QUESTIONS TRUSTEES CAN ASK FUND STAFF AND CONSULTANTS ABOUT POTENTIAL PRIVATE EQUITY INVESTMENTS

Below are a set of questions trustees can ask fund staff and consultants regarding potential private equity investments. These questions were developed for the Trustee Leadership Forum for Retirement Security by Eileen Appelbaum and Rosemary Batt, based on their book Private Equity at Work: When Wall Street Manages Main Street. The TLF, a project of the Initiative for Responsible Investment at the Harvard Kennedy School, is a participatory action research project on systemic thinking by labor-affiliated public and multi-employer pension fund trustees about responsible investment and its relationship to long-term pension fund stability. The TLF developed in the wake of the 2008 financial crisis and ensuing political and economic fallout. This crisis crystalized the need for a forum where pension fund trustees can work on hard questions related to the challenge of retirement security in the current market environment, and build on current leadership skills to assist navigating complicated topics and situations.

1. **In some limited partner agreements, GPs stipulate that they may waive their fiduciary responsibilities.** Some agreements stipulate that GPs may have a conflict of interest and may resolve it in their own favor. This is tantamount to waiving fiduciary responsibility.

   Does the limited partner agreement for this fund allow the GP to waive his or her fiduciary responsibility?

   For any previous fund sponsored by this PE firm?

2. **Regarding debt, in previous funds sponsored by the PE firm:**

   Did the debt used to purchase a portfolio company ever exceed 70% of the purchase price?

   What were the 10 largest purchases and how much debt was used in each?

   What was the average amount of debt used when purchasing portfolio companies?

   Did any portfolio company do a dividend recap in the first 2 years after being purchased?

   Did any portfolio company go bankrupt while under the ownership of this PE firm?

3. **Restaurants and retail are cyclical businesses** that tend to own their own property as an economic buffer against slow sales in an economic downturn. PE firms often sell the real estate of their portfolio companies to pay off debt or to reward investors rather than to improve the operations of these companies – also known as asset stripping. The companies are then required to 'lease back' properties they once owned, putting them at risk.

   In previous funds sponsored by the PE firm, did any portfolio company engage in a sale-lease back agreement whose main purpose was to pay back debt used to acquire it or to reward investors in the PE fund?

4. **363 bankruptcies are for rare, exceptional circumstances. Some PE firms use 363 bankruptcies to get rid of pension liabilities.**

   Have any portfolio companies in funds sponsored by this PE firm gone through a 363 bankruptcy? If yes, in what way were the circumstances exceptional?

5. **Regarding fees:**

   LPs pay management fees to the GP for managing the investment. What is the lowest management fee paid by an LP in this fund?

   The PE firm may charge advisory or monitoring fees to portfolio companies. Are all of these fees clearly enumerated in the LPA?

   Are all of these fees shared with the LPs? If not, why not? What expenses does the PE firm subtract from fees before sharing?

   A portfolio company may be required to sign a contract to pay these fees for 10 years. However, PE funds typically hold companies for 3 to 5 years. When the PE firm requires a 10-year contract, it collects fees for services it will never provide. Has this occurred in previous funds sponsored by this PE firm?

6. **Returns "net of fees" can be calculated in different ways.**

   In calculating the average net return (net of fees), is the GP contribution to the fund's equity included? Including it makes the *average* returns net of fees look bigger than they are. The carried interest collected by GPs should be subtracted from fund returns since they reduce the returns available to LPs.

   Are GP contributions to fund capital excluded and all fees and carry subtracted from fund returns when calculating average net return?

   IRR is not a good way to measure PE returns. Finance economists and others (e.g., Goldman Sachs) use PME. Using PME, what is the rate of return on previous funds sponsored by this PE firm?

7. **In multi-employer pension plans, a company that exits a plan is supposed to make a payment to the pension fund,** but a bankrupt company doesn't have resources. Some GPs claim they are not managers, refuse joint responsibility and don't make the payment.

   Has any prior PE fund sponsored by this PE firm faced this situation, and if yes, how did it handle it?

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