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The fifth edition of *The Private Equity Review* comes on the heels of a solid but at times uneven 2015 for private equity. Deal activity and fundraising were strong in North America, Europe and Asia, but the year ended with uncertainty in the face of declining growth in China, Brazil and other developing and emerging markets, increased volatility in commodity, stock, currency and other financial markets, and deflation concerns in developed countries. Nevertheless, we expect private equity will continue to play an important role in global financial markets, not only in North America and western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa. As large global private equity powerhouses extend their reach into new markets, home-grown private equity firms, many of whose principals learned the business working for those industry leaders, have sprung up in many jurisdictions to compete using their local know-how.

As the industry continues to become more geographically diverse, private equity professionals need guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. This review has been prepared with this need in mind. It contains contributions from leading private equity practitioners in 29 different countries, with observations and advice on private equity deal-making and fundraising in their respective jurisdictions.

As private equity has grown, it has also faced increasing regulatory scrutiny throughout the world. Adding to this complexity, regulation of private equity is not uniform from country to country. As a result, the following chapters also include a brief discussion of these various regulatory regimes.

While no one can predict exactly how private equity will fare in 2016, it can confidently be said that it will continue to play an important role in the global economy. Private equity by its very nature continually seeks out new, profitable investment opportunities, so its further expansion into growing emerging markets is also inevitable. It remains to be seen how local markets and policymakers respond.
I want to thank everyone who contributed their time and labour to making this fifth edition of *The Private Equity Review* possible. Each of them is a leader in his or her respective market, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie  
Kirkland & Ellis LLP  
Chicago, Illinois  
March 2016
Chapter 18

SOUTH AFRICA

Johan Loubser, Jan Viviers and Magda Snyckers

I GENERAL OVERVIEW

The private equity industry in South Africa is among the most established in emerging markets and has fund types that vary by investment stage, size and sector specialisation.

With respect to the size of the industry, at the end of 2014 (the most recent year for which data is available), the industry employed around 557 investment professionals and had funds under management of approximately 171.1 billion rand, located both locally and abroad. The membership of the local industry association, the South African Venture Capital Association (SAVCA), includes more than 80 fund manager firms. These numbers include fund managers who raise funds from third parties and fund managers who manage on-balance sheet investments for banks, insurance companies, investment holding companies and government development agencies (including government pension funds). For example, the Public Investment Corporation, which manages investment funds for the Government Employees Pension Fund and other government institutions, had allocations to private equity in 2014 of 45.5 billion rand. At the end of 2014, fund managers managing third-party funds had approximately 61.1 billion rand of assets under management and undrawn commitments of approximately 29.6 billion rand.

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1 Johan Loubser, Jan Viviers and Magda Snyckers are directors at ENSafrica. The authors wish to acknowledge the research assistance of Olwethu Gusha and Yani van der Merwe in the preparation of this chapter.
The amount raised from third parties during the 2014 calendar year was estimated to be 6.8 billion rand. The South African private equity industry is dominated by a small number of independent fund managers who can point to their successful historical track records, although there are also a fair number of promising new players and fund managers affiliated with local banks and insurers.

While private equity fundraising activity and the success rate thereof has not returned to 2006–2007 levels, the relatively expensive level of equities on the Johannesburg Stock Exchange, regulatory acceptance of investment by South African pension funds in private equity funds, the South African government’s renewable energy programme, the need for banks to reduce their loan books, infrastructure requirements and the economic growth enjoyed by some sub-Saharan African countries are fuelling renewed interest in private equity investment.

There is also an increase in funds raised outside South Africa and which will invest in other sub-Saharan African countries, but which will be managed by managers with strong links to South Africa. Investors in such funds typically include international development finance institutions and, increasingly, South African institutional investors.

Significant recently publicised fundraising activity relating to fundraising by fund managers from third parties included the following:

- Investec Asset Management successfully closed the Investec Africa Private Equity Fund 2 at US$295 million in early 2016 and the Investec Africa Credit Opportunities Fund I at US$226.5 million in 2015;
- Metier Capital achieved the first close of its Metier Capital Growth Fund II in February 2015, with investors including Dutch and German development agencies. The fund targets investments in South Africa and other sub-Saharan countries in a range of sectors, including transport and logistics, retail, health, tourism, education, fast-moving consumer goods, agri-processing and infrastructure services;
- International Housing Solutions announced the first close of its Fund II in 2014 at 1.5 billion rand. Investors include the National Housing Finance Corporation, the World Bank’s International Finance Corporation, WBD Investment Holdings, the Global Environmental Facility, the Eskom Pension and Provident Fund and the Overseas Private Investment Corporation; and
- the Pembani Remgro Infrastructure Fund achieved a successful first closing at US$245 million in May 2015 with the aim of achieving final close at a target

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6 The KPMG/SAVCA Survey, 2014, p. 27.
fund size of US$500 million. The fund received commitments from Remgro, Phuthuma Nhleko, CDC Group plc, development institutions as well as private pension funds, family offices and investment companies. The strategy of the fund is to invest equity and quasi-equity in infrastructure opportunities, with a focus on sub-Saharan Africa.\textsuperscript{10}

The JSE Limited recently introduced new listing requirements permitting the listing of special purpose acquisition companies. Such a company may not carry on any commercial or business operations at the time of its application for a listing,\textsuperscript{11} but must within 24 months from the date of its listing\textsuperscript{12} acquire assets meeting the qualifying criteria of the main board or the alternative exchange (AltX) of the JSE.\textsuperscript{13} In order to list on the main board of the JSE an applicant must raise at least 500 million rand through the issue of shares. A minimum of 50 million rand must be raised for a listing on the AltX.\textsuperscript{14} All capital raised must be held in escrow with an escrow agent until acquisitions of qualifying assets are made.\textsuperscript{15} We anticipate that this type of vehicle may in future be used as an alternative to the more traditional private equity funds structures discussed below. Recent examples of such companies listing on the JSE are:

\begin{itemize}
  \item \textit{a} Renergen Limited (June 2015), which raised approximately 74 million rand and listed on the AltX;
  \item \textit{b} Capital Appreciation Limited (October 2015), which raised approximately 1 billion rand and listed on the main board; and
  \item \textit{c} Gaia Infrastructure Capital Limited (November 2015), which raised approximately 500 million rand and listed on the AltX.
\end{itemize}

\section*{II LEGAL FRAMEWORK FOR FUNDRAISING}

As mentioned in Section I, \textit{supra}, the South African private equity industry includes significant on-balance sheet investment by special purpose acquisition companies, insurance companies, banks, investment holding companies and government agencies and institutions. The legal, tax and regulatory framework within which the above-mentioned industry participants raise and invest funds are not discussed below. The focus of this chapter is on fundraising by fund managers from third parties who invest into closed-ended funds domiciled in South Africa and that are governed by South African law and also on certain tax and exchange control issues arising for South African investors into foreign domiciled funds.

\textsuperscript{11} JSE Listings Requirements 4.34(a).
\textsuperscript{12} JSE LR 4.35(a).
\textsuperscript{13} JSE LR 4.3. – see definition of ‘Viable Assets’.
\textsuperscript{14} JSE LR 4.34(g).
\textsuperscript{15} JSE LR 4.34(h).
i South African private equity structures

The principal vehicle housing South African private equity funds investing in South Africa is the limited liability partnership (called en commandite partnerships). A trust structure (called a bewind trust) is also sometimes used. The main reasons for the use of these entities to house funds are the following:

- they permit the income and capital gains of the fund to be taxed in the hands of investors according to the tax profile of each investor;
- they provide investors with limited liability, so that an investor will not have liability exceeding its contractual commitment to the fund;
- they are not subject to cumbersome regulatory oversight and can be established with relative ease;
- they allow the day-to-day affairs of the fund and all operational matters to be outsourced, which permits the fund manager a high degree of autonomy; and
- they permit the use of the types of contractual terms and organisational practices that are commonly used internationally.

Limited liability partnership

An en commandite partnership is established by contract. The contract between the parties should expressly reflect the intention of establishing an en commandite partnership and should expressly identify the general or disclosed partner.16 There are no registration requirements for establishing, and no legislation regulating, en commandite partnerships. An en commandite partnership is carried on by one or more partners, called the general or managing partner or partners, to which every partner whose name is not disclosed, called a commanditarian partner or partner en commandite, contributes a fixed sum of money on condition that he or she receives a certain share of the profit, if there is any, but that in the event of loss he or she is liable to his or her co-partners to the extent of the fixed amount of his or her agreed capital contribution only. Commanditarian partners:

- are not presented as partners (and accordingly, persons dealing with the partnership do not form the mistaken impression that they are entitled to rely on the credit of the commanditarian partner);
- are not liable for partnership debts to creditors of the partnership, but only to their co-partners (and therefore enjoy the benefit of limited liability);
- may not participate actively in the business of the partnership (although the commanditarian partner may be entitled to advise the managing partner and may also enjoy limited consent rights); and
- cannot claim repayment of their contributions or payment of their share of the partnership profits in competition with the creditors of the partnership.17

The general partner of the en commandite partnership has unlimited liability toward creditors of the partnership in circumstances where the partnership’s assets are insufficient to settle relevant debts. The en commandite partnership usually terminates by agreement

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17 Id., Paragraph 258.
between all the partners or in accordance with the terms of the partnership agreement, which may, for example, provide that the general partner may terminate the partnership on notice to the other partners. All commercial aspects of the partnership, such as profit share arrangements, permitted expenses, investment restrictions and so forth, are usually contained in the partnership agreement. The partners have wide discretion to arrange their affairs in the partnership agreement in accordance with their commercial intentions, provided that the partnership adheres to the requirements for an en commandite partnership (and subject to general requirements for enforceable contracts, such as the requirement that the terms of the agreement should be sufficiently certain). The terms of the partnership agreement are not publicly available. En commandite partnership agreements usually provide for the removal and replacement of the general partner. In terms of common law legal requirements, such removal and replacement would usually require the consent of all creditors of the en commandite partnership.

**Bewind trust**

A bewind trust differs from other forms of trusts under South African law in that the trustees do not own, but merely hold and administer, the assets of the trust that are owned in undivided shares by the beneficiaries of the trust.\(^{18}\) The trust property does not form part of the estate of the trustee\(^{19}\) except insofar as the trustee is a beneficiary. The trust is established by way of a trust deed. Copies thereof may be requested from the Master of the High Court by any person who has, in the opinion of the Master, sufficient interest therein.\(^{20}\) The trustees may not act as such until they have been authorised to do so by the Master\(^{21}\) after following a simple registration process. The Master has limited regulatory powers in relation to the trust in terms of the Trust Property Control Act, 1988 and may, for example, in certain instances remove the trustee or apply to court for his or her removal.\(^{22}\)

**Fund organisation**

In the South African context, the vehicle housing the private equity fund (whether a partnership or a trust) would typically appoint the fund manager or adviser in terms of a written mandate to manage the day-to-day affairs of the fund and to identify and execute investments and disinvestments. Increasing use is also made of independent valuators.

Although practice varies, the fund manager or adviser would not always have direct contractual obligations to specific investors (save if created by way of a side letter) and would in many cases only owe contractual obligations to the trust or partnership housing the fund.

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19 Section 12 of the Trust Property Control Act 1988 (the Trust Property Control Act).
20 Section 18 of the Trust Property Control Act.
21 Section 6(1) of the Trust Property Control Act.
22 Section 20 of the Trust Property Control Act.
Although it is standard practice for the attorneys advising on the establishment of the fund to issue an opinion confirming that the applicable agreements have been duly authorised and are lawful, valid and enforceable, such opinion is often given to the fund rather than applicable investors.

The matters typically addressed in the applicable trust deed or partnership agreement have, over time, to a large extent become standardised. Investors in a South African private equity fund could expect contractual provisions dealing with the following matters, among others:

- a minimum investment requirement for the fund manager, adviser or associate;
- the admission of further investors following the first closing;
- time periods for the making of investments and disinvestments by the fund;
- investor default;
- guidelines, requirements and prohibitions relating to investments;
- the composition and functions of the investor advisory board;
- reporting requirements;
- key personnel assurances during and after the commitment period;
- conflicts of interest;
- co-investments;
- allocation of expenses;
- distributions (including whether distributions must be in cash and clawback provisions);
- carried interest (in this regard, investors increasingly insist that the carried interest be calculated over the life of the fund and that distributions of carried interest be kept in escrow);
- fees of the adviser or fund manager;
- replacement of the fund manager;
- limitations of liability for managers;
- termination of the fund;
- side letters; and
- requirements in respect of valuations.

Marketing of South African private equity funds

Investors commit to the fund by signing deeds of adherences to the partnership agreement or trust deed, as the case may be. Fundraising is typically organised by the fund manager, and in some cases investors are introduced to the fund by way of the distribution of a short-form private placement memorandum, which functions as a summary of the applicable terms. The key matters disclosed in such a memorandum would include the historic success of the fund manager, the fees payable to the fund manager, any carried interest arrangements, and whether any investor commitments have already been received and the amount thereof. In addition, the list of conditions for investment in private equity funds (see Section III.ii, infra) applicable to South African pension funds contains a checklist of prescribed due diligence matters that a pension fund must consider before investing in a private equity fund. It is likely that future private placement memoranda will be structured in order to provide comfort in relation to the items on this prescribed checklist.
Partnerships and trusts could in theory satisfy all of the requirements of a collective investment scheme and fall to be regulated as such in terms of the Collective Investment Schemes Control Act 2002 (CISCA) if ‘members of the public’ are invited and then permitted to invest. Since there is currently no licensing scheme in place to regulate private equity funds under the CISCA, triggering the application of the legislation by inviting or permitting members of the public to invest in the fund could result in the fund being unlawful and persons involved in the administration of the fund being criminally liable. For this reason, it is not advisable for any person to advertise investment opportunities in a private equity fund in the press or for private placement memoranda to be made available indiscriminately. Moreover, although the statutory limit on the number of partners in a partnership was abolished in 2011, it remains prudent to limit the number of investors in the fund in order to counteract any suggestion that ‘members of the public’ are permitted to invest, but there is no bright line as to how many partners or investors would be too many. One way of permitting a larger number of investors to invest is for an insurance company to invest in the private equity fund and then to permit policy holders to share in the performance of the investment through ‘linked policies’. There is a measure of uncertainty and debate as to whether the investor’s partnership interest or interest in a bewind trust housing a private equity fund would constitute a ‘financial product’ under the Financial Advisory and Intermediary Services Act 2002 (FAIS). If so, then persons who provide advice in respect thereof to potential investors or otherwise provide an intermediary service in relation to any such investment as a regular feature of their business may fall under the regulatory ambit of the FAIS. The uncertainty arises because, although the applicable partnership or trust interest would provide the investor with undivided ownership (together with other investors) in the shares of portfolio companies (which are indeed ‘financial products’), the partnership or trust interest itself is not a ‘security’ or ‘instrument’, although it could amount to a ‘combined product containing’ financial products, such as shares. Given this uncertainty, the prudent approach is to limit marketing of the applicable interest within South Africa to financial services providers authorised under the FAIS. As will be seen below, the fund manager is usually so licensed.

Where the FAIS applies, it imposes the duty on the relevant financial services provider to render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry. Apart from the FAIS, the fund manager or other promoters could potentially attract contractual or delictual liability pursuant to, for example, non-performance, negligent misrepresentation or fraud. There is no well-developed body of case law dealing with such liability in the context of private equity funds.

23 See Sections 5 and 115(b) of CISCA.
24 The Companies Act No. 71 of 2008 does not contain a prohibition similar to that contained in Section 30 of the Companies Act No. 61 of 1973.
25 Definition of ‘financial product’ in Section 1 of the FAIS.
iii Investment clubs

A new trend, which has proven to be successful in the United Kingdom, is also being adopted in South Africa. This entails the formation of an investors’ club or circle of persons who are usually high net worth individuals, although there is no reason why this structure cannot include institutional investors. In this structure, investors pay an annual fee to the investors’ club, which is managed by the private equity fund manager, and in return are afforded the opportunity to invest in investment opportunities identified by the fund manager and brought to the investors’ club. Investors are not required to provide committed capital and can elect which investment opportunities they wish to participate in, subject to certain rules of the investors’ club. Each investment would typically be housed in a separate en commandite partnership or bewind trust. This structure is flexible and gives investors greater control over the particular investments making up their bouquet of investments.

iv Tax and exchange control

To encourage the use of South Africa as a springboard for investment into Africa, the government has over the past few years made significant changes to the country’s tax and exchange control regime, which was in the past fairly unfavourable to outward investment and to the management of offshore investments from South Africa. Such changes include various amendments to the tax legislation to prevent the activities of South African investment managers from causing the investments of non-South African investors to be taxed in South Africa.

General principles

Both en commandite partnerships and bewind trusts constituted in terms of South African law are fiscally transparent vehicles for South African tax purposes. All of the tax implications in respect of the underlying investments of the fund will accordingly arise directly in the hands of the relevant investors. In addition, a ‘foreign partnership’, as defined in the Income Tax Act, is a fiscally transparent entity. 27

South African investors in such partnerships, foreign partnerships or trusts will be required to include income generated in respect of the underlying assets in their gross income and will be taxed in accordance with the tax regime applicable to such investors. Dividend income on shares in South African companies will generally be exempt from income tax in South African investors’ hands 28 (subject to certain exceptions in respect

of preference share type investments and lending arrangements), while any dividends on shares in non-South African companies or interest income will generally be subject to income tax in South African investors’ hands. Dividends on shares in South African companies and cash dividends on shares in non-South African companies listed on the JSE may be subject to dividends tax, subject to certain exemptions that may depend on the nature of the investor (e.g., if the investor is a South African company, the dividend should be exempt from dividends tax). Certain documentary requirements must be met in order to rely on exemptions from, or reductions in the rate of, the dividends tax. Specific anti tax-avoidance provisions exist which may deem interest payments on a debt instrument that qualifies as a ‘hybrid debt instrument’ or interest that qualifies as ‘hybrid interest’ to be dividends and taxed accordingly. A South African investor into a ‘foreign partnership’ may be required to include a notional amount equal to the net income of any controlled foreign company (CFC) into which the partnership invests in its income and be taxed on such inclusion, subject to one of the exemptions or exclusions to the CFC rules not applying.

Non-South African investors will only be required to include income generated in respect of the underlying assets in their gross income if the income is from a South African source. This will be the case, inter alia, in respect of interest on loans applied in South Africa and dividends on shares in South African companies or interest that is deemed to constitute dividends. Such dividends will generally be exempt from income tax.

29 The Income Tax Act deems the dividends on certain shares containing debt-like characteristics to be income in the hands of the recipient. These rules, found in Sections 8E and 8EA of the Income Tax Act, have been subject to extensive amendments over the past few years. The amended rules impact, among others, on the type of security arrangements that may be utilised in respect of preference share funding as well as the purpose for which the funding may be utilised.

30 South African investors are required to include foreign dividends in their income. Certain exemptions (see Section 10B of the Income Tax Act) are available in respect of foreign dividends. The general exemptions achieve an exemption of foreign dividends to the extent that the dividend is effectively only subject to income tax at a rate of 15 per cent (which equates to the dividends tax rate in respect of dividends distributed by South African companies). In certain instances the full dividend may be exempt, for example where the South African resident holds at least 10 per cent of the equity shares and voting rights in the foreign company and subject to certain provisos and exclusions not applying.

31 The dividends tax regime was introduced on 1 April 2012 and is contained in Part VIII of the Income Tax Act. Dividends tax is levied at a rate of 15 per cent, subject to certain exemptions, and a reduction of such rate in terms of any applicable treaty.


33 See the definition of ‘gross income’ in Section 1 of the Income Tax Act.

34 Historically, the Income Tax Act did not provide specific source rules, which were determined largely with regard to tests laid down by the courts. With effect from 1 January 2012, certain deemed source rules were introduced in Section 9(2) of the Income Tax Act. These rules provide, inter alia, that dividends distributed by South African companies and interest on
tax in the non-South African investors’ hands (subject to certain exceptions in respect of preference share-type investments and lending arrangements). Any interest income should be exempt from income tax in the non-South African investors’ hands, unless it is a natural person investor who has been physically present in South Africa for more than 183 days in aggregate in the 12-month period preceding the date on which the interest was received or accrued, or if the debt from which the interest arises is effectively connected to a permanent establishment of the non-South African investor in South Africa. This exemption would not apply to interest which is deemed to be a dividend as the provisions relating to dividends would apply. Provided certain requirements are met, the actions of the general partner or trustees should not result in the non-South African resident investor having a permanent establishment in South Africa for purposes of the Income Tax Act. Any dividends declared by a South African company and interest deemed to be a dividend or interest from a South African source that is paid to a non-South African resident investor will be subject to dividends tax and, with effect from 1 March 2015, interest withholding tax, respectively (subject to certain exemptions and any available treaty relief). Certain documentary requirements must be met in order to rely on certain exemptions from, or reductions in the rate of, the interest withholding tax.

Any gains in respect of a disposal of the underlying assets may give rise to income tax or capital gains tax implications in the hands of the South African investors, depending on whether the investor trades in the underlying assets or not, which will be taxed in accordance with the tax profile of the applicable investor. Generally, non-resident investors will only be subject to South African tax in respect of such disposals if they have a permanent establishment in South Africa (see above).  

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36 See footnote 23.
37 See Section 10(1)(h) of the Income Tax Act.
38 The definition of ‘permanent establishment’ in Section 1 of the Income Tax Act has been amended with effect from 1 January 2011 to exclude the activities of certain general managers and trustees from creating a permanent establishment for qualifying investors. A ‘qualifying investor’ is a defined concept – see Section 1 of the Income Tax Act.
39 See footnote 25.
40 With effect from 1 March 2015 interest withholding tax is levied at a rate of 15 per cent on the amount of any interest that is paid by any person to or for the benefit of any foreign person to the extent that such amount of interest is from a South African source. Exempt from the interest withholding tax is any amount of interest that is, inter alia, paid in respect of any listed debt; or paid by the South African government, any bank or the South African Reserve Bank.
41 The new deeming source rules (see footnote 27), simplistically speaking, provide that gains made in respect of the disposal of an asset by a non-resident is only deemed to be from a
An *en commandite* partnership and a bewind trust can give rise to complexity from a tax perspective in respect of exiting partners or the admission of new partners. This is so since every time a new partner or beneficiary enters the partnership or bewind trust, on a technical basis, each of the partners or beneficiaries will dispose of a portion of the underlying investments to the new partner or beneficiary, which may cause the realisation of unrealised gains for the other partners or beneficiaries and which may be subject to tax in their hands.

**Carried interest**
Where a fund manager or an affiliate of the fund manager obtains an additional distribution from the applicable fund, there has been an ongoing international debate as to whether such carried interest is subject to capital gains tax or income tax. The debate is currently unresolved.

**Non-South African private equity funds directly investing into South African companies**
In respect of non-residents, South Africa imposes income tax on amounts from a South African source. As discussed above, interest on loans applied in South Africa and dividends on shares in South African companies are deemed to be from a South African source. A non-resident fund will accordingly be required to include such interest or dividends in its gross income, but should be entitled to an exemption in respect of the dividends (subject to certain exceptions in respect of preference share-type investments and lending arrangements) and any interest income should be exempt from income tax in the non-resident fund’s hands, unless the debt from which the interest arises is effectively connected to a permanent establishment of the non-resident fund in South Africa. Furthermore, any capital gains will be subject to tax in South Africa if the fund has a permanent establishment in South Africa.

Furthermore, the activities of a South African fund manager may result in the gains on the underlying investments being from a South African source. This issue has largely (but not completely) been resolved in terms of the recent introduction of the deemed source rules.

source in South Africa if it is attributable to a permanent establishment of the non-resident in South Africa. Furthermore, the capital gains tax provisions contained in the Eighth Schedule to the Income Tax Act only apply to non-residents in respect of immovable property or interests in immovable property (which is a defined concept – see Paragraph 2(2) of the Eighth Schedule to the Income Tax Act) situated in South Africa or assets effectively connected with a permanent establishment of the non-resident in South Africa.

42 See footnote 27.
43 See footnote 22.
44 See footnote 23.
45 See footnote 30.
46 See footnote 34.
47 See footnote 27.
In addition, as discussed above, non-resident investors will be subject to dividends tax\textsuperscript{48} and, with effect from 1 March 2015, interest withholding tax\textsuperscript{49} in respect of dividends on South African shares and interest deemed to be dividends or interest regarded as having been received or accrued from a South African source that is paid to them (subject to certain exemptions and any available treaty relief).

Furthermore, should the fund be managed in South Africa, this may result in the fund being effectively managed in South Africa, in which case the fund may become a South African tax resident with the result that its income and capital gains will be subject to tax in South Africa and distributions may be subject to dividends tax. However, statutory provisions have been introduced in terms of which a foreign investment entity (which is a defined concept) will not be effectively managed in South Africa by reason of having a South African fund manager, meaning that having a South Africa fund manager will not result in a non-resident fund becoming a South African resident provided the requirements of the relevant provisions are met.\textsuperscript{50} These provisions do not apply to foreign funds where South African investors directly or indirectly hold an interest of more than 10 per cent.

\textit{Exchange control}

South African residents are generally prevented from transferring capital to any country outside the common monetary area (consisting of South Africa, Namibia, Lesotho and Swaziland), subject to a number of exceptions. In relation to South African private equity funds wishing to invest outside of South Africa, such investment will generally be made through an institutional investor, utilising its institutional investor allowance. An institutional investor allowance is available to certain institutional investors and fund managers in South Africa, subject to limitations (institutional investors’ foreign exposure of retail assets may not exceed 25 per cent in the case of retirement funds and the underwritten policy business of long-term insurers, and fund managers registered as institutional investors, collective investment scheme management companies and the investment-linked business of long-term insurers are restricted to 35 per cent of the total retail assets under management). Institutional investors may, directly or indirectly invest an additional 5 per cent of total retail assets in terms of the African allowance.

In addition, private equity funds that are members of SAVCA, mandated to invest into Africa, may apply to the Financial Surveillance Department of the South African Reserve Bank for an annual approval to invest into Africa (information that must accompany the application includes a copy of the local \textit{en commandite} partnership’s mandate to invest into Africa or, in the case of a local fund running parallel with an offshore fund, a copy of the co-investment agreement between the local and foreign partnership, cash-flow projections for a 36-month period indicating the amount of capital

\begin{footnotes}
\item[48] See footnote 25.
\item[49] See footnote 33.
\item[50] This has been effected in terms of an amendment to the definition of ‘resident’ in the Income Tax Act, which was introduced by the Taxation Laws Amendment Act 22 of 2012 with effect from 1 January 2013.
\end{footnotes}
to be exited from South Africa for investment purposes into Africa, and confirmation that the local private equity fund will obtain a minimum of 10 per cent of the voting rights in the respective investment into Africa). In the context of a local fund running parallel with an offshore fund where the private equity fund is managed from South Africa, the minimum 10 per cent requirement may be measured on a fund-wide basis, after the conversion of investment rights into voting rights. Applications will also be considered where an unintended loop structure is created as a result of private equity funds investing into companies in the rest of Africa with a portion of their business in South Africa. In terms of the ‘look through’ principle, any offshore acquisitions by an institutional investor held indirectly via a local private equity fund must be marked off against its respective foreign portfolio investment allowances.

v Offshore structures
For reasons relating to South African tax legislation, South African private equity managers have in the past often created parallel offshore structures within which to house investments from non-resident investors and which offshore funds co-invested with South African-domiciled funds. Mauritius, the Cayman Islands and the British Virgin Islands have in the past often been used as the domicile for these parallel structures. Although recent tax changes to the Income Tax Act have removed some of the previous obstacles, the introduction of new taxes, such as the interest withholding tax may neutralise or remove the benefits which resulted from the changes. Fund managers and their advisers should carefully consider the potential South African tax implications and applicable double taxation relief prior to taking decisions as to whether a parallel offshore structure is required.

Because of its wide network of double taxation treaties and low tax rates, Mauritius is a popular jurisdiction for the establishment of private equity funds, including funds with South African investors, and funds that will invest in sub-Saharan African countries other than South Africa or countries within the common monetary area. A new double taxation agreement between South Africa and Mauritius has entered into force on 28 May 2015 which replaced the previous agreement.

It should be noted that certain sovereign fund investors may not invest in funds domiciled in certain jurisdictions.

III REGULATORY DEVELOPMENTS
Private equity funds are not subject to specific regulations and there is no government agency that exercises regulatory oversight specifically over such funds. There is no requirement that a fund be registered with a government agency. Fund managers are, broadly speaking, required to register as financial services providers under the FAIS. (We understand that the Financial Services Board is considering the creation of a new category of FAIS licence for private equity fund managers.) As mentioned below, fund managers are, from a practical perspective, also required to register as members of SAVCA, the voluntary industry body.
We have discussed the regulatory requirements that apply to the marketing of funds above. Regulatory developments over the past couple of years that deserve mention are the position with respect to black economic empowerment (BEE) and the position with respect to pension fund investors.

i BEE

By way of background, since the election of South Africa’s first democratic government in 1994, the government implemented a comprehensive programme aimed at the transformation of South Africa’s economy in order to address racial and other discrimination of the past. The Broad-Based Black Economic Empowerment Act, 2003 provides the general legislative framework for the promotion of BEE, empowering the Minister of Trade and Industry to issue Codes of Good Practice. The approach under these Codes is to measure the contribution of each South African firm to broad-based BEE in accordance with a detailed prescribed scorecard. An important element of this scorecard involves the percentage of the equity shares of a firm held directly or indirectly by black persons. On a practical level, a firm’s BEE score affects whether it qualifies to participate in regulated industries (such as mining or gaming) and its chances of winning business (including government tenders).

Accordingly, an important consideration in respect of any investment in a portfolio company by a private equity fund is how the investment (together with co-investments) will affect the BEE score of the portfolio company.

In this regard, the Codes of Good Practice published in 2013 (Revised Codes) are designed to give an advantage to private equity fund managers who meet certain requirements, since portfolio companies will be entitled to deem all of the shares held by funds managed by qualifying managers to be held by black persons. Broadly speaking, the qualifying requirements include the following:

a at least 51 per cent of the fund manager’s voting rights associated with the equity investments in the underlying portfolio companies must be held by black persons;  

b black persons must own 51 per cent of the shares of the fund manager and receive at least 51 per cent of the profits (including carried interest earned by the fund manager or its associate) of the fund manager;  

c 51 per cent of the executive management and senior management of the fund manager must consist of black persons;  

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52 P. 22 of the Revised Codes. Paragraph 3.10.1.1. There is debate as to the application of this requirement.
53 Pp. 22–23 of the Revised Codes, Paragraphs 3.10.1.3 and 3.10.3.
54 Id., p. 23, Paragraph 3.10.1.2.
the fund manager must invest a prescribed percentage of the value of its funds under management in firms that are at least 25 per cent black-owned. This prescribed percentage is 5 per cent in 2014 and gradually rises to 51 per cent over a period of nine years.\textsuperscript{55}

These provisions in the Revised Codes have arguably served as an impetus for the development of more black-owned and controlled private equity fund managers. (Note though that it should be established, with respect to each portfolio company, whether there are sector-specific BEE charters or licensing conditions that may preclude the application of the provisions in a specific case.)

ii South African pension funds

The prudential investment limits for pension funds registered under the Pension Funds Act, 1956 were amended in 2011 to expressly permit pension funds to invest up to 10 per cent of their assets in private equity funds (with sub-limits of 2.5 per cent per private equity fund and 5 per cent per fund of funds). In terms of the regulatory framework, the Registrar of Pension Funds published conditions for investment in private equity funds (the Conditions) in March 2012\textsuperscript{56} that stipulate requirements in order for a private equity fund to qualify for investment by a pension fund. The Conditions came into effect in 2012. Although the applicable requirements do not bind private equity funds, pension funds are significant investors and private equity funds therefore have a strong incentive to comply.

The most significant requirements contained in the Conditions are the following:

\begin{enumerate}
\item permissible local private equity structures are limited to \textit{en commandite} partnerships, bewind trusts and companies;\textsuperscript{57}
\item fund managers must be members of SAVCA\textsuperscript{58} and are required to be authorised as discretionary financial services providers under the FAIS – a category of licence that many fund managers did not hold before the Conditions were published;\textsuperscript{59}
\item the auditors of the private equity fund must verify the assets of the fund on a biannual basis\textsuperscript{60} and the fund must produce audited financial statements complying with international financial reporting standards within 120 days of the end of its financial year;\textsuperscript{61}
\end{enumerate}

\textsuperscript{55} Id., pp. 23-24, Paragraphs 3.10.8 – 3.10.13.
\textsuperscript{56} Conditions for investment in private equity funds; approval in terms of Section 5(2)(e) of the Pension Funds Act 15 March 2012.
\textsuperscript{57} Condition 2(1).
\textsuperscript{58} Condition 2(2).
\textsuperscript{59} Condition 3(1).
\textsuperscript{60} Condition 6.
\textsuperscript{61} Condition 9(1).
the private equity fund must have clear policies and procedures for determining the fair value of the assets of the fund in compliance with the International Private Equity Valuation Guidelines, and any valuations must be verified at least annually by a third party;\textsuperscript{62} and

e the pension fund must consider a list of prescribed due diligence matters before investing in a private equity fund, including the fee structure of the private equity fund and the risk and compliance policies and procedures of the private equity fund.\textsuperscript{63}

In our experience, the Conditions have affected the contractual terms of new private equity funds in that pension funds seek warranties from the private equity fund and the fund manager that they will adhere to the requirements set out in the Conditions and wish to see that the contractual terms expressly address the checklist of due diligence matters prescribed by the Registrar. Generally speaking, the regulatory framework has in our view encouraged interest by pension funds in private equity investment.

\section*{IV OUTLOOK}

We do not anticipate major regulatory or tax changes that will affect the private equity industry in the coming 12 months. Since many funds were established some years ago, increased exits from existing private equity investments as well as increased fundraising activity can be expected. Although South African private equity funds are likely to have increased exposure to sub-Saharan African countries other than South Africa, the current trend is for most South African private equity funds to maintain a primary focus on investment in South Africa. A trend that is likely to continue is the creation of credit opportunity funds with terms very similar to those of private equity funds, but whose investments are primarily in credit assets and whose investment objective is to earn interest and other income.

\textsuperscript{62} Condition 8.\textsuperscript{63} Condition 7.
Appendix 1

ABOUT THE AUTHORS

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Johan Loubser is a director at ENSafrica in the banking and finance department and specialises in debt and preference share funding transactions; private equity funds, hedge funds and collective investment schemes and in financial services law.

Recent representative matters in his practice include: advising asset managers on setting up co-investment funds investing in credit assets; advising asset managers on the formation of South African hedge funds and the registration thereof as collective investment schemes; advising pension funds on investment into local and foreign private equity funds; representing pension funds in respect of the acquisition of investment policies from insurers and the outsourcing of their pension liabilities; and advising local and foreign financial services providers, pension funds, insurers and collective investment schemes on various registration and compliance matters.

Johan is recognised as a leading or recommended lawyer by the following reputable rating agencies and their publications: Best Lawyers 2016, 2013 – banking and finance law (South Africa); and The Legal 500 Guide to Outstanding Lawyers 2015, 2014 – investment funds (South Africa).

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Jan Viviers is a director at ENSafrica in the corporate commercial department. He specialises in mergers and acquisitions, corporate restructuring, financial services, financial markets and securities law. He has acted for various large corporate institutions, local and international investment funds, insurance companies and asset management companies.

Jan’s experience includes acting for Metropolitan Holdings Limited in its merger with Momentum Group Limited, a merger with a transaction value of 30 billion rand,
various other large acquisitions, matters relating to the Takeover Regulation Panel and the Listing Requirements of the JSE, as well as the structuring and restructuring of local and international private equity and venture capital funds.

Some of Jan’s other areas of focus in the firm include black economic empowerment transactions and the Black Economic Empowerment Codes of Conduct. He has spoken at various conferences on matters in the financial services industry, as well as on BEE transactions and codes of conduct.

Jan is recognised as a leading or recommended lawyer by Best Lawyers 2013 – mergers and acquisitions (South Africa).

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Magda Snyckers is a director at ENSafrica in the tax department. She specialises in providing South African tax and exchange control advice to resident and non-resident investors. She provides tax advice on income tax, capital gains tax, dividends tax, international tax (including double taxation relief), withholding tax and securities transfer tax.

Magda’s experience includes advising on the South African tax implications and exchange control implications of corporate structures, financing transactions, international structures, cross-border investments into and out of South Africa, corporate mergers and acquisitions (locally and abroad), investments by pension funds as well as investments by local and foreign collective investment schemes, hedge funds and private equity funds. She assists local and foreign investors with the drafting and submission of exchange control applications. In addition, she assists corporates and trusts with the resolution of disputes between such taxpayers and the South African Revenue Service.

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