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UK MID-MARKET DEBT 2017

The Brexit checklist

As negotiations to exit the EU drag on, dealmakers are doing their best to make sense of what UK private equity will look like in the future. These are the three key issues the industry is keeping a close eye on.

By *Nicholas Neveling*

1. LP appetite for managers investing in the UK

Although the fundraising market is still going strong and a number of UK firms have raised capital after the Brexit referendum, there is some evidence that certain LP groups are taking a cautious position on UK managers.

"A bifurcation among investors is emerging and some LPs have taken a "risk off" approach towards the UK. The fact is that perception is reality, and if LPs are worried about what happens with Brexit then GPs need to deal with those concerns," says Silverfleet Capital managing partner Neil MacDougall.

Bala Krishnan, investment director at Sovereign Capital, says the biggest challenge for LPs is dealing with the political uncertainty of the Brexit process. "Until everyone knows exactly where the land will lie, it is difficult to have a specific conversation about what the economic impact of Brexit will be," Krishnan says. "Political uncertainty is hard to price in and makes it difficult to assess risk profiles and portfolio exposure."

Lyceum Capital director Anne-Claire de Pompignan says the value of a consistent message across the industry through a period of uncertainty should not be underestimated.

"Perceptions are shaped by what all of us say. All firms would benefit if there was collective industry view on what Brexit means and the opportunity that it can present," de Pompignan says.

2. Domicile decisions

Before the Brexit vote European buyout managers were already moving to onshore their fund domiciles in Luxembourg. The vote to leave the EU has accelerated this trend, according to Macfarlanes partner Damien Crossley.

"If you are a non-EU fund and have used the Channel Islands there won't be much of an impact to be honest, but if you are a UK manager you will be looking at the other options. The general shift onshore has been underway for a few years now, but it has certainly speeded up since Brexit," Crossley says.

For managers, the big concern is what happens in two years when the exit negotiations conclude.

"The big question I have is what an alternative investment fund manager (AIFM) will look like in 2019? We just don't know at this stage," MacDougall says.

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JTC associate director Simon Gordon says there is still a large amount of horse trading that needs to play out before there is more clarity.

"The UK will want to have equivalence with the EU, but there is a lot of political bartering that needs to be done. The Channel Islands, for example, are waiting to see when ESMA will grant them the passport, but that decision will not be dealt with until Brexit is finalised," Gordon says. "That said, there hasn't been much of a drop-off since the referendum and we are still observing a large number of clients choosing to set up funds in the UK."

Palamon Capital Partners' Louis Elson adds: "The worst-case scenario is if there is a cliff edge and no new set of rules in place, which could leave firms unable to operate. You do not want to be in a situation where an LP can't make a drawdown because of uncertainty around the regulatory position."

3. Talent and recruitment

At portfolio company and firm level, private equity has generally benefitted from the freedom to recruit the best talent from a wide pool of people across Europe. This flexibility is not off the table yet, but there is a risk that firms will not be able to recruit as in the past.

"The UK has attracted people from around the world because it was frictionless. That can still be the case, but it depends on how the exit is managed. There will be bright young people out there asking if this is still where they want to be?" says Elson.

de Pompignan adds: "When I was starting out my career New York and London were the exciting locations that talented young people wanted to go to. Can the UK maintain that position after Brexit? We will have to wait and see what the outcome of the negotiations is."

Thomas Seddon, principal at Riverside Partners Europe, however, says that the UK is not about to undergo a brain drain.

"It is not a question of people leaving, but one of who doesn't come to the UK," he says. "It is also important to note that there isn't another beacon at the moment to head to instead." ●