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Getting The Deal Through

Market Intelligence

PRIVATE EQUITY 2023

Global interview panel lead by Simpson Thacher & Bartlett LLP

Lexology GTDT Market Intelligence provides a unique perspective on evolving legal and regulatory landscapes.

Led by Simpson Thacher & Bartlett LLP, this Private Equity volume features discussion and analysis of emerging trends and hot topics within key jurisdictions worldwide.

Market Intelligence offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most significant cases and deals.

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Colombia

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Lina has worked in the legal departments of different local and international financial entities, among them, Banco Corpbanca Itaú (former Helm Bank) and Banco Corficolombiana [Panamá]. She has also worked in top-tier Colombian law firms.



1 What trends are you seeing in overall activity levels for private equity buyouts and investments in your jurisdiction during the past year or so?

Overall, in Colombia, investments by private equity firms have slowed down compared to last year, due to a number of factors that include, among others, the change of administration and the global economic situation. In effect, compared to 2022, investment opportunities in Colombia have reduced in number and value. However, according to the latest relevant transactions in the market and some recent market studies, private equity and M&A activity is expected to grow substantially during the next two years.

The current conditions of the financial markets, especially the stock market, show a trend where the valuation of the assets typically tends to be lower than the fundamental value of the assets, creating an investment opportunity for private equity players. In addition, Colombia continues experiencing a significant growth in public stock markets, driven primarily by a significant influx of resources coming from foreign and sovereign funds. Moreover, for the most part, private equity players are not competing with strategic buyers, and, in many cases, they have participated from the seller side in the tender offers and acquisitions initiated by strategic buyers during the year.

2 Looking at types of investments and transactions, are private equity firms primarily pursuing straight buyouts, or are other opportunities, such as minority-stake investments, partnerships or add-on acquisitions, also being explored?

In Colombia, private equity firms have investment strategies that allow a combination of acquisitions, minority-stake investment and partnerships. Less frequently, such firms expand their portfolios



through add-on acquisitions, which are more typical in the domain of strategic buyers. In the current market, any specific type of investment often depends on the sector targeted.

In the local market, there is no specific hotspot for investments, but rather a broad spectrum of areas in which investments have proved to be more attractive for private equity firms. During the past couple of quarters, Colombia has seen significant investments in the health, food, IT and infrastructure industries.

The recent change of administration, and some of the regulatory initiatives announced by the new government, have stalled some of the capital influx that was coming to Colombia after the pandemic. Thus, some private equity players are leaning towards low-risk investments and investment that require less capital. Moreover, there have been some relevant acquisitions made through debt

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management and debt restructuring mechanisms, such as assumption of debt or capitalisation of certain accounts.

3 What were the recent keynote deals? And what made them stand out?

The ecosystem of entrepreneurs and startups has gained relevance in the Colombian market and has managed to raise significant private equity investments, despite the challenges faced by many companies during the first quarter due to Silicon Valley Bank crisis. The strongest subsectors in the Colombian entrepreneurial ecosystem are fintech, e-commerce and proptech.

Some of the most relevant deals in Colombia are the acquisition of Grupo Nutresa, the acquisition of ISA by Ecopetrol, the acquisition of Viva Air by Avianca, the sale of Telefónica's assets to KKR and the merger of the stock exchanges of Chile, Colombia and Peru. In addition to such multimillion-dollar deals, the market has seen some medium size private equity and M&A transactions for values between US\$50 and US\$150 million, such as the recent acquisition of a majority stake of GDA Luma in Credivalores-Crediservicios SA.

4 Does private equity M&A tend to be cross-border? What are some of the typical challenges legal advisers in your jurisdiction face in a multi-jurisdictional deal? How are those challenges evolving?

Most of the small and medium size M&A deals in Colombia tend to be local, while cross-border operations are frequent in transactions that require a larger influx of resources, or that are initiated by firms located abroad.





In cross-border transactions, one of the main legal challenges faced by counsels is the application of tax laws, due to the different treatment that any particular investment may have in each of the jurisdictions involved. In addition, legal advisers also face significant challenges related to regulatory approvals that may be required for certain deals, and that may delay the consummation of the transaction. Normally, these challenges are solved contractually, with the participation of law firms located in all the jurisdictions participating in the deal. Such contractual provisions allow firms and companies to pursue the deal in a safe and profitable manner, while addressing some of the issues that may be raised by tax laws and regulatory approvals. Moreover, they allow parties involved to continue with the transaction while the regulatory approvals are obtained, without having to put the entire transaction on hold.

5 What are some of the current issues and trends in financing for private equity transactions? Have there been any notable developments in the availability or the terms of debt financing for buyers over the past year or so?

Recently there has been a trend for private equity firms to finance transactions and manage cash flow through lines of credit. These loans tend to be secured short-term financings, often collateralised with shares of the target company. In addition, these loans, when international private equity firms actively participate in them, tend to be governed by New York laws, and linked to the SOFR or Term SOFR rates.

During the past couple of quarters, there have been two main challenges regarding the availability and terms of debt financing for buyers. First, and due to the sustained increase in interest rates over the past months, debt financing has become more expensive and less available to buyers. Thus, the number and value of such

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financings has lowered compared to previous years. Second, with the recent death of Libor, legal counsels and parties to loan agreements have been pushed to renegotiate and amend the terms of ongoing agreements, to transition from a LIBOR rate to a SOFR rate.

6 How has the legal, regulatory and policy landscape changed during the past few years in your jurisdiction?

Decree 1393 of 2020 modified the investment limits that institutional investors (such as pension and severance funds and insurance companies) must follow to make investments in private equity. With this change, more flexibility and autonomy was given to institutional investors so that their boards of directors can determine in their internal policies the maximum investment limits applicable to that class of assets, instead of the regulator determining the limits. The practical effect of this change is that institutional investors will allocate more funds to investing in private equity.

“Policymakers are promoting the development of the private equity market.”

Likewise, Decree 1393 of 2020, set forth new rules on corporate governance to avoid the materialisation of conflicts of interest in investments made by institutional investors in a private equity fund that invests in an entity that belongs to the same financial conglomerate. In summary, the new rules imply approval of the investment by the board of directors and not by the investment committees of the institutional investors, as well as the prohibition on the general partner of the private equity fund being a person or entity linked to the institutional investor.

Additionally, Law 2112 of 2021, regulated by Decree 1458 of 2022, set forth an obligation for mandatory pension funds to invest a minimum of 3 per cent of their assets under management in funds in private equity and private debt funds that invest in companies and productive projects in Colombia to strengthen entrepreneurship and grow the business fabric of the country.

Moreover, the new administration has proposed several reforms that may impact the attractiveness of the Colombian market to foreign

investment. Those reforms concern several critical areas, such as labour, pension and tax reforms. However, those initiatives have witnessed some pushback from Congress, and have been deferred for a year.

7 What are the current attitudes towards private equity among policymakers and the public? Does shareholder activism play a significant role in your jurisdiction?

Recently in Colombia, policymakers have focused on increasing the opening and evolution of the capital markets. Policymakers are promoting the development of the private equity market, for instance, through regulatory changes in the limits of investment in private equity by institutional investors and mandatory investments by pension funds. In general, policymakers are seeking to make the local market more flexible and align with best practices and international regulatory standards.

Moreover, the public, institutional investors and entrepreneurs, specifically, perceive private equity as an investment that allows them to channel funds for the development of companies in different sectors.

In Colombia, shareholder activism has been gaining relevance in the past couple of years. On the one hand, with the recent launch of several tender offers aimed at acquiring a majority stake in one of the biggest conglomerates in the country, Colombia has seen an increase in shareholder activism in public companies, particularly those involved in this acquisition. On the other hand, regarding closely held companies, the country has also witnessed more involvement from stockholders in the form of major participation in the management of the company and the negotiation of stricter covenants in investment or financing agreements.





Additionally, as part of the shareholder activism, institutional investors have placed more relevance in ESG criteria, which have been included in different forms in the negotiated agreements (eg, sustainable loans in which the interest rate is linked to the achievement of certain sustainable milestones).

8 What levels of exit activity have you been seeing? Which exit route is the most common? Which exits have caught your eye recently, and why?

The private equity industry is currently facing a local economic context with high inflation and rising interest rates. Consequently, it is foreseeable that the exit activity will be reduced until a later period, when the exit may align with the target price. In effect, some private equity firms have paused their exit, and in many cases some additional investments, until the political and economic landscape stabilises.

Typically exit routes in Colombia consist of sales to strategic investors, including, in some cases, sales to other private equity fund managers. IPOs are not a common exit in Colombia.

9 Looking at funds and fundraising, does the market currently favour investors or sponsors? What are fundraising levels like now relative to the past few years?

Due to a faster market growth compared to previous years, fundraising currently benefits sponsors. On average, funds for a particular investment are raised between one and a half and two years, which is unfavourable to investors, especially institutional ones, mainly because it implies having a tighter schedule for defining

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their asset allocation. The macroeconomic context has impacted the investment limits of institutional investors, and this may mean that good investment vintage is lost, so investment opportunities are subject to cherry-picking.

10 Talk us through a typical fundraising. What are the timelines, structures and the key contractual points? What are the most significant legal issues specific to your jurisdiction?

Typically, the private equity market has a timeline for fundraising and structuring of 12 to 18 months. If the fund is oversubscribed and the manager has a good track record, the timeline can be reduced to six months.

Regarding the structures of private equity funds, in Colombia, there are no main funds or feeder funds, as is the case in the international industry. In contrast, in Colombia, there is a single fund that can have different investment compartments or lines with different investment



strategies. Typically, the compartments of local private equity funds are intended to separate debt and equity investments. Recently, the market has seen a growing tendency for institutional investors to be able to excuse themselves from complying with investment commitments, for instance, due to corruption risks. However, this type of request has legal and operational challenges due to the stringent regulation applicable to these types of investments and the difficulties in determining the unit value of the funds.

Moreover, in Colombia, companies often raise capital through foreign private markets. In particular, they tend to issue securities, normally notes, under Regulation S and Rules 144 and 144A of the US Securities Laws. This allows companies to raise capital from a highly sophisticated market, while also permitting private equity funds to invest and acquire interests in growing private companies. Notably, most legal challenges in this area come from the negotiation of the lengthy documentation needed for the offering, especially when it is the first issuance carried out by the company.

11 How closely are private equity sponsors supervised in your jurisdiction? Does this supervision impact the day-to-day business?

Although the regulator and supervisor in Colombia is becoming more comfortable with private equity investment, private equity funds are closely supervised by the Colombian Financial Superintendence.

This supervision implies, among other things, the approval of the legal documentation for the incorporation of the private equity funds, the reporting of daily information on the valuation of the funds and their assets and adherence to the requirements of the Superintendency regarding contingencies or risks faced by the fund. The foregoing implies that private equity sponsors must have robust operational

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and technological structures to meet the supervisor's requirements, which naturally carries higher operational costs and the participation of more players in the management of private equity funds.

12 What effect has the AIFMD had or will it have on fundraising in your jurisdiction?

Currently, the AIFMD is closely followed by local institutional investors when making a particular investment in European private equity funds. Although AIFMD is not directly applicable in Colombia, it may impact the local market. In effect, there are two main ways in which EU regulation is likely to have an effect in Colombia. First, it is likely that foreign investors adopt internal policies to adapt to AIFMD requirements. Second, the local authorities may consider these regulations during the lawmaking process in Colombia. Colombian financial authorities have always paid close attention to foreign and international regulations when they pursue an update to the current financial laws.

13 What are the major tax issues that private equity faces in your jurisdiction? How is carried interest taxed? Do you see the current treatment potentially changing in the near future?

The private equity industry at the local level is waiting for the changes that the tax reform announced by the new government may bring to the industry. Currently, the funds have tax exemptions, and the regulations of the funds do not spend much time regulating tax matters. In the local market, carried interest is typical for real estate and infrastructure funds and is currently subject to VAT.

In addition, investments by private equity funds are often carried out by special purpose vehicles incorporated abroad (eg, Delaware, Spain, etc), which may be subject to additional tax restrictions. However, Colombia has recently seen a significant increase in deals that involve the application of the international agreements reached with different countries to avoid double taxation.

14 Looking ahead, what can we expect? What might be the main themes in the next 12 months for private equity deal activity and fundraising?

Colombia has not been immune to the political uncertainty and economic instability of the Latam region. In the next 12 months, the private equity industry will be waiting for new regulations and policies coming from the new administration. This new political agenda will impact the quantity and value of new investments in Colombia.

Nevertheless, Colombia is expected to have a significant increase in M&A activity during the next two years. A recent study conducted by KPMG shows a special interest from private equity and venture capital managers in Latin America. To that extent, from a legal perspective, due diligence activity will certainly see a significant increase and will be a fundamental part of the agenda during the next 12 months.

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The Inside Track

What factors make private equity practice in your jurisdiction unique?

One of the factors that makes the practice of private equity unique in Colombia is the level of sophistication of investors, who constantly challenge legal advisers to incorporate the best international practices into the structures of the funds or investments. On the other hand, although it can sometimes conflict with flexibility, the standardisation of the legal structures of private equity funds has contributed to making the sector homogeneous in its practices. Finally, we can highlight that in Colombia the regulator is fully aware of continuing to issue regulations to promote the development of this industry.

What should a client consider when choosing counsel for a complex private equity transaction in your jurisdiction?

Undoubtedly, a key aspect for successful legal advice on private equity transactions is a robust knowledge of the rules applicable to private equity funds and the applicable tax regulations. Similarly, it is important to have extensive knowledge of M&A and corporate law matters. Ideally, clients should seek law firms with extensive experience in regulatory matters, as well as firms with a broad range of transactional practices. In addition, having dual-qualified attorneys may be a plus, to the extent that they may facilitate the negotiations and the understanding of all the legal documents involved in any particular transaction.

What interesting or unusual issues have you come across in recent matters?

In some private equity funds, players such as institutional investors have requested excluding their participation in some specific investments. These requests have been made seeking greater alignment of the investments with the ESG policies of these investors and seeking to mitigate reputational risks. In practice, these requests are unusual and difficult to accept from a legal perspective, particularly because capital commitments in Colombia are irrevocable and must be disbursed, even despite the ESG considerations that investors may have. On the other hand, we have seen a growth in private equity deals on distressed assets after the pandemic crisis. We are witnessing the closing of many distressed M&A transactions that were negotiated after the pandemic and were waiting for all conditions precedent to be fulfilled during this year.



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