Hot Topic Primer

Obama plans to bar banks from investing in and owning private equity funds

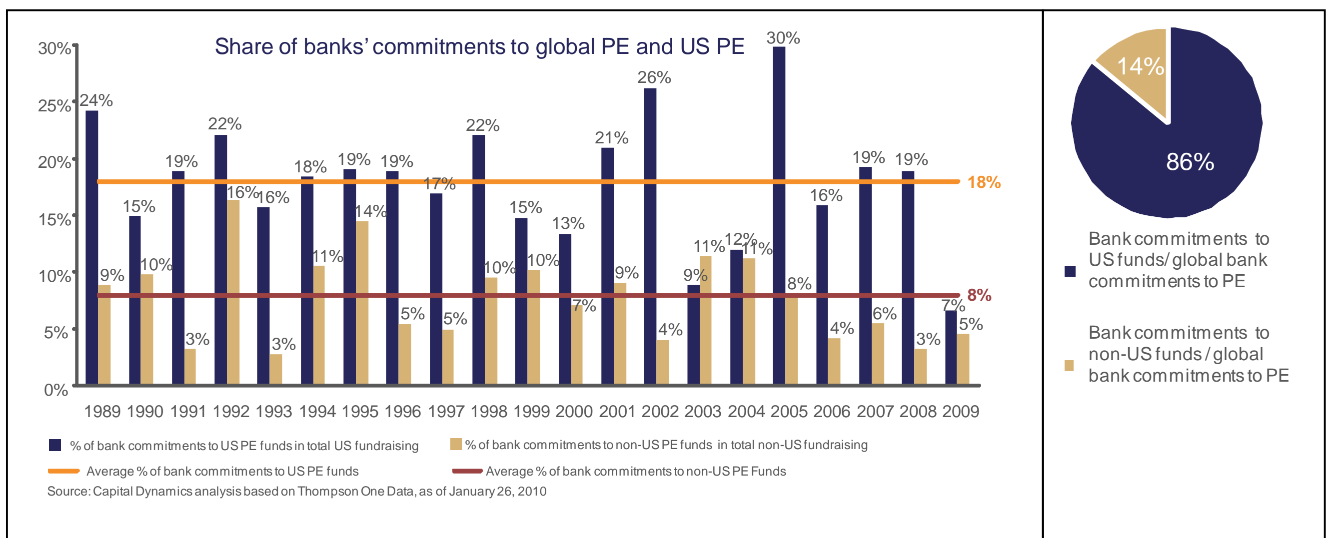
President Barack Obama announced on Thursday, January 21 that he plans to bar banks from investing in hedge funds and private equity funds, plus bar them from owning the respective fund managers. The outline below briefly details what the impact on private equity could be. Further, there might also be a cap on bank size.

Key questions

- What would the impact on private equity be?
- Who, on the banking side, would be impacted?

Key answers

- The initiative is unlikely to deal a blow to the global private equity industry as only a minority of funds are captive (i.e. owned by banks), and only 8% of non-US commitments on average have been contributed by banks.
- However, the US fundraising market would be strongly affected as banks committed, on average, 18% of the funds raised by US private equity (working on the assumption that much of the 86% of global funds committed by banks to US PE are originating from US banks).
- A potential downsizing of very large banks could have more of a widespread negative effect as smaller banks would not be in the same position to provide leverage and services to the large end of private equity as large banks do.
- Main banks impacted would be Goldman Sachs (USD 50 billion managed by its private equity group , USD 14.5 billion PE assets on the balance sheet as part of a USD 145 billion alternative assets portfolio); JPMorgan (USD 6.8 billion of private equity assets); Citigroup, Bank of America, Merrill Lynch, Wells Fargo and Morgan Stanley.



Short commentary

President Barack Obama announced on Thursday, January 21 that he plans to bar banks from investing in hedge funds and private equity funds, plus bar them from owning the respective fund managers. It is not yet clear how this initiative will be implemented, nor is it clear whether banks would still be allowed to invest client money into private equity. Further, it is not yet clear what the geographic reach could be, or if it will include FoF and co-investment activities as well.

Irrespective of the details, US private equity will feel the brunt of the initiative. Of all funds committed by banks globally, 86% are placed in the US. A large part of captive funds are run by US banks, and commitments by banks have made up, on average, 18% of total commitments to US private equity funds. The impact on the rest of the world will be much less. Commitments by banks represent only 8% of total funds raised in the rest of the world. Working on the assumption that many US banks do invest in their home market, much of the 18% raised by US private equity funds from banks could be affected.

Furthermore, a potential downsizing of very large banks could have more of a widespread negative effect on private equity as smaller banks would not be in the same position to provide leverage and services to the large end of private equity as large banks do.

The initiative's motive is to further reduce financial market risk that could stem from alternative assets. What is questionable, however, is whether including private equity, given its limited potential systemic risk impact, in the same initiative with hedge funds is justified; especially when compared against the potentially negative impact it could have on the overall US private equity industry.

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