

likely to outperform both public markets and private equity indices while building a balanced and diversified portfolio that is therefore more likely to weather up and down market cycles. In order to achieve upper-quartile returns, most fund-of-fund managers make commitments to less than 25% of the funds in the market, negating the “index” effect. HarbourVest typically invests in only approximately 6% to 7% of funds in the market over an investment cycle. I don't think you can fairly call 7% representative of an index.

And what about broader challenges, and specifically the growing regulatory focus on the alternative investment fund industry from both the US and Europe... do you know yet what the impact on HarbourVest is likely to be?

We take an active interest in the proposed regulatory changes. Because HarbourVest is both an investor and a manager, we have a fundamental interest in the eventual shape of the regulation that is currently being debated both in Europe and in the US. With respect to the AIFM Directive, HarbourVest has been proactively engaged in lobbying for nearly a year, both through our membership in trade groups such as the EVCA, BVCA, ILPA, EMPEA, and LPEQ, and through direct dialogue and correspondence with Brussels politicians. As I speak, one of our London-based executives is in Brussels to engage on the AIFM Directive. But it is too early and unwise to make plans at this stage as the eventual shape of the AIFM Directive remains unclear.

Two things are certain, however: the first is that whatever the eventual regulation, it will not prevent another financial, market, or economic crisis in the future. Second, it will change business and investment models: costs of operation will rise; returns may fall as a consequence of the currently proposed reduced sphere of fund and manager choice; a second wave of extreme market volatility and price depression may result if investors are required to divest of current holdings that may become ineligible under the new regime; and some managers may withdraw from either investing in or raising money from Europe. On the other side of that coin, European investment in emerging markets may be sharply curtailed and innovation may be stymied as smaller businesses find themselves unable to support the costs of compliance that may result from private equity investment.

With respect to listed investment companies, we are disappointed that Brussels continues to believe that additional regulation is necessary. No one should underestimate the potential and long-term ramifications of the AIFM Directive as currently drafted.

By contrast, the US approach has generally been less controversial. That is not to say that HarbourVest is not focused on the areas where we believe there is room for improvement, but the proposals have been less politically motivated. HarbourVest is registered with the SEC and has been since the early 1980s, both in our current form and as our predecessor firm, Hancock Venture Partners, Inc. As such, we are already in compliance with the principal specifications of the Restoring American Financial Stability Act, which requires registration with the SEC and managers to maintain records and reports. With respect to the Volcker Rule, it is certainly possible that HarbourVest may be a beneficiary of the proposed prohibition on banks sponsoring and investing in private equity funds.

Time for a crystal ball moment – what's your prediction for how the fund of funds industry will develop over the next 10 years? Who will be the winners and who will be the losers?

Well, I have to start out by saying that I certainly wish I had a crystal ball, but I don't, and it is very difficult to predict anything in good or bad markets. The past 18 months have been a roller coaster, and I don't think anyone could have predicted what's happening now in both public and private markets. One day experts say we're on the road to recovery, and then a currency crisis hits Europe; we just never know what's going to happen next.

With respect to the fund of funds industry in general, we do expect some managers to slowly disappear as the industry undergoes a contraction. This could result in smaller funds, fewer managers and fewer investors (or LPs) as some decide that they can invest on their own or even abandon the asset class, venture capital in particular. We have already seen fundraising levels drop, with less than half of the capital raised in 2009 than in 2005, 2006 and 2007. We expect the industry to downsize, illustrated by less capital raised and invested. Those investors who have committed to private equity for the long term are going to look for the survivors, hopefully because

