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Buy-out investors at risk of default in next two years

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One in 10 investors in private equity are likely to default on commitments to invest funds in the next two years, research has suggested.

The findings underline the scale of challenges facing the sector as it scrambles to adapt to a harsh new environment of falling returns, cash-strapped investors and a backlash from regulators and politicians.

The research, which covered 120 big investors in private equity, or limited partners, was carried out by Coller Capital, the specialist investor in second-hand private equity assets. Three-quarters of investors polled expect distributions of cash back from private equity investments to decline this year.

Slightly more than half the investors said the drop in distributions would constrain their ability to find and manage new private equity investments.

Many of the world's biggest investors in private equity, including US pension funds and endowments, have already been forced to cut back on money they commit to new funds, in response to losses.

"Generally investors seem to think things are going to get worse before they get better," said Jeremy Coller, chief investment officer at Coller Capital. "Scarce capital, slower returns and political uncertainty are the immediate future . . . "

Lawyers say there have so far been few defaults by limited partners, as the penalties for failing to meet a capital call are so severe that most prefer to sell their holding at a discount.

"For the most part, limited partner defaults haven't really been seen before, except for some high net worth individuals in venture capital funds after the dotcom bubble," said Geoffrey Kittredge, a partner at law firm Debevoise & Plimpton. However, he added: "There is more talk about defaults than actual defaulting going on . . Suing your investors may be a difficult process and general partners have limited resources to deal with a lengthy and costly lawsuit."

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