agents by fund managers seeking commitments from public pension funds and other government investors

In order to assess the impact to the industry, our analysts have surveyed the opinions of the institutions that really matter in this debate - public pension plans and other investors in the US.

We have also analyzed our databases, and produced some key statistics showing the usage of placement agents, the importance of private equity and other alternative investment funds using third-party marketing to the portfolios of public pension plans, and the size of the placement industry.

As ever, we welcome any feedback and comments that you may have.

We will also be submitting this document to the SEC. If you would like to view this document amongst other comments, or would like to voice your own opinion, the file number for comments to this proposal is S7-18-09

Tim Friedman
Head of Communications
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Introduction

Private equity provides a number of benefits to the US economy. It directly employs over an estimated 36,000 people in the US[1] and in many cases, the capital and industry expertise that private equity firms put to work assist businesses in expanding and developing their operations, providing additional employment to thousands of Americans each year. Private equity also helps to foster innovation in numerous sectors, including technology and healthcare, and improve efficiency by a variety of means. Additionally, the industry helps both public and private pension funds achieve the returns they require to fund their obligations by consistently outperforming the public markets. As of December 2008, private equity had outperfomed the Standard and Poor's 500 index over a one-year, three-year and five-year period. Although returns for 2008 were negative at -27.6%, the asset class was still ahead of the -37.0% which was posted by the S&P 500 in the same period.[2]

Preqin therefore believes that preventing placement agents from making public pension funds aware of an array of private equity fund investment opportunities that otherwise, in all likelihood, would not all come to the attention of the public pension funds would be detrimental to the investment returns of such plans. When the choice of opportunities available to investors is restricted, it generally leads to degradation of the potential returns available at all levels of risk.

In order to prevent any unwarranted influence on investment decisions made at public pension funds, the ban on investment advisors receiving compensation from public pension funds for the two years following a political contribution made by someone at the advisory firm to an official at the public pension fund is welcome. However, a blanket ban on private equity firms employing placement agents to raise capital from public pension funds in order to obstruct any potential circumvention of the political contribution restrictions is too overreaching, and we believe that better alternatives to this approach exist, which will be outlined later in this report.

The services provided by placement agents are extremely valuable, especially to smaller private equity firms, helping them to raise capital and gain access to a wide universe of institutional investors, including public pension funds, that would otherwise be very difficult for small private equity firms without dedicated placement teams to reach. From the point of view of placement agents themselves, public pension funds represent a highly significant group of investors for sourcing commitments on behalf of their fund manager clients. Overall, public pension funds represent approximately one-quarter of all capital committed to private equity funds (excluding by fund of funds managers and asset managers).[3] If placement agents were to lose 25% of their total potential investor pool, it could result in a loss of revenue of such magnitude that it would force many of these firms out of business.

The importance of retaining a good reputation amongst their contact base is paramount for placement agents, and as a result, reputable placement agents will only work with funds that they feel are of a high quality and will be able to successfully complete their fundraising. They therefore provide a valuable service to investors, including public pension funds, by being highly selective in the private equity firms they choose to work with. Although institutional investors should never allow the word of a placement agent to replace any part of their due diligence process, placement agents do often provide a 'seal of quality' – the loss of which could result in more work for pension funds in initially separating the wheat from the chaff.

Without placement agent involvement, the best new fund managers would become harder to identify, and both new and small private equity firms that are no longer able to raise capital from public pension funds via placement agents may struggle to survive without this vital source of investment, meaning that the economy could lose fresh, motivated value creators, and businesses in need of private capital for expansion and development will suffer, especially in the current climate where bank lending to small businesses is severely limited. This could lead to a decrease in the number of start-ups developing innovative new products and technologies, features vital to the US's economic growth, due to the lack of available venture and expansion capital.

The loss of the smaller private equity firms could result in consolidation by the larger firms in the industry and will mean that investors will have fewer firms and funds to choose from. The lack of choice itself could well have a detrimental effect on returns. In addition, fewer private equity firms could mean an overall increase in fees, which would also reduce net returns to investors, including public pension funds, making it harder for them to fulfil their obligations to their plan members.

One of the reasons cited by the SEC for the outright ban on placement agents soliciting commitments from public pension funds relates to a similar proposal it made in 1999 that was eventually shelved. The former proposal suggested a two-year ban on investment firms receiving compensation from the relevant public pension fund if the investment firm had used a placement agent that had made a political contribution to officials at the pension fund in question. However, it was noted at the time that implementing this would be problematic – one reason being that investment firms would have to monitor the activities of the third parties they employ. Nonetheless, we do not believe these compliance challenges justify the "sledgehammer" approach now being adopted by the SEC. There are alternative solutions that will address these issues without the damaging effects which will result as a consequence of the prohibition of placement agents raising capital from public pension funds.

The SEC also suggests that the new rules will level the playing field for fund managers that cannot afford to or will not make political contributions to better their chances of receiving commitments from public pension funds. However, this is unlikely to be the case because larger private equity firms are better placed, with more resources, to install or expand in-house placement teams to assist in their fundraising activities, whilst the smaller houses will not be able to do so. If they cannot use third-party placement agents, it will reduce their chances of receiving commitments from public pension funds as well as from other investors.

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[1] *Preqin estimate based on statistics taken from Preqin Fund Manager Profiles online database*
[2] *The 2009 Preqin Private Equity Performance Monitor, pp. 9 -10*
[3] *The 2009 Preqin Global Private Equity Review, p. 78*

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Results of Preqin Investor Survey

In order to ascertain the expected impact the SEC's proposal would have, if implemented, on the alternative investment funds industry, we spoke to private equity professionals at just over 50 prominent US-based institutional investors and asked them their opinion of the proposed changes. Though the proposal will clearly have an impact on investments in various other industries, including hedge funds, in the interest of simplicity, we have opted to look specifically at the expected impact of the proposal on the private equity industry. In particular, we sought to determine the effect that the prohibition of the use of placement agents in soliciting capital from public entities, including public pension funds and other government agencies, would have on the investments of institutions of all types in private equity.

In addition to displaying the overall views expressed by investors, we have also separately analyzed those responses provided by both public investors and non-publicly funded investors. Respondents were evenly divided between the two groups, and investors in the latter group included endowments, foundations, insurance companies, investment companies and private sector pension funds.

Investors' Initial Responses to the SEC's Proposal

The SEC's proposal aims to "prohibit an investment adviser from providing advisory services for compensation to a government client for two years after the adviser or certain of its executives or employees make a contribution to certain elected officials or candidates."[1] We asked investors whether they agreed with this overall aim, and the results are displayed in Fig. 1. More than half (54%) of investors informed us that they agreed with this aspect of the report, though a higher proportion of public funds supported this than non-public funds. However, a considerable 27% of investors told us that they were unaware of the proposal and this rose to a third when only non-public investors were considered.

One of the proposed regulations "would prohibit advisers from paying third parties to solicit government entities for advisory business," meaning placement agents and other third-party solicitors would be banned from approaching public funds for investment in private equity funds and hedge funds.[2] As shown in Fig. 2, although more than half of investors agree with the overall aim of the proposal, 45% disagree with the banning of placement agents, compared to just 19% who agree with this aspect of the plan. Opposition is especially strong amongst non-public funds, with

Fig. 1:

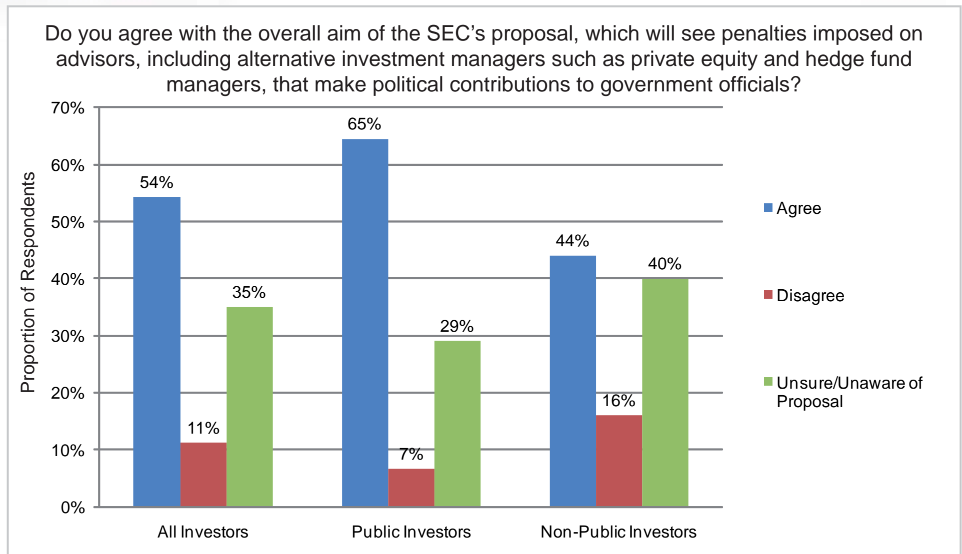
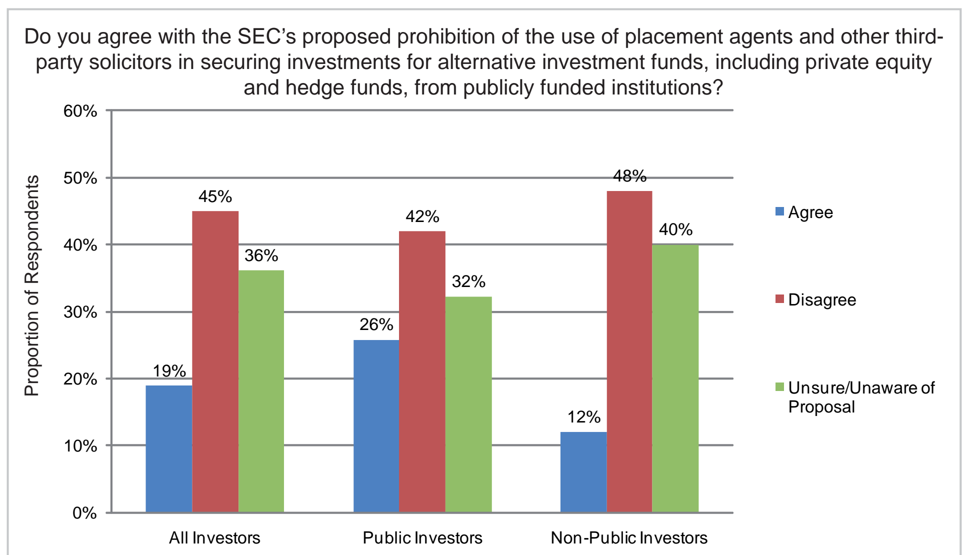


Fig. 2:



[1] SECURITIES AND EXCHANGE COMMISSION, 17 CFR Part 275, [Release No. IA-2910; File No. S7-18-09] RIN 3235-AK39, Political Contributions by Certain Investment Advisers, p. 1
[2] SEC Release No. IA-2910, pp. 77-78

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just 12% of these investors supporting the banning of placement agents, compared to 25% of public funds.

Usage of Placement Agents

In order to establish the extent to which investors utilize placement agents and, by extension, the implications the proposed partial ban would have for both the private equity industry and for investors themselves, we asked institutions whether they find placement agents useful in finding the best investment opportunities. As shown in Fig. 3, 37% informed us that placement agents are a useful method of discovering the best investment opportunities, compared to 39% who disagreed.

In addition, we asked investors how frequently they had made commitments to funds pitched to them by placement agents in the past and their responses are displayed in Fig. 4. A considerable 60% of investors had committed to funds managed by firms that had initially approached them through a placement agent. In fact, 21% of investors have frequently made commitments to funds pitched to them by placement agents.

Overall, though some investors feel placement agents offer little value, many other investors felt they were an important part of the industry: one public pension fund told us that placement agents are a “valuable tool... offering a breadth of knowledge which [they] rely upon,” and another said that they have relationships with a small number of agencies that, in effect, assist in “pre-screening” GPs, as they feel these placement agents are especially careful not to promote poor investment opportunities, since to do so would risk affecting the relationship they have with that investor.

Fig. 3:

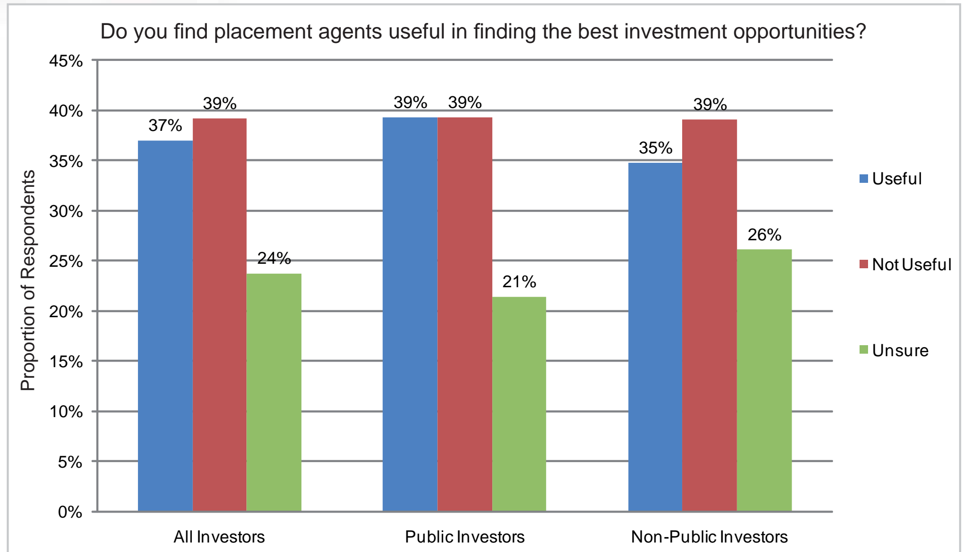
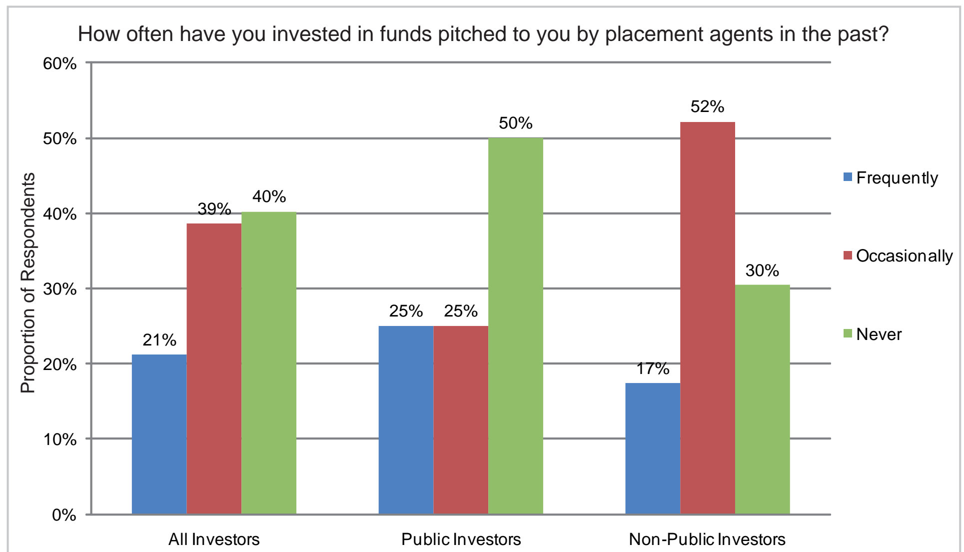


Fig. 4:



A number of investors informed us that losing placement agents would result in the loss of a useful source of leads and though most were confident they could still source suitable opportunities, it would take longer for them to do so, and as one endowment told us, “thinly-staffed LPs that do not have the budget or capacity to know the smaller managers” will find it difficult to source the same range of opportunities. A public pension fund also felt “it will be detrimental to the plans that have a small investment committee,” and the proposed changes would lead to “far more work to do, and they may not have the expertise” to source leads as effectively.

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Fig. 5:

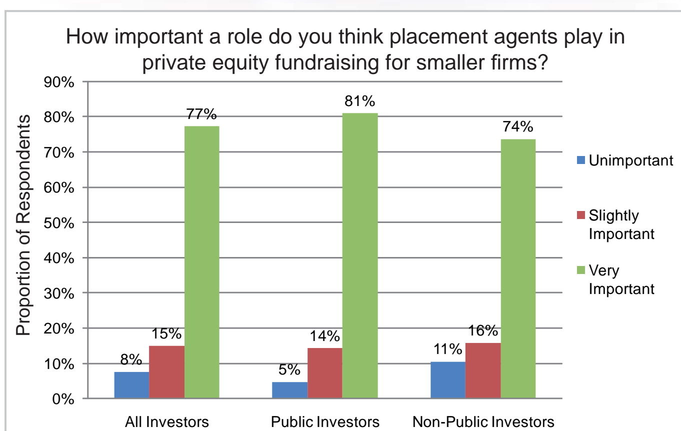
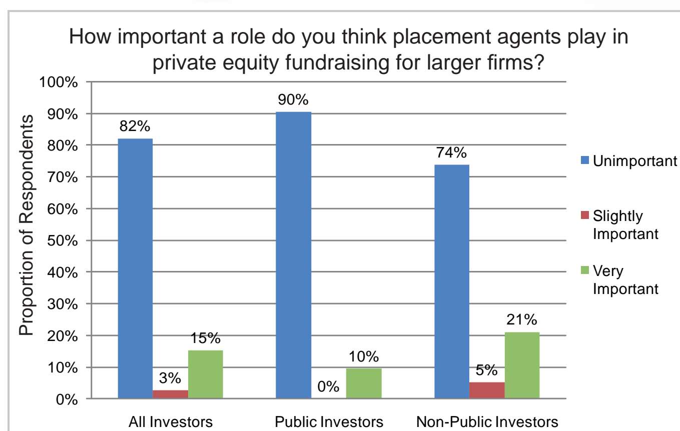


Fig. 6:



Indirect Assistance: An Important Consideration

Although 50% of investors state that they have never invested in an opportunity that has been brought to their attention by a placement agent, this does not account for re-up investments that have been made to firms which are using placement agents in an indirect manner.

Although a placement agent is unlikely to meet with a firm's existing investor base in order to solicit an investment for a new fund where a relationship is already in place, in a large number of cases, a fund manager will use the services of a placement agent indirectly, including to advise them on marketing, gain feedback from investors, draw up documents etc.

As the SEC proposals stipulate that such indirect interaction would also be banned, it is important to consider that the proportion of public investors that have committed to funds using a placement agent would be significantly higher than the 50% figure in our survey would suggest.

In addition, a number of large public pension plans utilise the services of gatekeepers/fund of funds managers when making investments into private equity and other alternatives. In many cases the gatekeeper would be approached by a placement agent, and although the investor would not have direct interaction with the placement agent in such instances, such activity would again not be acceptable under the new proposals[3], and as a result the proportion of public investors seeing placement agents as useful in Figs. 3 and 4 is likely to be higher still when this is taken into account.

"Leveling the Playing Field?"

Another motivation for banning the use of placement agents by managers when approaching public entities for commitments is the need to "eliminate or minimize manipulation of the market for advisory services provided to state and local governments," since "payments made to third-party solicitors as part of "pay to play" practices create artificial barriers to competition for firms that cannot, or will not, make those contributions or payments."[4] The proposal then states that "curtailing "pay to play" arrangements enables advisory firms, particularly smaller advisory firms, to compete on merit, rather than their ability or willingness to make contributions," what the SEC has termed "leveling the playing field," meaning smaller private equity firms are expected to benefit from the implementation of the SEC's proposal.[5] In order to assess the validity of this assertion, we asked investors a number of questions to ascertain whether, in their opinion, smaller firms would indeed benefit from the proposed changes and, in particular, whether banning the use of placement agents in the solicitation of investment from public funds would have a positive or negative impact on fundraising by these managers.

Firstly, we asked investors how important a role they perceive placement agents play in private equity fundraising by both smaller and larger firms. As Figs. 5 and 6 illustrate, placement agents are seen by investors as considerably more important to smaller managers than they are to larger firms: 77% of the investors we polled rated placement agents as very important for smaller managers, whereas 82% of investors told us placement agents were unimportant for larger managers.

We also asked investors about the level of experience possessed by the firms they have seen represented by placement agents in the past. The vast majority of investors, 92%, told us emerging managers had utilized placement agents in the past to approach them. In contrast, only 55% of investors had seen brand-name managers use placement agents and 58% had seen more experienced managers use placement agents.

Again, these statistics relate to placement agents acting directly for the managers in question. Although investors are less likely to be approached by placement agents acting on behalf of bigger funds, this does not necessarily mean that a placement agent has not

[3] SEC Release No. IA-2910, p. 50
[4] SEC Release No. IA-2910, pp. 77-78
[5] SEC Release No. IA-2910, pp. 77-78

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Fig. 7:

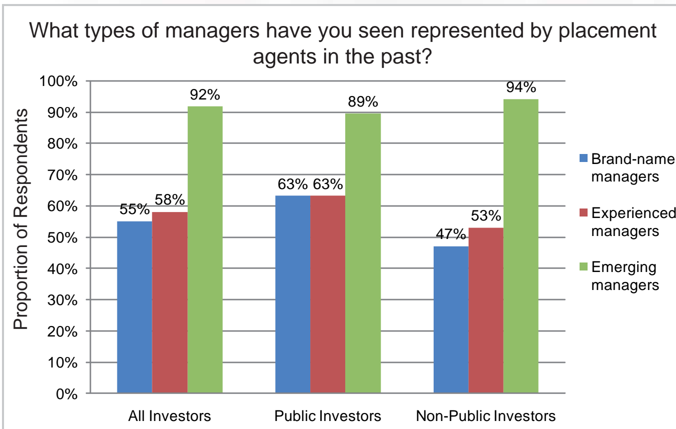
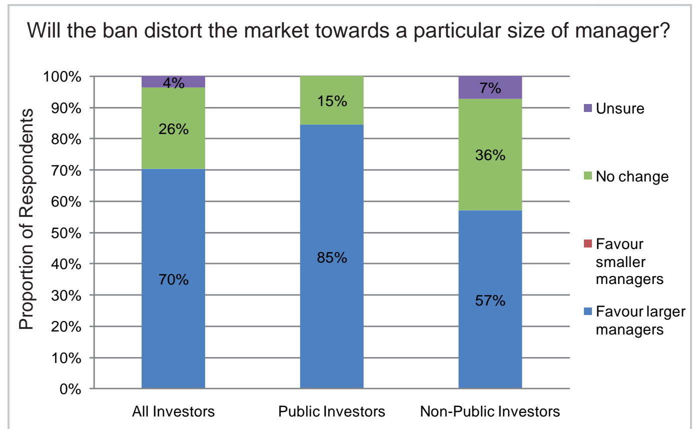


Fig. 8:



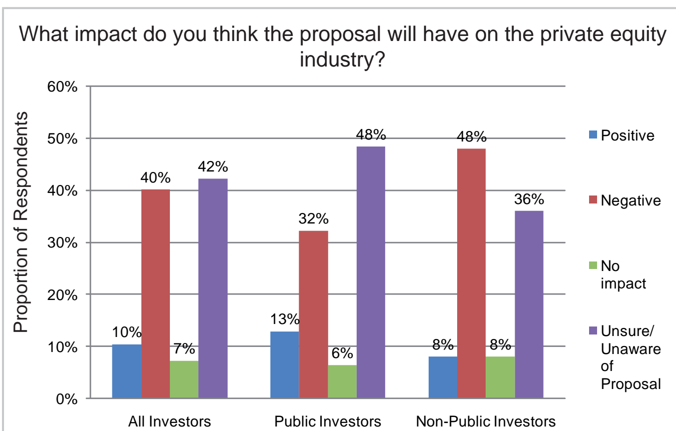
been working indirectly in an advisory role with brand-name funds that they have invested with.

Although bigger fund managers may not require the use of placement agents in gaining commitments from established markets where relationships are already in place, many will use placement agents to gain commitments from new regions such as Asia. This activity could also be brought into question if the proposals were brought into action, although it would not directly affect the US pension plans in question.

As shown in Fig. 8, we also asked fund managers whether they felt the proposal would lean the market towards fund managers of a particular size. 70% of investors told us they thought the changes would favor larger fund managers and no investors felt it would distort the market the other way, towards the smaller managers the SEC is aiming to help. In fact, a massive 85% of public pension funds and other institutions handling public money felt larger managers would be the main beneficiaries of the proposed banning of placement agents.

These results clearly show that it is the smaller, less experienced fund managers that most rely upon placement agents when fundraising and that consequently, rather than realigning the market back towards these smaller managers as the SEC states it has set out to do, the proposal will actually make fundraising more difficult for these firms. Rather than being unable to afford the services of a placement agent, many smaller managers actually rely on them as they lack the resources to employ their own internal marketing teams and frequently outsource all fundraising activities. In most cases placement agents are compensated through success fees as a proportion of the commitments they are able to garner, and as result, the expense of their services is not necessarily an issue for smaller managers.

Fig. 9:



Expected Impact of the Prohibition of Placement Agents

We also aimed to establish what overall impact investors anticipate the proposal would have on the private equity industry as a whole if implemented in its current form. As Fig. 9 shows, just 10% of investors felt that the proposal would have a positive impact on the industry. Several of these investors stated they felt the proposal would certainly result in less corruption and/or conflicts of interest in private equity fundraising.

In contrast, 40% of investors told us it would have a negative impact, with many pointing out what they deem to be a clear distinction between those 'finders' implicated in recent scandals and actual placement agents, who are, as one insurance company put it, merely "facilitators in the industry" that are being treated as "scapegoats". Another public pension fund stated "you do not need to throw the baby out with the bath water... [There] should be a ban

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on the practices by the agent, not a ban on the agent."

Investors also expressed to range of additional concerns relating to the impact of the proposal. Numerous investors, both public and private, cited the distortion of the market towards larger, more experienced firms as a key area of concern, since these are the types of fund managers that they perceive as being the least reliant on placement agents to raise capital for them. Another concern frequently cited by investors included the worry that the increasing costs incurred by private equity firms would be passed on to investors. Others felt that the restrictions on placement agents would have a detrimental impact on the quality of available opportunities. We therefore examined these concerns in more detail.

We asked investors whether they were concerned that private equity firms would pass any additional costs incurred in complying with the proposed regulations on to the investor, since many firms outsource all or part of their fundraising to placement agents, and would therefore need to employ an in-house team if they wanted to approach publicly funded institutions for investment. As Fig. 10 shows, 42% of investors were concerned the proposal would lead to increasing costs being imposed upon investors since, as one public pension fund said, "somebody will have to pick up the costs, so either the fund manager will collect smaller returns for their work, or it will be passed onto investors, or a combination of the two." However, a further 31% told us these costs would not be passed on; as one endowment put it, it would "put [its] foot down and not pay this as it is part of the private equity firm's marketing fees in a sense and they should take it from the fees they get for management." Furthermore, a public pension fund said "managers are having a tough time raising funds, and to pass on any more costs would be ridiculous."

Fig. 10:

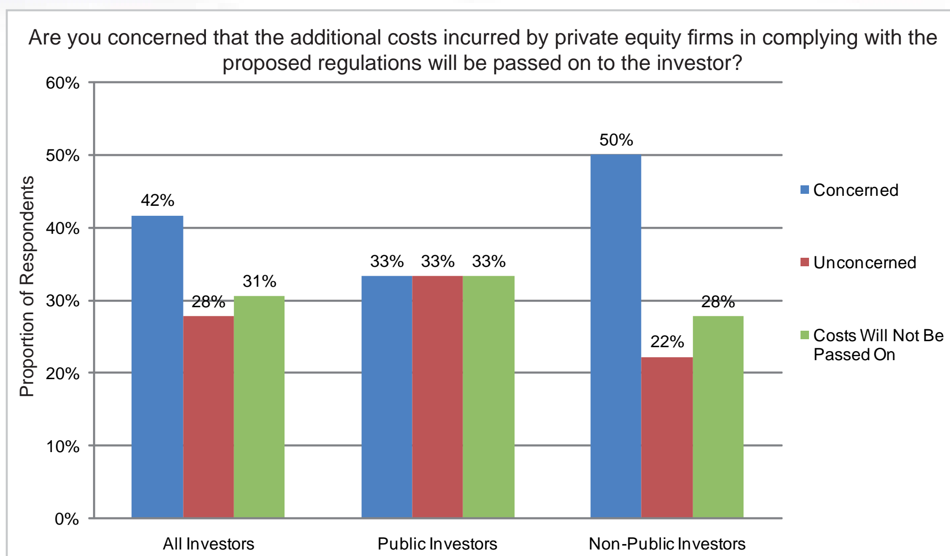
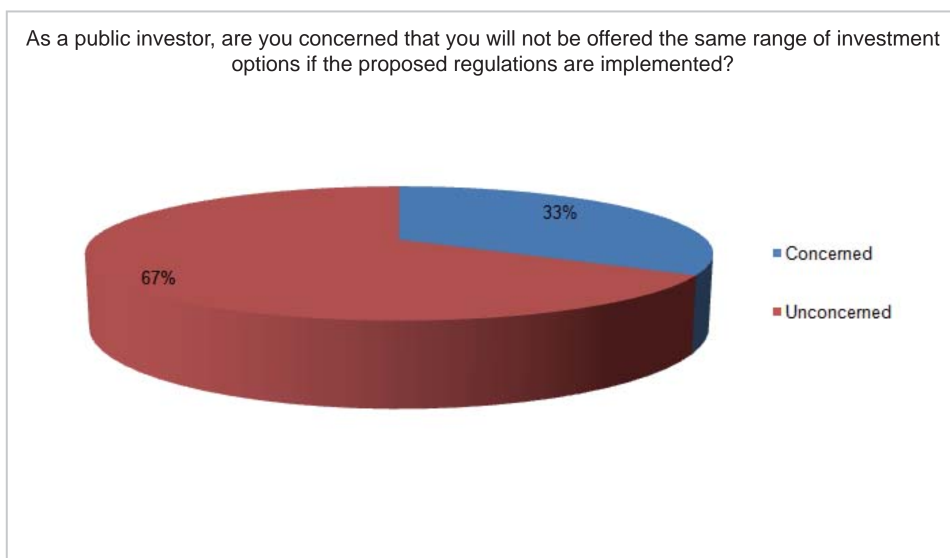


Fig. 11:



We also posed the following question to just publicly funded institutions: are you concerned that you will not be offered the same range of investment options if the proposed regulations are implemented? As Fig. 11 shows, a third of respondents were worried they would not be able to access the same range of opportunities if the proposal were to be implemented in its current form, owing to the way in which they source investment opportunities at present. Although most felt that after a time, they would be able to source alternative means to access groups, and consequently it would only affect investments in the short to medium term.

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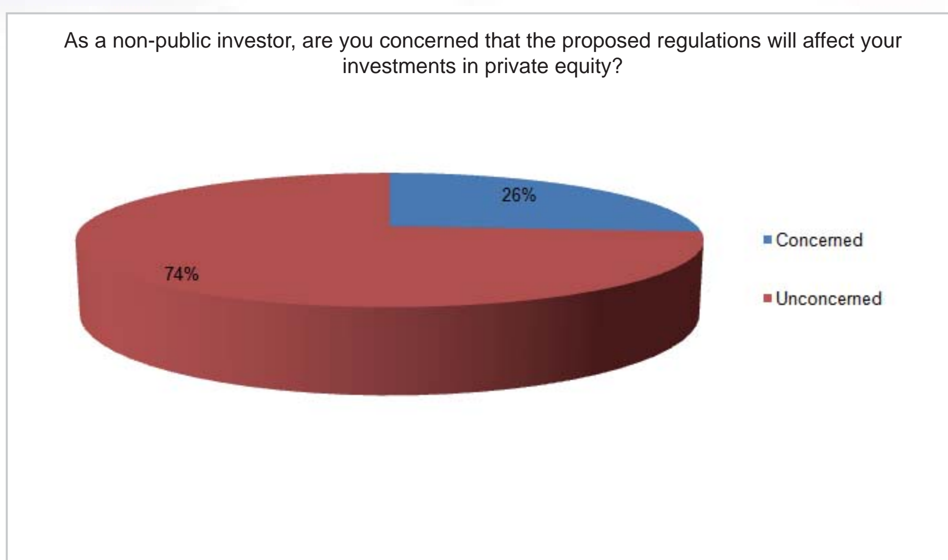
We also asked private investors whether they foresaw the proposed regulations, if passed, affecting their investments in private equity. Just over a quarter, 26%, were concerned it would affect their investments. An endowment said the changes "could possibly force out certain managers and affect [its] investments in the asset class." One investment company was concerned that "public pension funds are frequently the lead investors and this may have a knock on effect on everyone else."

Fig. 12:



Investors' Responses to the SEC's Proposal

The SEC found in 2005, in its dealings with the municipal securities market, that public disclosure of the terms of agreement between advisors and consultants under rule G-38 was not adequate to prevent circumvention of rule G-37, which "prohibits a broker-dealer from engaging in municipal securities business with a municipal issuer for two years after making a political contribution to an elected official of the issuer who can influence the selection of the broker-dealer."[6] Consequently, it amended rule G-38 to "impose a complete ban on the use of third-party consultants to solicit government clients."[7] The SEC is now proposing to apply the same additional legislation to the private equity industry to avoid such issues arising again.

However, although the results of our survey of investors clearly demonstrate that the majority of investors support the overall aim of the SEC's proposal – eradicating "pay to play" practices and seeking to reduce the potential for corruption and conflicts of interest in the fundraising process for alternative investment funds – 45% of investors we polled told us they disagreed with the prevention of placement agents from soliciting capital from public funds, compared to just 19% of investors who supported this aspect of the plan.

Investors frequently told us they find placement agents a valuable source of leads and market intelligence, some reasoning that they added an initial layer of screening to the overall fund evaluation process that, though not essential for the effective running of a private equity investment program, is certainly beneficial to the overall process. Many of the investors we spoke to were keen to stress the difference between legitimate placement agents and, what one public pension fund termed, "corrupt people who only called themselves placement agents, which have tarnished the reputation of these firms." Another public pension fund told us "it is not effective or efficient to introduce such wide-ranging, blanket bans on placement agents when the few individuals that try to beat the system will find a way to get round it eventually anyway."

The majority of investors were in favor of greater transparency and disclosure by GPs of the relationships they have with third-party placement agents, rather than, as one endowment termed the proposed partial ban of placement agents, "basically trying to swat a fly with a sledgehammer." Although demanding such transparency from GPs and avoiding the potential for managers to circumvent these regulations will be challenging, it is clear from our survey of investors that a complete ban on the use of placement agents by fund managers when approaching public funds is itself going to cause significant, and in most cases unnecessary, disruption to the industry and this aspect of the proposal fails to obtain support from most of the prominent investors in private equity that we spoke to.

[6] SEC Release No. IA-2910, pp. 8-9; pp. 43-44
[7] SEC Release No. IA-2910, p. 44

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Potential Effects of IA-2910

Proposed amendments to bill from investors

We asked investors that were aware of the SEC proposal whether they felt that it was appropriate to apply the same rules used in the bond market to the private equity market, regarding the use of third-party solicitors, since the proposal mentions in several instances that similar regulations are already in place in the bond market. As is apparent from the feedback below, the general feeling was that a tailor-made set of rules is required for private equity:

- **Public pension fund:** *It is not ideal. A tailor-made approach should be used. They have to understand the different roles that placement agents and "finders" have. Placement agents are not the bad guys.*
- **Public pension fund:** *The SEC will tweak its plan and make some changes to the rules it imposed on the bond market, which was far more ill-disciplined than the private equity market.*
- **Public pension fund:** *They're trying to solve very select problems with a "one size fits all" approach, but the concern is that it will affect very reputable firms.*
- **Public pension fund:** *This approach should not be implemented and a more specific, tailor-made one should be used.*
- **Public pension fund:** *This should not be used. The situation should be looked at differently and handled in a way specific to the industry in question.*
- **Endowment:** *They should not implement such a ban as the industries are very different. A tailor-made solution is best.*
- **Endowment:** *This is not suitable as it should be tailor-made for the private equity industry.*
- **Insurance company:** *A "one size fits all" approach is fine for clamping down on political contributions.*
- **Foundation:** *A tailor-made solution would be more appropriate.*

These responses demonstrate that the majority of institutional private equity investors would be in favor of the SEC devising a private equity-specific proposal to regulate the market rather than relying on a framework from a very different industry. However, as can be seen from the remark made by the insurance company above, a few investors do not feel that the proposal is an inappropriate fit for preventing future corruption. Nonetheless, the overriding view was that the proposal's approach to placement agents, the vast majority of which are viewed as reputable, is unsuitable.

We then asked the respondents that felt the prohibition of placement agents soliciting commitments from public pension funds was inappropriate what alternative regulations could be implemented that would better fit the requirements of the private equity industry. Some of their responses are listed below:

- **Public pension fund:** *Create legislation which means they have to mandatorily disclose any relationships they have with third party placement agents.*
- **Public pension fund:** *Have more regulation of state employees. Create an ethics body of some sort.*
- **Public pension fund:** *Implement a disclosure policy for placement agents and advisors.*
- **Public pension fund:** *It takes two to tango and it is not just placement agents that are involved in "pay to play" schemes. Elected officials need to be better regulated; the approach needs to take account of the fact that sometimes these people accept bribes.*
- **Public pension fund:** *Just to make everyone more comfortable, they can aim to have more disclosure from placement agents and managers.*
- **Public pension fund:** *Make all managers and placement agents fully disclose all relationships and payments.*
- **Public pension fund:** *Separate the banning of placement agents from the "pay to play" schemes. They are different things. Let there be strict disclosure and an increased amount of "qualification" rules for the placement agents to go through.*
- **Public pension fund:** *The problem is with the politicians and sole trustees, and corruption doesn't happen in situations where a governing council oversees the private equity program. With sole trustees, one corrupt person can get away with it, but when there are five or 10 other people, they will self-police.*
- **Public pension fund:** *We would love to see some sort of reporting requirements for private placements. We know that valuations are an issue but guidelines for reporting and regulation would be good. We think the situation at the moment is one of largely unregulated securities; the hedge fund industry blew up because of excuses to conceal info and private equity could be heading for the same.*
- **Foundation:** *Get the state in question to implement tougher punishments for the corrupt state and municipal employees.*
- **Endowment:** *Full disclosure of all conflicts of interests by the public entities, the placement agents and the managers.*
- **Endowment:** *Registration/vetting process of placement agents. This exists already but there should be wider use of code of conduct and disclosure regulations.*
- **Endowment:** *They should create legislation to make placement agents disclose more information, or some sort of body for them to register with.*

The general feeling amongst investors that are against the outright ban on placement agents is that the SEC should make them increase their transparency and levels of disclosure through new regulation and wider use of existing regulation, bringing about the full divulgence of any potential conflicts of interest. Additionally, a more comprehensive system of official registration for placement agents was frequently suggested. Although outside the remit of the SEC, another point brought up by several respondents was a greater focus on the elected officials at the public pension funds. Several investors felt that the officials needed to be better regulated and that decisions should be made by a council of trustees rather than one individual, as is the case at some public pension funds.

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Proposed amendments to bill from investors

Following up on this point, we then asked our respondents to elaborate on whether they felt there should be better regulation of state and municipal employees. Some of their comments are listed below:

- **Public pension fund:** *Yes. However, this is verging on impossible. How can they possibly do it?*
- **Public pension fund:** *This can be attempted but the SEC would have to give a guideline/template which the individual states then try to follow. It can be attempted but it will certainly be difficult to regulate.*
- **Public pension fund:** *No. If employees are already up to things they face criminal charges anyway. The structure is already in place for employees.*
- **Public pension fund:** *No, but make sure investment decision making is handled by a larger council with five to 10 members.*
- **Insurance company:** *Yes, they should certainly do more to monitor them.*
- **Foundation:** *Each state should find a way to regulate this. New York is the worst, with "pay to play" schemes being very rife.*
- **Endowment:** *This could be attempted but may not be easy to implement.*

Several respondents also mentioned that their particular states and others were already well regulated. As can be seen from the comments above, many investors are in favor of better regulation and oversight of state and municipal employees, but feel it would be very difficult to implement. Additionally, many feel that appropriate regulation is already in place, with criminal charges for those suspected of wrongdoings, but again enforcement is the issue. It has been suggested that larger investment boards would prevent such problems, with one corrupt official not being able to solicit payments when acting as part of a larger team.

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Suggested Alternatives to SEC Proposal

Preqin believes that there are viable and effective alternatives to the current proposed blanket ban on placement agents soliciting investments from public pension funds that would have fewer adverse consequences for the various actors in the industry:

- First, increased disclosure and reporting requirements, including communicating the nature of services provided by the placement agent on behalf of the private equity firm and the arrangements for the compensation of the placement agent by the private equity firm. There should be a disclosure, in the instance where a public pension fund has invested in a fund marketed to it by a placement agent, of the placement agent and fund involved.
- Second, all placement agents should be required to register as broker-dealers.
- Third, a ban on all political contributions by placement agents and associated parties should be implemented.
- Fourth, although it is outside the remit of the SEC, there should be better oversight of public pension funds, and investment committees should consist of a minimum number of members in order to prevent a sole official being responsible for the investment decision-making process.

We believe that these measures would be successful in preventing repeats of the "pay to play" episodes whilst preserving the important and hugely beneficial role that placement agents provide to private equity firms and investors alike.

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Preqin Research Report:
Potential Effects of IA-2910

Overview of US Public Pension Plans' Exposure to Alternatives

US-based public pension funds and other government-funded institutions form an integral part of the global private equity investor universe. Using figures from Investor Intelligence, we can see that these publicly funded institutions currently have $193 billion allocated to private equity. This equates to 38% of the aggregate capital allocated to private equity by North American investors and a considerable 20% of the aggregate capital allocated to private equity on a global basis, making them an essential source of capital to private equity funds worldwide.

In addition, public pension funds and government-funded institutions are also significant investors in other alternative asset classes, including private real estate, infrastructure and hedge funds, as shown in the table below. These funds will also utilize third-party marketers, including placement agents, in their fundraising processes, and therefore the investments made by public institutions in these asset classes will also be affected by the implementation of the SEC's proposal to ban third-party solicitors from securing investments from publicly funded institutions.

Table 1:

	Private Equity	Private Real Estate	Infrastructure	Hedge Funds [1]
No. Actively Investing	230	249	77	194
No. Considering Entering Asset Class	18	5	27	42
Aggregate Allocation ($bn)	193	193	16	82
Aggregate No. Fund Investments Made Since 2007	2,455 across all three types			N/A

[1] *Figures taken from Preqin's online databases Private Equity Investor Intelligence, Real Estate Online, Infrastructure Online and Hedge Fund Investor Profiles*

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Overview of Placement Agent Usage

Of the firms that successfully closed funds during 2008, 54% utilized a placement agent, representing an increase of 19% from the previous year. For funds closing to date in 2009, 51% have used a placement agent.

Which Firms are Using Placement Agents?

Using our data for funds closed in 2008, we were able to analyze the various factors that influence the likelihood of a fund manager employing a placement agent, including fund type, fund focus and manager experience.

Influence of Firm History

The level of experience of a fund manager has an impact on the likelihood of it turning to a placement agency for assistance in its fundraising campaign. As shown in Fig. 14, 39% of fund managers raising their maiden vehicles in 2008 used a placement agent.

More experienced fund managers, those raising at least their tenth fund, are the least likely to utilize a placement agent. Though these fund managers will have, in most cases, built up longstanding relationships with a core group of LPs, it is not surprising that 29% of them still use placement agents, since many will need to forge relationships with additional LPs during each fundraising campaign. They may use a placement agent in order to widen their investor base or to supplement their own fundraising efforts, possibly by gaining access to the network of investor contacts in particular geographic regions possessed by placement agents.

Effect of Use of Placement Agents on Achieving Fundraising Target

We have examined trends in the use of placement agents by GPs, but it is also worth considering the extent of the impact of placement agents on the success of fund managers' fundraising campaigns. Some benefits are difficult to quantify, such as the advice and guidance given by agencies and the access they provide to their network of investor relationships. However, using our data for funds closed in 2008, we have analysed the effect that placement agent use had on the likelihood of a fund manager hitting its fundraising target in the past year.

Of those firms that used placement agents in their fundraising efforts in 2008, 64% exceeded the target size of their funds, as shown in Fig. 15. In comparison, 45% of firms that conducted their own fundraising campaigns beat their initial targets, though an additional 21% managed to close their funds on target.

Fig. 13:

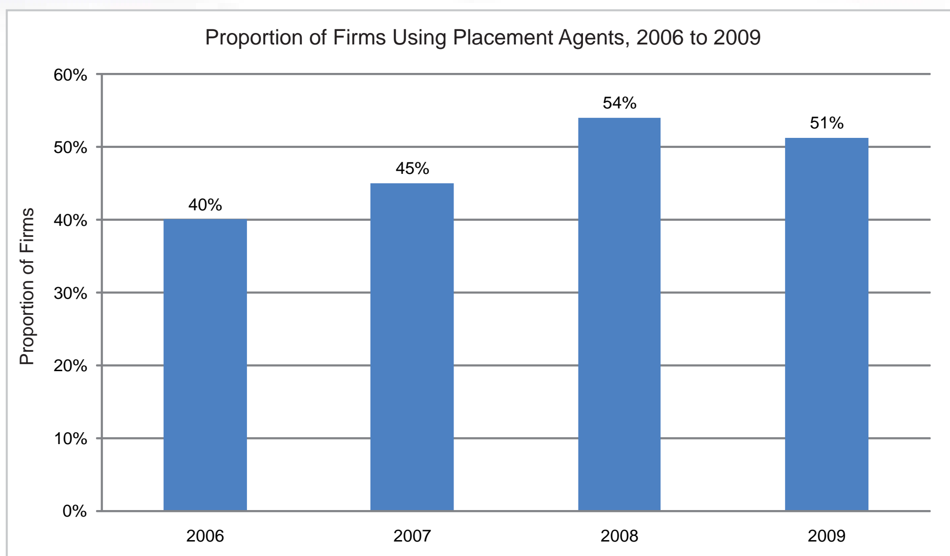
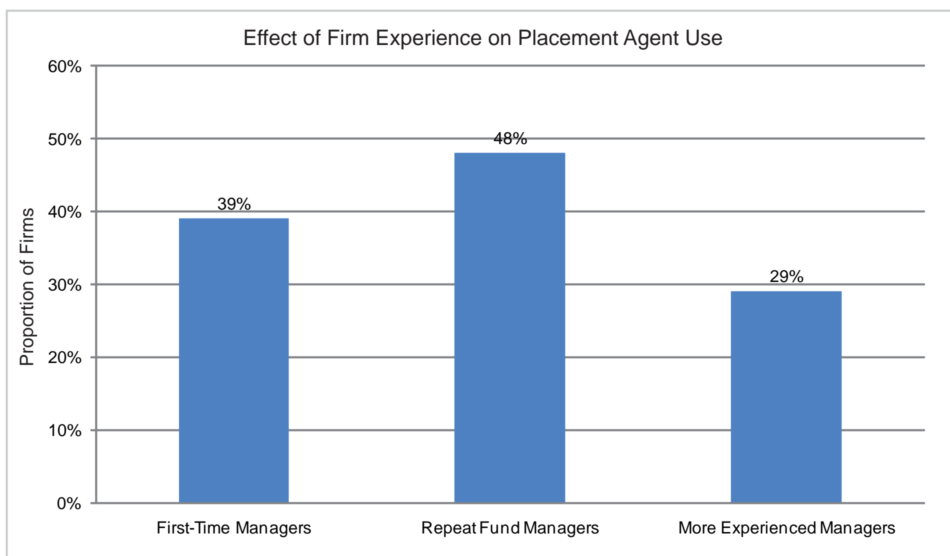


Fig. 14:



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Overview of Placement Agent Usage

Furthermore, 27% of GPs that used placement agents raised less than their targets, in comparison to 34% of those that sourced their own commitments. Therefore it is clear that the use of a placement agent can significantly increase the chance of a fund manager exceeding its target, although it has less of an impact on the likelihood of a fund manager falling below target. When examining just those funds that exceeded their target sizes, 59% used a placement agent.

Effect of Use of Placement Agents on Time Spent in Market

As Fig. 16 shows, 72% of funds that used a placement agent were able to close within 18 months of launch, with 34% achieving a final close within a year. For firms that did not use a placement agent, only 61% closed within 18 months of launching, although the 32% achieving a close within a year is broadly similar to those using a placement agent. A significantly higher proportion of funds that did not use a placement agent took more than 24 months to complete their fundraising compared to those funds that did use a placement agent.

Fig. 15:

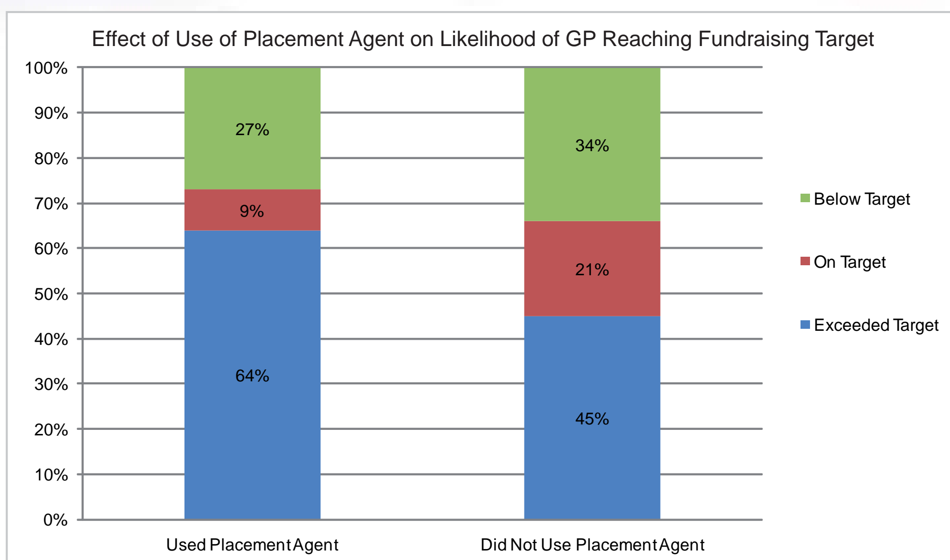
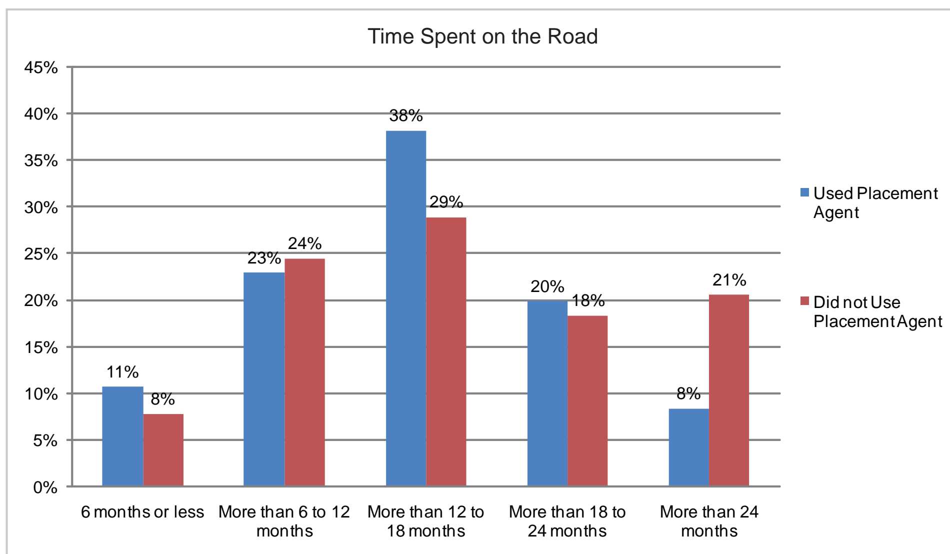


Fig. 16:



All figures in this section based upon data taken from Preqin's Funds in Market online database

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Preqin Research Report:
Potential Effects of IA-2910
Overview of Placement Agent Industry

Preference for Fund Type

We analysed the proportion of agencies which specialize in raising capital for funds of particular types, as well as those that will work on a variety of fund types. The results are shown in Fig. 17. As placement agents adapt to the new economic landscape, more of them are likely to specialize in a certain type or types of fund. 25% of placement agencies now specialize in fundraising for one particular type of fund, a significantly higher proportion than in 2007, when just 6% of agencies did so. Of this 25%, 65% specialize in fundraising for real estate funds and 12% for venture funds, whilst the remaining 23% specialize in securing capital for a variety of other types of private equity vehicle.

In 2008, 24% of placement agencies informed us that they specialize in raising capital for between two and four different types of fund. 51% of all placement agencies will work on a wide variety of fund types and do not have a particular fund specialization.

Preference for Fund Size

As shown in Fig. 18, nearly all placement agencies are willing to work on funds that are looking to raise between $100 million and $499 million, making this category by far the most popular range amongst firms in the industry. The next most popular choice was the $500-999 million range, with 44% of placement agencies happy to work on funds falling into this category. Only a small proportion, one-fifth, of placement agencies will work on funds with a target size of $1 billion or more. 17% will work on funds targeting less than $100 million

Size and Age of Placement Agents

Analysis of the size of placement agencies shows that more than half of firms have 10 or fewer members of staff, with approximately 30% having five or fewer employees and 23% having between six and 10 employees. 31% have more than 15 employees. Whilst smaller firms will typically only work on one or two funds annually, these larger agencies are obviously able to work on a higher number of funds and diversify their businesses to a greater extent. 56% of placement agencies operate from a single office, whilst 9% have five or more office locations.

Looking at the age of placement agencies in the private equity industry, we can see that 41% of firms were established before 1997, 34% were formed from 1997 to 2002, and around one-quarter have been set up since 2003.

Fig. 17:

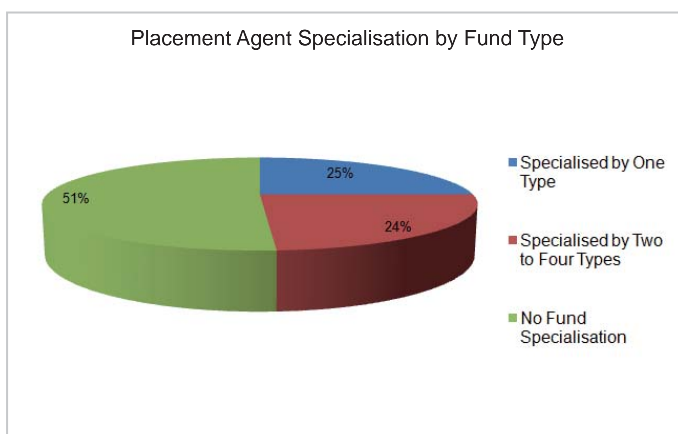


Fig. 18:

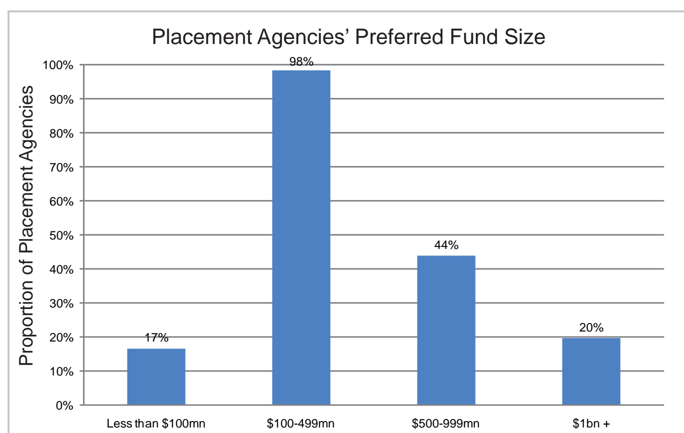
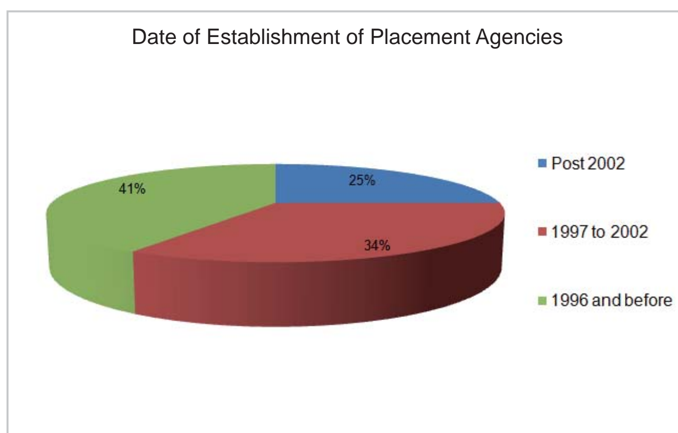


Fig. 19:



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Preqin private equity provides information products and services to private equity and venture capital firms, fund of funds, investors, placement agents, law firms, investment banks and advisors across five main areas:

- Fund Performance
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- Investor Profiles
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