



**TO LICENCE OR REGISTER PRIVATE EQUITY:**

**LESSONS FOR UGANDA**

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**Research and Market Development Department**

## 1. Background

Since the 2008 global financial crisis, there has been a trend in increasing oversight of previously unregulated entities such as Private Equity (PE) funds and hedge funds. The G20's November 2008 summit was a defining point, leading to the decision to require all significant financial market participants to be regulated, to preserve financial stability and to ensure investors are protected.<sup>1</sup>

The definition of PE differs, but broadly, speaking; PE includes the entire asset class of equity investments that are not quoted on stock markets.<sup>2</sup> PE funds invest in either private companies that are not publicly traded or in companies that are listed on the stock exchange to take them private. Venture Capital (VC) is a PE investment strategy that consists of financing the early stage development of companies that have innovative business ideas. Venture capitalists frequently invest in start-up companies that exist merely as an idea or as a business plan. The company may have only a few employees, have little or no revenue, and still be developing its product or business model.

Uganda currently has no framework in place for licensing and regulating PE and VC funds, although the CMA Act, 2016 specifically provides for VC funds<sup>3</sup> to be licensed. In African countries such as Ghana, Nigeria and Kenya, PE funds and PE fund managers are regulated and licensed by the respective securities regulators. In Uganda, it is not mandatory for PE fund managers to be licensed. However locally registered Pearl Capital Partners has applied for a fund manager's license from Capital Markets Authority (CMA), as a way of building credibility among prospective investors (Limited Partners) in the funds it creates.

There is need for a framework to be developed by CMA for PE funds and fund managers as well as VC funds and fund managers in order to allow Ugandan registered PE funds and fund managers to operate and develop the market. Some form of regulatory oversight of Uganda's PE and VC sectors could engender investor confidence. Institutional investors, particularly in markets where the PE sector is nascent such as Uganda, are less comfortable investing in an asset class which is unregulated. Thus, some degree of oversight could increase the flow of capital into Uganda's PE sector. Currently Ugandan pension funds are only allowed to invest in assets within the East African region. This means that PE funds would need to be registered in either Uganda or any of the other East African countries for Ugandan pension funds to invest in them yet currently majority of PE funds investing in Uganda are registered in Mauritius.

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<sup>1</sup> World Bank Group. (October 2018). *Ghana Private Equity and Venture Capital Ecosystem Study*

<sup>2</sup> CFA Institute. (2018). *Private Equity Valuation*

<sup>3</sup> The definition of Venture Capital Funds in the CMA Act, 2016 describes PE funds in general and not just the venture capital strategy employed by PE funds

## 2. Licensing and Regulation of Private Equity in Other Jurisdictions

### 2.1 Ghana

In 2018, the Securities and Exchange Commission (SEC) of Ghana passed guidelines for PE funds. The guidelines are quite extensive, onerous and prescriptive requiring all hedge funds, PE and VC funds, fund managers, representatives of the fund or manager and custodians of the fund to be licensed by SEC. The guidelines also clearly state the roles and responsibilities of the directors of the PE fund, manager, and custodian.

PE and VC fund licenses are only granted to either companies incorporated under the Companies Act or to external companies that are fit and proper persons with a business place in Ghana as per the Companies Act. PE funds are prohibited from offering any securities to the public or allotting any securities with a view of making an offer to the public. The shares of the PE fund are only sold to qualified investors. A qualified investor is defined as a person who has agreed in writing to be regarded as such and is any government, public institution or multilateral agency; institutional investors or any other person declared by SEC to be a qualified investor.<sup>4</sup>

PE funds are required to appoint a fund manager at the time of a license application or renewal. The application for a license must be accompanied by formation documents; an offer document; fund manager's latest audited report; custodian's latest audited report; and evidence of payment of the prescribed fee.<sup>5</sup> Among the requirements that the PE fund should fulfill to be granted or renew a license is having the provision of risk capital to small, medium and large businesses as the stated principle objective; initial minimum fund size of approximately USD 1.7 million; at least one independent director on the board; appointed an auditor who is a member of a recognized professional institute; and appointed an independent legal professional as a company secretary.<sup>6</sup>

The PE manager appointed by the fund should be licensed by the SEC as a Collective Investment Scheme (CIS) manager. However, the SEC may allow a PE fund to be managed by its own board of directors (self-managed fund) on condition that the board performs the functions a manager would. It is the duty of the manager to act solely in the interest of investors, ensuring that assets of the PE fund are held separately from those of the manager and any other funds managed by the manager.<sup>7</sup>

According to the guidelines, PE and VC funds may be held by a SEC licensed custodian on behalf of the investors, with a valuation policy to assess the value of investments in line with the International Private Equity Valuation Guidelines. The appointed custodian

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<sup>4</sup> Securities and Exchange Commission – Ghana. (2018). *Guidelines for Private Funds*

<sup>5</sup> Securities and Exchange Commission – Ghana. (2018). *Guidelines for Private Funds*

<sup>6</sup> Securities and Exchange Commission – Ghana. (2018). *Guidelines for Private Funds*

<sup>7</sup> Securities and Exchange Commission - Ghana. (2018). *Guidelines for Private Funds*

should be licensed by SEC as a custodian of assets of CISs, and must be independent of the PE fund.

The license application requirements for PE funds in Ghana are quite onerous and may not work for Uganda. Imposing application requirements such as offer documents; fund manager's latest audited report; custodian's latest audited report; and initial minimum fund could increase the time and cost of doing business for PE funds in Uganda. While the aforementioned requirements would increase transparency and investor confidence in the PE sector, Uganda's PE sectors is still at a growth stage and imposing onerous requirements would only curtail the growth of the sector. A search on the SEC website does not show any licensed PE funds under the licensees. This could be an indication that due to the onerous license application requirements, PE funds have been discouraged from applying for licenses.

## **2.2 Nigeria**

The PE rules in Nigeria are lighter than the PE guidelines in Ghana. In Nigeria, PE funds are licensed by the Securities and Exchange Commission (SEC – Nigeria) as a type of Collective Investment Scheme (CIS) that primarily invests in private equity/unlisted companies, whether or not in an attempt to gain control of the company.<sup>8</sup> To get a license, PE funds must have a minimum commitment of USD 2.75 million. Just like in Ghana, PE funds in Nigeria can only sell shares to qualified investors. However, unlike in Ghana where there is no limit on investment in a single asset, in Nigeria PE funds can invest only up to 30% of the fund's assets in a single asset.

A PE firm that intends to establish a local PE fund must first be registered as a fund manager with the SEC before proceeding to register the PE fund. The rules clearly state the requirements for registration are an information memorandum; quarterly reporting requirements to SEC – Nigeria, and the PE fund valuation requirements.<sup>9</sup> The license application requirements in Nigeria are much lighter than the license application requirements in Ghana. This essentially means PE funds in Nigeria spend less time and cost to register. The Nigeria rules would be more applicable to Uganda subject to adjustments to tailor it to the prevailing circumstances in Uganda's PE sector.

## **2.3 Kenya**

In Kenya, there is currently no overarching PE fund regulatory framework, although the Capital Markets Authority (CMA) regulates Venture Capital (VC) companies through the Capital Markets (Registered Venture Capital Companies) Regulations, 2007.

Unlike Nigeria and Ghana that employ heavy regulations, Kenya takes a lighter approach. A VC company must be registered with the Capital Markets Authority (CMA) before

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<sup>8</sup> Securities and Exchange Commission - Nigeria. (2018). *Rules on Private Equity Funds*

<sup>9</sup> Securities and Exchange Commission - Nigeria. (2018). *Rules on Private Equity Funds*

commencing operations. An application for registration as a VC company should be accompanied by among other things, details of the investment policy in respect of each fund. Details of the investment policy should set out the following: investment objectives; minimum and maximum investment amounts in any single enterprise; investment rules, investment process (including minimum commitment and investment periods and procedures for draw down) and exposure limits to individual eligible VC enterprises; preferred mode of divestiture from eligible VC enterprises; disclose a clear strategy for the diversification of investments in eligible VC enterprises; policies on fees and charges; profile of companies invested in (where applicable); and details of risks factors that are specific to the chosen investment sectors, or sectors intended to be invested in.<sup>10</sup>

The application should also be accompanied by a letter of acceptance of appointment from a CMA licensed fund manager; and a management agreement between the registered VC company and the fund manager. Once satisfied that the applicant meets all the necessary requirements, the CMA may register the applicant and issue a certificate of registration. The certificate of registration issued remains in force until it is revoked by the CMA.

To fundraise, the VC company is required to file a placement memorandum with the CMA at least thirty days before publication.<sup>11</sup> The VC company is required by the CMA to publish the placement memorandum, containing details on the terms and conditions on which funds are to be raised from investors. At the close of the offer, the VC company is required to make returns of the funds raised to the CMA.

As part of continuing reporting obligations for VC companies, the fund manager is required to keep books of account and maintain records that accurately reflect the affairs of the funds under management. Further to this, the fund manager within one month after the end of each quarter, files a return with the CMA that includes the following information: details of any investments made by each fund under its management during the quarter; consideration paid for investments; details of any disposals of investments during the quarter; and any profit derived or loss incurred from disposals.<sup>12</sup>

The directors of the registered VC company are required to file annual returns with CMA at the end of the registered VC company's financial year. The returns are accompanied by a report of the fund manager in respect of each fund under the registered VC company detailing: proposed changes in information specified by CMA or the investment policy; particulars of investments in eligible VC enterprises by that fund as at the end of that year; and any changes in the course of the year.

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<sup>10</sup> The Capital Markets (Registered Venture Capital Companies) Regulations, 2007

<sup>11</sup> The Capital Markets (Registered Venture Capital Companies) Regulations, 2007

<sup>12</sup> The Capital Markets (Registered Venture Capital Companies) Regulations, 2007

### 3. Lessons for Uganda

Nigeria and Ghana employ a heavy regulatory approach while Kenya employs a light regulatory approach. While institutional investors may be more comfortable investing in a heavily regulated asset class, a heavy regulatory approach could curtail the growth of Uganda's PE sector. Given the nascent stage of Uganda's PE sector, PE and VC funds need incentives to invest in Uganda, not a heavy regulatory framework that would only further discourage the funds from setting up locally.

While PE funds in Nigeria and Ghana need to attain a license from the relevant securities regulator, in Kenya, VC funds register with the securities regulator after meeting set requirements with no need for annual license renewal. This makes it easier for the VC companies to operate in Kenya because registration is carried out once. As opposed to licensing PE funds, CMA – Uganda could take the Kenyan approach and simply have PE funds registered. The PE funds would register once with the Authority but meet light continuous registration obligations. Alternatively, the Authority could have a registration regime that provides for renewal every three or five years. This will drive confidence in the PE sector and build trust in the capital markets. However, the approach chosen by the Authority should not be too onerous.

In Ghana, Nigeria and Kenya, there are continuous reporting obligations for PE funds. However, the reporting obligations in Nigeria and Ghana are much heavier than the reporting obligations in Kenya. In Nigeria quarterly and annual returns are filed with the SEC, and semi-annual returns with the investors, while in Ghana semiannual and annual returns are filed with SEC and the investors. In Kenya, quarterly and annual returns are filed with the CMA.

Notably, PE and VC funds have reporting obligations to their investors. Such reports may contain information that the investors and fund managers would prefer to keep away from the public. Therefore, having requirements for PE and VC funds to disclose this information may act as a disincentive for entering the Ugandan market. Should the Authority require information considered confidential by the PE funds, the Authority should commit to keep this information confidential. However, to keep track of the activities in Uganda's PE sector, the reporting obligation could be limited to information such as quarterly reports from the fund manager highlighting: details of any investments, and the consideration paid for the investments; any disposals of investments; any profit derived or loss incurred from those disposals; and any other information prescribed by the Authority.

SEC – Ghana issued guidelines for PE funds while SEC – Nigeria issued rules and Kenya issued regulations. A guideline aims to streamline particular processes according to a set routine or sound practice.<sup>13</sup> By definition, following guidelines is not mandatory and therefore not binding and enforceable by law. In terms of legislative hierarchy, Acts and

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<sup>13</sup> <https://www.tempe.gov/home/showdocument?id=41925>

regulations take precedence over rules and guidelines. Rules and guidelines are not enforceable by law and regulators have to coerce market players to follow them. Acts are statutory legislation passed by Parliament while regulations are subordinate to Acts. Given the nascent stage of Uganda's PE sector, anchoring the registration of PE and VC funds in the existing licensing regulations would be optimal and timely as the review process for the aforementioned regulations is currently in progress.

#### 4. Recommendations

To encourage more PE funds to register and domicile in Uganda, a light regulatory approach through registration under the licensing regulations is recommended. Specifically:

- i. Provisions should be created in the Licensing Regulations allowing for the registration of PE and VC funds. The registration requirements should include:
  - a) Investment policy statement;
  - b) Letter of acceptance of appointment from a CMA licensed fund manager;
  - c) Policies on fees and charges; and
  - d) Management agreement between the PE fund and the fund manager.
  
- ii. The continuous registration requirements should include:
  - a) Fund manager's quarterly returns showing the following
    - Amount initially invested in the portfolio company (including loans and guarantees);
    - Any amounts invested in the portfolio company in follow-on transactions;
    - A discussion of recent key events in respect of the portfolio company;
    - The changes in the investments in the assets of the PE fund since the end of the preceding accounting period showing whether they are new holdings, or changes in existing holdings, and giving a description of each holding and showing the net changes in the number of shares in or the nominal value of that holding since the end of the preceding accounting period;
    - The total cost of purchases of investments since the last portfolio statement;
    - The total proceeds of sales of investments since the last portfolio statement.
  
  - b) PE fund's annual returns showing the following
    - Assets and liabilities
    - Investments made
    - Changes in partners' capital
    - Cash flows of the PE fund
  
- iii. As an incentive for registration, PE and VC funds should be able to raise funds locally from pension savings.

## APPENDIX 1: OFFER DOCUMENT – INFORMATION TO BE DISCLOSED<sup>14</sup>

### 1. Registration of the PE fund

The Register with the CMA, the fund shall submit the following:

- a) Name, legal form, registered address and place and date of creation of the PE fund, with an indication of its duration if limited.
- b) compliance requirements of other regulatory bodies (if any);

### 2. Investment objectives and restrictions

Details of investment objectives and policy, size of the fund including summary of any investment and borrowing restrictions.

State the fundamental investment objectives of the PE fund, target sector(s), the types of securities or other property in which the PE fund proposes to invest, as well as the fund's investment process.

Explain the nature of the risks, including minimum exposure to the stock market, sensitivity to rate of interest risk, exposure to currency risk, concentration risk, investment in illiquid securities risk, etc. If the nature of the investment policy so dictates, a warning that investment in the private fund is subject to abnormal risks, and a description of the risks involved.

### 3. Prohibition of public offers

A PE fund is prohibited from offering its shares to the public and shall sell its shares only to qualified investors.

### 4. No public resale

A statement that shares acquired in the PE fund by investors shall not be resold to the public and investors shall be specifically advised of this restriction at the moment of subscription.

### 5. Principals

The names and registered addresses of the following parties (where applicable)

- a) Board of directors of private fund;
- b) the manager and its Board of directors;
- c) the custodian;

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<sup>14</sup> Securities and Exchange Commission – Ghana. (2018). *Guidelines for Private Funds*

- d) the investment adviser;
- e) the fund administrator;
- f) the auditors;
- g) the lawyers; and
- h) any other persons to whom activities of the private fund may be outsourced and the nature of those activities.
- i) details and track record of the core investment management team

#### 6. Capital structure of the Fund

- a) Rights and interests attached to shares.
- b) Minimum investment (if any)
- c) A description of the different types of shares, including their currency of denomination.
- d) Form of certification.
- e) Frequency of valuation.
- f) Capital structure of the fund

#### 7. Asset valuation and pricing

A statement of the provisions for the valuation of assets and for the pricing which must include:

- a) the method of determining the value of the assets and liabilities of the property of the scheme and the net asset value accordingly;
- b) the method of calculating the issue price; and
- c) the method of pricing and the circumstances under which it may change.

#### 8. Distribution policy

The distribution policy and the approximate dates on which dividends (if any) will be paid (if applicable).

#### 9. Fees and charges

- a) the level of all fees and charges payable by investors, including all charges levied on subscription; and

- b) the level of all fees and charges payable by the PE fund, including management fees, custodian fees and start-up expenses.

## 10. Custodial arrangements

Name and address of custodian.

A statement that the assets of the PE fund are held by the custodian on trust for the PE fund.

A statement as to the obligations of the custodian to monitor the conduct of the manager and to ensure that the interests of the investors are protected and safeguarded.

## 11. Taxation

Details of principal taxes levied on the fund's income and capital, including tax, if any, deducted on distribution to investors.

## 12. Reports and accounts

The period of the PE fund's financial year.

Particulars of what reports will be sent to investors and when.

If there are bearer units in issue, information must be given on where in Uganda reports can be obtained.

## 13. General information

A list of the formation documents and an address in Uganda where they can be inspected free of charge.

The date of publication of the offer document.

Information about measures to be taken to prevent money laundering and the financing of terrorism.

A statement that the manager accepts responsibility for the information contained in the offer document as being accurate as at the date of publication.

## 14. Termination of PE fund (where applicable)

A summary of the circumstances (if any) in which the PE fund can be terminated and possible exit strategies for investors

## 15. Liability for offer document

A person responsible for issuing this offer document is liable to pay compensation to any person who –

- a) purchases or agrees to purchase shares in the private fund; and

- b) suffers loss due to an untrue or misleading statement, or the omission of any facts required to be included by these rules.

## 16. Corporate Governance

Any corporate governance issues related to independence between the Board of the Target Company and the Board/investment team of the fund manager/Investment Adviser should be disclosed.

## **APPENDIX 2: INVESTORS' REPORTS<sup>15</sup>**

### **A: Report of the manager**

The following matters shall be set out in every annual and half-yearly report of the manager –

1. The names and addresses of the following –
  - a) the PE fund;
  - b) the manager
  - c) the custodian;
  - d) any investment adviser;
  - e) any fund administrator;
  - f) the auditor.
2. The objectives of the PE fund.
3. The manager's policy for achieving the objectives of the PE fund.
4. A statement that the PE fund is licensed under the Act.
5. A review of the PE fund's investment activities during the period to which the report relates.
6. Particulars of any significant change in the offer document made since the making of the last report by the manager and of any change in the directors of the manager.
7. A statement of the amount (if any) to be distributed to investors or accumulated in respect of the period in question.
8. A statement of the total number of the shares in existence or deemed to be in existence at the beginning of the period to which the report relates and at the end of that period.
9. A statement of the mid-market value per share of the assets of the PE fund at the beginning of the period to which the report relates and at the end of that period.
10. Any other significant information which would enable investors to make an informed judgement on the development of the activities of the PE fund during this period and the results of those activities as at the end of that period.

### **B: Portfolio statement**

The following shall be set out in the portfolio statement included in the report to investors

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<sup>15</sup> Securities and Exchange Commission – Ghana. (2018). *Guidelines for Private Funds*

- a) the changes in the investments in the assets of the PE fund since the end of the preceding accounting period showing whether they are new holdings, or changes in existing holdings, and giving a description of each holding and showing the net changes in the number of shares in or the nominal value of that holding since the end of the preceding accounting period;
- b) the total cost of purchases of investments since the last portfolio statement;
- c) the total proceeds of sales of investments since the last portfolio statement.

### **Portfolio Company Reports**

A fund should provide quarterly a report on each portfolio company with the following information:

- Amount initially invested in the portfolio company (including loans and guarantees);
- Any amounts invested in the portfolio company in follow-on transactions;
- A discussion by the fund manager of recent key events in respect of the portfolio company;
- Summary financial statement (quarterly and annually) for each portfolio company

### **C: Comparative table**

The following matters shall be set out in the comparative table included in the report of the company

- a) a comparative table covering the last three financial years and including, for each financial year, at the end of the financial
  - I. the total net asset value;
  - II. the net asset value per share.
- b) a performance record over the last ten financial years or, if the fund has not been in existence during the whole of that period, over the whole period in which it has been in existence, showing the highest issue price during each of those years.

### **D: Report of the auditor**

The report of the auditor to investors for any annual accounting period shall state

- a) whether in the auditor's opinion the accounts prepared for that period have been properly prepared in accordance with generally accepted accounting principles and in accordance with these rules and the formation documents;

- b) without prejudice to the foregoing, whether in the auditor's opinion a true and fair view is given of the financial position of the fund as at the end of that period;
- c) if the auditor is of the opinion that proper accounting records have not been kept by the PE fund or that the accounts are not in agreement with the company's accounting records, that fact together with any resulting qualification, that fact;
- d) if the auditor has not been given all the information and explanations which, to the best of his knowledge and belief, are necessary for the purposes of his audit, that fact together with any resulting qualifications, that fact; and
- e) if the auditor is of the opinion that the information given in the report of the manager for that period is inconsistent with the accounts, that fact together with any resulting qualifications.

#### **E: Report of the custodian**

The report of the custodian to the investors for any annual accounting period shall state whether in the custodian's opinion the manager has managed the PE fund in that period

- a) in accordance with the limitations imposed on the investment and borrowing powers of the PE fund and custodian by the formation documents, by the offer document and by these rules; and
- b) otherwise in accordance with the provisions of the formation documents, the offer document and these rules; and if the company has not done so, the respects in which it has not done so and the steps which the custodian has taken in respect thereof.