Analysis

Q&A: Carlos Lavilla, Ascri

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Ascri president Carlos Lavilla discusses regulatory constraints on pension funds, the need for hybrid vehicles and the arrival of international GPs in the local market in a Q&A with Amy King at the Ascri conference, held yesterday in Barcelona

Amy King: Pension funds' allocations to private equity are significantly lower in Spain compared to elsewhere in Europe, due to regulatory constraints. What can be done to improve this situation?

Carlos Lavilla: The problem is that according to the law, the maximum fees a pension fund can pay is equal to 2% of the asset base. When you add together the fees that the pension fund manager charges and the fees that the fund pays to other managers such as GPs, there is of course a conflict of interest because pension fund managers have an incentive not to allocate that money to other managers as it reduces the fees they can charge. At Ascri, we are trying to encourage the government to change that limit, but it is challenging.

There has also been a substantial tax deferral from the administration for pension funds; 25% of the assets under management are de facto a tax deferral that the Spanish administration has granted to these funds to promote them. Based on that, we think the argument can be made that from a regulatory standpoint there should be something to encourage these funds to invest in private equity. At the end of the day, private equity is used to finance SMEs, which in turn are the basis of the economic recovery. In a general sense, the state is making an effort to sustain and promote pension funds, and so these funds should make an effort to promote and sustain the economy as a whole.

AK: International investors have flocked to Spain recently, with several opening local offices. What could this do for exits?

CL: It's a great exit route, for sure. The amount of money that is flowing into Spain is very important; international investors have acknowledged that many good things have been done in the Spanish economy in the last two years. Fortunately we had a change in government in 2011 and the government that has been in office for two years has taken the tough decisions the economy needed.

One of the main implications is Spanish companies are much more competitive now than they were, and that is attracting a lot of foreign GPs, which is very good for the private equity market and the economy. It will provide an exit route for a number of companies because typically local players do smaller deals, and if we are successful with a smaller transaction that has grown into a bigger deal then that might attract the attention of these large global players.

AK: A number of SMEs in Spain may have emerged from the recession in need of capital but are unconvinced that now is the time to sell. Given the regulatory constraint on hybrid funds in Spain, are there sufficient direct lending options to match this increasing demand?

CL: The capital structure of companies is not binary; they don't want debt or common equity. That is a very simple approach that existed in every market 25 years ago. It's also an approach that continues in markets not as developed as the UK, the US and so on. The reality is the capital structure of a company is a continuum from pure debt to common equity with full equity and full risk. It is very important we acknowledge that and we create a regulatory environment that allows GPs, and LPs via the GPs, to invest in any point in that continuum.

There are SMEs in Spain looking for cash but they don't want to give away common equity and control. They want something different. If you have a regulatory situation that allows that to be done and funds to provide hybrid instruments then you can place yourself in the point of the continuum that is appropriate for the company.

However, we were told this morning at the conference the government is preparing a new set of legislation so Spanish GPs will be able to manage debt funds of all sorts – hybrid instruments. The government said this will be done with a tax regime that is comparable to what exists in the UK and other European jurisdictions. If that happens, it will be very important. In Spain 85% of financing to SMEs is provided by banks; that has to change.

AK: Last year Fondo ICO Global, a €1.2bn fund-of-funds, was launched by the Spanish government. The first tender saw six local funds receive commitments, with the second tender results to be announced shortly. What has been the market's reaction to this new and significant LP?

CL: ICO has done a very good job of getting the fund up to speed very quickly, in a very efficient manner. The funds that have so far received ICO commitments are obviously very happy, but even those funds that did not receive commitments understand the reasons why. It is having a very positive impact on the fundraising environment in Spain.

It's important to remember that ICO funding is there to replace the savings banks as LPs. For that reason, ICO will not create an excess of funding in the market – that is not the case. It is simply replacing LPs that have gone from the market in Spain.

AK: With so many GPs in the market fundraising at the moment thanks to ICO kick-starting the process, is there a danger of market distortion?

CL: No, I don't think that will be the case because ICO is deploying its money, but nobody will be able to raise a fund because of ICO alone. The fund will only commit if around 70% of LP commitments are provided by private investors; GPs have to first qualify for ICO money, but they also have to raise the majority of the fund from the market. Essentially this implies that only those who deserve it will be able to raise a fund because of ICO. There won't be any distortion.

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