The Outlook for Private Equity in Colombia

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Overview of the Colombian Regulatory Landscape

During the last decade, stable economic growth, high-impact political and economic reforms together with impressive improvements in security and investor protections have drawn the spotlight to Colombia. Gross domestic product has grown an average of 4.7% annually over the past 10 years[1] and foreign direct investment increased 10.9% in 2012, exceeding an all-time record of US$15 billion.

Improvement in Colombia's economic indicators is creating a more favorable climate for foreign investments, which also draws on a strong institutional legacy: the country has never defaulted on its foreign debt, it has suffered only one recession in nearly a century (1999) and has an unusually long democratic tradition compared to its peers in the region with only one military government since 1880, from 1953 to 1957. In recent years, President Juan Manuel Santos has opened a formal "peace process" with the Revolutionary Armed Forces of Colombia (FARC) and has enacted strong policies against organized crime and corruption following Alvaro Uribe's double presidency that brought confidence back to international investors. Peace with FARC would gently benefit Colombia's economy, as it would engender even greater confidence in the country and stability in its international relationships. All these attributes have been highlighted by The Economist Intelligence Unit, which listed Colombia among the promising "CIVETS" countries poised for fast economic growth on par with the BRIC countries.[2]

Colombia is prepared to seize this opportunity, with transparent and reliable rules regarding investment protection. The country participates in 6 Investment Protection Treaties (IPTs) and 5 double taxation treaties with important economic partners.[3] Besides commercial agreements with major Latin American markets and Canada, Colombia's Free Trade Agreement (FTA) with the US has been in place since May 2012 and an FTA with the EU entered into force in July 2013. The World Bank's 2013 Doing Business Report ranked Colombia 45th out of 185 countries overall but 6th in terms of investor protections, scoring 86.3 out of 100 points in that category, reflecting for example Colombia's heavy restrictions against expropriation and requirements for fair compensation to private investors.[4]

Recent reforms have reinforced the sentiment that Colombia is on the right track: in 2011 Congress enacted the Anticorruption Statute (Estatuto Anticorrupción) stipulating very strong prohibitions against corruption in the public and private sectors. Reforms are also anticipated to Colombia's social security and pension schemes as is an overhaul of the judiciary system, aimed at providing greater transparency and efficiency.

Infrastructure investment is another area that has been the target of reform. Congress enacted in 2012 the first law for Public-Private Partnerships (Asociaciones Público Privadas), articulating clearer rules for private sector participation in infrastructure projects, which is crucially important in light of the estimated US$44 billion needed for connectivity and logistics integration.

Private Equity Regulatory Outlook

From a legal perspective, Colombia's private equity regulations are well developed and are contributing to the development of a robust domestic industry. The fondos de capital privado regime has been in place since 2007 when domestic pension funds were allowed to invest in private equity and pooled fund structures. In 2013 Colombia significantly enhanced its standing in the annual LAVCA Scorecard which rates the attractiveness of Latin American countries for private equity, rising from 42 to 61 points (out of 100) and ranking as the fourth strongest environment in Latin America for the development of private equity.[5] In addition, the Ministry of Finance recently issued a reform of Decree 2555 (2010) to reduce operational concerns and facilitate custody and investment management services for pooled funds and private equity funds. This reform is expected to elevate the domestic industry's sophistication to international standards.

The structure of local private equity funds is consistent with global market practice, having a similar general-limited partner structure, and with an additional administration figure in charge of a local supervised financial entity (mainly for back office purposes). General partners do not have to be registered companies but must demonstrate at least five years of experience in managing private equity investments. Regarding their incorporation process, private equity funds are not subject to the prior approval of the local regulator and required only to file certain documents with the Colombian Superintendent of Finance.

1. Source: IMF.
2. Source: http://www.investincolombia.com.co/newsletter/622-the-colombian-economy-between-the-strong-and-the-powerful-the-economist.html. CIVETS = Colombia, Indonesia, Vietnam, Egypt, Turkey, South Africa.
3. Colombia has entered into IPTs with China, India, United Kingdom, Belgium, The Republic of Korea and Japan and double taxation treaties with Canada, Spain, Chile, Switzerland, and is part of the *Comunidad Andina de Naciones* CAN.
4. Source: http://english.doingbusiness.org/data/distance-to-frontier.
5. The Latin America Venture Capital Association (LAVCA) Scorecard on the Private Equity and Venture Capital Environment in Latin America and the Caribbean, available at www.lavca.org.

Sampling of Private Equity Investments in Colombia, 2012-2013

PE Firm	Investor Company	Sector
Sociedad Gestora Valorar Futuro	Mejisulfatos	Agribusiness
Sociedad Gestora Valorar Futuro	Laboratorios Higietex	Industrials & Manufacturing
Teka Capital	Inverdesa (Bodytech)	Consumer
Nexus Group	Empaques Flexa	Industrials & Manufacturing
IFC Asset Management Company (AMC)	PetroNova	Oil & Gas
Southern Cross Group	Sociedad Portuaria Regional de Barranquilla (SPRB)	Ports, Waterways, Shipping
Ashmore Management Company Colombia	Promitel (Promigas Telecomunicaciones)	Telecom & Internet Infrastructure
Kandeo	Acercasa	Banking & Financial Services
Advent International	Alianza Fiduciaria	Banking & Financial Services
CIPEF and ACON	Vetra	Oil & Gas
Meso america	OMA & Toscafe	Food & Beverage

Source: Emerging Markets Private Equity Association. Data as of 30 June 2013. Published 29 July 2013.

Sampling of Private Equity Funds Investing in Colombia

PE Firm	Fund	Focus
Teka Capital	Teka Capital I	Growth
Ashmore Management Company Colombia	Ashmore Colombian Infrastructure Fund I FCP	Infrastructure
Latin America Enterprise Fund Managers (LAEF)	Colombian Investment in Hydrocarbons Fund III (PROJECT INVESTMENTS)	Growth
ACON Investments, LLC	ACON Latin America Opportunities Fund	Growth
CoreCo	CoreCo Central America I	Growth
Altra Investments	Altra Private Equity Fund II	Buyout
Axon Partners Group	Amerigo Ventures Colombia	Venture Capital
Altra Investments	Altra Private Equity Fund II	Buyout
Brilla Group	Bricapital Colombia Private Equity Fund	Growth/Real Estate
MAS SEAF Equity Partners	Fondo MAS Colombia Latam	Buyout
Terranum Capital	Terranum Capital Colombia Fund	Growth/Real Estate

Source: Emerging Markets Private Equity Association. Data as of 30 June 2013. Published 29 July 2013.

PE Fundraising

Local private equity funds raise capital primarily from institutional investors (pension funds and insurance companies) but the number of private investors, family offices and other financial institutions are steadily increasing. In most cases, fund raising among local institutional investors is conducted directly by Colombian and foreign general partners, although use of placement agents is rising. Among domestic institutional investors, an estimated US$3 billion is available to be deployed to both local and international private equity funds, with less than US$1.2 billion allocated to date. Colombian pension fund assets are increasing by an average of 25% annually, and total AUM is estimated to be US$60 billion as of June 2013.

Regarding international pooled funds (generally UCITS, SICAVS, private equity, hedge funds and mutual funds), offshore general partners are able to market and distribute their interests to local mandatory pension funds, voluntary pension funds, severance funds and insurance companies. However for these entities to invest in offshore PE vehicles, the law provides for specific requirements: the fund's manager must be located in an investment grade jurisdiction, the general partner or its representatives must have at least five years of experience in managing private equity assets and either the general partner or the administrator of the fund shall credit at least US$ 1 billion in assets under management, among others.

International managers are increasingly establishing a local presence for both capital raising and investment purposes, many of which have incorporated both on and offshore vehicles operating via co-investment structures.

For Colombian pension funds the alignment of interests is crucial. All fund documents are expected to adhere to global standards of practice regarding specific provisions around transparency in the administration of the fund´s portfolio, particularly in relation to advisory committees, capital calls, investment reports, AML and KYC requirements, indemnities and limitation of responsibilities.

Despite being a recently young industry, Colombian managers have already produced a number of interesting success stories, earning the respect of local and international players alike. Locally managed fund ALTRA II recently raised more than US$330 million for investments in the region and other players as Laefm, Tribeca, MAS SEAF, Terranum and Teka have drawn the interest of local and international institutional investors as well.

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In general, Colombian regulations do not require the international investment vehicle or the general partner to be registered with the Superintendent of Finance, but distributors and investment managers must comply with certain marketing and promotion restrictions in undertaking such activities.

Competitive taxation regime

With respect to tax regulations, the local private equity industry benefits from some competitive advantages that serve to attract foreign investment. Carried interest income is treated as capital gain and not ordinary income and is generally subject to a tax rate of 10%. In addition, the fund itself is not subject to income tax ("Transparency Principle") and therefore distributions to the investors are taxed as direct gains of the investors depending on whether they are Colombian or offshore residents and particularly depending on the taxes being paid by each of the underlying assets of the fund.

Latin America PE Investment (US$m) by Country, 2008–1H2013

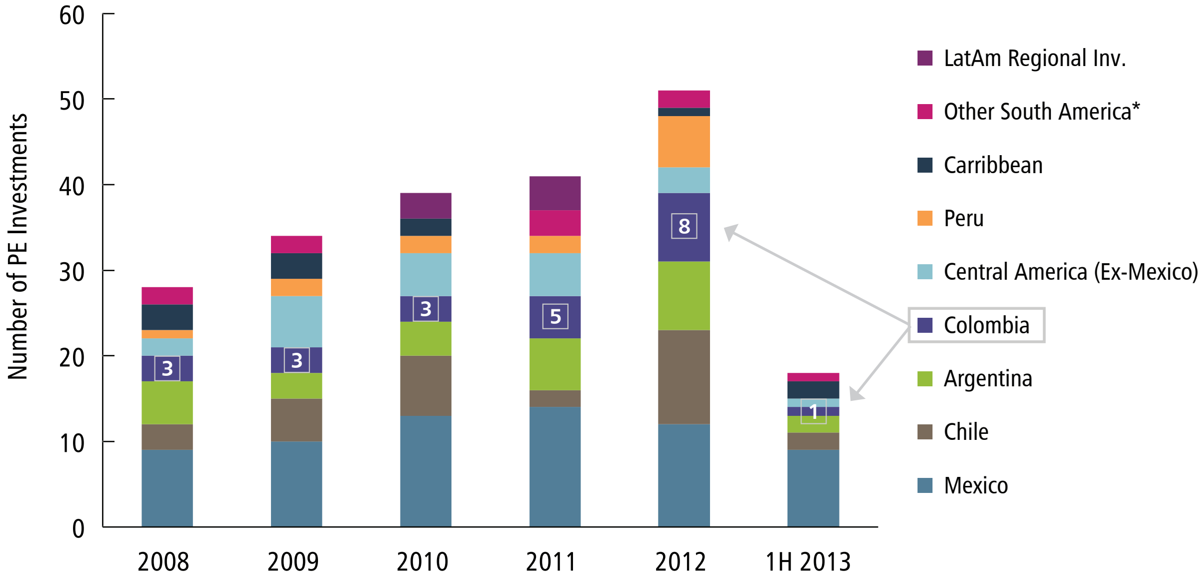
COUNTRY	2008	2009	2010	2011	2012	1H 2013	TOTAL INVESTED (US$m)
Brazil	3,020	989	4,604	2,461	4,384	689	16,146
Chile	929	40	298	3	248	290	1,809
Peru	1,400	7	2	0	N/A	0	1,409
Colombia	123	10	612	376	115	N/A	1,236
Carribbean	950	42	53	0	0	50	1,095
Mexico	455	67	150	128	69	118	987
Argentina	85	151	525	89	65	6	920
LatAm Regional Inv.	0	0	405	4	0		409
Central America (Ex-Mexico)	0	11	1	174	73	65	323
Other South America*	0	1	0	11	5	0	16
Latin America	6,962	1,318	6,648	3,245	4,959	1,218	24,350

* Includes Ecuador, Guyana, Paraguya, Uruguay, Venezuela
Source: Emerging Markets Private Equity Association. Data as of 30 June 2013. Published 29 July 2013.

Outlook

Colombia's private equity industry is expanding and becoming more sophisticated thanks to notable strides in investor protection and regulations consistent with international standards. Sophisticated local investors managing sizeable and growing pools of capital are familiar with international guidelines and ready to invest both onshore and offshore, demonstrated by the volume of international managers flocking to Colombia in search of new pools of capital. But Colombia offers more than just new fundraising prospects for overseas managers. With its professional and regulated industry, sophisticated and well trained individuals and depth of opportunities yet to be discovered, Colombia presents an attractive investment option for domestic and international investors alike.

Private Equity Investment in Latin America ex–Brazil, No. Deals, 2008–1H2013



* Includes Ecuador, Guyana, Paraguya, Uruguay, Venezuela
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