STOCKHOLM SCHOOL OF ECONOMICSS
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New regulations' effect on fundraising and deal flow for Swedish private equity funds

A snapshot of the Regulatory Frameworks that will impact fundraising within the Swedish private equity and venture capital markets

Nicholas Sundén-Cullberg[α]   Niklas Wenneberg[β]

Abstract

The objective of our thesis is to map the regulatory landscape and discuss its expected impact on fundraising within the Swedish private equity market. Solvency II, Basel III and AIFMD are about to be implemented into European and national legislations. In order to understand the impact from these regulations on private equity fundraising, interviews have been conducted with some of Sweden's most prominent private equity fund managers and investors. We find that the Swedish fund managers and investors expect these regulations to have wide implications for future fundraising. We therefore expect the new regulatory landscape to affect the whole private equity value chain including investors, managers and their funds and portfolio companies. Although the AIFMD will increase costs and the administrative burden, Solvency II and Basel III/CRD IV are expected to have a more severe impact on fundraising and deal flow for private equity firms. In conclusion, no private equity firm or investor will be completely unaffected as the regulations come into force.

Keywords: Private equity, Fundraising, Solvency II, Basel III (CRD IV), AIFMD

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[α] 40117@student.hhs.se   [β] 40002@student.hhs.se

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1. Introduction

In 2008, fundraising in the European private equity market reached top levels, and almost EUR 100 billion was raised over the year. The Nordic private equity market, a market that Sweden dominates in terms of amount of capital raised, has historically been the most active within continental Europe (Unquote, 2009). Due to the financial crisis, few new investments into private equity funds were made in 2008 to 2010, and going forward, we expect the competition for capital to be fierce as the market is faced with financial uncertainty but also with a changing regulatory landscape that we believe will cause long lasting changes in the private equity sector. EU-wide regulations, currently under implementation, will affect private equity investors, as well as private equity and venture capital fund managers. A framework for alternative investment fund managers, AIFMD, will become effective in July 2013; a framework for life insurance companies, Solvency II, is planned to become effective in October 2012, and; an updated regulatory framework for banks, Basel III/CRD IV, will be phased in over the years 2013-2019.

Our thesis presents a theoretical overview of Solvency II, Basel III and AIFMD and discusses its expected impact on fundraising on the Swedish private equity market. The thesis will focus on Swedish investors that invest in Swedish private equity funds. Core research questions are: How will life insurance companies respond to Solvency II and how will banks react to Basel III/CRD IV, in terms of investments in private equity? How will AIFMD affect private equity fund managers and its investors? These core questions will help us understand; *"how will the new regulatory landscape affect fundraising and deal-flow for Swedish private equity firms in years to come?"* The potential areas of impact are formulated within four hypotheses:

Hypothesis 1*: Regulatory changes will negatively affect fundraising capabilities*
Due to conservative capital requirements in Basel III and Solvency II, we expect less well capitalized banks and insurers to decrease their private equity investments

Hypothesis 2*: AIFMD will affect all private equity fund managers*
Due to certain thresholds, not all private equity fund managers will abide directly under the AIFMD. However, due to AIFMD's suggested validation effects and its guiding properties on new national legislation, all fund managers will in reality be affected by it

Hypothesis 3*: Information sharing from private equity fund managers to investors, regulators as well as to the public will increase due to AIFMD*
The private equity industry has been criticized for limited disclosure to stakeholders. AIFMD aims to increase openness and disclosure in the industry

Hypothesis 4*: Fees charged to fund investors will increase due to AIFMD*
AIFMD will increase the administrative burden and costs for private equity firms. We believe that these costs will increase the fixed fees charged to fund investors

In order to confirm these four hypotheses, interviews have been conducted and questionnaires have been collected from investors in (LPs) and managers of (GPs) Swedish private equity and venture capital funds. The findings are analyzed with our theoretical toolbox presented in chapter 3, in order to understand the impact from the regulations on the private equity industry.

Solvency II, a framework that introduces a comprehensive risk measurement framework for insurers and reinsurers in the EU, is expected to affect insurers' ability to invest within private equity. Solvency II provides a common regulatory approach for defining required capital levels and for implementing procedures to identify, measure, and manage risk levels. The capital requirement calculations in Solvency II should be aligned to the specific risk profile of the undertaking, for example investing in alternative assets such as private equity (Meyer, 2011).

We find that the conservative capital adequacy requirements under Solvency II will force some life insurers to reduce their commitments to private equity in the future. The effect from the implementation of the framework will depend much on how well capitalized the individual life insurers are. Well capitalized, often large, life insurance companies will be able to continue making commitments to the asset class. These insurers generally invest into large private equity funds. Less well capitalized, often small-medium sized, life insurance companies are more likely to abandon the asset class. These insurers generally invest into small-medium sized private equity funds. Therefore, we expect that the impact from Solvency II, on private equity funds' capacity to secure commitments from insurers, will impact smaller funds to a wider extent. Larger funds will naturally also be affected, but management teams with good track records will still be able to have their new funds fully invested.

We find that Solvency II is expected to impact the distribution of assets within insurers' investment portfolios, steering investors toward low risk assets, sovereign or central bank debt securities, and away from equities. Further, due to large scale advantages in the insurance industry stemming from increased regulations, we expect consolidation effects within the life insurance market. Consolidation within the insurance market will lead to consolidation also within the private equity market, since large insurers demand the opportunity to invest within large private equity funds.

Just like in Solvency II, the capital requirements for banks under the **Basel III (CRD IV)** framework are conservative. According to the Basel Committee on Banking Supervision (BCBS), one of the main reasons why the previous economic and financial crisis became so severe was that banks were highly leveraged. The banks were also holding insufficient liquid buffers and therefore were not able to absorb trading and credit losses. The Basel III framework therefore aims at strengthening capital and liquidity rules in order to establish a more resilient banking sector. The liquidity rules will be implemented through two measures for funding liquidity, the Liquidity Coverage Ratio and the Net Stable Funding Ratio (BIS, 2011a).

We believe that those banks that have earlier invested in private equity from their own books will have much less capacity to do so, once the new regulatory framework comes into force. However, the commitments from banks to Swedish private equity funds in the last three years are negligible, hence the effect that the framework can have on the Swedish private equity fundraising market going forward is highly limited. However, our main finding in relation to Basel III/CRD IV is its impact on banks' decreased ability to, and increased cost of, lending to private equity portfolio companies. Therefore, we believe that Basel III/CRD IV will have an instrumental impact on the large buyout funds that normally use high levels of leverage on their portfolio companies.

The Alternative Investment Fund Managers Directive **(AIFMD)** will establish a framework for all European alternative investment fund managers ("AIFM") and all AIFMs that manage or market alternative investment funds ("AIF") within the European Union. AIFMD aims at establishing common requirements governing the authorization and supervision of AIFMs in order to provide a coherent approach to the related risks and their impact on investors and markets in EU. AIFMD is designed to establish a secure and harmonized framework that will monitor and supervise the risks that AIFMs pose to their investors, counterparties and other market participants. The Directive also aims to permit, subject to compliance with strict requirements, AIFMs to market and manage their funds across EU (European Parliament, 2011).

We find that AIFMD will affect all private equity fund managers, even those who are not immediately required to abide under it. Some large Swedish private equity funds have their AIFMs registered in non-EU domiciles, e.g. Jersey or Guernsey. This means that they will not abide directly under the Directive nor be directly affected by it. But since the European market is such an important fundraising market, we expect that those who are not automatically included under AIFMD will seek authorization under it anyway. Those fund managers that manage funds below the threshold size for mandatory abidance, see that AIFMD has positive validation effects for their funds, and will for that reason seek authorization under it. A third category of fund managers, whom will not seek authorization under AIFMD, will still be affected by AIFMD due to its impact on national legislation. Therefore, we find it alarming that a significant amount of Swedish AIFMs have given AIFMD limited or no thought at all. As mentioned above, we believe that all AIFMs will be directly or indirectly affected by AIFMD and it is therefore important that those managers, wrongly assuming they will only be marginally affected or completely unaffected, prepare their management teams and evaluate how the AIFMD will impact their business model.

In conclusion, we see that small or newly started private equity firms will be hardest hit by the regulatory frameworks, AIFMD and Solvency II, when it comes to raising capital for new funds in the future. These funds will struggle to manage the increased costs due to AIFMD but also to attract new capital due to Solvency II, which was probably not the intention of regulators at the outset. Since many entrepreneurial businesses and technology developing companies are financed by venture capital or small private equity funds, we believe this may have detrimental effects on the growth and innovation prospects of the Swedish economy as a whole. Large buyout funds will probably manage the changes from AIFMD and maintain attractiveness from large life insurers, but we expect that they will be heavily affected by Basel III, since the cost and availability of leverage will affect their expected returns. Further, we expect incoming regulations (Solvency II and Basel III) to bolster consolidation within the financial markets. As a result of fewer and larger investors, consolidation of private equity firms will follow.

Our thesis is structured as follows. Section 2 gives an overview of historical figures for fundraising in Sweden and a mapping of important investors within private equity. Section 3 gives a theoretical overview of AIFMD, Solvency II and Basel III and present our thesis hypotheses. Section 4 reviews the methodology and discusses the practical implications of our interviews. Section 5 presents our results and Section 6 contains a summary and discussion of our results. Finally, sections 7 include concluding comments and implication for future research, respectively.

2. Overview of the Swedish private equity market and its investors

The level of commitments to private equity firms depend on various factors. Gompers and Lerner (1996) find that firm specific characteristics, like track record and reputation, affect fundraising for private equity organizations, but they also find that regulatory changes affect private equity organizations' fundraising capabilities. Our thesis attempts to investigate whether future regulations will affect fundraising for Swedish private equity and venture capital funds. In this section, we analyze the role of different investor types, and their importance for the Swedish private equity industry. Prior to this we present an overview, based on previous research, of the relationship between GPs and LPs.

2.1. GP-LP relationship

A private equity or a venture capital fund is usually structured as a partnership or limited liability corporation, where the limited partners (investors) provide most of the capital and the general partners are responsible for managing the fund (Kaplan and Strömberg, 2009). These organizations are usually lean, decentralized organizations with relatively few investment professionals and employees (Jensen, 1989).

The limited liability corporation is usually structured as a "closed-end" fund[1], where investors commit to provide a certain amount of capital (Kaplan and Strömberg, 2009). The committed capital will be used for investments, for management fees and for administrative costs. Investments within a closed-end fund cannot be withdrawn and the market for selling these commitments is generally characterized by high illiquidity. Hence, a commitment, which is usually sold when the fund or the investor is in financial distress, will be subject to major write offs.

The fund usually has a fixed life of approximately ten years, but the fund-life can be prolonged for a few additional years. A fund life-cycle can be described with different phases. The first period, usually up to five years after the fund is fully committed, is the investment period during which committed capital is invested into companies (portfolio companies). After the investment period, the fund has an additional five to eight years to exit its investments and return the capital to its investors (Kaplan and Strömberg, 2009). If possible, a new fund is established well before the previous fund is closed. Hence, a private equity or a venture capital firm usually has several funds under management at the same time, although in different life-cycles as described above.

A private equity partnership consists of three main constituencies: partners within the private equity firm, institutional investors and company managers (Jensen, 1989). A company manager holds an equity stake in the portfolio company where he is involved, and thus does not hold an equity stake in the private equity fund directly. The equity stake establishes higher incentives for the manager to create value than compared to when the manager has little or no equity stake in the outcome of the company. But there are also severe penalties involved in the incentive scheme which usually vest the manager's equity stake if underperforming (Sahlman, 1990). This incentive scheme structure is an important feature in the private equity model and is argued to be important in order for the funds to create value from their investments.

The limited partners in a private equity fund usually consist of larger insurance companies, pension funds and other financial institutions such as fund-of-funds and banks. Other investor categories that commit large amounts of capital to private equity funds are sovereign funds, foundations,

[1] See Stein (2005) for analysis of the economic differences between "closed-end" and "open-end" funds

endowments and wealthy family offices. The importance of different investor groups varies geographically and over time, which will be discussed in section 2.2.

A venture capital fund is usually structured in a similar way as a private equity fund with a limited partnership agreement. Divergences from the private equity model are that a venture capital fund focuses on investments within early-stage companies and that previous owner or managers within the portfolio companies have higher equity stakes (Sahlman, 1990). The limited partners usually consist of smaller financial institutions and foundations but it is also common that wealthy individuals invest in venture capital funds.

According to Gompers & Lerner (1996), the terms and conditions that govern the contractual relationship between general and limited partners are critical to limiting opportunistic behavior and ensuring allocation efficiency. Basically, the general partners are responsible for the committed capital of the fund, and as long as basic covenants are fulfilled the limited partners have little to say about the choice of investments and other strategic decisions (Kaplan and Strömberg, 2009). Covenants usually put restrictions on that key management need to stay within the fund over its life-cycle. Another important covenant restricts how much fund capital that can be invested in a single portfolio company. Apart from these covenants, the partnership agreement set out the rights and obligations of each group. The compensation system or the fee structures to general partners are an important feature in this partnership agreement. The fee structure usually consists of one base fee and one bonus component. The fee structure applied usually follow the 2/20 rule, where the limited partners pay a fixed fee of 1 to 2% of the committed capital and 20% of the returned funds above the initial capital (Chung et al, 2010).

2.2. Fundraising

2.2.1. Sources of raised capital

In late 1990s, European fundraising experienced substantial growth driven by booming technology markets and increasing activity from European buyout firms. The fundraising environment was affected by the crisis in early 2000s but recovered and started to increase in 2005. In 2008, the fundraising in the European private equity market reached top levels, when almost EUR 100 billion was raised (Unquote, 2009). The Nordic market has several well-established buyout and venture firms with track record of 20 years and more and has historically been one of the most active areas for private equity in continental Europe. Sweden is the dominant market in the Nordics, in terms of the amount of capital raised (Unquote, 2009). See table 1 for European and Nordic fundraising statistics between 1998 and 2008.

Table 1 - European fundraising statistics 1998-2008

Region	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Nordic	**1 761**	**1 111**	**4 196**	**3 111**	**124**	**3 295**	**3 871**	**2 504**	**10 089**	**5 077**	**8 965**
Nordic % of total	***11%***	***49%***	***10%***	***8%***	***0%***	***16%***	***26%***	***5%***	***15%***	***8%***	***9%***
Benelux	87	632	1 168	549	26	0	670	108	1 848	640	2 014
DACH	619	1 277	3 449	205	1 124	761	748	103	1 657	2 731	3 565
France	1 016	1 839	3 031	2 106	3 527	629	426	6 293	6 082	3 315	1 038
Southern Europe	348	663	3 299	1 112	775	123	605	127	1 029	3 765	341
Continental Europe	3 831	5 522	15 143	8 928	6 692	5 915	632	11 205	20 705	15 527	28 334
UK & Ireland	11 366	11 625	17 172	24 618	1 221	13 554	743	2 858	34 713	31 787	30 797
Other	1 257	5 564	8 648	4 272	5 915	600	887	9 442	11 709	17 482	37 152
Totals	16 454	2 271	40 963	37 818	24 817	20 069	14 637	49 226	67 127	64 795	96 283

Fundraising in 2009 and 2010 has been very slow due to the financial crisis, since many of the larger formalized European investment programmes were on hold throughout late 2008 and 2009. Therefore, the fundraising statistics for these years do not give a fair view of what the expected split between investor types will be in 2011 and onwards, nor are they comparable with the distribution patterns during prior years. Figure 1 compare fund raised with investments between 2000 and 2008 in Europe and figure 2 illustrate fund raised in Sweden from 2005 to 2010. These figures illustrate the drastic slowdown in fundraising for 2009 and 2010.

Figure 1 - European fundraising and investments between 2000 and 2010

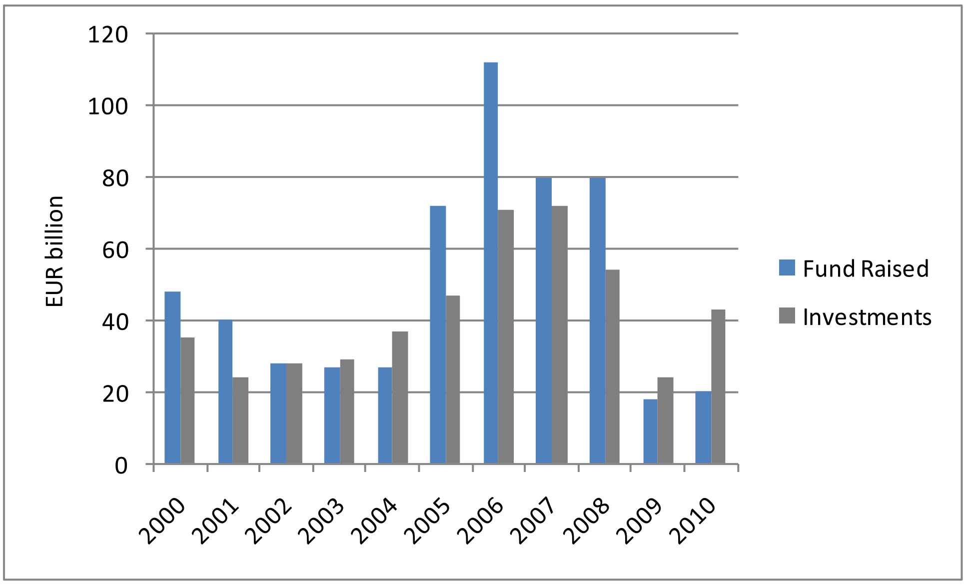
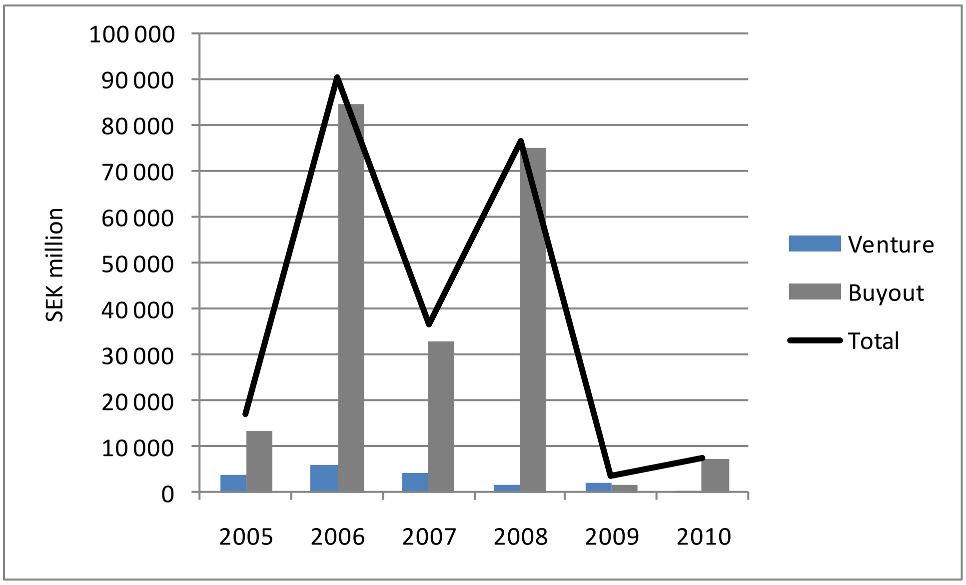


Figure 2 - Sweden fundraising between 2005 and 2010



We focus on figures from 2006 to 2008 in order to determine key sources of capital for Swedish private equity firms, since we believe that the years prior to the financial crisis, i.e. before 2009 provide data that is more informative. Key sources of capital for Swedish Private Equity funds are fund-of-funds, life insurers and pension funds including the Swedish National Pension funds. Looking at historical figures from SVCA between 2006 and 2008, these four investor groups have contributed with the majority of all private equity capital raised in the last five years. Pension funds have made the largest aggregated investment (33% of total fund raised) and fund-of-funds have made up for an increasingly large proportion of total investments (25% in of fund raised). Life insurers' investments in private equity have also increased, from almost anything in 2006 to around 14% in 2008, amounting to around 8% of total investments in the industry. Banks, on the other hand, barely invested anything into the Swedish private equity sector in 2008. In aggregate, banks' investments have constituted around 8% of total financial resources invested into the Swedish private equity funds between 2006 and 2008 (SVCA, 2006 to 2010). See table 2 for key sources of capital, by type of investor, for the Swedish private equity market between 2006 and 2010.

Table 2 - Key sources of capital, by type of investor, for Swedish private equity market between 2006 and 2010

Type of investor	2006	2007	2008	Average (2006-2008)	2009	2010	Average (2006-2010)
Pension funds	35%	17%	39%	**33%**	4%	4%	**32%**
Life insurers	0%	12%	14%	**8%**	2%	0%	**7%**
Fund-of-fund	20%	34%	26%	**25%**	11%	43%	**25%**
Banks	16%	7%	0%	**8%**	17%	0%	**8%**
Other	29%	30%	22%	**26%**	66%	52%	**28%**
Fund raised (SEKm)	90 603	36 822	76 820		3 728	7 445	

From a geographical perspective, European- (outside the Nordic region) and North American investors have invested the largest portion of capital to private equity in 2006-2008. However, Swedish investors are an important source of the capital invested in the Swedish private equity market. Between 2006 and 2008, Swedish investors contributed on average with 15% of total capital.

In the period between 2009 and 2010, a period characterized with uncertainty in the financial markets, Swedish investors constituted for a larger proportion of the total capital invested within Swedish private equity and venture capital funds. See table 3 which illustrate the geographical distribution of raised capital within the Swedish private equity market (SVCA, 2006 to 2010).

Table 3 - Key sources of capital, by type of region, for Swedish private equity market between 2006 and 2010

Geographical Source	2006	2007	2008	Average (2006-2008)	2009	2010	Average (2006-2010)
Sweden	16%	16%	13%	**15%**	52%	50%	**29%**
Other Nordics	16%	16%	14%	**15%**	14%	0%	**12%**
Other Europeans	29%	43%	30%	**34%**	29%	38%	**34%**
North America	25%	25%	30%	**27%**	4%	12%	**19%**
Rest of world	14%	0%	12%	**9%**	0%	0%	**5%**
Unknown	0%	0%	0%	**0%**	0%	0%	**0%**
Fund raised (SEKm)	90 603	36 822	76 820		3 728	7 445	

2.2.2. Outlook

Few new investments in private equity were made in 2010 and many of the larger formalized European investment programmes were completely put on hold throughout late 2008 and 2009. Going forward, the fundraising environment is expected to become more polarized, with the most popular funds raising capital very quickly, while others struggle to reach their fundraising targets (Unquote, 2011). This is because the competition for money is scarce, and although 2011 may be a better year for fundraising, a crowded market means that only those fund managers with a good track record, and a well-defined investment strategy will be able to get their funds fully invested (Unquote, 2011). The prospects for first time funds, which lack a strong and familiar investor base, are daunting to say the least (Unquoute, 2010a). LPs generally concentrate their allocations to fewer funds, which strengthen the theory of a highly polarized market.

2.2.3. Swedish investors

For **banks,** appetite for Swedish PE investments is low. Banks have barely invested anything within the Swedish private equity market from 2008 and onwards (see table 2). The figures for the European market look different, since banks were an important source of capital for European private equity funds between 2006 and 2010 (EVCA, 2011a). Banks are currently regulated under the Basel II framework (CAD III in Europe), but will abide under the Basel III/CRD IV, expected to be phased in between 2013 to 2019.

Fund-of-funds will continue to play an important role in the private equity industry (Preqin, 2011). Their investment strategy provides investors with a reduced-risk approach to the asset class private equity, through diversified investment portfolios. Because these funds have relatively low minimum commitments levels, they usually have a diversified investor base consisting of many small investors. Hence, an investor that is not able to commit capital directly to a private equity fund can get exposure to the asset class. With more than 280 active managers of private equity fund-of-funds in the world, investors have a considerable amount of fund-of-funds to choose from (Preqin, 2011).

A fund-of-fund is either regulated under UCITS (Undertaking for Collective Investment in Transferable Securities) or will be regulated under AIFMD *(The Alternative Investment Fund Managers Directive)*.

The original UCITS directive from 1985 has been amended over the years through three new directives, the latest in 2001. A new UCITS directive (UCITS IV) was published in 2009, and was implemented into Swedish law in August 2011 (European Parliament, 2009).

Swedish Funds that are regulated under UCITS are open-end funds that mainly invest in listed securities. Investments in other assets, such as private companies, real estate and commodities are not allowed for a UCITS fund, and therefore, a private equity fund-of-fund will instead be regulated under the AIFMD (Fondbolagen, 2011).

For **insurance companies**, a traditional investor in private equity, appetite for private equity investments is relatively stable. As the market has settled down somewhat after the financial crisis, the majority of experienced LPs have made little or no change to their investment strategies because they remained conservative in their approach throughout the greatest excesses of the boom period, endeavoring to back the best teams and assessing the individual risks associated with each commitment on a case-by-case basis (Unquote, 2010b). However, this investor group will face a challenge in coming years, due to increased capital requirements in Solvency II that will be implemented in January 2013.

Most of the pension provisions in Sweden are managed by life insurance companies, and a similar trend can be seen in a few other countries within Europe. Therefore, this capital will also effectively be subject to the Solvency II regulation. In 2010, Swedish life insurance companies had SEK 1 463 billion in assets under management and institutions for occupational retirement provision had SEK 81 billion under management. The Swedish government is currently investigating whether institutions for occupational retirement provision, if managed under a separate legal entity, shall abide under Solvency II or IORP (Finansinspektionen, 2011). In January 2006, the Directive on Institutions for Occupational Retirement Provisions (IORP) was implemented in Sweden (Homenius and Söderström, 2007). A new regime (IORP II) will be established for pension funds and Solvency II is likely to set the tone. Since life insurance companies manage pension provisions to a large extent in Sweden, we will focus solely on the impact of Solvency II with regard to fundraising within the Swedish private equity market.

Appetite for private equity among the world's **pension funds** is particularly strong. Equity portfolios have eroded to the extent that they are barely out-performing gilts and government bonds. And in the global reality of pension deficits, these investors are forced to seek higher returning assets to plug the gaps. If these investors accept the illiquidity of the asset class, then private equity remains an important tool (Unquote, 2010b). Pension funds are the largest investor group within the Swedish private equity market (see table 2). This investor group includes Swedish national pension funds and therefore, an overview of the Swedish national pension funds can be seen below.

The purpose of the **Swedish National Pension Funds** (AP-funds) is to increase the stability of the Swedish pension system. More specifically, AP1, AP2, AP3, AP4, and AP6 (buffer funds) are structured to even out periods with under- or over balance between incoming and outgoing payments. The system is built up so that the incoming payments finance the outgoing payments, which could be characterized as a "pay as you go" – system where the basic idea is that the system is supposed to be self financing (McKinsey&Company, 2011).

AP1, AP2, AP3, and AP4 approximately manage 25% each of total AUM (SEK 895 billion) and the allocation to alternative investments from the four National Pension Funds has experienced a successive increase from 3% in 2005 to 10% in December 2010, of which 3% is invested in private equity funds. AP3 has the highest allocation to alternative investments at approximately 14% (McKinsey&Company, 2011).

Comparing investment strategies with comparable foreign pension funds, the allocation to alternative investments is substantially lower. Foreign pension funds are allocating between 18 to 38% to alternative investments, where 5 to 15% consists of private equity investments. One important factor for these differences is that the AP-funds are more restricted than its European peers. The allocation to private equity for AP1, AP2, AP3, and AP4 is limited by Swedish law (2000:192). According to (4:1) the overall risk level should be low, and in (4:8) it is stated that allocation in non-public private equity firms cannot exceed 5%. According to (4:9), AP1, AP2, AP3, and AP4 are not allowed to own more than 30% of outstanding shares in a private equity fund.

AP6 is one of five buffer funds but the investment strategy differs a lot from AP1, AP2, AP3, and AP4. It is regulated under the law (2000:193) and according to (3:1) the fund should solely invest in the private equity and venture capital market, both through fund investments and direct investments. The fund had a total capital of approximately SEK 20 billion in December 2010, and has experienced an average return after costs of 4.7% between 1997 and 2010. This return is mainly driven by investments in mature companies (17.7%) and listed small cap companies (13.0%). Investments in companies within an expansion face experienced a negative return for the same period of 7.5%. AP6 is divided up in seven strategic business units where the two largest units are direct investments and fund investments with SEK 7.7 billion and SEK 7.6 billion in AUM, respectively. Hence, fund investments correspond to approximately 38% of total AUM. This business unit invests in both private equity and venture capital funds (McKinsey&Company, 2011).

AP7 manage the individual premium pension, through an aged-based combination of their equity and interest fund. AP7's main philosophy is passive management but approximately 25% of the capital is under active management. Private equity investments are included in the capital that is actively managed. AP7 is regulated under the same law as AP1 to AP4 and therefore subject to the same restrictions as mentioned above (McKinsey&Company, 2011).

In this section we have investigated the role of different investor types, and their importance for the Swedish private equity industry. An overview of allocation from different investor types can be seen in table 2. Capital from life insurers constituted 8% of total capital between 2006 and 2008. Life insurance companies will be regulated under Solvency II, a framework that also will set the tone for the development of IORP II, a framework for pension funds. Capital from pension funds, including Swedish national pension funds, constituted 33% of total capital between 2006 and 2008. Investments from fund-of-funds constituted 25% of total capital between 2006 and 2008, and the importance of capital from fund-of-funds are expected to increase in coming years. Fund-of-funds that primarily invest within private equity companies will be regulated under AIFMD. Although banks have decreased its allocation to Swedish private equity from 2008 and onwards, they still represent an important source for European private equity funds. Banks are also important in order to facilitate leverage within portfolio companies for private equity funds. Banks will be regulated under Basel III/CRD IV.

3. Regulations

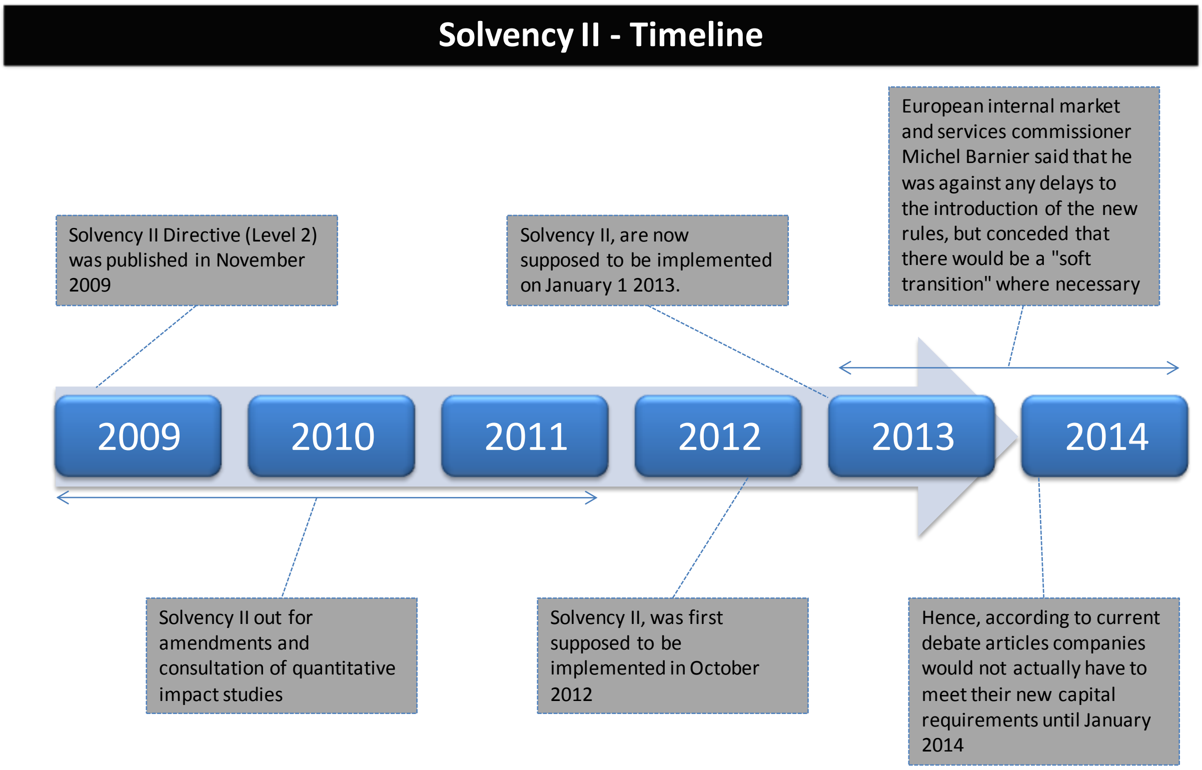
In this section we present a theoretical overview of the new regulatory landscape, Solvency II, Basel III and AIFMD. We expect these regulations to have a wide impact on the Swedish private equity market. We define our beliefs about how these regulations will affect the Swedish private equity market with four hypotheses, presented at the end of this section.

3.1. Solvency II

Private equity allocations under Solvency II

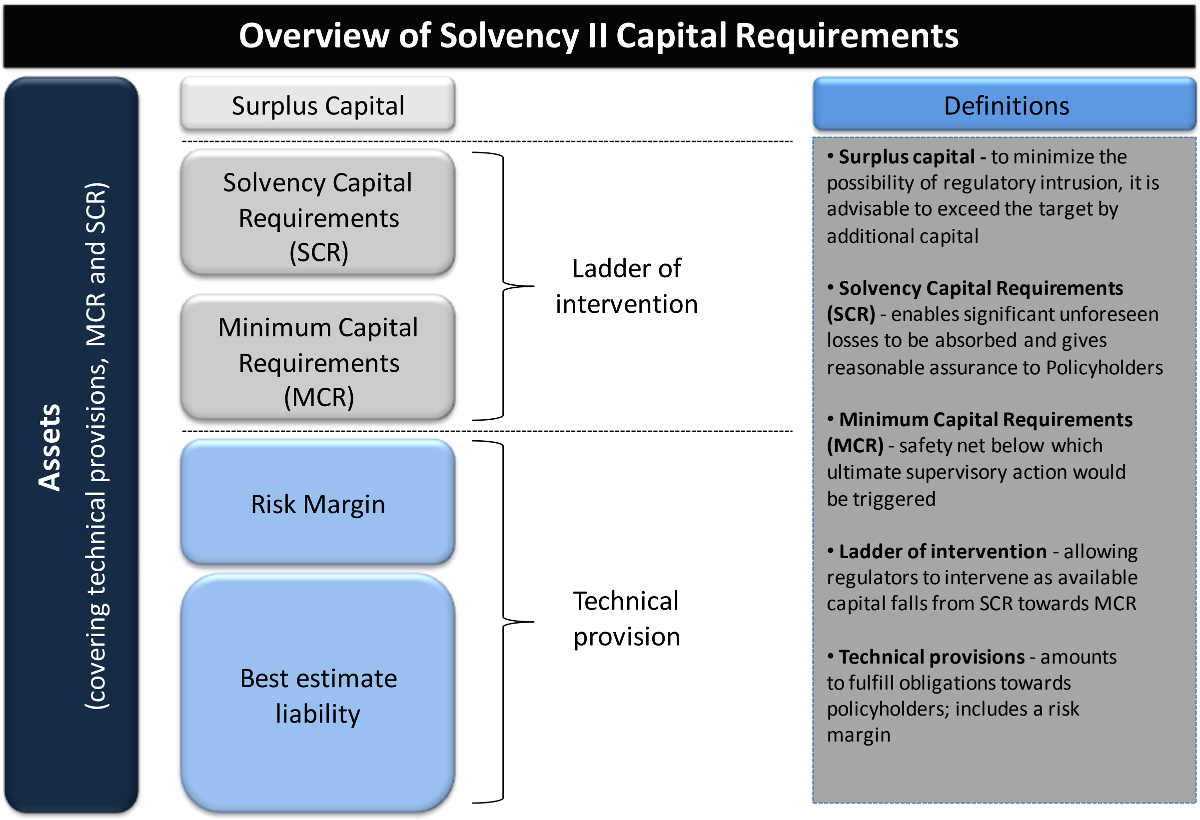
The regulatory framework Solvency II introduces a comprehensive risk measurement framework for insurers and reinsurers in the EU. It provides a common regulatory approach for defining required capital levels and for implementing procedures to identify, measure, and manage risk levels. The rationale is to facilitate the development of a single market in insurance services in Europe (Meyer, 2011). Solvency II is scheduled to come into effect on January 1, 2013 but there might be delays to the introduction of the new rules. See figure 3 for a timeline of Solvency II.

Figure 3 - Timeline of Solvency II



The framework is based on economic principles where risks are captured by subjecting assets and liabilities to an adverse shock test. The capital requirement calculations should be aligned to the specific risk profile of the undertaking, for example investing in alternative assets such as private equity. The capital requirements consist mainly of two thresholds. The first is the Solvency Capital Requirement ("SCR"); supervisory action will be triggered (based on the governance rules defined under pillar II) if an insurer's resources fall below this level. The second is the Minimum Capital Requirement ("MCR"). It will define the level at which the supervisory authority can invoke severe measures, including the closure of the company to new business. See figure 4 for an illustrative overview of Solvency II capital requirements (Studer and Wicki, 2010).

Figure 4 - Overview of Solvency II capital requirements



Solvency I regime, the predecessor of Solvency II, went into effect for member states of the European Union in January 2004. It is a relatively simplistic yet robust approach to the supervision of insurers' capital. It mainly relies on minimum standards. Solvency II, on the other hand, aims to create a risk-based supervision reflecting the trend in international best practice which in recent years has leaned toward the risk-based regulatory approach. Solvency II puts forward two different approaches for measuring risks, an internal model or a standard model:

a) The "Internal Model"

Insurance companies will be able to adopt their own models and calibrations once they have received the approval of their supervisors. Insurers are encouraged to implement internal models to assess their risks as accurately as possible. They can do this for the entirety of their balance sheet or alternatively they can opt to use internal models only for some components of their balance sheet, for example alternative investments such as private equity (Studer and Wicki, 2010).

According to Meyer (2011), setting up partial internal models is not likely to be as costly for smaller and mid-sized insurers as first might be expected. However, there is a chance that the policymakers' continuously perceive private equity as a "high risk asset". Therefore, the internal model approach could be conditioned to specific floors under which the insurance companies could not go below even if their own estimates of risk advocate for lower stress test (Meyer, 2011).

b) The "Standard Model"

Because implementation of the internal model can be difficult and costly, the European Commission also established a scenario based "standard model" approach to cover the entire spectrum of risks faced by an insurer. In the standard model risks are computed into modules for which separate Solvency Capital Requirements (SCR) are computed. For each module the value-at-risk is approximated by the changes that come from a pre-specified shock. Private equity investments are included in the category “Other Equities” in the “Equity Risk” module. Other Equities include other asset classes such as commodities, hedge funds and emerging market public equity. Based on the current proposal, “Other Equities” and thus investments in private equity are subject to a base shock of 49% (Studer and Wicki, 2010).

In order to determine the appropriate stress factor, i.e. the base chock of 49%, the Committee of European Insurance and Occupational Pensions Supervisors (“CEIPOS”) use the LPX 50 index for private equity calibrations. The stress factor proposed by these calibrations suggest capital requirements of 70 % for private equity exposure and a study performed by Sanyal (2009), using the LPX 50 Value Weighted Total Return, suggested capital requirements of 72%. Several stakeholders have argued against the suitability of using the LPX 50 index, even though these calibrated stress factors are higher than the stress factor applied for private equity within the Solvency II framework (Studer and Wicki, 2010). The main argument against LPX 50 is that it is not representative of a typical institutional private equity portfolio. The index is also argued to be heavily overweighed to European, especially UK, private equity investments and is therefore argued to have higher idiosyncratic risk that the diversified portfolio of a large institutional investor. Since the funds within LPX 50 are traded, the returns on the LPX 50 are also subject to significant volatility from premiums/discounts to NAV, which is highly dependent on the general financial market environment and does not, to full extent, reflect the underlying portfolios of the funds. Finally, the relatively small data history for private equity limits the explanatory power of these statistical analyses. Although, Sanyal (2009) saw LPX 50 as the best proxy because better data for this asset class were not available, other alternatives for the calibrations of stress factors exist within Solvency II. According to Studer and Wicki (2010) data from large institutional investors such as public pension funds and endowments, suggests stress factors for private equity of 25-35%, less than half the stress factor suggested by the LPX 50. As will be discussed below, chances are slim that private equity investments under Solvency II will arrive at more favorable stress levels, since it would be inconsistent with the entire philosophy of Solvency II (Meyer, 2011).

However, the actual stress factor applied for private equity in the standard model will be mitigated, since the base shock will impact both the asset and liability sides but also because the framework allows for a diversification effect of private equity on the entire equity portfolio of insurers (Meyer, 2011). The capital charge for equities (39%) is lower than it is for “other equities” (49%) and a correlation coefficient of 0.75 between the two categories is to be applied, which allows for the above mentioned diversification benefits. For example, with an allocation of 35% to other equities the correlation leaves the overall aggregated capital charge for both equities and “other equities” at around 45% for most life insurers. Arguments have also been put forward to reduce the correlation coefficient in the range between 0.45-0.55 which would increase the diversification effect of a private equity holding (Studer and Wicki, 2010.)

The EVCA Risk Working Group

EVCA (European Private Equity and Venture Capital Association) is continuously lobbying in the context of Solvency II. EVCA Risk Working Group is in the process of developing its principles for internal models for measuring private equity risks that will constitute the new Private Equity Risk

Measurement Guidelines, which National Private Equity and Venture Capital Associations across Europe will be encouraged to endorse. But EVCA cannot develop an internal model that can be used for all insurance companies, they can only support with guidelines on how to develop an internal model since it is required that historical figures are based on own exposure to the asset class. The aim for EVCA is to develop an alternative to the high base shock under Solvency II, showing that risks for private equity under an internal model approach indeed needs to be significantly lower compared to the coarse standard model (EVCA, 2011b).

While EVCA and various national associations provide powerful arguments to arrive at a more favorable stress level for private equity under the standard model, the chances of any significant reduction of the base shock are extremely remote because it would be inconsistent with the entire philosophy of Solvency II (Meyer, 2011). The 49% base shock is intended to be ultra-conservative, in order to encourage insurers to develop internal models for prudent risk management. The risk, however, is that private equity funds lose an important funding source if insurers choose to leave or decrease their exposure to the asset class due to the tough capital requirements that the high base shock entails (EVCA, 2011b).

Impact of Solvency II on private equity

The importance of commitments from life insurers within Swedish private equity firms is substantial. Allocation from life insurance companies comprised between 14-16 % of total commitments in 2007 and 2008 but has declined in 2009 and 2010 (SVCA, 2006 to 2010). The importance of Solvency II for private equity is further strengthened since a comparable regime will be established for pension funds in the coming years, and Solvency II is likely to set the tone. The recent decline in allocation from life insurance companies is argued to be that smaller insurance companies are waiting with new private equity investments, until Solvency II is settled. Hence, the decline may be a response to incoming regulations. However, this statement is far from certain and the impact of Solvency II on private equity is, for now, difficult to tell.

While EVCA will continue to argue that the standard approach calibration as it stands currently is inappropriate in relation to the risk borne by insurers investing in private equity funds, it is futile for the private equity industry to resist this development and such action is most likely to merely prolong a period of investor uncertainty and reticence. The industry does best in accepting the increased regulation and focus on adapting to it, either through a development of the internal model or through an application of the standard model (Meyer, 2011).

However, one positive feature is that this broad regulatory review of capital adequacy has begun with insurers. Insurers are, more than other players investing in private equity, used to modeling "exotic" risks and are therefore the best type of LP for the private equity industry to co-operate with in order to build its risk models. But for many LPs, private equity still constitutes a small proportion of the overall portfolio, which makes modeling of private equity to a non prioritized activity.

3.2. Basel III

From Basel I to Basel III

In 1988, the Basel Committee reached an agreement of mutual principles concerning capital requirements for banks. This developed into an EG-directive, called Basel I. The directive was criticized and therefore the Basel Committee started to develop a new directive in 1998. Parallel to this the European Commission performed a review of the previous capital requirements in Basel I. This resulted in a new directive for bank regulation under the name Basel II (Génetay and Rhenman, 2010). The final version of Basel II was issued by the Basel Committee in June, 2004. The Basel II framework was implemented in the European Union, through the publication of the Third Capital Adequacy Directive (CAD III) in 2006 (Meyer, 2011). The Basel II framework is built upon three pillars which set guidelines for capital adequacy requirements, supervisory actions, and market disciplines (Decamps, Rochet and Roger, 2003).

According to the Bank for international settlement (BIS, 2011a), one of the main reasons why the previous economic and financial crisis became so severe was that banks were highly leveraged. The banks were also holding insufficient liquid buffers and therefore were not able to absorb trading and credit losses. The Basel III framework package, consisting of two documents[2], aims to strengthen the global capital and liquidity rules in order to establish a more resilient banking sector. Basel III builds upon the three pillars of Basel II framework, and will raise both the quality and quantity of the regulatory capital base as well as enhance the risk coverage of the capital framework (BIS, 2011a: 7). A timeline of these phase-in arrangements can be seen in Figure 5. Europe, Basel III framework will be implemented though the fourth Capital Requirements Directive (CRD IV) (AFME, 2011).

Figure 5 - Timeline of the phase-in arrangements in Basel III

Basel III - Timeline

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Minimum Common Equity Capital Ratio			3,5%	4,0%	4,5%	4,5%	4,5%	4,5%	4,5%
Add: Capital Conservation Buffer						0,625%	1,25%	1,875%	2,5%
Minimum Tier 1 Capital			4,5%	5,5%	6,0%	6,0%	6,0%	6,0%	6,0%
Minimum Total Capital			8,0%	8,0%	8,0%	8,0%	8,0%	8,0%	8,0%
Total Capital + Conservation Buffer			8,0%	8,0%	8,0%	8,625%	9,250%	9,875%	10,5%
Add: Countercyclical Buffer						0%-2,5%	0%-2,5%	0%-2,5%	0%-2,5%
Leverage ratio	Supervisory monitoring		Parallel run: 1 Jan 2013 - 1 Jan 2017 Disclosure starts 1 Jan 2015					Migration to Pillar 1	
Liquidity coverage ratio	Observation period starts				Introduce minimum standards (2015)				
Net stable funding ratio	Observation period starts				Introduce minimum standards (2015)				
Instruments that no longer qualify as non-core Tier 1 or Tier 2 capital			Phased out over 10 year horizon beginning in 2013						

The first document, *Basel III: A global regulatory framework for more resilient banks and banking systems,* set out the limit for increased quality and quantity of capital. The quality of the capital base will increase since Common Tier 1 capital must be at least 4.5%, Additional Tier 1 capital at least 6%

[2] 1) Basel III: A global regulatory framework for more resilient banks and banking systems, 2) Basel III, International framework for liquidity risk measurements, standards and monitoring

and Total Capital at least 8% of risk-weighted assets at all time (BIS, 2011a: 49). Common Tier 1 capital basically includes common shares, retained earnings and accumulated income. The document set up several criteria in order to define if other instruments issued by the bank or by a consolidated subsidiary can be included in Additional Tier 1 capital or Tier 2 capital (BIS, 2011a: 54-59). Comparing Basel II with Basel III, a few capital instruments will no longer qualify as Additional Tier 1 capital and Tier 2 capital and will be phased out over a 10 year horizon (BIS, 2011a: Annex 4).

The minimum capital requirement for Total capital of 8% in Basel III is not an increase compared to Basel II. However, the minimum requirement of Common Tier 1 capital has increased from 2% which lead to a lower proportion of Tier 2 capital within the Total Capital requirement, hence increasing the overall quality of the capital base (Génetay and Rhenman, 2010).

According to the Basel Committee there is a need to ensure that all material risks are captured in the capital framework. Therefore, in addition to increase the level and the quality of the capital base a counterparty risk framework reform will become effective in Basel III (BIS, 2011a: 97). In order to determine the risk-weight assign to each asset, the bank can choose between a standardized approach or an internal rating based approach (Meyer, 2011). Essentially, Basel III will aim to ensure that these models better capture the counterparty risk. Compared to Basel II, the counterparty risk is measured in a more absolute context in Basel III, resulting in that the counterparty risk needs to be measured and priced in every transaction. Since private equity exposure is addressed with a high counterparty risk banks will require a high return for these investments, however the technical specifications of these calibrations is outside the scope of our thesis.

An additional capital buffer (add 2.5% of Common Tier 1 capital to minimum capital requirements) will ensure that banks build up capital buffers in good periods in order to meet losses in periods of stress. This could be done by reducing dividends and share-backs or to raise new capital from the private sector (BIS, 2011a: 129). Further, a countercyclical buffer (between 0 and 2.5%) will be deployed by national jurisdictions in order to build up additional capital defenses in periods when risk is growing in the financial system. This buffer relies upon the judgment by the authority, will add to the conservation buffer, and will therefore be subject to the same restriction on earnings distribution (BIS, 2011a). Hence, when a bank is subject to a 2.5% countercyclical requirement the Common Tier 1 ratio need to be above 9.5% (4.5% + 2.5% + 2.5%) in order to not affect the distribution possibilities of retained earnings (BIS, 2011a: 139).

A new leverage ratio will also be introduced in Basel III framework which will deal with one of the underlying features of the previous crisis, namely the build-up of excessive on- and off-balance sheet leverage. This ratio will be a simple, transparent and non-risk based leverage ratio which will aim to complement the risk based capital requirements (BIS, 2011a: 151). The ratio provide an extra layer of protection against model risk and measurements errors and seeks to limit Tier 1 capital to no less than 3% of total exposure (AFME, 2011).

The second document, "*International framework for liquidity risk measurement, standards and monitoring",* represents the liquidity portion of the Committee´s reforms and will aim to improve the banking sector´s ability to absorb shocks. The crisis showed that liquidity quickly can disappear, but also that illiquidity can last for an extended period of time (BIS, 2011b: 2). Therefore, two measures for funding liquidity have been developed, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR).

The LCR, including any revision, will be introduced in 2015, and aims to ensure that a bank maintains a satisfying level of high-quality assets that can be converted to cash to meet its liquidity needs for a 30 calendar day time horizon under a severe stress scenario (BIS, 2011b: 15).

$$\frac{Stock\ of\ high - quality\ liquid\ assets}{Total\ net\ cash\ outflows\ over\ the\ next\ 30\ calendar\ days} \geq 100\%$$

Fundamental characteristics of high-quality assets are low risk, ease and certainty of valuation, low correlation with risky assets and that they are listed on a developed exchange market. Certain markets-related characteristics such as a tendency to move into the asset in a systematic crisis (flight-to-quality) and that a diversified group of investors is available for buying and/or selling the asset is also listed in the document (BIS, 2011b: 22). These assets are categorized in two groups, Level 1 or Level 2, where Level 2 assets only can comprise up to 40% of the stock (BIS, 2011b: 35). Level 1 assets include cash, central bank reserves and marketable securities representing claims on or guaranteed by for example sovereigns, central banks and the European Commission. Level 2 assets include for example corporate and covered bonds. The term total net cash outflow is defined as the total expected cash outflows minus total expected cash inflows in a liquidity stress scenario (BIS, 2011b: 50). The funding sources representing possible cash outflows are assigned different run-off rates and the cash inflows can only be included if the bank has no reason to expect a default within the 30-day time horizon.

The NSFR, including any revision, will be introduced in 2018 and is developed in order to establish a more medium and long-term funding of the assets and activities of banking organizations. Based on the liquidity characteristics assigned to different assets the NSFR set up a minimum acceptable amount of stable funding (BIS, 2011b: 119).

$$\frac{Available\ amount\ of\ stable\ funding}{Required\ amount\ of\ stable\ funding} \geq 100\%$$

Components of available stable funding (ASF) and its ASF factor are defined in the Figure 6 (BIS, 2011b: 128). Essentially, Tier 1 and Tier 2 capital is assigned an ASF factor of 100% whereas the ASF factors for deposits are decreasing when assumed stability is decreasing. Components of required stable funding (RSF) and its RSF factor are defined in Figure 7 (BIS, 2011b: 133). The RSF factors assigned to various types of assets intends to approximate the amount of a particular asset that could not be sold or used in a secured borrowing on an extended basis during a liquidity event lasting one year (BIS, 2011b: 133). For example, cash and other assets that is immediately available is assigned an RSF factor of 0%, unencumbered corporate or covered bonds 20% and unencumbered loans to residential mortgages 65%. Since private equity is characterized as an illiquid asset with a high counterparty risk, a high amount of available stable funding is required.

Figure 6 - Components of available stable funding (ASF) and its ASF factor

Components of Available Stable Funding and Associated ASF Factors	
ASF Factor	**Components of ASF Category**
100%	• The total amount of capital, including both Tier 1 and Tier 2 as defined in existing global capital standards issued by the Committee.29 • The total amount of any preferred stock not included in Tier 2 that has an effective remaining maturity of one year or greater taking into account any explicit or embedded options that would reduce the expected maturity to less than one year. • The total amount of secured and unsecured borrowings and liabilities (including term deposits) with effective remaining maturities of one year or greater excluding any instruments with explicit or embedded options that would reduce the expected maturity to less than one year. Such options include those exercisable at the investor's discretion within the one-year horizon.30
90%	• Stable non-maturity (demand) deposits and/or term deposits (as defined in the LCR in paragraphs 55-61) with residual maturities of less than one year provided by retail customers and small business customers.31
80%	• Less stable (as defined in the LCR in paragraphs 55-61) non-maturity (demand) deposits and/or term deposits with residual maturities of less than one year provided by retail and small business customers.
50%	• Unsecured wholesale funding, non-maturity deposits and/or term deposits with a residual maturity of less than one year, provided by non-financial corporates, sovereigns, central banks, multilateral development banks and PSEs.
0%	• All other liabilities and equity categories not included in the above categories.32

Figure 7 - Components of required stable funding (RSF) and its RSF factor

Detailed Composition of Asset Categories and Associated RSF FactorsFactors	
RSF Factor	**Components of RSF Category**
0%	• Cash immediately available to meet obligations, not currently encumbered as collateral and not held for planned use (as contingent collateral, salary payments, or for other reasons) • Unencumbered short-term unsecured instruments and transactions with outstanding maturities of less than one year34 • Unencumbered securities with stated remaining maturities of less than one year with no embedded options that would increase the expected maturity to more than one year • Unencumbered securities held where the institution has an offsetting reverse repurchase transaction when the security on each transaction has the same unique identifier (eg ISIN number or CUSIP) • Unencumbered loans to financial entities with effective remaining maturities of less than one year that are not renewable and for which the lender has an irrevocable right to call
5%	• Unencumbered marketable securities with residual maturities of one year or greater representing claims on or claims guaranteed by sovereigns, central banks, BIS, IMF, EC, non-central government PSEs) or multilateral development banks that are assigned a 0% risk-weight under the Basel II standardised approach, provided that active repo or sale-markets exist for these securities
20%	• Unencumbered corporate bonds or covered bonds rated AA- or higher with residual maturities of one year or greater satisfying all of the conditions for Level 2 assets in the LCR, outlined in paragraph 42(b) • Unencumbered marketable securities with residual maturities of one year or greater representing claims on or claims guaranteed by sovereigns, central banks, non-central government PSEs that are assigned a 20% risk-weight under the Basel II standardised approach, provided that they meet all of the conditions for Level 2 assets in the LCR, outlined in paragraph 42(a)
50%	• Unencumbered gold • Unencumbered equity securities, not issued by financial institutions or their affiliates, listed on a recognised exchange and included in a large cap market index • Unencumbered corporate bonds and covered bonds that satisfy all of the following conditions: - Central bank eligibility for intraday liquidity needs and overnight liquidity shortages in relevant jurisdictions35 - Not issued by financial institutions or their affiliates (except in the case of covered bonds)term deposits with a residual maturity of less than one year, provided by non-financial corporates, sovereigns, central banks, multilateral development banks and PSEs. ￼ - Not issued by the respective firm itself or its affiliates - Low credit risk: assets have a credit assessment by a recognised ECAI of A+ to A-, or do not have a credit assessment by a recognised ECAI and are internally rated as having a PD corresponding to a credit assessment of A+ to A- - Traded in large, deep and active markets characterised by a low level of concentration • Unencumbered loans to non-financial corporate clients, sovereigns, central banks, and PSEs having a
65%	• Unencumbered residential mortgages of any maturity that would qualify for the 35% or lower risk weight under Basel II Standardised Approach for credit risk • Other unencumbered loans, excluding loans to financial institutions, with a remaining maturity of one year or greater, that would qualify for the 35% or lower risk weight under Basel II Standardised Approach for credit riskabove categories.32
85%	• Unencumbered loans to retail customers (ie natural persons) and small business customers (as defined in the LCR) having a remaining maturity of less than one year (other than those that qualify for the 65% RSF above)
100%	• All other assets not included in the above categoriesabove categories.32

Basel II /III impact on Private Equity

The final text of Basel II was issued in 2004. Under the Basel II Capital Accord the risk weights for private equity varied depending on the choice of model. Standardized models were available but the framework also allowed for the development of internal models, which would aim to argue for lower risk weight on a bank´s private equity exposure (Meyer, 2011). EVCA argued in a position statement that these capital charges on private equity exposure, suggested by Basel II, would impact private equity and in particular venture capital and could potentially lead to a withdrawal from the asset class by banks (EVCA, 2004). Further, they argued that Basel II did not consider the specific characteristics of having a diversified private equity and referred to an independent research paper, "The Risk Profile of Private Equity", by Weidig & Mathonet (2004)". When the European Commission published CAD III for implementation of Basel II in EU, the treatment of private equity was friendly because CAD III resulted in lower capital requirements for private equity exposure compared to Basel II capital accord. According to Meyer (2011), no internal models would have supported a lower capital requirement for private equity exposure, after the implementation of CAD III. This statement is based on the research by Bongaerts and Charlier (2008). Their results support capital requirements for private equity lower than in Basel II, but not as low as in CAD III (Bongaerts and Charlier, 2008).

Although the risk weight assigned to private equity within the Basel II framework affected the exposure negatively from 2000, CAD III hardly established any incentives for banks to leave the asset class. The recent slowdown of raised funds within the private sector may instead be a result from the previous economic crisis than from financial institutions response to the new regulatory landscape.

There have been few research papers investigating the role of private equity under Basel II, and even less in the case of Basel III, which could be an effect from the low risk-weights assigned to private equity in CAD III (Meyer, 2011). If no model would be able to suggest a more friendly treatment of the asset class, why then bother to develop a new model for calibrating the risk-weight.

3.3. AIFMD

Scope

The regulatory framework AIFMD (The Alternative Investment Fund Managers Directive) will establish a framework for all European alternative investment fund managers ("AIFM") and all AIFMs that manage or market alternative investment funds ("AIF") within the European Union. It aims at establishing common requirements governing the authorization and supervision of AIFMs in order to provide a coherent approach to the related risks and their impact on investors and markets in EU.

Many different opinions exist regarding the impact of private equity funds on the financial crisis. Several research papers argue that private equity funds do not constitute any systemic risk for the financial system. According to Nyberg and Strömqvist (2009), it is questionable whether hedge funds and private equity funds constitute a systematic risk for the financial system. But according to the Directive, the financial crisis has shown that the AIFs are exposed and vulnerable to risks that are of direct concern to the stability of the financial markets (European Parliament, 2011: 2). The Directive is therefore designed to establish a secure and harmonized framework that will monitor and supervise the risks that AIFMs pose to their investors, counterparties and other market participants. The Directive also aims to permit, subject to compliance with strict requirement, AIFMs to market and manage their funds across EU (European Parliament, 2011: 4).

The Directive encompasses entities managing AIFs as a regular business, both open- and close ended, whatever legal form, both listed and non-listed, which raise capital from a number of investors. The Directive does not regulate AIFs. AIFs should therefore be able to continue to be regulated and supervised at national level (European Parliament, 2011: 10). The AIFMs that will be regulated under the Directive are defined as all AIFMs that manage funds that are not regulated under the UCITS Directive[3]. These include private equity-, hedge-, real estate-, commodity- and infrastructure funds.

There will be two exemptions with regard to this definition where the Directive opens up for a lighter regime. Firstly, an AIF with total assets under management less than EUR 100 million should not be subject to full authorization. Secondly, funds with total assets under management of less than EUR 500 million will also be excluded from full authorization, conditional on that they are not leveraged and do not grant investors redemption rights during the first five years (European Parliament, 2011: 17). The definition of leverage has been subject to intensive debate, but is now set in the Directive (European Parliament, 2011: Article 4.v). The definition of leverage does not include leverage at the level of the portfolio company, so PE funds will be subject to the limit of EUR 500 million in total assets under management, i.e. committed capital.

If private equity does not have a specific regulation in the AIFM's home member state, the lighter regime is conditional on that the member state, in which the AIFM is active, puts a national regulatory framework in place that covers those funds below the threshold. It is therefore uncertain, on a country-by-country basis whether these lighter regimes will put similar or stricter regulation on the AIFMs in the home country.

Another exemption from the general rule is that AIFMs managing already established AIFs can be excluded from the requirements of the Directive ("Grandfathering"). In order for the AIFMs to be exempted from the Directive, the AIF needs to be a closed-end fund where no new further investments are possible after 22 July 2013, i.e. two years after the entry into force of the Directive (European Parliament, 2011: Article 61, 3). The AIFM can also be excluded if the subscription period for the AIF's investors has closed before the entry into force of the Directive, and the AIF expires within three years after the Directive has been implemented (European Parliament, 2011: Article 61, 4). However, these exempt AIFMs must still comply with certain requirements, including the production of an annual report (European Parliament, 2011: Article 22) and other information related requirements (European Parliament, 2011: Article 26-30).

Timeline

The Directive and its implementation will be carried out according to the expected milestones:

- The proposal for the Directive was made public in April 2009. Since then the Directive has been out for amendments and the final version was made public in June 2011. By 22 July 2013 member states shall adapt the laws and regulations necessary to comply with the Directive (European Parliament, 2011: Article 66).
- On 13 July 2011, the European Securities and Markets Authority (ESMA) published its consultation paper setting out draft advice concerning the content of the implementing measures for AIFMD. The consultation paper is in response to the request for assistance which the European Commission sent to ESMA's predecessor, CESR, in December 2010. ESMA is required to deliver its final advice to the Commission by 16 November 2011.
- As the practical difficulties resulting from a harmonized regulatory framework and an internal market for non-EU AIFMs that perform managing and/or marketing within the Union

[3] Undertakings for Collective Investment in Transferable Securities (adopted in 1985)

and EU AIFMs managing non-EU AIFs, are hard to predict due to lack of experience a review mechanism should be provided for. After the entry into force of a delegated act by the Commission a harmonized regulatory framework, for non-EU AIFMs that perform managing and/or marketing within the Union and EU AIFMs managing non-EU AIFs, will be applicable after a transitional period of 2 years, in 2015. Then a passport regime becomes applicable to the AIFMs described above. Between 2013 and 2015, this group abides under national regimes with minimum EU conditions (European Parliament, 2011: 4).

- During a further 3 years (2015-2018), the harmonized regime should co-exist with national regimes of the EU member states. EU AIFMs that perform marketing of non-EU AIFs within the Union and non-EU AIFMs managing and/or marketing AIFs in the Union can then choose to abide under national regimes with minimum EU conditions or use the EU passport (European Parliament, 2011: 4).
- After 2018, it is intended that national regimes should end on the entry of a further delegated act by the Commission. This means that non-EU AIFMs that perform managing and/or marketing within the Union and EU AIFMs managing non-EU AIFs will abide under the harmonized framework and use the EU passport (European Parliament, 2011: 4).
- Reviews of the Directive will take place in 2015 and 2017.

Figure 8 is showing who will be under the Directive, and an illustrative timeline of the implementation of AIFM Directive can be seen in figure 9.

Figure 8 - Who will be covered by AIFMD

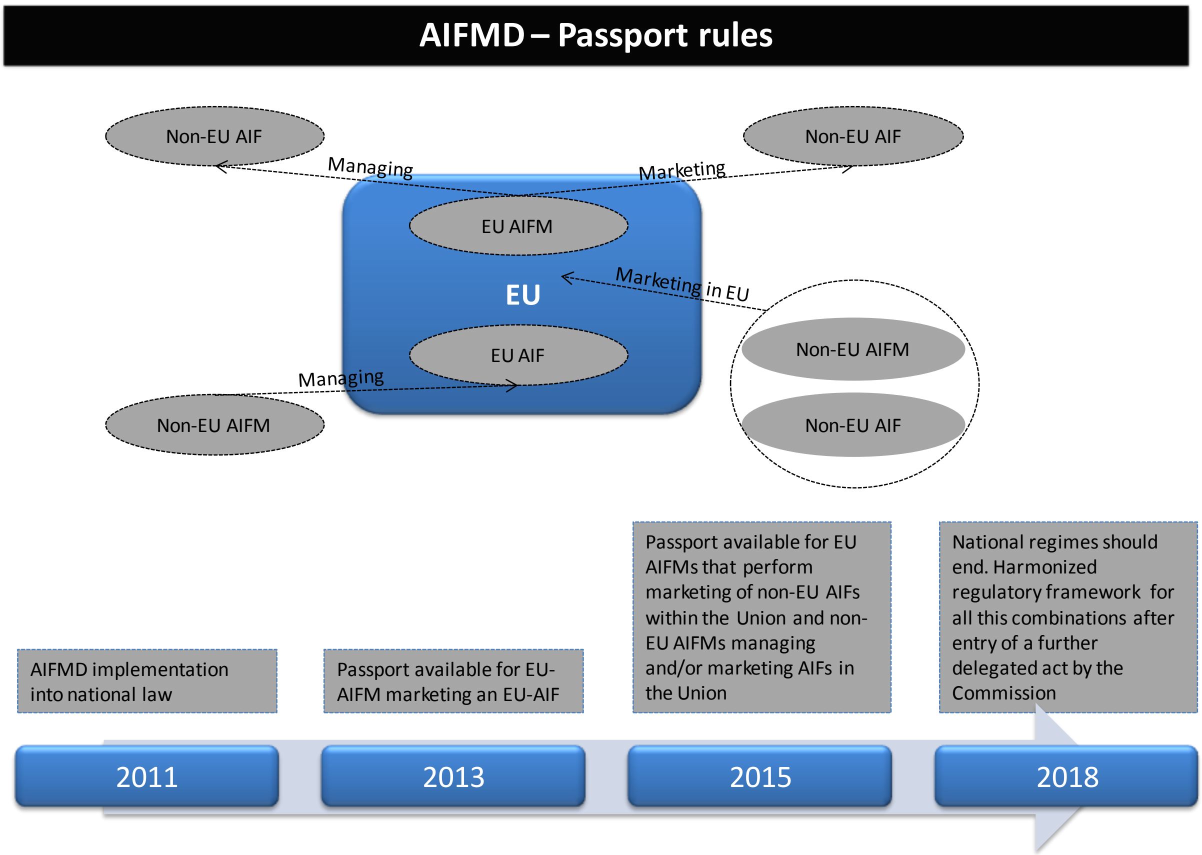
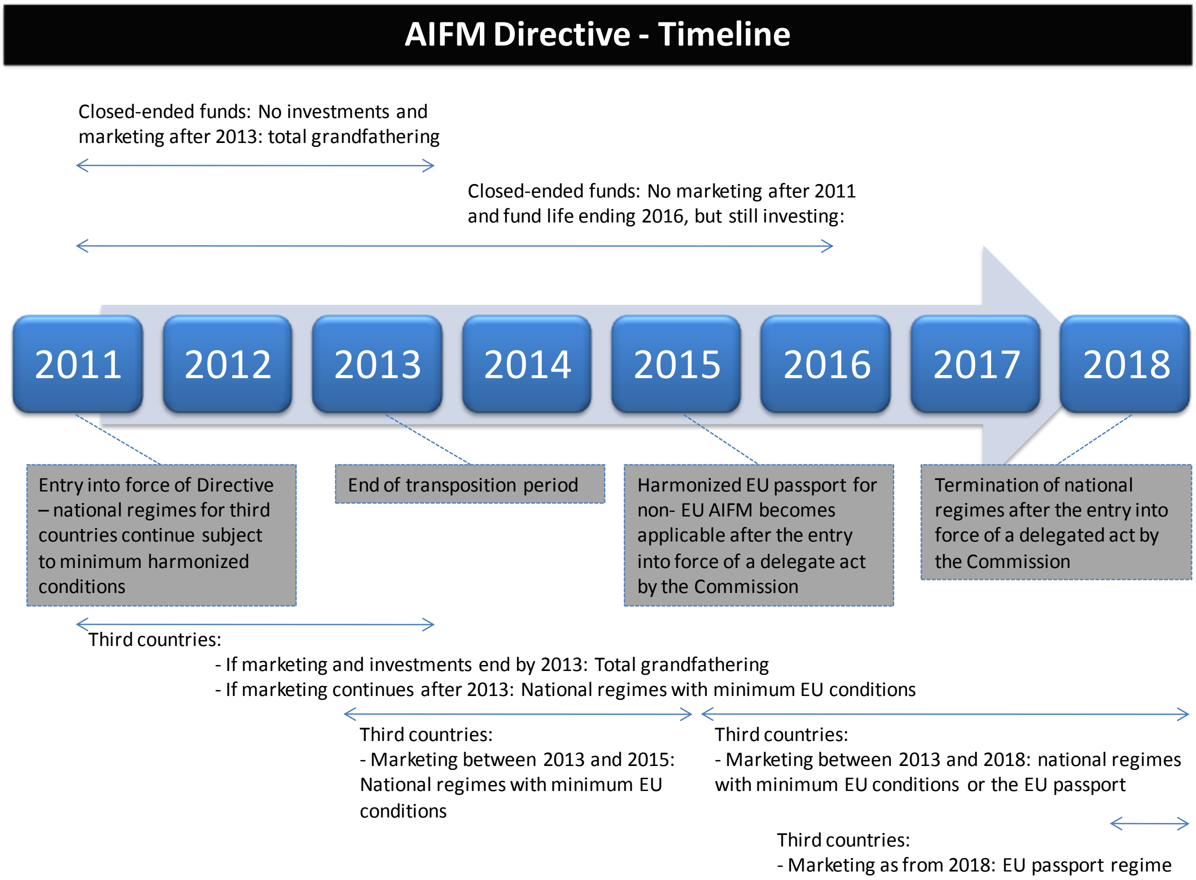


Figure 9 - Timeline of AIFMD



Authorization and compliance requirements

An AIFM should, for each of the AIFs it manages and for each of the AIFs it markets in the Union, make available an annual report for each financial year no later than 6 months following the end of the financial year (European Parliament, 2011: 48). However, after lobbying activities from interest organizations, the deadline for publication has been extended. The AIFM managing the relevant AIFs exercising control of non-listed companies, i.e. private equity funds, are permitted to extend the time period for the publication of the annual report (European Parliament, 2011: Article 29.3b). The AIFM is required to submit additional information to authorities in the member state, in excess of the annual report. This additional information includes, but is not limited to investment strategy, leverage policy and risk profile (European Parliament, 2011: Article 24). And, additional information needs to be submitted when the fund acquires majority ownership stake of a portfolio company (European Parliament, 2011: Article 26). The Directive allows the member state authority to require additional information from the AIFM, but the magnitude of this additional information requirements are not specified in the Directive (European Parliament, 2011: Article 24.5).

Under the Directive an AIFM is required to disclose, among other items, their investment strategy, the legal implications, valuation methods and all costs to investors (European Parliament, 2011: Article 23).

Capital Requirements

It is necessary to provide for the application of minimum capital requirements to ensure the continuity of the management of AIFs (European Parliament, 2011: 23). The internally managed AIF will be required to maintain initial capital of €300,000 but also to have additional capital of 0.02% of an amount by which the total value of the portfolios under management exceeds €250 million, subject to a cap of €10 million (European Parliament, 2011: Article 9.1,3). There is a possibility for a member state to allow that 50% of these additional funds are secured by a bank credit facility (European Parliament, 2011: Article 9.6).

Valuation

According to the Directive, reliable and objective asset valuation is crucial for the protection of investor interests. AIFMs employ different methodologies and systems for valuing assets and markets in which they invest. It is important to recognize those differences but still require in all cases that AIFMs implement valuation procedures resulting in the proper valuation of assets of AIFs. The valuation process should be independent from the portfolio management and the remuneration policy of the AIFMs, and may be performed by an external valuation (European Parliament, 2011: Article 61).

Depositary

AIFs need to have a depositary separate from the AIFM appointed to exercise depositary functions with respect to AIFs. The depositary should be responsible for the proper monitoring of the AIF's cash flows and, in particular, for ensuring that investor money and cash belonging to the AIF or to the AIFM acting on behalf of the AIF is booked correctly for the safekeeping of the assets of the AIF (European Parliament, 2011: 31-46).

Fundraising and marketing

The authorization of EU AIFMs in accordance with the Directive covers the management of EU AIFs established in the home Member State of the AIFM. If the AIFM plans to market the AIF outside the member state it is required, before the fundraising process starts, to submit a notification to the competent authorities of the member state (European Parliament, 2011: 15). After receiving authorization ("EU-passport") an AIFM manager is allowed to market the fund to all member states of the Union (European Parliament, 2011: 15). Conditions for passport authorization, when the AIF or the AIFM is domiciled in a third country, i.e. outside the Union, are conditional on fulfillment of a number of criteria that will be put forward in the delegated act (expected in 2015), which encompasses the passport regime for non-EU AIFMs that perform managing and marketing within the Union and EU AIFMs managing non-EU AIFs (European Parliament, 2011: 4).

Until 2018 it is expected that both EU-AIFM and non EU-AIFM are allowed to market their third country AIF without the marketing-passport. Instead they should fulfill the national regulation frameworks in those countries where the fund is marketed (European Parliament, 2011: 4). As previously discussed, these national laws will be, to a large extent, based on the Directive.

A review of the Directive will take place in 2015, after the 2 year transitional period (European Parliament, 2011: 4, 88). The review will focus on the application of the Directive into national law. A second review will take place in 2017, four years after the initial deadline for transposition of the Directive, which will focus on whether the Directive has functioned effectively (European Parliament, 2011: 5, 91). After 2018, it is intended that national regimes should end on the entry of a further delegated act by the Commission.

3.4. Hypotheses

We have presented a theoretical overview of Solvency II, Basel III and AIFMD. An illustration of who will be covered and which areas that we expect to affect the Swedish private equity market is presented in table 4. We believe that these regulations will impact the Swedish private equity market in several aspects. These potential areas of impact are formulated within four different hypotheses:

Hypothesis 1*: Regulatory changes will negatively affect fundraising capabilities*
Due to conservative capital requirements in Basel III and Solvency II, we expect less well capitalized banks and insurers to decrease their private equity investments

Hypothesis 2*: AIFMD will affect all private equity fund managers*
Due to certain thresholds, not all private equity fund managers will abide directly under the AIFMD. However, due to AIFMD's suggested validation effects and its guiding properties on new national legislation, all fund managers will in reality be affected by it

Hypothesis 3*: Information sharing from private equity fund managers to investors, regulators as well as to the public will increase due to AIFMD*
The private equity industry has been criticized for limited disclosure to stakeholders. AIFMD aims to increase openness and disclosure in the industry

Hypothesis 4*: Fees charged to fund investors will increase due to AIFMD*
AIFMD will increase the administrative burden and costs for private equity firms. We believe that these costs will increase the fixed fees charged to fund investors

Table 4 - Overview of Solvency II, Basel III and AIFMD

Framework	Who will abide under it	Requirements with largest impact on the Swedish private equity industry
Solvency II	Insurance companies	Capital requirements
Basel III	Banks	Requirements on liquid assets and stable funding
AIFMD	Private equity fund managers	Requirements on the administration and fundraising process

4. Methodology

In this section we describe our research methodology, which primarily consists of semi-structured interviews with managers and investors within the Swedish private equity market. Our data sample consists of ten interviews, which is complemented with questionnaires by respondents that chose not to undergo the interview process.

Our methodology can be classified as a descriptive study (Patel and Tebelius, 1987), and the purpose is to provide a snapshot of the regulatory frameworks and their potential impact on fundraising within the Swedish private equity and venture capital market.

The fundraising process for a new private equity fund does not solely depend upon the attractiveness of the fund, i.e. the management team and their investment strategy. Fundraising is also dependent on how much investors are able to allocate to the asset class private equity. Therefore we perform interviews with both general and limited partners, in order to illustrate the regulatory framework landscape from both parties' perspectives. Hence, we perform interviews with relevant partners, managers or employees of Swedish private equity and venture capital funds as well as with asset managers from different investor groups. To complement these interviews we also perform interviews with generalists, i.e. professionals with a comprehensive understanding and knowledge of the private equity industry and the regulatory landscape surrounding.

4.1. Interviews

Our results are based on information gathered from interviews. In a structured interview, researchers follow a specific questionnaire in order to receive quantitative results, whereas an unstructured informal interview is performed when researches want to generate ideas and hypothesis about the subject being investigated (Crawford, 1997). In order to receive quantitative results but primarily to capture a wide range of ideas from our respondents, we choose to combine these two interview structures (applying a semi-structured interview process).

We choose not to record our interviews. We believe that the upside from this approach is that we get an open and in-depth discussion with our respondents. The negative aspect of not recording the interviews is that the discussion could be inaccurately refereed (Crawford, 1997). In order to avoid this we take rigorous notes and consolidate these notes directly after an interview is performed.

4.2. Data sample

In order to implement our methodology we start with constructing a list of relevant general and limited partners. We aim to capture a wide spectrum of general partners, including large to medium sized Swedish private equity firms and larger venture capital firms that potentially could be affected by the AIFMD and indirectly by Solvency II and Basel III frameworks. We also aim to capture a few respondents from every important investor group that will be directly or indirectly by Solvency II, Basel III and AIFMD. Finally, we aim to perform interviews with generalist from various interest groups such as private equity and venture capital organizations, regulators and consultants. Prior to the interviews, we send out questionnaires to our respondents – one for PE/VC firms and one for investors. Our two questionnaires, "GP-Questionnaire" and "LP-Questionnaire" can be found in appendix. Additional information comes from respondents that choose to fill in our questionnaire, without undergoing the interview process. This process is illustrated in table 5.

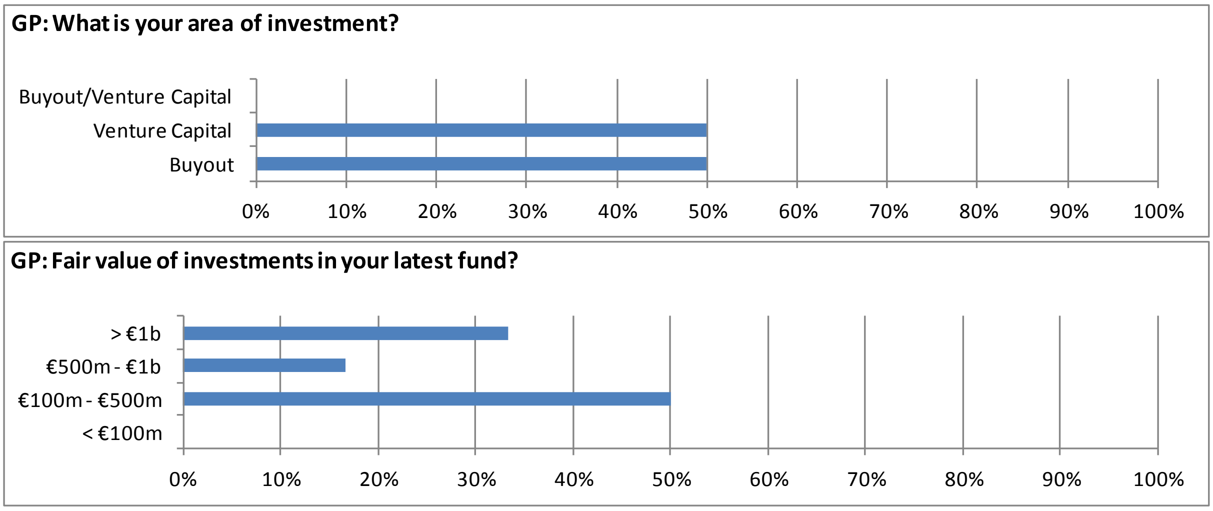
Table 5 - Illustrative description of our methodology

Group	# Potential interviewees	# Performed interviews	# Additional questionnaires	# Mail contact
GPs	11	5	1	-
LPs	20	3	2	1
Generalists	4	2	-	2
Total	**35**	**10**	**3**	**3**

4.2.1. GP characteristics

Interviews have been conducted with some of Sweden's most prominent fund managers. The interviewees consist of GPs, ranging from small-mid cap venture capital funds to large private equity funds with billions of euro under management. 50% of our respondents are buyout funds and 50% are venture capital funds, all of them with an investment focus within the Nordics. The buyout funds' all have more than EUR 500 million in assets under management and hence land up above the threshold for inclusion in the AIFM Directive. However, many of the Swedish private equity funds have their AIFs based in the UK, while the related AIFM is registered in a non-EU domicile, e.g. Jersey or Guernsey. These fund managers will not automatically fall under the Directive, but will have to abide under it anyway if they choose to market their funds within EU. The venture capital funds have between EUR 100 million and EUR 500 million in asset under management. These funds will land below the threshold of AIFMD and therefore instead be subject to national legislation. See figure 10 for an overview of GP characteristics.

Figure 10 - GP characteristics



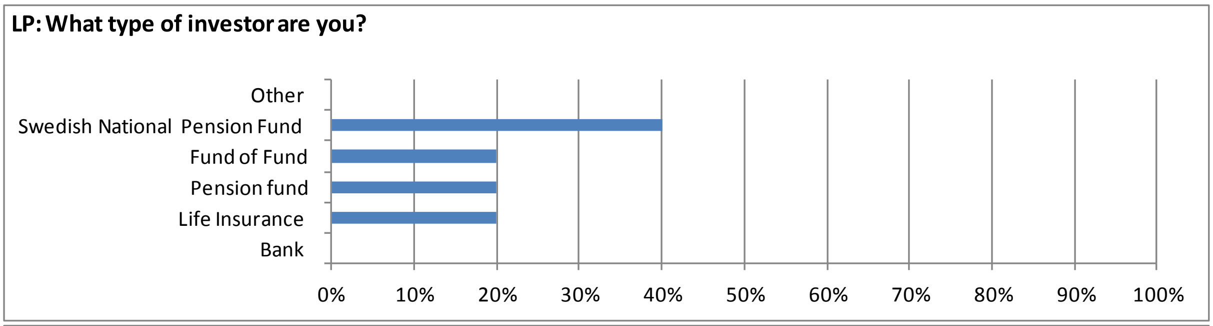
4.2.2. LP characteristics

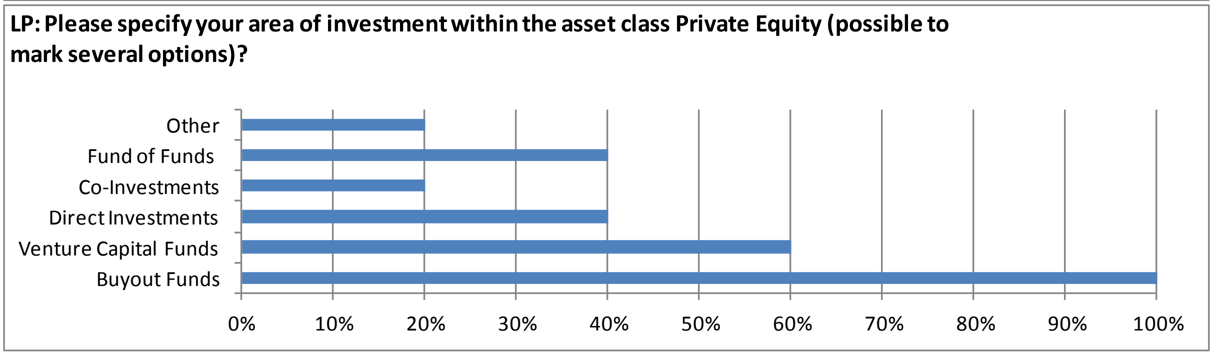
The group LPs represents the major types of investors in Swedish private equity. This group includes life insurers, Swedish national pension funds and fund-of-funds. Banks have historically been a sizeable contributor of capital to private equity funds, but have in recent years not invested anything into the industry. It would have been relevant for this paper to get insight from a representative from a Swedish bank that has historically invested in private equity to confirm that current and incoming regulations prompts a halt to investments in the asset class. We have not been able to follow through any such interviews. However, the private equity managers, investors and the generalists have provide us with good insight of Basel III and its implications for the private equity industry.

All of our respondents invested in buyout funds, 60% in venture capital funds, 40% in fund-of-funds, and 40% perform direct investments but only 20% perform co-investments in unlisted companies. Most of them had no industry focus, although a few of them did not invest in funds with a specific industry focus. On average, LPs investments within Swedish private equity correspond to 43% of their total exposure in the asset class.

The distribution between buyout and venture capital can partly be explained by the supply of attractive investment possibilities/good managers within each segment, since those investors that had exposure to both buyout and venture capital funds experienced that they had more attractive buyout investments available. Further, large investors are limited regarding the amount of fund investments and may therefore choose larger but fewer investments. This will alter investments within the buyout segment since venture capital funds usually is smaller than buyout funds. See figure 11 for an overview of LP characteristics.

Figure 11 - LP characteristics





5. Results & Analysis

Interviews have been conducted with some of Sweden's most prominent investors (LP) and private equity fund managers (GP). The interviewees consist of GPs, ranging from small-mid cap venture capital funds to large private equity funds with billions of euro under management, as well as LPs, including representatives from the major investor types. Interviews are complemented with answers received by questionnaire. Note that all views expressed in this section are interpretations of our interviewees' answers. After completing the theory sections, compiling relevant information regarding the regulatory frameworks of our focus, four hypotheses were formed. These express the key consequences for the Swedish private equity market that we expect will result from implementation of new regulations. We want to emphasize that the analysis is limited to the effects on Swedish investors (LP) and in particular Swedish private equity funds (GP).

5.1. Hypothesis 1 – Regulatory changes will negatively affect fundraising capabilities

Hypothesis 1: <u>Partially Accepted</u>. Solvency II will have an impact on the life insurers directly, and pension funds indirectly, as it makes it more expensive for those entities in terms of higher capital requirements to invest in private equity. Since the commitments from banks to Swedish private equity funds in the last three years are negligible, Basel III is not expected to cause a change in the fundraising prospects within the industry. For those fund managers that abide under AIFMD, the Directive will not have a material effect on fundraising capabilities. The results are presented in figure 12.

The proposed **Solvency II** framework will negatively affect life insurers' ability to invest in private equity. Solvency II will also, to a large extent, affect the formulation of the pension directive, which is expected to regulate pension funds ahead. Therefore, the framework will have an instrumental impact on private equity firms' ability to raise capital altogether.

GPs expect that Solvency II will affect insurers' (LP) ability to invest within private equity. The conservative capital adequacy requirements under Solvency II will force some life insurers to reduce their commitments to private equity in the future. The effect from the implementation of the framework will depend much on how well capitalized the individual life insurers are. Well capitalized, often large, life insurance companies will be able to continue making commitments to the asset class. These insurers generally invest into large private equity funds. Less well capitalized, often small-medium sized life insurance companies are more likely to abandon the asset class. These insurers generally invest into small-medium sized private equity funds. Therefore, the impact from Solvency II on private equity funds capacity to secure commitments from insurers is expected to impact smaller funds to a wider extent.

Under Solvency II, life insurers can choose between two different models, the standard model and the internal model, to calculate their respective capital adequacy requirement levels. Even though large insurers are likely to have sufficient resources to develop an internal model to calculate the level of capital requirement appropriate for them, they are not expected to do so. For example, an allocation to private equity at 5% of the total assets under management does not warrant the cost to develop an internal model. Most large life insurers will use the standard model even though the capital requirements under it are extremely tough. Large life insurers are in general overcapitalized, which means that the high capital requirements under the standard model can be fulfilled. Because of that, their future commitments to private equity funds will only be marginally affected.

It is the small insurers, which are often not as well capitalized, that would really need to use an internal model in order to demonstrate lower capital adequacy levels for their private equity investments. It would allow more of those companies to continuously invest in private equity. However, fewer small insurers have the required resources needed to develop their own models, and thus have to apply the standard model with conservative capital requirement levels. As a result, the smaller, often less well capitalized life insurers, may have to allocate a larger portion of their capital to lower risk asset classes in order to meet their overall capitalization requirements. Tendencies of this are already starting to show in the Swedish private equity and venture capital fundraising market, in which representatives notice some hesitance from smaller life insurers in making commitments to future funds.

In terms of fundraising, industry participants that we have interviewed agree that the smaller private equity funds will be hardest hit by new regulations. This is due to the practical difficulty for large insurers and pension funds to invest in small funds. The large funds, that are practically investible, will be affected to the extent that they are good, or not. The "good" funds will always be able to attract capital to cover their investment opportunities, regardless of new regulations known today. The three most important characteristics of a GP that it should encompass for it to attract the LPs' investment, i.e. a "good" fund, include a good track record, ability to demonstrate value creation capabilities, and a high quality team. Investors prefer highly motivated management teams with a good track record. A majority of the investors stated that they would not invest within a new team at all.

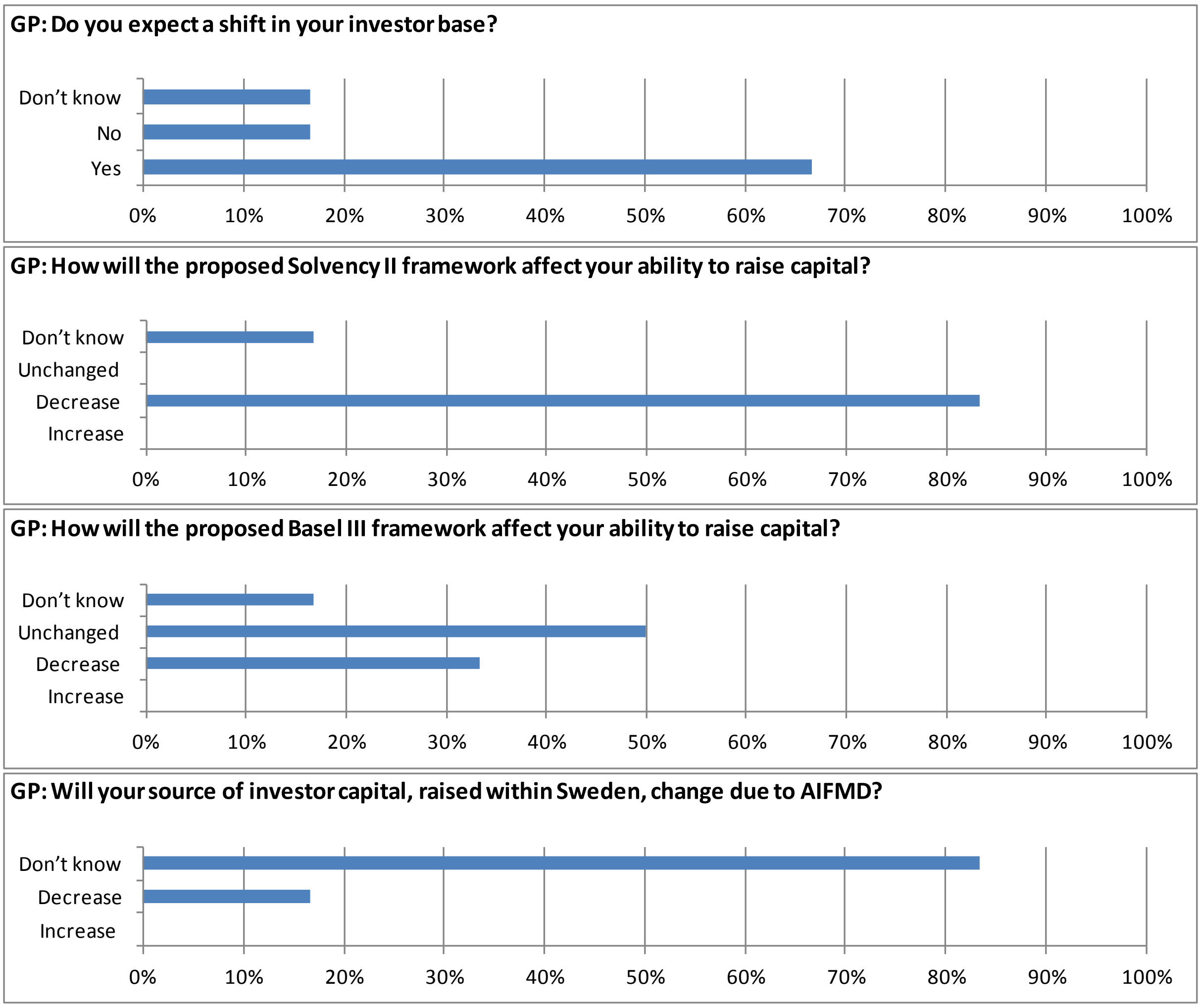
Just like in Solvency II, the capital requirements for private equity in the **Basel III (CRD IV)** framework are conservative. Those banks that have earlier invested in private equity from their own books will have much less capacity to do so once the new regulatory framework comes into force. However, the commitments from banks to Swedish private equity funds in the last three years are negligible (2008-2010, SVCA). So, the effect that the framework can have on the Swedish private equity fundraising market is highly limited. Unfortunately we have not been able to consult any representative from the Swedish banking industry as to discuss the reasons behind the sudden obliteration of allocations of capital to private equity in 2007.

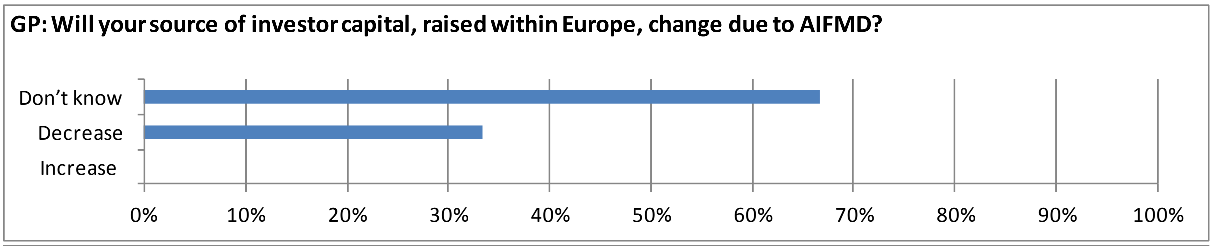
The **AIFM Directive** will affect the private equity firms in managing and marketing their funds. The GPs' ability to raise capital depends on whether they abide under the Directive or not. The implications of inclusion are presented in Hypothesis 2, 3, and 4. Interesting to note is that the majority of smaller GPs do not anticipate that they will have to abide under the Directive nor that it will have any major impact on their capacities to raise funds.

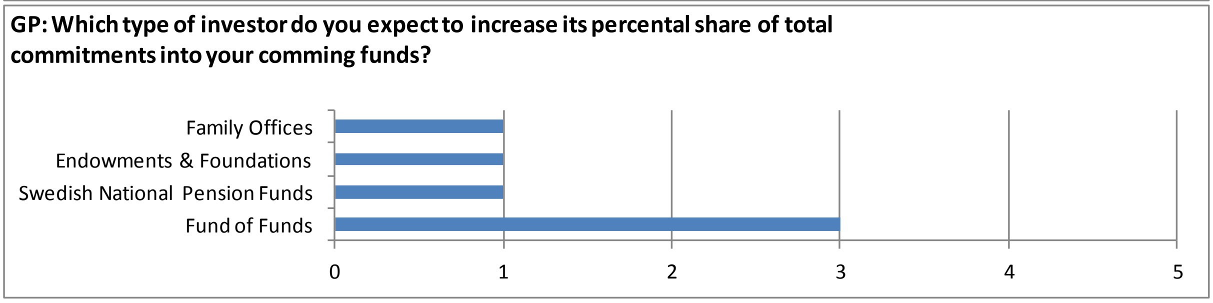
GPs expect a shift in their investor base due to the changing regulatory landscape (figure 12). Larger GPs expect that capital raised in EU will decrease as the Directive comes into force, since European investors may become less attractive due to AIFMD. Hence, an impact from AIFMD could potentially be that the geographical source of capital changes, with increased amounts of committed capital from investors outside the European Union.

These suggested changes in the sources of investor capital are not expected to be dramatic in the short term. However, in the long term, all private equity firms will need to review their investor base, and GPs believe that within Europe, more capital will come from those countries that have many large institutional investors like the Nordics, Benelux, Switzerland, UK, France, and Germany. Some investor categories will grow in importance and new ones may become attracted to the asset class. Particularly many GPs believe that fund-of-funds will expand as an investor type but investor types such as family offices, university endowments, and sovereign wealth funds were also mentioned. In the long term perspective, National pension funds are expected to increase their exposure to the private equity industry.

Figure 12 - Descriptive charts to Hypothesis 1







5.2. Hypothesis 2 – AIFMD will affect all private equity fund managers

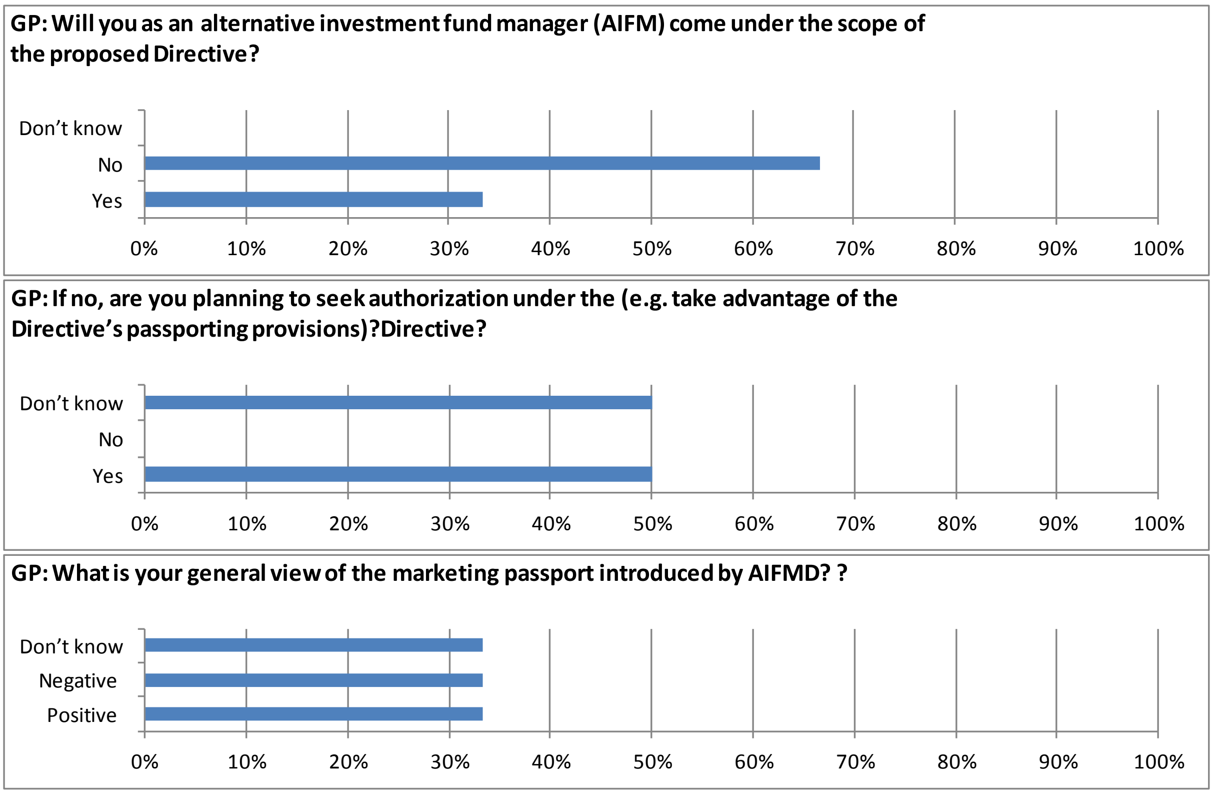
Hypothesis 2: <u>Accepted</u>. AIFMD will affect all private equity fund managers, even those who are not immediately required to abide under it. Some fund managers will seek authorization under the AIFMD so that they can market their funds in the EU region. Other fund managers see that AIFMD has positive validation effects for their funds, and will for that reason seek authorization under it. A third category of fund managers, whom will not seek authorization under AIFMD, will still be affected by AIFMD due to its impact on national legislation. The results are presented in figure 13.

A majority of the private equity fund managers will not directly fall under AIFMD. Two categories of fund managers, in particular, do not mandatorily have to seek authorization under AIFMD, but are still highly likely to do so. 1) AIFMs registered in a non-EU domicile. Some large Swedish buyout funds have their AIFs based in the UK, while the related AIFM is registered in a non-EU domicile, e.g. Jersey or Guernsey, and hence by definition fall outside the scope of AIFMD. For many of these funds (> EUR 500 M in AUM, AIFMD threshold), the European market constitutes an important pool of capital. In order to market their funds in the region, fund managers will need to seek authorization under AIFMD to receive the marketing passport. So, in practice, these funds are expected to voluntarily abide under AIFMD even though they are not required to. 2) Managers of small AIFs (< EUR 500 M in AUM, AIFMD threshold). These are also not included within the scope of AIFMD. However, many of these fund managers see that AIFMD has a positive validation effect on their funds, i.e. the funds are more "investible" and "marketable" just for the fact that the manager is regulated under AIFMD. For this reason, the AIFMs are willing to bear the additional cost and administrative burden imposed by AIFMD, and thus seek authorization under it.

Finally, there is one further category of AIFMs that does not mandatorily have to seek authorization under AIFMD - managers of small AIFs (< EUR 500 M in AUM, AIFMD threshold) that do not seek authorization under AIFMD. The fund managers in this category are not likely to seek authorization under AIFMD, but are nonetheless expected to be affected by it. The AIFMs will be subject to national legislation in the country they operate in. Most countries in Europe, including Sweden, do not have legislation for private equity fund management. Therefore, it is expected that AIFMD will serve as a guide for upcoming national legislation, which will effectively legislate those fund managers of funds that are below the thresholds for inclusion under AIFMD.

The Directive may become very important in the future. Many institutional investors will have internal directives that require them to exclusively invest in funds that abide under AIFMD. For example, state owned funds may have a hard time defending an investment within a private equity fund, not abiding under AIFMD, even if they have the expertise internally to evaluate and make such investments. Investors can thus use AIFMD to motivate and validate investment decisions internally.

Figure 13 - Descriptive charts to Hypothesis 2



5.3. Hypothesis 3 – Information sharing from private equity fund managers to investors and regulators will increase due to AIFMD

Hypothesis 3: <u>Partially Accepted</u>. Both investors and fund managers agree that there is a need for increased information sharing and transparency in the private equity market. More information about the private equity business model, investments, fund leverage etc., should be transmitted from the private equity market participants to the general public. The information flow between investors and fund managers, however, is considered by both GPs and LPs to be at a satisfactorily level. A majority of GPs and LPs agree that AIFMD will not increase the quantity or quality of information to investors. However, GPs do expect that disclosure to authorities of the member states will increase, but they do not expect this to affect their portfolio companies' competitive situation.

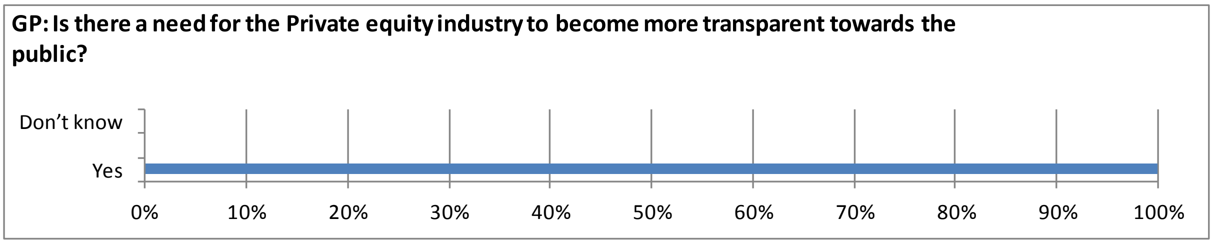
The AIFMD sets up requirements regarding what information that needs to be disclosed to investors and to national supervisors of the member states. We asked our interviewees on their view on the proposed information sharing requirements of the AIFMD. The results are presented in figure 14.

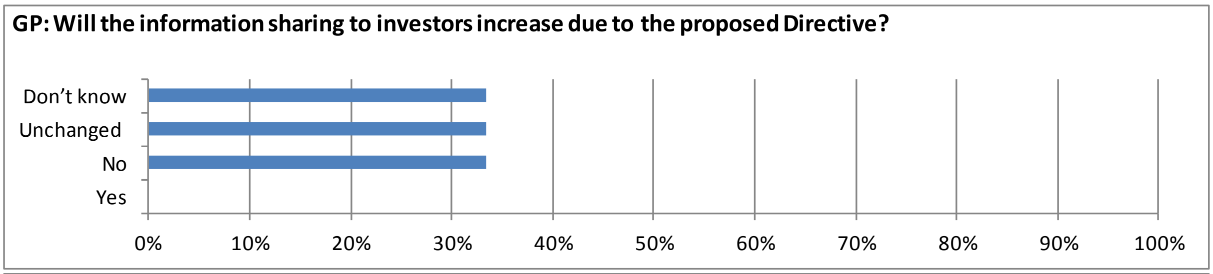
There is a need for increased information sharing within the private equity industry because the public's perception of private equity needs to be improved. For a long time the industry has been characterized by secrecy and resistance to sharing information to the public. The public's image of private equity, mostly constructed by media, needs to be improved. To do so, the industry can increase the level of public knowledge of its business model. The majority of GPs believes that the private equity industry has self-interest and would gain profit from providing more information about its activities.

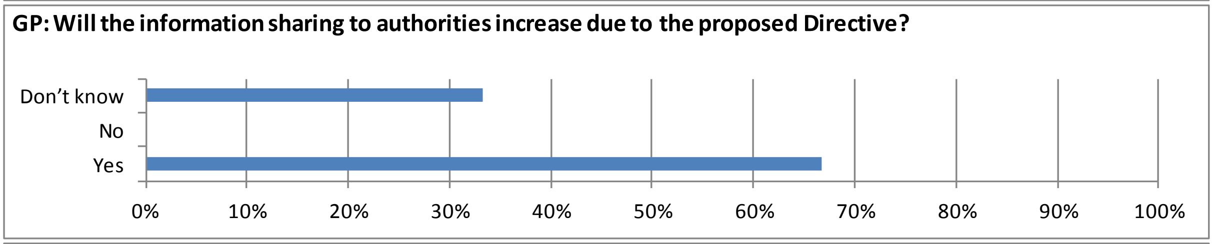
GPs do not expect that the quantity or quality of information to investors will increase due to AIFMD. Investors already get access to the information they require, so GPs, as well as LPs, do not see that the Directive will really have an impact on the information sharing between them. An intended purpose of the Directive is to increase investor protection. However, a great majority of the investors cannot relate to the supposed problems that the Directive aims at solving. The reason why higher information requirements are redundant in this aspect is that most investors have developed long-term relationships with the GPs they invest with. The Directive sets up strict marketing rules, which do not consider or at least undervalue these unique and well established relationships. Many LPs apprehend that the LPs' relationship to private equity managers may become more static under AIFMD, under which investors are restricted from negotiating the detailed terms of the investment contract directly with the GPs. A private equity fund is actually not a "fund" in the ordinary sense, but a co-investment understanding that is based on direct negotiations between two parties, GPs and LPs. A private equity investment is not the same as buying an "off-the-shelf" product. The private equity firms' business model is built on that they are able to have close communication with their investors. Therefore, a great majority of investors have a negative view on the Directive.

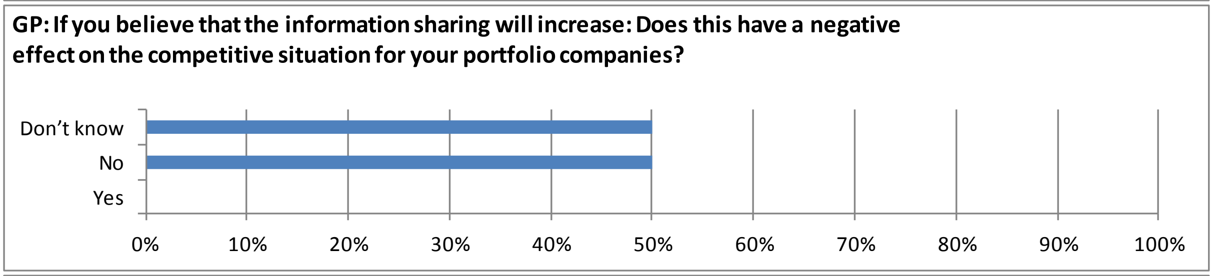
Information sharing to authorities will increase as a result of the implementation of AIFMD. Some of the larger funds, however, already fulfill most of the information sharing requirements as set forth in AIFMD, e.g. the valuation requirements. The Directive has improved much since its first proposal, regarding the reporting requirements for private equity portfolio companies. Now, GPs do not perceive that the Directive requires them to share any sensitive information that could affect portfolio companies' competitive situation against its peers.

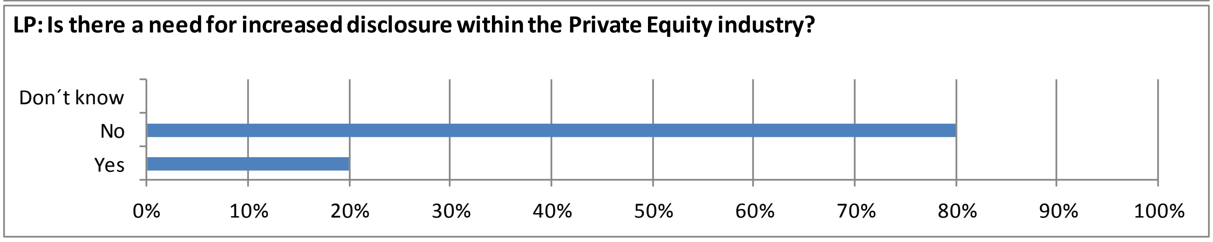
Figure 14 - Descriptive charts to Hypothesis 3











5.4. Hypothesis 4 – Fees charged to fund investors will increase due to AIFMD

Hypothesis: Rejected. Interview results pronounce that administrative costs will increase due to the disclosure requirements set forth in the AIFM Directive, but that the majority of private equity firms will not be able to pass on the increased cost to investors. Hence, management fees are not expected to increase as result of this.

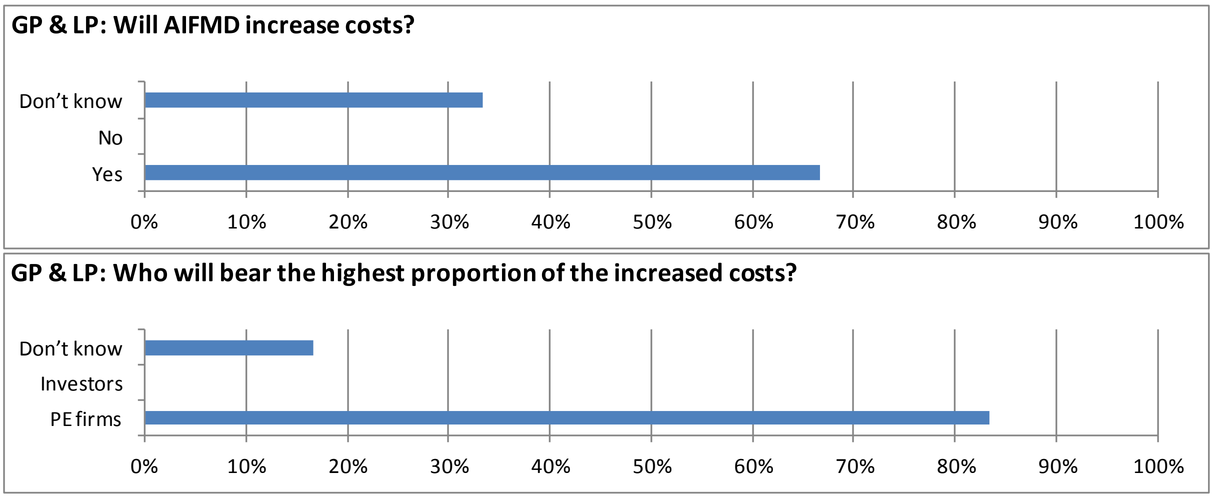
Investors agree with fund managers that AIFMD will increase administrative costs for GPs, although it is unclear who will bear the highest proportion of these costs. The results are presented in figure 15. Investors believe that the increased costs imposed by the Directive will proportionally have a more negative effect on the smallest funds. Although economies of scale might appear as a normal phenomenon, they anticipate that this would make it harder for new investment teams to enter the market. Since the disclosure requirements are static in nature (they are the same for all funds authorized under AIFMD, regardless of size), the small funds will be relatively harder hit by increased costs. For the large funds, the extra marginal cost resulting from compliance with the Directive is diminutive.

The large GPs have healthy margins on their management fees. Investors, whom normally prefer to pay a low fixed fee and high carried interest in order to incentivize management, know this and are therefore not willing to share much or anything of the additional costs resulting from the Directive.

Another reason why GPs are expected to bear the lion's share of increased cost is that many of the larger and successful private equity firms have been able to build up capital buffers during the years of successfully closed funds. These two drivers underpin the general industry trend that fixed fees, i.e. management fees, are stable or decrease slightly while carried interest is expected to be stable or increase. LPs view is that fees have been decreasing slightly but that this trend will come to a halt, due to increased administrative burden and costs imposed on GPs. This indirectly implies that investors would bear the costs. However, those LPs that have large commitments to private equity still expect to be able to pass on the most of the increased cost to GPs, and the large GPs are able to cope with that.

There is a trend involving small GPs that they to a larger extent keep an open book and communicate its cost structure to its investors. The increased transparency in smaller GPs towards investors and the downward pressure on management fees results from lower investor demand. However, to ensure that smaller GPs can cover operational costs, investors allow for flexibility in regards to the management fees that smaller GPs charge.

Figure 15 - Descriptive charts to Hypothesis 4

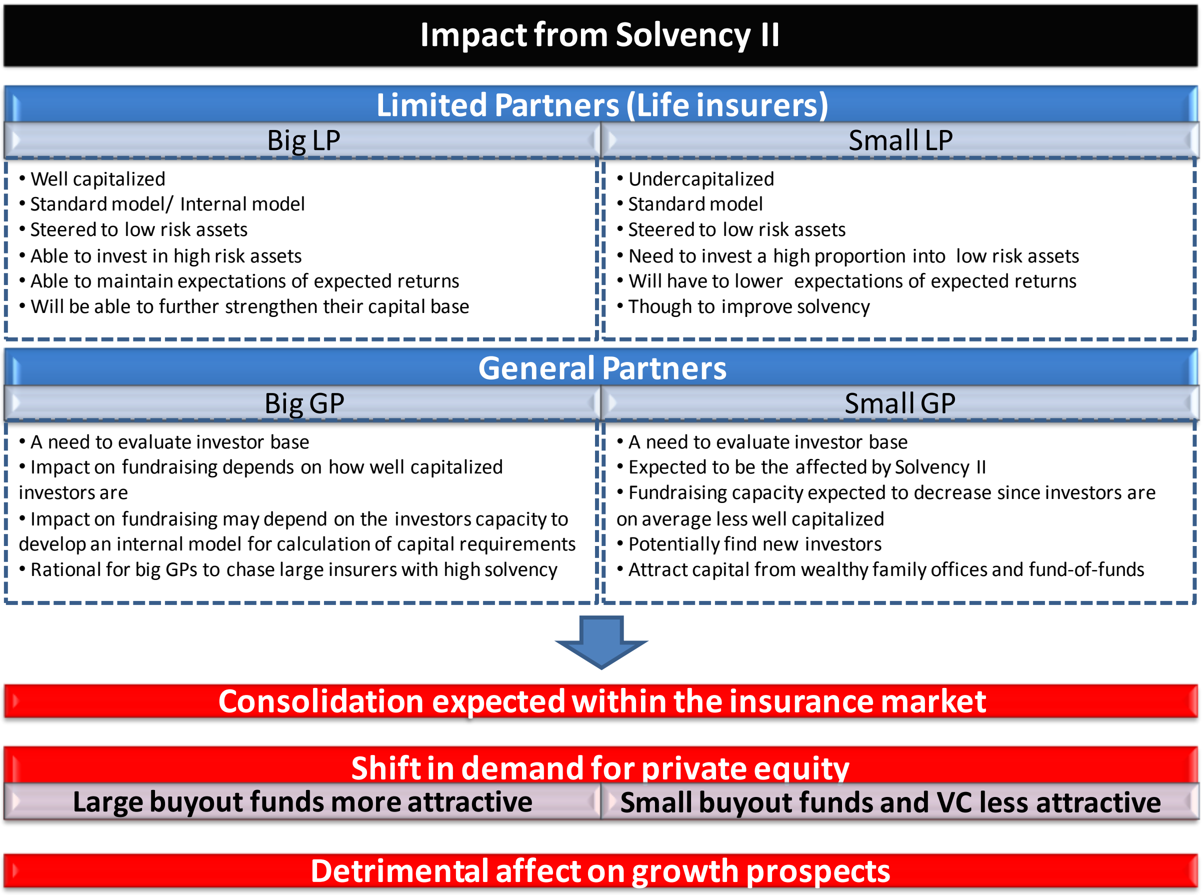


6. Summary and Discussion

The previous section presented the four main hypotheses of the thesis, which were analyzed using the information that we collected from practitioners during interviews and from questionnaires. In this section, we choose to relate these four hypotheses to the respective regulatory frameworks, in order to discuss and analyze our main thesis question: how will the new regulatory landscape affect fundraising and deal-flow for Swedish private equity firms in years to come? These analyses are illustrated in figure 16 to 18.

6.1. Solvency II

Figure 16 - Impact from Solvency II



Solvency II aims to protect the capital base for insurance companies by implementing procedures to identify, measure and manage risk levels. It provides minimum capital requirements aligned to the specific risk profile of the undertaking, for example investing in alternative assets such as private equity. The framework is scheduled to come into effect on January 1 2013, but a soft transition period is expected to be actualized, implying that insurance companies need to fulfill the minimum capital requirements by January 2014.

Solvency II is expected to impact the distribution of assets within life insurance companies' investment portfolios. Under Solvency II, private equity investments ("Other equities") are subject to a base shock of 49% if the standard model is used. Not surprisingly, life insurers argue that the base shock for "Other equities", as well as for Equities, is disproportionally high compared to that for sovereign or central bank debt securities (government bonds). While EVCA and various national association providers have provided arguments to arrive at more favorable stress levels, the chances of any significant reduction of the base shock is remote because it would be inconsistent with the entire philosophy of Solvency II. Insurers will have to live with the requirements and then evaluate whether they will be able to sustain their levels of commitments to private equity or not. A likely industry development is that only highly solvent life insurers will be able to hold private equity in its portfolio. Hence, Solvency II will steer insurance companies to low risk assets, meaning that investors will move to sovereign or central bank debt securities and away from high risk equities. Current market conditions within EU, high national budget deficits in PIGS countries, heavily depend upon these countries' capacity to issue governmental bonds with low interest rates. In order to decrease interest rate on these securities the demand for these assets need to increase. Unfortunately, Solvency II would potentially be a response of an increased anxiety within the parliament, since the framework steer investors towards governmental bonds.

The development of an internal model, which theoretically would lower the capital requirements for private equity holdings, have been suggested not be as costly for smaller and mid-sized insurers as was first anticipated (Meyer, 2010). However, we find that few Swedish insurance companies plan to develop internal models. The cost of developing an internal is not justified since private equity holdings generally are small in relation to the total balance sheet size, both for small and large life insurers. So, most insurers will use the standard model. As discussed above, only the large and well capitalized insurers are able to sustain commitments to "risky" asset classes like private equity under its capital adequacy requirements. Hence, the choice of model is not the key factor in deciding to invest in private equity, or not. Rather, it is the solvency of insurance companies.

We find that future expectation of returns will deviate across the life insurance and pension markets. Already overcapitalized investors will be able to hold a diversified portfolio, including high risk assets, while undercapitalized insurance companies need to increase their exposures to low risk assets and therefore decrease future expectations on returns. Hence, already well capitalized insurers will be able to generate returns that strengthen their capital base, while undercapitalized insurers will struggle to generate returns that increase their solvency. The differences between overcapitalized insurers and undercapitalized insurers will therefore increase due to Solvency II. Therefore, we expect consolidation within the insurance market, implying the existence of fewer but larger insurance companies in the future. The risk will therefore be shared among fewer institutions, increasing the macro-financial impact of one player's default, i.e. the impact from Solvency II will potentially and unfortunately be that the systematic risk increases within the financial system.

Private equity investors often invest in a limited number of funds. Large insurance companies are likely to invest in large buyout funds, because it is impractical for them to invest in smaller GPs. The smaller GPs cannot offer large enough absolute returns to make it worthwhile for large investors to run through the due diligence process. An LP also needs to consider maintaining a good relationship to the GPs it invests with. This aspect also practically limits the amount of GPs a LP can invest in. As the insurance market consolidates the insurers will demand larger private equity fund investments. To stay attractive, and meet the demand from their investors, GPs will raise larger funds. Hence, consolidation within the insurance industry will lead to consolidation effects within the private equity industry, which is problematic because it will become increasingly difficult for smaller and medium-sized private equity firms to attract capital from life insurers. If small buyout funds and venture capital funds, whose investment strategies focus on growth companies and seed investments, will struggle to get funding the growth prospects for the economy in general will be negatively impacted. This is true for those funds that normally get commitments from life insurers or pension funds.

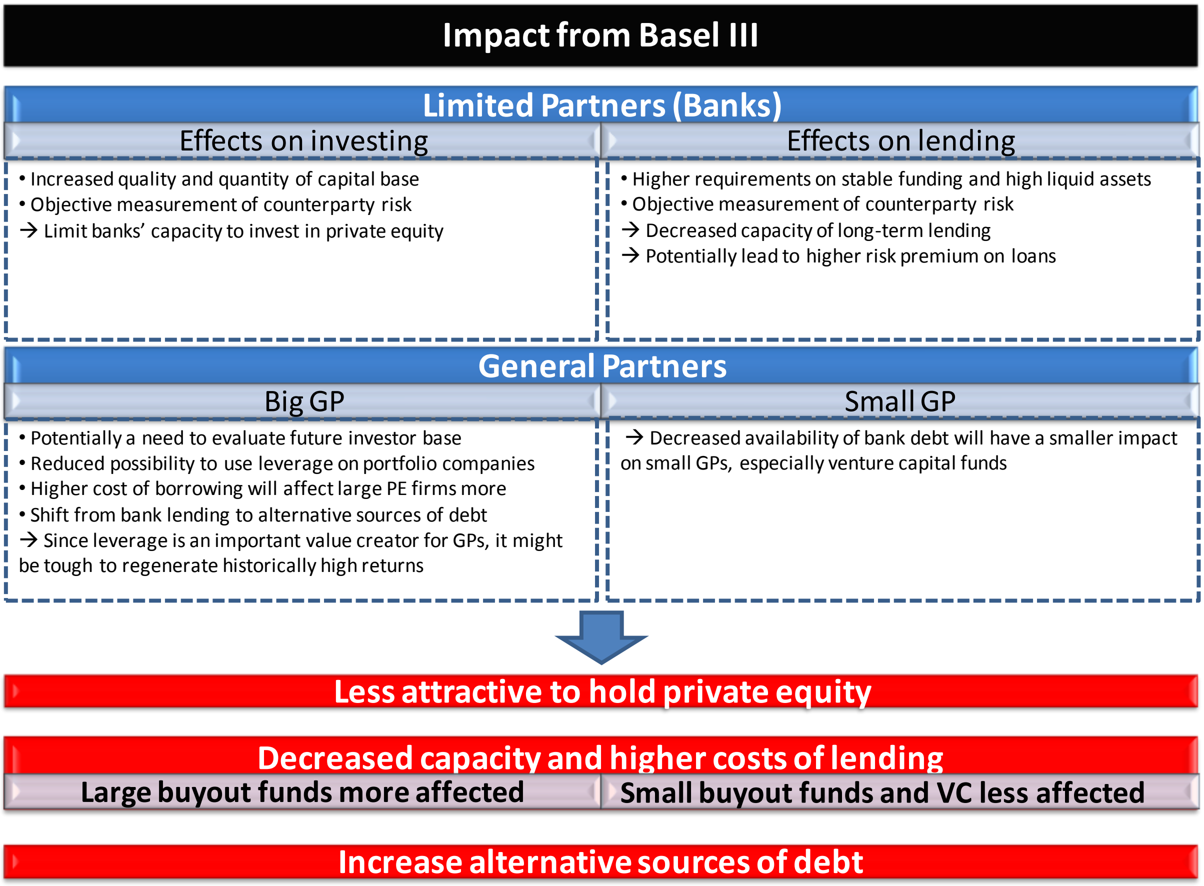
The impact from Solvency II on private equity and venture capital firms is of course closely related to their respective current investor bases. A fund that heavily relies upon commitments from insurers is required to evaluate the impact from Solvency II on their fundraising capabilities. It is expected that small buyout and venture capital firms will be most affected by the implementation of Solvency II as fewer small LPs have the capacity to invest in private equity. These firms, therefore, have incentives to search for new investors types for future fundraising processes.

The dialogue between GPs and investors is continuously good and larger GPs are actively involved in lobbyist organizations that strive to assist investors in adapting to incoming regulations. The investors are starting to attain a good level of understanding of what implications the incoming regulations will have. We asked the GPs whether they assisted the investor community to develop internal models. They do not. However, EVCA continuously works with developing guidelines that will help investors to develop internal models. Since each life insurer must base their internal models on observed data on their past allocations to private equity, the investment returns and the volatility of those returns, as well as correlation of those factors to those of other assets classes in order to come up with a measure of risk, EVCA cannot build one “internal model” that fits all.

The decrease in allocations of capital from the life insurers to private equity in 2009 and 2010 is not seen as evidence of a decrease in the attractiveness of private equity as an asset class. Instead, the decrease is a result of over-allocations to private equity that grew large during the financial crisis. Since private equity investments are illiquid and the capital is committed during approximately 10 years, it is hard for the investors to pull out before maturity (it would also harm their credibility as a potential investor in future fund raisings). When the value of other investments that the life insurers and pension funds had on their balance sheets plummeted, the proportionate amount of private equity investments became too large, hence the slowdown in investment activity since the crisis. However, a few investors believe that the decrease in allocations to private equity may be an effect of the uncertainty regarding incoming regulations. If you cannot tell how the regulations (AIFMD, Solvency II and Basel III) will affect your portfolio and your future investment possibilities, it might be better to wait until the effects are clear and measurable.

6.2. Basel III

Figure 17 - Impact from Basel III



Since the commitments from banks to Swedish private equity funds have been close to zero in the recent years, GPs are familiar with the thought of not being able to raise capital from banks in upcoming funds. Arguably, the effects of Basel III are already observed in the Swedish fundraising market and commitments to new Swedish private equity funds from banks are therefore expected to remain very low. Losing banks as a source of capital for fundraising is therefore less severe than losing insurance companies or pension funds, whose commitments to the industry are substantial.

Managers of Swedish buyout funds apprehend that Basel III will decrease their capacity to finance leveraged buyout transactions with loans from banks to the same extent as earlier. Basel III will establish higher capital adequacy requirements, increase the proportion of assets with high liquidity and increase the requirements for medium- to long term funding. Therefore, banks can no longer expand their balance sheets with excess lending. Decreased availability of lending primarily stems from the introduction of the non-risk weighted leverage ratio and the NSFR. Arguably, an effect from Basel III on the Swedish private equity industry is a decreased availability and increased cost of lending. An increased cost of taking on leverage is expected to impact large buyout funds the most, since those funds generally apply higher leverage to finance their portfolio companies.

Previous theories suggest that leverage is an important value driver for buyout funds (Loos, 2006), but the sharp decline of leverage in the global financial system has reduced private equity firms' ability to create value through financial engineering. Going forward, Matthews, Bye and Howland

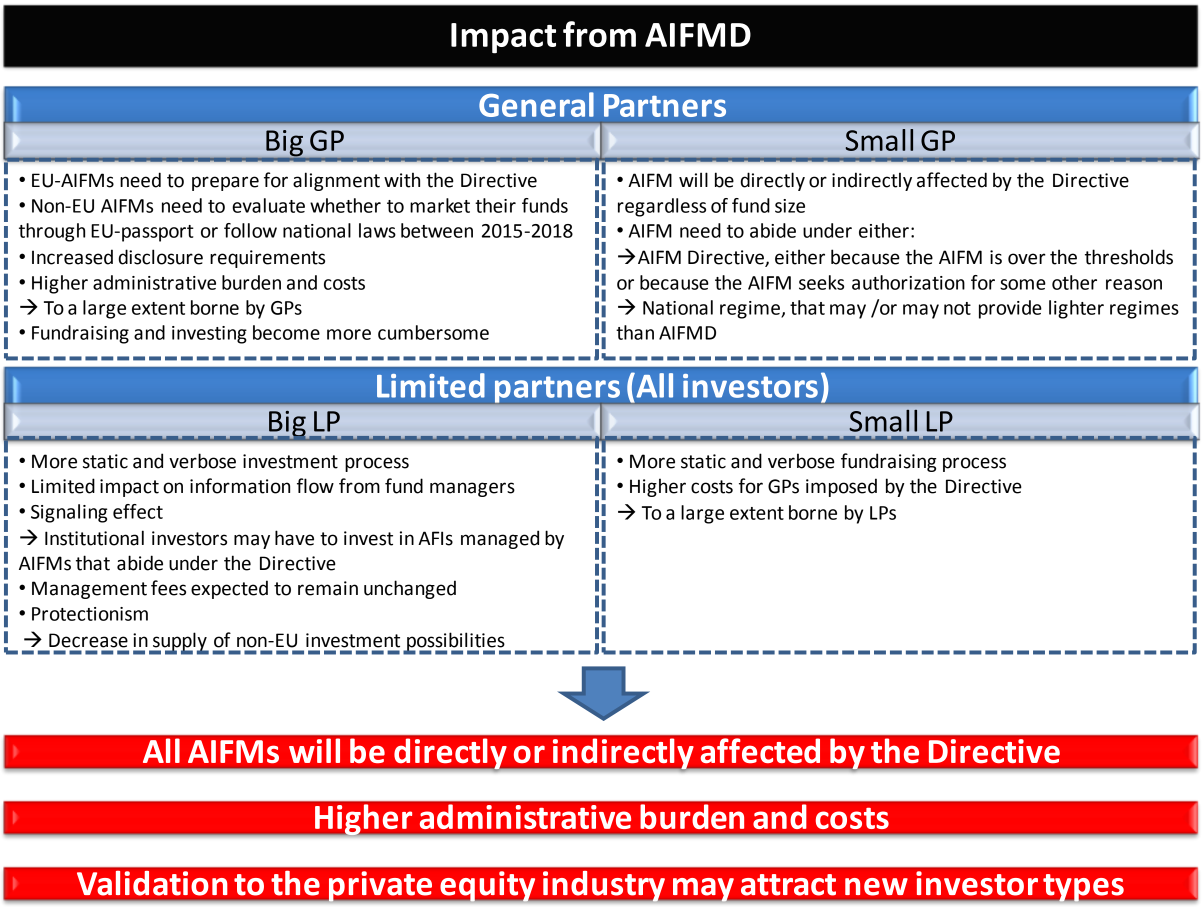
(2009) argue that, private equity firms will be more dependent on their ability to improve operational performance to achieve their investment goals and generate attractive returns.

Axelson, Strömberg and Weisbach (2008), on the other hand, argue that, GPs make better investment decisions when leverage is limited or more expensive, since the incentives for choosing good projects is higher when they have more equity within the project. This argument is further strengthened by evidence showing that the availability of financing impacts booms and busts in the private equity market, (Axelson et al, 2007). So limited and/or more expensive debt financing can decrease the high cyclicality of the private equity.

If we accept the theory that leverage is an important source of value creation within buyout funds (Loos, 2006), GPs will need to find new sources of value or find new ways to improve performance of their portfolio companies, in order to sustain required returns. If they do not, GPs need to revise returns which might have a negative effect on the attractiveness of their funds. As a result of implementing Base III (CRD IV), we expect buyout funds to increasingly look for alternative sources of debt.

6.3. AIFMD

Figure 18 - Impact from AIFMD



The regulatory framework AIFMD (The Alternative Investment Fund Managers Directive) will establish a framework for all European alternative investment fund managers ("AIFM") and all AIFMs that manage or market alternative investment funds ("AIF") within the European Union. The

Directive is scheduled to come into effect by 22 July 2013 when member states are required to adapt the laws and regulations necessary to comply with the Directive.

We believe that the AIFMD may have validation effects on the industry and hence attract new types of investors, a welcome result, given the implications of Solvency II and Basel III on insurers, pension funds, and banks. On the downside, the Directive will make the investment process more static and verbose since it will be difficult for investors to negotiate terms of investments prior to the prospectus of a new fund being set. A result that is not well received by current investors, whom have close relationships with the funds they invest in.

The administrative burden and costs will increase due to AIFMD, mainly due to higher requirements of disclosure to authorities and the requirements of an independent depositary. The higher costs will primarily affect smaller firms, which have limited administrative resources and lower margins on management fees. It is not clear who will bear the highest proportion of the increased costs, however we expect that large private equity firms will have to bear these costs themselves. In the short run the small firms may encounter challenges in the supply of certain professional staff as many firms will need to increase their finance and compliance teams. In the longer run, the Directive may limit the amount of small private equity and venture capital firms.

The smaller funds will have to deliberate whether to seek authorization or not., by weighing the costs of abiding under it against the benefits it may encompass. It is expected that the smaller funds' managers will prepare an overview of whom their investors are and see if they are likely to gain from the Directive's smoothening function or if it is easier to take advantage of national regulations. These smaller funds and larger funds domiciled in non-EU countries do not automatically have to abide under the Directive, but we have found clear indications that all managers need to prepare for the implementation of the Directive into national laws, regardless of size and fund structure. Some managers will of course be better prepared than others, but it is alarming that a significant amount of AIFM within Sweden have given the Directive limited, or no thought at all. We find that all AIFMs will be directly or indirectly affected by the Directive and it is therefore important that those managers, wrongly assuming they will only be marginally affected or completely unaffected, prepare their management teams and evaluate how the AIFMD will impact their business model and internal organization.

Political pressure has played an important role in the advancements of new regulations and a majority of the interviewees think that the development has been rushed. For example, the common belief is that, if the AIFMD had not taken its original form in a rush, it would not have bunched together hedge funds, real estate funds, commodity funds, infrastructure funds, as well as private equity funds to abide under the same regulatory framework. Until the AIFMD comes into force it is important that politicians and regulators are educated further so that the framework is improved. However, it is tough for the private equity industry to make their voice heard among politicians, mainly because private equity still constitutes a relatively small part of the economy as a whole, especially in Germany and France whom are some of the "heavy hitters" in the EU. Work can be performed to slightly tune the framework until its entry into force, but in large the Directive is set and contents that we have today is close to what the end product will look like.

7. Concluding comments

Solvency II, Basel III and AIFMD are approaching implementation into European and national laws. We find that Swedish GPs and LPs expect these changes in the regulatory landscape to have wide implications for future fundraising processes within the Swedish private equity market. In other words, the new regulatory landscape will affect the whole private equity value chain including investors, managers and their funds and portfolio companies. No private equity firm or investor within private equity will go completely unaffected when these regulations come into effect.

Although the AIFMD will increase costs and administrative burdens, Solvency II and Basel III/CRD IV are expected to have a more severe impact on fundraising and deal flow for private equity firms. Solvency II will make it more expensive for life insurers, in terms of higher capital adequacy requirements, to invest in private equity. This will have a detrimental effect on commitments to private equity from all life insurers, and some smaller investors are expected to abandon the assets class because they are not well capitalized enough to invest in such "risky" assets. This shrinks one important source of capital for large GPs and eliminates it for small GPs.

The low commitments from banks to Swedish private equity funds in the last three years might indicate that banks have already taken measures to meet incoming regulations. However, the real change that we expect from Basel III/CRD IV is that GPs capacity to lever their portfolio companies decreases, since the effect from the framework is that banks have to decrease lending. As a result, fund managers need to find complementing sources of value creation, other than leverage.

We find that AIFMD will affect all managers of AIFs, either directly or indirectly. The administrative burden in relation to fundraising and fund operations will increase. Therefore, it is important for all managers to recognize and prepare for the implementation of AIFMD, irrespective of whether the relevant AIF falls below the thresholds or not, so that they can be cost effective when the higher administrative burdens come into effect. The increased costs will principally be borne by GPs.

Even though both GPs and LPs believe that the private equity fund investment process will become more static and verbose, they agree that the industry can gain validation when AIFMD is implemented. In conclusion, we find that the new regulatory landscape will have an impact on Swedish private equity and venture capital firms' ability to raise capital in the future. We find that small or newly started private equity firms will be hardest hit by the regulatory frameworks, AIFMD and Solvency II, when it comes to raising capital for new funds in the future. These funds will struggle to manage the increased costs due to AIFMD but also to attract new capital due to Solvency II, which was probably not the intention of regulators at the outset. In Sweden, where the private equity and venture capital industry constitutes a substantial proportion of GDP, it is cumbersome if these funds will struggle to attract new capital. We find that large, well performing, buyout funds will manage the changes from AIFMD and maintain attractiveness from insurers, but we expect that they will be heavily affected by Basel III, since the cost and availability of leverage will negatively affect expected returns.

As discussed before, we find that consolidation within the private equity market will result from incoming regulations. Therefore, politicians need to carefully investigate how the regulations will affect the availability of capital for small companies looking to expand their businesses with external capital, but also how the potential consolidation within the Swedish private equity industry will affect the systematic risk within the financial system.

8. Implications for future research

Our thesis focuses on the Swedish private equity market and its Swedish investors. The regulatory frameworks will be implemented within the European Union, and therefore many of our findings are applicable to other member states within the Union. However, some factors aggravate generalization of the findings to a broader arena, e.g. the implementations of the regulations into national law and variations of investor bases (e.g. banks investments into PE in the broader Europe are still substantial). A member state within the Union with many large private equity firms that to a large extent relies upon commitments from institutional investors might be affected differently than a member state with small private firms with a large proportion of capital committed from endowments and foundations. Therefore, we want to emphasize that our findings reflect our view of the regulatory landscape from a Swedish perspective and each reader will have to perform its own analysis whether these findings might be applicable within other EU member states.

We have performed qualitative interviews with mangers and investors within the Swedish private equity industry, and our findings and conclusions are drawn from these interviews. In total, ten interviews were performed and additional surveys were collected. We tried to gather a large sample and are satisfied with the information received from our interviews, but realize that a larger sample of quantitative information from our surveys would increase the validity of our analysis. Our research question was wide which led us to many discussions regarding delimitations. Hence, we recognize that our thesis does not generate any clear answers on the current situation, nor can it prove any certain affects on future fundraising within the Swedish private equity industry. However, this is not our intention since our aspiration is to create a discussion that leads to more research. Below, we give examples of topics and questions that we choose to leave unanswered, but that would add important insight and understanding of the future challenges facing the Swedish private equity industry.

We suggest that future research focuses on the quantitative effects from Solvency II and Basel III. What will the costs be from increased requirements on capital bases and how much private equity allocation are the Swedish insurance companies able to hold? Another interesting research question would be to investigate how much value is derived from leverage and how Basel III/CRD IV therefore will affect the expected return from investments within Swedish buyout funds. A separate study could also look at how Basel III/CRD IV will affect lending possibilities for Swedish banks, after the final implementation of CRD IV, in 2019. To fully understand and investigate these suggested research questions one needs to get more information about the Swedish private equity and venture capital firms´ investor bases. Understanding of the capital bases would lead to a higher understanding of the solvency of investors within the Swedish private equity firms. With this information, it would also be possible to extend our research and discuss the effect from the regulation over the entire investor base, i.e. the impact on foreign investors' capabilities to allocate capital to Swedish private equity firms. The above suggested further studies are executable only after actual implementation of the regulatory frameworks. One cannot investigate the aggregated impact of the new regulatory landscape until the frameworks are fully implemented and technical details are set.

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Appendix

Interview questions – General Partners

Thank you for participating. Please see the below questions as an indication of what we wish to discuss during the interview. Your answers are anonymous and will be reported in aggregated form. We would be delighted if you could provide some motivation for the choices you make below. Our objective is to understand what effect present and future regulations will have on LPs allocation of capital to Private Equity.

Overview

1. **What is your area of investment?**

   Buyout   Venture Capital   Buyout/Venture Capital

2. **Do you have any specific industry focus on your investments?**

   ___

3. **Do you have any specific geographical focus on your investments?**

   ___

4. **Fair value of investments in your latest fund**

   < €100m   €100m - €500m   €500m - €1b   > €1b

5. **Geographical breakdown of your source of investor capital**

   a) Capital raised within Sweden

      __ %

   b) Capital raised within Europe (excluding Sweden)

      __ %

6. **What do you think that LPs perceive as the greatest risk when investing in the Private Equity?**

   ___

AIFM Directive

7. Will you as an alternative investment fund manager (AIFM) come under the scope of the proposed Directive?

Yes | No | Don't know

8. If no, are you planning to seek authorization under the Directive? (e.g. take advantage of the Directive's passporting provisions)?

Yes | No | Don't know

9. What is your general view of the marketing passport introduced by AIFMD?

Positive | Negative | Don't know

10. Will your source of investor capital change due to the proposed Directive?

a) Capital raised within Sweden

Increase | Decrease | Don't know

b) Capital raised within Europe

Increase | Decrease | Don't know

11. If the proposed Directive comes into force as proposed

a) Will your costs increase?

Yes | No | Don't know

b) Would this lead to higher fees?

Yes | No | Don't know

c) If yes, can you estimate by how much the fees will increase?

0-50bp | 50bp-100bp | 100bp-200bp | > 200bp

d) Who will bear the highest proportion of the increased costs?

PE firms | Investors | Don't know

12. Information sharing

a) Is there a need for increased information sharing within the Private Equity industry?

Yes No Don't know

b) Will the information sharing to investors increase due to the proposed Directive?

Yes No Unchanged Don't know

c) Will the information sharing to authorities increase due to the proposed Directive?

Yes No Unchanged Don't know

d) If you believe that the information sharing will increase: Does this have a negative effect on the competitive situation for your portfolio companies?

Yes No Don't know

13. Are you actively considering moving your company from an EU domicile as a consequence of the proposed Directive?

Yes No Don't know

14. View of the proposed Directive

a) How have your investors viewed the proposed Directive to date?

Favorably Unfavorably Neither favorably nor unfavorably Don't know

b) How have managers and other stakeholders in your portfolio companies viewed the proposed Directive to date?

Favorably Unfavorably Neither favorably nor unfavorably Don't know

Fundraising

15. How will the proposed Solvency II framework affect your ability to raise capital?

Increase Decrease Unchanged Don't know

16. How will the proposed Basel III framework affect your ability to raise capital?

Increase Decrease Unchanged Don't know

17. How will the proposed AIFM Directive affect your ability to raise capital?

Increase Decrease Unchanged Don't know

18. Everything else being equal, how will these regulations affect your ability to raise capital in a short term perspective (< 3 years)?

Increase Decrease Unchanged Don't know

19. Everything else being equal, how will these regulations affect your ability to raise capital in a long term perspective (> 3 years)?

Increase Decrease Unchanged Don't know

20. Investor type

a) Please list (1-6) which type of investors that has committed the highest amount of capital to your latest fund

___ Swedish national pension funds

___ Pension funds

___ Life insurance companies

___ Fund of funds

___ Banks

___ Other

b) Please list (1-6) which type of investors that you expect to commit the highest amount of capital to your next fund

___ Swedish national pension funds

___ Pension funds

___ Life insurance companies

___ Fund of funds

___ Banks

___ Other

Thank you for completing the questionnaire. Please contact us if you have any further questions.

Nicholas Sundén-Cullberg
M.Sc. Student in Business and Economics,
specialization in Accounting & Financial Management.
Stockholm School of Economics

Mobile phone: +46 (0) 735 08 10 14
E-mail: 40117@student.hhs.se

Niklas Wenneberg
M.Sc. Student in Business and Economics,
specialization in Finance.
Stockholm School of Economics

Mobile phone: +46 (0) 704 38 51 54
E-mail: 40002@student.hhs.se

Interview questions – Limited Partners

Thank you for participating. Please see the below questions as an indication of what we wish to discuss during the interview. Your answers are anonymous and will be reported in aggregated form. We would be delighted if you could provide some motivation for the choices you make below. Our objective is to understand what effect present and future regulations will have on LPs allocation of capital to Private Equity.

Overview

21. What type of investor are you?

Bank	Life Insurance	Pension fund
Fund of Fund	Swedish National Pension Fund	Other

22. Please specify your area of investment within the asset class Private Equity (possible to mark several options)

Buyout Funds	Venture Capital Funds	Direct Investments
Co-Investments	Fund of Funds	Other

23. Do your Private Equity investments have any specific industry focus?

____

24. Do your Private Equity investments have any specific geographical focus?

____

25. Geographical breakdown of your invested capital within Private Equity

c) Capital invested in Sweden

__ %

d) Capital invested in Europe (excluding Sweden)

__ %

Allocation

26. **How has your allocation to Private Equity changed during the last 5 years?**

Increased	Decreased	Remained unchanged

27. **How has your allocation to Private Equity changed during the last year?**

Increased	Decreased	Remained unchanged

28. **How will your allocation to Private Equity change in the short-to-medium term (1-5 years)?**

Increase	Decrease	Remain unchanged

29. **Please indicate the three most important characteristics of a GP for it to attract your investment**

Track record and distributions	Clear differentiation	International capabilities
Demonstrate value creation capabilities	Responsible investor	Transparent and humble
Diversification (buyout/venture, geography, distressed/secondaries)		Other

AIFM Directive

30. Is AIFMD positive from your point of view?

Yes　　No　　Don't know

31. Is there a need for increased disclosure within the Private Equity industry?

Yes　　No　　Don't know

32. Do you believe that AIFMD will change your relationship to the Private Equity funds that you invest in?

Yes　　No　　Don't know

33. What is your general view of the marketing passport introduced by AIFMD?

Positive　　Negative　　Don't know

34. Do you think that the passport will limit the amount of funding opportunities?

Yes　　No　　Don't know

35. If the proposed Directive comes into force as proposed:

e) Do you think that the costs for Private Equity firms will increase?

Yes　　No　　Don't know

f) Would this lead to higher fees?

Yes　　No　　Don't know

g) If yes, can you estimate by how much the fees will increase?

0-50bp　　50bp-100bp　　100bp-200bp　　> 200bp

h) Who will bear the highest proportion of the increased costs?

PE firms　　Investors　　Don't know

Regulatory framework

36. Under which regulatory framework do you abide?

Basel II/III　　*(please answer questions 16 to 22)*

Solvency I/II　　*(please answer questions 23 to 31)*

Other　　*(please answer questions 32 to 35)*

If you abide under Basel II/III, please answer these questions…

37. Does the implementation of Basel II impact your allocation of capital to Private Equity?

Yes No Don't know

38. Will the continued implementation of Basel II and Basel III impact your allocation of capital to Private Equity?

Yes No Don't know

39. In your view, what are the main risks that you are exposed to when investing in the Private Equity sector?

____

40. Given higher capital requirements on Private Equity investments, do you think that you could still increase your exposure in any way?

____

41. Given that there are no capital adequacy requirements; would you increase your allocation of capital to Private Equity?

Yes No Don't know

42. Calculation of capital requirement

a) Do you use the standard model or have you developed an internal model?

Standard Model Internal model Don't know

b) Does the choice of model affect your allocation to Private Equity?

Yes No Don't know

If you abide under Solvency II, please answer these questions…

43. Does the implementation of Solvency I impact your allocation of capital to Private Equity (Other Equities)?

Yes No Don't know

44. Will the implementation of Solvency II impact your allocation of capital to Private Equity?

Yes No Don't know

45. What type (size) of insurers will be affected the most/least by Solvency II?

Small Large Don't know

46. For those insurers that continue to invest in Private Equity, which will be the predominant model that they use?

Standard Model Internal Model

47. What do you believe will happen to insurers' overall commitments to Private Equity going forward? Is the effect a response to incoming regulation, or perhaps something else?

Yes No Don't know

48. In your view, what are the main risks that you are exposed to when investing in the Private Equity sector?

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49. Given higher capital requirements on Private Equity investments, do you think that you could still increase your exposure in any way?

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50. Given that there are no capital adequacy requirements; would you increase your allocation of capital to Private Equity?

Yes No Don't know

51. Calculation of capital requirement

a) Do you use the standard model or have you developed an internal model?

Standard Model Internal model Don't know

b) Does the choice of model affect your allocation to Private Equity?

Yes No Don't know

If you are a Swedish National Pension fund, please answer these questions…

52. In your view, what are the main risks that you are exposed to when investing in the Private Equity sector?

53. Solvency II and Basel III will increase capital requirement for Private Equity investments

a) Please provide your view on the potential impact of these regulations on fundraising within Private Equity?

b) Will these regulations affect your attractiveness as an investor?

Yes No Don't know

c) Would this make Private Equity investment more attractive from your point of view (more bargaining power/lower fees)?

Yes No Don't know

d) Will these regulations decrease your opportunities of co-investment?

Yes No Don't know

54. On what basis is your allocation of capital to Private Equity determined?

55. Would a higher allocation limit to Private Equity result in higher investments?

Yes No Don't know

Thank you for completing the questionnaire. Please contact us if you have any further questions.

Nicholas Sundén-Cullberg
M.Sc. Student in Business and Economics,
specialization in Accounting & Financial Management.
Stockholm School of Economics

Mobile phone: +46 (0) 735 08 10 14
E-mail: 40117@student.hhs.se

Niklas Wenneberg
M.Sc. Student in Business and Economics,
specialization in Finance.
Stockholm School of Economics

Mobile phone: +46 (0) 704 38 51 54
E-mail: 40002@student.hhs.se