



The following represents the *majority* opinion of the members of the ILPA only. In no way shall these Best Practices be construed to represent the opinion of all members of the ILPA. The ILPA strongly recommends adoption of ‘ILPA Reporting Best Practices’ but it is at the member’s discretion to do so.

ILPA Memorandum

February 19, 2004

RE: Advisory Committees - Best Practice Note

The Following outlines the summary findings on the Best Practices - - Advisory Committees

The Role of the ILPA: The ILPA is committed to serving Limited Partner investors in the global private equity industry by:

- (i) facilitating value-added communication;
- (ii) enhancing education in the asset class;
- (iii) promoting research and standards in the private equity industry; and
- (iv) conducting research and providing guidance on best practices.

Topic: Advisory Committees play an important role in the business of private equity investing. Most private equity funds are structured as Limited Partnerships. Institutional investors invest in funds as Limited Partners and have no direct operating control or control over investment decisions. General Partners, in compliance with the partnership agreement, are solely responsible for the day-to-day operations and all decision-making of the partnership. An Advisory Committee is comprised of an invited group of investors usually identified at a fund’s formation that provide limited governance and oversight of the Fund and the General Partner, as agreed in the Limited Partnership agreement. It is through Advisory Committees that investors are able to gain deeper insight into the progress of the partnership and provide important advice to the General Partner as they manage multi-million and billion dollar pools of investment capital.

Issue: It is clear that Advisory Committees can be valuable tools for both General and Limited Partners as they conduct the business of private equity investing; however, no guidelines or best practices exist regarding the operation of Advisory Committees. Industry practitioners note that there is a lack of consistency in the size, formation, role, responsibilities, effectiveness and other characteristics of Advisory Committees across funds. ILPA members have commented how certain Advisory Committees work exceptionally well while others tend to function more as marketing platforms for General Partners to coddle their largest existing or potential investors. Some Limited Partners worry that their can misconceptions about the role of the Advisory Committees as relates to consents, amendments and other activities. Nevertheless, Advisory Committees can and do play crucial roles

in the healthy workings of a fund, and the ILPA has determined that it is in its members interest to develop best practices for them.

Process: The ILPA charged the Research, Benchmarking Standards Committee with development of best practices for Advisory Committees. A panel on the topic was convened for the spring 2003 ILPA conference and a roundtable discussion ensued at the same event. Through the discourse and feedback garnered at the spring conference, an RBS subcommittee developed the following best practices for consideration and comment from the ILPA membership and eventual Board endorsement.

BEST PRACTICES:

Formation: General Partners should formally, in writing, invite Limited Partners to serve on their Advisory Committees. These requests should explain the responsibilities of the Advisory Committee and of the General Partner, expectations of the annual number of Advisory Committee meetings and explain the provisions for reimbursement of travel and other reasonable expenses of Advisory Committee members.

Membership: Advisory Committees should comprise a relevant cross section of the more -experienced Limited Partners in a fund. Preference may be given to those investors' with the largest commitments to the fund or to those Limited Partners with a breadth of private equity experience. The Advisory Committee seat should be held by the investor entity, not an individual representing the investor entity. Advisory Committees should permit their members to designate an alternate from their respective organizations in order to ensure regular attendance at meetings. Ideally, General Partners should have representatives on the Advisory Committee that have been investors with that General Partner for multiple funds, while also providing opportunities for select new investors to participate. On the other hand, other challenges may present themselves, when dealing with cross-fund conflict issues, if a significant majority of the Members of the Advisory Committees are the same for both Funds. Advisory Committees should not include non-investors. Neither the General Partner nor any of its Affiliates should be eligible to be members of the Advisory Committee. While it is preferable for the Limited Partnership Agreement to clarify eligibility and to define Affiliate in the broadest possible terms; regardless of the terms of the Agreement, Best Practice in the case of voting on matters that involve conflicts of interest, as an example, would be for LP Investors who have economic interests in the General Partner to declare their conflict, and refrain from voting. As another example, Best Practice in the case of cross-fund conflict issues would be for the matter to be decided by a majority of those who are Members of only one of the Advisory Committees involved in the matter. Experience and professional judgment must be applied to particular circumstances, as there may be practical limitations to following what might otherwise be considered to be Best Practice.

Size: General Partners should limit the size of their Advisory Committees to a number that is manageable and meaningful. It is may be difficult for Advisory Committees whose membership is larger than ten to operate efficiently and effectively.

Structure: Advisory Committee roles and responsibilities should be detailed in the partnership agreement. Advisory Committee members should be indemnified by the partnership and it should be explicitly agreed in the Limited Partnership agreement that Advisory Committee members have no fiduciary obligation to the fund, but are instead acting solely and exclusively in the best interests of their respective organizations. It is appropriate for the partnership to reimburse Advisory Committee members for reasonable travel expenses incurred for attending Advisory Committee meetings, but other types of remuneration are not considered appropriate. Advisory Committees should meet in person at least once a year and may meet more often in person or telephonically as appropriate, and this should be addressed in the partnership agreement.

Notice and Records: The General Partner should take minutes at all Advisory Committee meetings. Proper notice and delivery of all meeting materials in advance of meetings is appropriate. The General Partner should refrain from discussing Advisory Committee business one-off with individual members as this practice dilutes

the benefits and participation of the Advisory Committee. Some have suggested that consideration might be given to providing all LPs with copies of approved minutes of Advisory Committee meetings. All members of the Advisory Committee must be in agreement if such practice is to be adopted, and only approved minutes should be circulated.

Duties: Advisory Committees should have the core responsibilities of advising on conflict of interests and reacting to portfolio company valuations. In addition, Advisory Committees are ideally suited to facilitate the discussion and disclosure of partnership operations; including but not limited to:

- Audit – disclosure of auditors, changes in auditors, cost and conflicts
- Budget – disclosure of income from management fees and other fees (e.g. deal fees) and of the annual operating budget
- Compliance – with the partnership agreement (e.g. investment criteria, objectives and restrictions)
- Partnership expenses – disclosure of costs expensed to the partnership versus absorption as part of the management fee
- Investments by the General Partner (as an entity or as individuals) - outside of the fund
- Fees and Carried Interest – disclosure of the calculation (including offsets) of management fees, fees charged to portfolio companies, and carried interest
- Human resources – additions and deletions to personnel
- Strategy – changes or modifications to the investment strategy
- Valuation of Portfolio Companies – Valuation Policy and Practices should be documented by the General Partner, and reviewed and understood by the Advisory Committee. Changes in policy, practices or application to a particular portfolio company should be discussed and understood by the Committee. The valuation of portfolio companies should be reviewed with the Advisory Committee no less frequently than on an annual basis. The Advisory Committee does not, should not be asked to, and should not agree to, approve the Valuation Policy, Practices or individual portfolio company valuations. Valuation Policy and Practices, and valuation of portfolio companies are the responsibility of the General Partner.

Advisory Committee meetings should allow time for the conveyance of general advice from the Limited Partners to the General Partner, and when practicable Advisory Committees should allow for a period of time where the Limited Partners, without the General Partner, can meet to discuss the progress of the fund.

A regularly scheduled portion of each Advisory Committee meeting set aside for an “in camera” session, with only Limited Partners present, has been suggested by some. As the Members of the Committee usually only meet a couple of times per year, if time allows, it would be wise to take advantage of the organized time together. Such a regularly session would avoid the inefficiency of having to organize separate conversations and the potential stigma attached to Limited Partners wishing to discuss matters of mutual interest having to speak to other Members individually.

Amendments to Limited partnership Agreements: Some Limited Partnership Agreements allow for certain types of amendments to be made without requiring the approval of all Limited Partners. In other cases, the General Partner discusses proposed amendments with the Advisory Committee prior to finalizing the proposed amendment. In still other cases, the General Partner may ask the Members of the Advisory Committee to indicate to the General Partner, and possibly to other Limited Partners, whether they would approve an amendment, and perhaps even to recommend such amendment to the Limited Partners. While discussing the implications of amendments with other Limited Partners may be beneficial, and individual Limited Partners are not precluded from letting other Limited Partners and/or Advisory Committee Members know how one intends to vote and why, given that the implications of amendments to individual Limited Partners are unique their

individual circumstances, in most cases it would be inappropriate to recommend how individual Limited Partner investors should vote with respect to Limited Partnership Amendments. Such recommendations may have the unintended result of potentially assuming responsibility or even liability.

LP Commitment: In accepting a seat on the Advisory Committee, Limited Partners are making a commitment to attend all meetings, to come prepared and participate fully in all meetings, and to responsibly fulfill the duties of their role. .

Liability: Limited Partners considering becoming a Member of an Advisory Committee should seek advice from legal counsel so as to ensure that the LP Agreement makes it clear that the only duty of care owed is to the investing organization they represent (not other LPs or the GP), and/or that they and the organization they represent are properly indemnified.