

UNDERSTANDING RECOGNITION OF OWNERSHIP THROUGH A PRIVATE EQUITY FUND

1. Who are we?

1.1 The Broad-Based Black Economic Empowerment Commission (“B-BBEE Commission”) is established as an entity within the administration of the Department of Trade, Industry and Competition (“**the dtic**”). The B-BBEE Commission was established in terms of section 13B of the Broad-Based Black Economic Empowerment Act No. 53 of 2003 as amended by Broad-Based Black Economic Empowerment Act No. 46 of 2013 (“the B-BBEE Act”). Its role includes overseeing the implementation of the B-BBEE Act and acting against fronting practices.

2. The Purpose of the Brochure

2.1 This brochure aims to serve as a guide for the treatment and measurement of private equity funds with regard to B-BBEE ownership recognition.

3. What does a Private Equity Fund for B-BBEE purposes entail?

3.1 The ownership element of the Codes of Good Practice (the Codes) seeks to achieve a substantial change in the racial composition of ownership and management structures of existing and new enterprises. The use of private equity funds is one of the ways to ensure that there is a transfer of ownership of the South African economy into the hands of black people.

3.2 The purpose of a private equity fund is to encourage the creation and growth of black-owned private equity fund management firms. The private equity fund

refers to a third-party fund in which investments are made on behalf of the actual owner of the funds pursuant to a mandate given by that person to the fund. For example, a collective investment scheme used for making investments in various equity securities in line with the investment strategy of the fund.

3.3 Over and above promoting the creation of black-owned private equity fund management firms, the fund is further utilised as a conduit to facilitate investment in black-owned entities in order to alleviate the challenge of access to finance that is still faced by a number of such entities. In this regard, certain provisions were included to allow investments made by such private equity fund managers to be recognised as being investments made by black shareholders while at the same time requiring them to provide funding that will facilitate economic participation by black investors.

3.4 These provisions are aligned to Section 2 (e) of the B-BBEE Act, which stipulates that the objectives of B-BBEE among others are to promote investment programmes that lead to broad-based and meaningful participation in the economy by black people in order to achieve sustainable development and general prosperity.

4. What are the criteria for recognition of ownership through a private equity fund?

4.1 Where a private equity fund can be recognised, it is subject to strict criteria in the Codes, which prevents circumvention and misrepresentation. This subjection means that not every private equity fund will qualify for B-BBEE purposes, even if it legally complies in the normal commercial sense.

4.2 A measured entity may treat any of its ownership arising from such an investment as if it were held by black people, where the private equity fund meets the following criteria:

- a) At least 51% of any of the private equity manager's exercisable voting rights associated with the equity instruments through which the private equity fund holds rights of ownership must be held by black people;
- b) At least 51% of the private equity fund's executive management and senior management must be black people;
- c) At least 51% of the profits made by the private equity fund manager, after realising any investment made by it, must be, by a written agreement, accrued to black people. The term profit is deemed as profit from the operations of the private equity fund manager and the carried interest that the fund manager (and/or its associated entities, provided that at least 51% of the profits of the associated entities accrue to the fund manager) receives after realising any investment made by it;
- d) The private equity fund manager must also be a B-BBEE owned company which is defined as a juristic person having shareholding, or similar members interest, that is B-BBEE controlled. Black participants must enjoy a right to economic interest that is at least 51% of the total of such rights measured using the flow-through principle; and
- e) The private equity fund manager must seek to invest at least 51% of the value of funds under management in companies that have at least a 25% direct shareholding using the flow-through principle. The fund manager can facilitate direct black shareholding at the time of entering the transaction should the target company not meet the requirement of at least 25% black shareholding at the time the transaction is concluded.

4.3 The black ownership of the private equity fund manager will be determined using the criteria in Statement 100. This criteria dictates that there has to be exercisable voting rights, which are the rights of a shareholder to vote in meetings or in respect of decisions based on the number or percentage of shares held and the rights associated with the class of those shares in the entity. It also dictates that economic interest, which refers to the rights of a

shareholder to receive dividends and capital gains or growth. The criteria also dictate net value in the hands of black people because of either direct or indirect participation in the measured entity. The purpose of net value is to consider aspects such as loan repayments and issuance of dividends to ensure the repayment of the loans used to acquire shares by black participants.

5. When can the B-BBEE ownership points be recognised?

5.1 If a private equity fund meets the criteria above then the fund and its underlying investee companies can claim B-BBEE ownership points, and the determination will be as follows:

- (i) At each measurement date (the status given to the private equity fund manager will be applicable for a period of 12 months); the later of 11 October 2014 and the date of establishment of a new fund;
- (ii) Within one year from the commencement date, more than 5% of the value of funds invested by the private equity fund must at all times be invested in enterprises that have at least 25% direct black shareholding;
- (iii) Within two years from the commencement date, more than 10% of the value of the funds invested by the private equity fund must at all times be invested in enterprises that have at least 25% direct black shareholding;
- (iv) From the first day of the third year and the last day of the fourth year from the commencement date, more than 20% of the value of funds invested by the private equity fund must at all times be invested in enterprises that have at least 25% direct black shareholding;
- (v) From the first day of the fifth year and the last day of the sixth year from the commencement date, more than 30% of the value of the funds invested by the private equity fund must at all times be invested in enterprises that have at least 25% direct black shareholding;

- (vi) From the first of the seventh year and the last day of the eight-year from the commencement date, more than 40% of the value of the funds invested by the private equity fund must at all times be invested by the private equity fund must at all times be invested in enterprises that have at least 25% direct black shareholding; and
- (vii) From the first day of the ninth year and beyond from the commencement date, at least 51% of the value of the funds invested by the private equity fund must at all times be invested in enterprises that have at least 25% direct black shareholding.

5.2 This simply put means that:

Year of investment	Percentage to Achieve
1	>5%
2	>10%
3 to 4	>20%
5 to 6	>30%
7 to 8	>40%
9 and beyond	51%

5.3 It should be noted that the measurement of at least 51% of the value of funds invested by any private equity fund that must be invested in enterprises with at least 25% direct black shareholding is to be measured with reference to the cost of the investment made by the private equity fund;

5.4 In the case of private equity funds that were fully invested prior to 11 October 2014, investments by the fund managers will be considered as being made by black people if the private equity fund management entities meet the following criteria:

- (i) At least 51% of any of the private equity fund manager's exercisable voting rights associated with the equity instruments through which the

private equity fund holds rights of ownership in a measured entity, must be held by black people;

- (ii) At least 51% of the profits accruing to the private equity fund manager after realising any investment made by it, must by a written agreement, accrue to black people; and
- (iii) The private equity manager must be a B-BBEE owned company.

5.5 Therefore, if a private equity fund meets the criteria above, then irrespective of the capital providers, the fund and its underlying investee companies can claim that the private equity shares are held by black people.

6. How are private equity funds verified?

6.1 When determining the ownership points of a private equity fund, the verification agency or professional, as prescribed in the verification manual issued by **the dtic**, must apply the prescribed verification methodologies to determine that:

- (i) The private equity fund manager must be a B-BBEE owned entity;
- (ii) At least 51% of the private equity fund managers' exercisable voting rights associated with the equity instruments through which the private equity fund holds rights of ownership are held by black people as per the Codes;
- (iii) At least 51% of the private equity fund's executive management and senior management must be black people as defined in the Codes; and
- (iv) At least 51% of the profits made by the private equity fund manager after realising any investment made by it must, by a written agreement, accrue to black people.

6.2 Therefore, the role of the verification agency or professional is to conduct an independent verification of the claims made by a measured entity in respect of above-mentioned requirements. This role does not include the provision of advice to the measured entity on the interpretation of the B-BBEE Act as that inherently compromises the independence required to conduct a verification. Such advisory would amount to unprofessional conduct that is contrary to the objectives of the B-BBEE Act.

6.3 The verification agency or professional does not serve as an appeal or review platform on the position of the B-BBEE Commission where an assessment or advisory opinion on the status of a private equity fund was issued to the measured entity.

7. Emerging Concerns on Private Equity Funds

7.1 The B-BBEE Commission during the execution of its mandate has identified the following concerns on the structure of private equity funds:

- a) The black ownership of the private equity fund management does not meet the three ownership criteria as per Statement 100, and even if the black ownership is through a trust or broad-based ownership scheme, it does not meet the rules in Annexes 100 (B) and (D).
- b) There is no operational influence by black people in entities where the investment has been channelled.
- c) The use of commercial terms and practices are used in defence for not empowering black people. For example, profits distributed do not result in 51% of the profits flowing into the hands of black people.
- d) The inclusion of B-BBEE undertakings which appear to be motivated by the need to ensure that the measured entity can recognise black ownership for as long as the B-BBEE ownership requirement persists

and not for the empowerment of black people in a manner that is anticipated in the B-BBEE Act.

How to contact us:

B-BBEE Commission
Block E, 2nd Floor
the dtic Campus
77 Meintjies Street
Sunnyside
0002

Postal Address
Private Bag X84
Pretoria
0001

Tel: (+27) 12 394 1535
Email: MRamare@beecommission.gov.za
the dtic customer Contact centre: 0861 843 384
Website: www.bbbeeecommission.co.za