AIMA JOURNAL

AIMA

The D&I data imperative
Simmons & Simmons

From niche to norm: Impact investing in agriculture continues to rise as investors recognise the opportunities associated with funding the future of food
INOKS Capital SA

Trend-following: What's not to like?
Man AHL

and more...

Edition 134 |Q2 2023 | aima.org

Contents

03 **The Long-Short Podcast**

04 **Message from AIMA's CEO Jack Inglis**

05 **AIMA Events**

06 **K&L Gates - Advert**

07 **RQC Group - Advert**

08 **Building the scalable future of capital markets** - *Clear Street*

12 **From niche to norm: Impact investing in agriculture continues to rise as investors recognise the opportunities associated with funding the future of food -** *INOKS Capital SA*

17 **Marketing sustainable investments in Europe and the UK: A path to clear blue water? -** *IQ-EQ*

22 **The D&I data imperative -** *Simmons & Simmons*

26 **Regulatory convergence sees proposed SEC rules echo FCA outsourcing standards -** *ACA Group*

32 **From risk disclosure to risk prevention: Up-levelling compliance for private fund advisers -** *AQMetrics*

36 **Trend-following: What's not to like? -** *Man AHL*

42 **Investing in real estate** - *Ninepoint Partners*

47 **Arbitrage for improving the performance of fixed income portfolios -** *Accelerate*

50 **The investor relations challenge -** *Dasseti*

54 **AIFMD 2.0 - The negotiations begin -** *Dechert LLP*

59 **ELTIF 2.0: Reforms set to drive significant growth in European private markets -** *State Street*

64 **Crypto as an asset class: Seeing past the volatility -** *KPMG*

69 **Five operational challenges facing the modern family office -** *SS&C Technology*

74 **Prime broking in a new era: Helping funds adjust to turbulent times -** *TD Cowen*

77 **Mitigation and insurance -** *WTW*

81 **NAV facilities gain momentum -** *Citco Capital Solutions Inc.*

83 **Mind the gap: Who will fill the void left by SVB tech lending? -** *Vistara Growth*

86 **Jersey funds in bespoke transaction structuring** - *Maples Group*

90 **Publication plan 2023**

91 **Contact us**

Important, please read:

The Alternative Investment Management Association Ltd (AIMA) holds the sole copyright for the AIMA Journal and all items therein for the purposes of controlling the copying, editing and re-distribution of all items by any other parties.

All those wishing to utilise part of all of any item within the AIMA Journal are required to obtain written permission from both AIMA and the author which will specifically outline the elements to be utilised together with the full distribution purpose and coverage.

The Long-Short

Podcast

AIMA

aima.org

Your window to the alternative investment universe

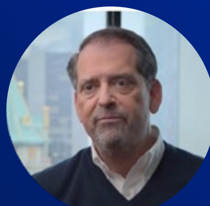
Hosted by

Tom Kehoe
Managing Director,
Global Head of Research and Communications
AIMA

Drew Nicol
Associate Director,
Research and Communications
AIMA

Latest guests include:

Robyn Grew,
President at Man Group



Bob Sloan
Founder and Managing Partner at S3 Partners

Elissa von Broembsen-Kluever
Partner and Managing Director at Omni Partners

Message from AIMA's CEO

I would like to open by welcoming the first contributions to this publication from writers that are not from AIMA members. By opening up the journal to non-members, we hope to bring a greater variety of perspectives on the alternative investment industry to better inform our global readership.

Not that the AIMA Journal has ever struggled with offering insights on a wide range of topics of the moment for the alternative investment industry. In fact, this edition is an exemplary one which takes readers on a journey through various jurisdictional and thematic trends of the moment.

The full breadth of ESG trends is addressed, with a compelling explainer on impact investing in agriculture, alongside an update on how regulators are increasingly scrutinising diversity in the financial services industry and are likely to require disclosure of certain metrics in the next few years.

Unsurprisingly, the significant US regulatory changes, including the recently confirmed Form PF final rule, are prominently discussed throughout the journal. In the EU, readers are also provided with the latest on the implementation of ELTIF 2.0 and the Trialogue negotiations on AIFMD 2.0. AIMA's Government and Regulatory Affairs team have been tirelessly working on all these live regulatory issues – and many more besides – and those seeking further information should visit the AIMA Newswire and the Compass section at AIMA.org.

Alongside the mega-trends of our industry, we are also happy to provide more granular articles that offer a walk-through of the market environments where trend following investment strategies perform best and how arbitrage can improve the performance of fixed-income portfolios.

Of course, the AIMA Journal covers all aspects of the alternatives investment industry, not just hedge funds. This edition features the latest data on capital flows into different segments of real estate investing. There is also an insightful review of the operational challenges facing family offices.

As always, my sincere thanks go to all those who contributed to this edition of the Journal. If you would like to contribute to our next edition, please contact my colleague Caterina Giordo who can advise on further details.

Sincerely,

Jack Inglis
CEO, AIMA

Upcoming AIMA conferences 2023

Learn, connect, collaborate.

7 Sep AIMA: Putting ESG into Practice 2023

14 Sep AIMA Australia Annual Forum 2023

4 Oct Alternative Credit Council Global Summit 2023

12-13 Oct AIMA Global Investor Forum 2023

19 Oct AIMA APAC Annual Forum 2023

7 Dec AIMA China Live 2023

For more information on AIMA's events, to view playbacks and to register for upcoming events visit www.aima.org/events

A GLOBAL PRESENCE. A WORLD OF EXPERIENCE.

Our Asset Management and Investment Funds practice has more than 160 lawyers in nearly 30 offices around the globe. We deliver the full range of legal services to a broad array of investment funds from regulated and mutual funds to many different types of alternative investment funds. Working across borders and across practices, we provide collaborative, comprehensive support to our clients. Our new Dublin office further expands our capabilities, providing a strategic new gateway to the global funds market.

With more than 850 fund clients around the globe, including some of the largest and best-known asset managers in the industry, we have the experience, knowledge, and skills to assist your company anywhere in the world.

K&L Gates LLP. Global counsel across five continents.
Learn more at klgates.com.

RQC GROUP

Helping you build your business by providing institutional-quality compliance infrastructure and advice that meets the expectations of regulators and institutional investors.

Compliance Consulting

Our team of FCA, SEC and CFTC/NFA compliance experts provide support and solutions tailored to your needs, including authorisation/registration, ongoing compliance support, health checks and ad-hoc projects.

Regulatory Hosting

Our experienced team of regulatory experts pragmatically manage your regulatory risk, leaving you to focus on the markets and attract institutional capital.

e-Learning

Our industry-leading CPD-certified online training courses deliver top quality, current and relevant content, in an engaging and entertaining way.

rqcgroup.com

Proud member of

Building the scalable future of capital markets

Modernising the post-trade for greater capital efficiency and reduced risk

Colin Bridges
Managing Director
Clear Street

Moore's Law observes that the number of transistors on a microchip doubles every two years, while its cost is halved over the same period. It has provided exponential growth in processing power for the past few decades, allowing many applications to improve performance by upgrading the hardware without fundamental architectural changes.[1]

In the decades since Intel co-founder Gordon E. Moore first made this observation in 1965, consumer technology has continued to rapidly innovate, while the technology powering capital markets has lagged behind. Although recent physical limitations have caused improvements related to Moore's law to taper off, advancements in distributed systems have continued the march of innovation. Much of the capital markets, on the other hand, have not taken advantage of such technological advancements and still operate in the past.

The €17 billion European post-trade industry plays a vital role in the securities markets, but it still relies on mainframe technology from the 1980s.[2] The result is fragmented systems and interfaces that leave market participants struggling to react to market changes and to meet the needs of data-hungry investors and regulators.

The mainframes that have supported global capital markets for decades were built to answer specific questions at a specific point in time. Over the years, modern technology has been layered on top of the antiquated infrastructure, only providing a temporary solution. Similar to building a new house on top of an old foundation, sooner or later the base will give way, and the whole structure will crumble.

Put simply, the silos have calcified over time to the point where it's easier for humans to talk to each other rather than find a way for the technologies to communicate. This tech debt creates broken processes that form the operational inefficiency that plagues firms today.

Investors, like all consumers, have become accustomed to on-demand service. They expect to be able to react quickly to market events and are looking to expand into alternative asset classes like crypto. Post-trade operations are challenged to keep up with these demands and provide the granularity, data visualisation, and user experience that investors and regulators need.

1 ACM News
2 The European Post-Trade Market

From cost center to competitive advantage

Modernising the post-trade tech stack is estimated to reduce costs by 20-30% in key areas like reference data management, reconciliations, clearing and settlement, middle office, regulatory reporting and overall application footprint.

For many firms, back-office processes are out of sight and out of mind—until something goes wrong. When factoring for borrowed stock, interest costs, balance sheet impact, and penalties, the cost of trade failure is substantial. A global trade failure rate of just 2% is estimated to result in costs and losses up to US$3 billion.[3]

In Europe, settlement failures have remained particularly high since the pandemic, fuelled by market volatility and ongoing pressure on a smaller number of operations staff.[4] Though the latest data shows a promising improvement in equities fail rates, fails remain a significant concern for both regulators and institutions.[5]

Adding to the pressure is the new Settlement Discipline Regime (SDR), which enforces penalties for failed trades in an effort to improve settlement discipline. Penalties range from 0.5-1 bps and apply to securities that are traded on an European Economic Area (EEA) exchange or cleared in an EEA central counterparty clearing house. Under these rules, central securities depositories impose the penalties on the counterparty responsible for the failed trade.[6]

As other regions—including the US, Canada, and India—announce their intention to shorten the settlement cycle, the Association for Financial Markets in Europe has launched a task force to explore whether Europe is right to follow the move to T+1.[7] Decreasing the number of days between execution and settlement will reduce counterparty, market, and credit risk across the settlement cycle, but the bulk of the cost introduced by the move to T+1 will be borne by broker-dealers, clearing firms, and prime brokers. Some firms may not be aware of the breadth of implications of T+1 internally and on their buy-side clients.

The antiquated technology that dominates the industry today will bring the mainframe batch cycle times in the compressed settlement cycle into question. Moreover, workflows will need to be reconsidered to reduce settlement failures and allow the move to T+1.

The solution is to minimise manual intervention in favour of automation and cloud-based solutions. Modernising the post-trade tech stack is estimated to reduce costs by 20-30% in key areas like reference data management, reconciliations, clearing and settlement, middle office, regulatory reporting, and overall application footprint.[8]

To operate at peak efficiency, banks and brokers must reduce the manual processes that increase risk of error and operate in silos in favour of technology that empowers users to make smarter decisions and to identify potential risks throughout the trading process.

3 DTCC, Roadmap to Automation
4 The Trade News
5 Global Custodian
6 Pershing
7 AFME
8 Broadridge, Advantage at Every Stage

Modern problems require modern solutions

The ripples of adoption are emerging across the industry—for example, in 2022 the London Stock Exchange (LSEG) partnered with Microsoft to architect LSEG's data infrastructure using the Microsoft Cloud, and to jointly develop new products and services for data and analytics.[9] The deal will explore the development of digital market infrastructure based on cloud technology, with a goal to transform how market participants interact with capital markets across a broad range of asset classes.

Simplifying the technology behind trading and post-trade functions can transform it from a cost centre to a competitive advantage. But for many firms, upgrading would require rewriting many systems with significant technical debt, with massive resourcing and planning costs—a daunting project with low chances of success.

Modern, high-performance computing coexists with COBOL, and microservices with mainframes. But as the value of data continues to rise, those who invest in the technology and capabilities to keep up with fast-paced, intraday market changes will come out on top.

It's time to update the infrastructure powering capital markets. A single source of truth platform has the potential to optimise operations across teams, asset classes and geographies, reducing cost, complexity and risk. In turn, this makes it easier for emerging managers, professional traders, and institutions to access capital markets.

To keep up with the accelerating pace of modernisation, firms will need to invest in technology to meet the needs of investors and regulators.

Those who do will be part of building the modern, scalable future of capital markets—improving access, speed, and service for all participants.

Simplifying the technology behind trading and post-trade functions can transform it from a cost centre to a competitive advantage.

9 LSEG

A New Era in Prime

The independent prime broker building financial infrastructure for today's institutions.

Our modern platform transforms the clearing, custody, execution, and prime brokerage experience.

Learn more at
clearstreet.io

Clear Street does not provide investment, legal, regulatory, tax, or compliance advice. Consult professionals in these fields to address your specific circumstances. These materials are: (i) solely an overview of Clear Street's products and services; (ii) provided for informational purposes only; and (iii) subject to change without notice or obligation to replace any information contained therein.

Products and services offered by Clear Street LLC, member FINRA and SIPC. Additional information about Clear Street is available on FINRA BrokerCheck (https://brokercheck.finra.org/firm/summary/288933), including its Customer Relationship Summary.

Copyright © 2023 Clear Street LLC. All rights reserved. CLEAR STREET and the Shield Logo are Registered Trademarks of Clear Street LLC.

From niche to norm: Impact investing in agriculture continues to rise as investors recognise the opportunities associated with funding the future of food

Giulia Schuck
Content & Public Relations Manager
INOKS Capital SA
Email Giulia Schuck

Over the past two decades, impact investing as a whole has gained traction, driven by the recognition of pressing global challenges and the potential for positive social and environmental impact alongside financial returns. The Global Impact Investing Network (GIIN) defines impact investments as those made with the intention to generate measurable social and environmental impact.[1]

As with other sectors, impact investing in agriculture should deliver much more than financial returns. It should aim to tackle any of the multifaceted challenges in order to contribute to building a sustainable food system capable of feeding the world's growing population while improving food security and nutrition; and reducing the carbon and water footprint. Capital flowing into food and agriculture value chains in emerging markets plays a crucial role in driving private sector economic growth in regions that need it the most.[2]

However, the need for sustainable agricultural practices is not limited to emerging markets. Developed markets within Europe also face considerable sustainability challenges, despite significant funding through programmes like the Common Agricultural Policy (CAP). Following reform, the EU's new farm deal was implemented from January 2023, worth €386.6 billion, reflecting the ongoing commitment to the sector, but highlighting the need for greater alignment and sustainability focus. [3]

Additionally, it is well-known that the agricultural sector, in its current form, is a major contributor to climate change and impact investments should contribute to adapt and mitigate its effects. With approximately one-third of human-caused greenhouse gas emissions linked to food production, there is a pressing need to rethink and transform food production methods. This transition requires substantial investment in sustainable practices, technologies, and infrastructure.

The evolution of impact investing in agriculture has been remarkable, and the sector is expected to continue expanding.[4] More institutional investors are expressing interest in the sector, recognising the potential for financial returns alongside the opportunity to create positive social and environmental outcomes.

1 GIIN. What you need to know about impact investing, available at: https://thegiin.org/impact-investing/need-to-know/
2 Harry Trick. Michel Mores. 2023. Impact investing in agriculture.
3 Kate Abnett. REUTERS. 2021. EU strikes deal on huge farm subsidies, ending three years of negotiations, available at: https://www.reuters.com/world/europe/late-night-breakthrough-brings-eu-closer-deal-farm-subsidies-2021-06-25/
4 Roberto Vitón. Le Déméter. 2022. Chapter: Investment Funds in the Food and Agriculture Sector: A Fertile Ground for Investors.

Market overview: impact investing and the agricultural sector

According to the Global Impact Investing Network (GIIN), the market counts over 3,349 organisations managing US$1.164 trillion in impact investments as of 2021.[5] Furthermore, the impact investing market research report from The Business Research Company highlights the market's impressive growth, with a compound annual growth rate (CAGR) of 17.8% between 2022 and 2023.[6]

Within the global market estimated by the GIIN, Swiss impact investing specialist Tameo estimates that US$84 billion is invested in private asset impact funds focusing on emerging and frontier markets. Its 2022 Private Asset Impact Fund (PAIF) report identified 672 funds run by 346 fund managers. The impact sector of food and agriculture represents merely 8% of funds' portfolios, where about 50% is dedicated to microfinance and 24% to SME development.[7] The sector's investor composition is dominated by institutional investors (59%), followed by almost 30% public funders and about 15% retail and HNWIs.

The agricultural sector holds immense potential for impact investors to drive positive change on various fronts. With nearly 900 million people employed in the sector worldwide, investing in agriculture can have significant social, economic, and environmental impacts.

The number of investment funds specialised in the sector keeps rising. In 2022, there were 730 investment funds specialised in food and agriculture, compared to fewer than 50 in 2005.[8] It remains surprising though, given the size of the market, that the number of fund managers in this space is not increasing even more rapidly.

The agricultural sector holds immense potential for impact investors to drive positive change on various fronts. With nearly 900 million people employed in the sector worldwide,[9] investing in agriculture can have significant social, economic, and environmental impacts.

The sector's contribution to the economy is substantial. For example, in the United States, food and related industries make a significant contribution to the country's gross domestic product (GDP), amounting to approximately US$1.264 trillion in 2021.[10] This highlights the economic value generated by the sector and underscores the opportunity for impact investors to support and enhance its sustainable growth.

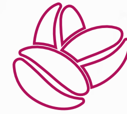
Similarly, in Europe, the farm sector's value goes beyond agricultural production. With a multiplier effect, each euro spent in the sector generates an additional €0.76, contributing to the gross value added of over €178.4 billion for the EU economy.[11]

5 Global Impact Investing Network (GIIN). 2022. *Sizing the Impact Investing Market 2022.*
6 The Business Research Company. Impact Investing Global Market Report 2023, available at: https://www.thebusinessresearchcompany.com/report/impact-investing-global-market-report
7 Tameo. 2022 PAIF Report.
8 Roberto Vitón. Le Déméter. 2022. Chapter: Investment Funds in the Food and Agriculture Sector: A Fertile Ground for Investors.
9 World Bank. 2020. Employment in agriculture, available at: https://www.stepstonegroup.com/wp-content/uploads/2022/11/Agriculture_-Ripe-for-Institutional-Investment.pdf
10 USDA. What is agriculture's share of the overall U.S. economy?, available at: https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/ag-and-food-sectors-and-the-economy/
11 News European Parliament. 2021. EU agriculture statistics: subsidies, jobs, production (infographic), available at: https://www.europarl.europa.eu/news/en/headlines/priorities/agriculture-and-food/20211118STO17609/eu-agriculture-statistics-subsidies-jobs-production-infographic

This demonstrates the interconnections between agriculture and the broader economy, emphasising the potential for impact investments to foster economic development, job creation, and regional prosperity.

Challenges and opportunities

The challenges and opportunities within the agricultural sector for impact investors encompass a range of factors such as climate change, access to capital, education, and food security. By addressing these challenges, investors have the opportunity to achieve both financial returns and positive social and environmental impact.



Coffee, being one of the world's most widely consumed beverages, provides a compelling example to highlight the challenges and opportunities within the agricultural sector for impact investors.

Coffee, being one of the world's most widely consumed beverages, provides a compelling example to highlight the challenges and opportunities within the agricultural sector for impact investors. It is one of the most valuable and widely traded tropical agricultural products with 80% of its production attributed to smallholder farmers. The livelihoods of approximately 125 million people worldwide rely on it.[12]

Climate change

Climate change poses a significant challenge for the sector and beyond. However, it also presents an opportunity for sustainable and regenerative practices to mitigate negative effects. The food system contributes to approximately 30% of the global energy consumption, with a significant portion still relying on fossil fuels that produce greenhouse gas emissions.[13] Impact investors can support and invest in climate-smart agricultural practices and technologies that improve resilience, conserve natural resources, and reduce greenhouse gas emissions. Examples include agroforestry, precision farming, sustainable irrigation systems, and climate-resilient crop varieties.

Access to finance, education and technology

Smallholder coffee farmers often face difficulties in accessing capital, limiting their ability to invest in modern farming techniques, infrastructure, and technology that could enhance sustainability. Similarly, lack of education can impede the adoption of sustainable farming practices, limiting productivity and efficiency across the entire value chain. Impact investors can play a vital role by providing financial and non-financial additionality, investing in initiatives that provide financial services and promote education and training, empowering farmers to adopt sustainable practices and improve productivity.

Food security and nutrition

Investing in sustainable food production and agricultural productivity contributes to building a future-fit food system, addressing global food security challenges. Impact investments in infrastructure, technology, and logistics can strengthen supply chains, improve efficiency, and reduce post-harvest losses, ensuring access to nutritious food.

12 Food and Agriculture Organisation of the United Nations (FAO). Markets and Trades. Commodities. Coffee. Available at: https://www.fao.org/markets-and-trade/commodities/coffee/en/

13 United Nations. The Science. Climate Action Fast Facts. 2022. On climate, food and agriculture, available at: https://www.un.org/sites/un2.un.org/files/fastfacts-food-and-agriculture-february-2022.pdf

Risk mitigation

Impact investing in agriculture can help mitigate risks associated with climate change and resource scarcity on one hand. On the other hand, risk management and mitigation are key to protecting investments. Investors can employ financial due diligence, diversification, technical assistance and capacity building which can help mitigate risks related to knowledge gaps and lack of skills, collateral control, insurance and risk-sharing mechanisms, partnerships with local stakeholders, regular monitoring and impact assessment and legal due diligence to manage risks effectively.

Portfolio diversification and further benefits

Impact investments in agriculture have the potential to deliver competitive financial returns. According to the GIIN's 2020 Annual Impact Investor Survey,[14] the majority of impact investors opt for market-competitive and market-beating returns, while a small percentage intentionally pursue below-market-rate returns matching their strategic goals.

Agriculture impact investing provides an opportunity to diversify investment portfolios. Historically, agriculture has shown low correlation with other asset classes such as stocks or bonds, which can help reduce overall portfolio risk and increase potential returns.[15] Investors can benefit from capital appreciation, dividend payments, and other financial incentives.

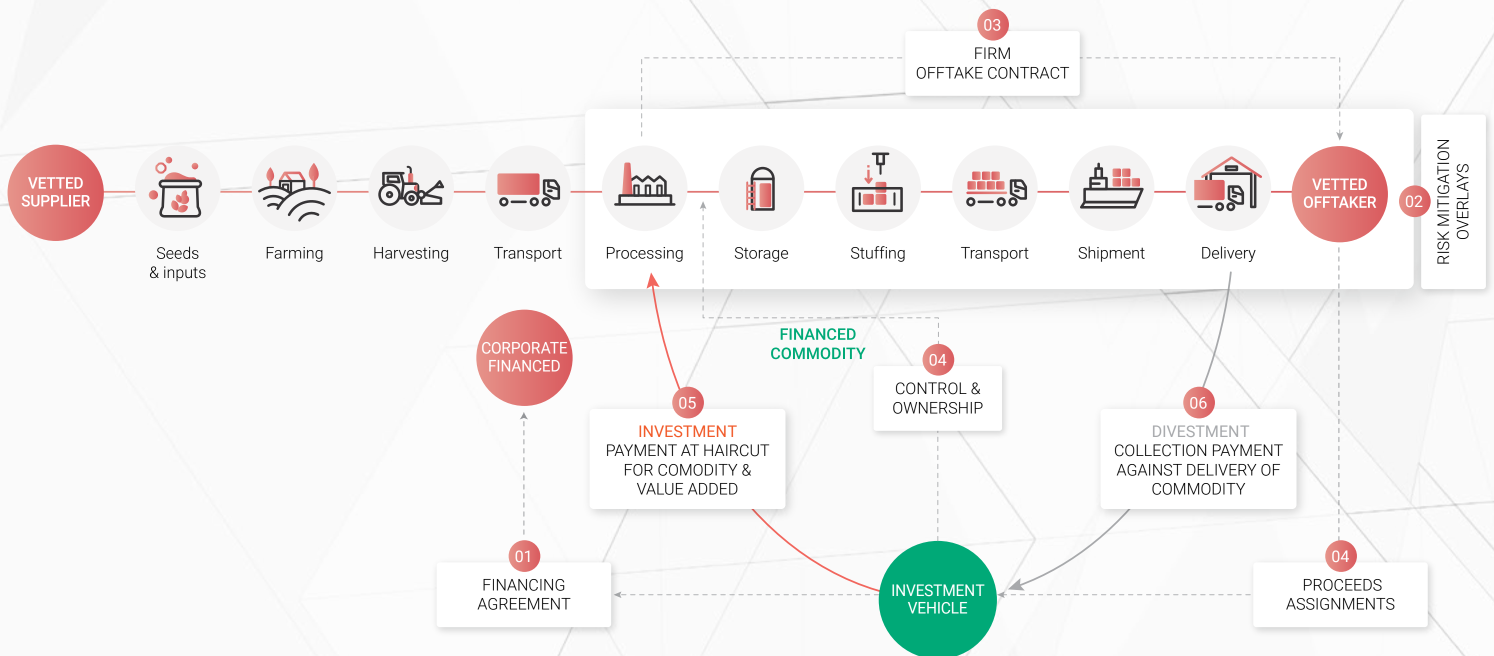


Figure1. Example of a transparent investment structure and sequence (post-harvest).

14 GIIN. 2020. *Annual Impact Investor Survey.*
15 Stepstone. 2020. *Agriculture: Ripe for Institutional Investment,* available at: https://www.stepstonegroup.com/news-insights/agriculture-ripe-for-institutional-investment/

A promising outlook

To conclude, it is essential for agriculture impact investors to navigate these challenges effectively, leverage the opportunities, and adopt a long-term perspective to achieve sustainable and impactful outcomes.

Asset managers should take note of the growing investor interest in alternative investments and the escalating demand for sustainable investing, as these trends will shape the industry's trajectory.[16] Surpassing the US$1 trillion milestone in impact investing reflects remarkable growth,[17] establishing impact investing as a significant component of sustainable finance, with potential for further integration into mainstream capital markets. The broader sustainable finance landscape, valued at US$35 trillion, emphasises the growing importance of impact investing and ESG integration strategies.[18]

Although institutional investors' allocation remains limited, there is potential for further progression as investors recognise the value of combining financial returns with positive social and environmental impact. The institutionalisation of the agriculture impact investing asset class is expected to accelerate with the increasing challenges around food production, driving the expansion of green finance vehicles.

The growth of this asset class and the developing interest from institutional investors point to a promising future for impact investments in agriculture, enabling investors to address global challenges, promote sustainability, and combat climate change. By actively engaging in this sector, stakeholders can contribute to building a more sustainable and efficient food production system while achieving their financial goals.

16 Boston Consulting Group. 2022. Global Asset Management 2022: From Tailwinds to Turbulence.
17 Tameo. 2022 PAIF Report.
18 Global Sustainable Investment Alliance. 2021. The Global Sustainable Investment Review 2020.

Marketing sustainable investments in Europe and the UK: A path to clear blue water?

Andrew Shrimpton
Chair, UK Regulatory & Compliance Solutions
IQ-EQ

Rachel Aldridge
Managing Director, UK Regulatory & Compliance Solutions
IQ-EQ

Sarmad Naim
Principal Consultant
IQ-EQ

Keeping up with the rapid pace of regulatory change can be exhausting - but when it comes to sustainability disclosures and environmental, social and governance (ESG) - related compliance, fund managers would do well to pay attention.

For the first time since Brexit, UK-based fund managers have a strategic choice to make about the sustainability regimes they will participate in. Each option contains unique pros and cons, so managers must understand each regime well to extrapolate their long-term impact. In addition, non-UK based fund managers aiming to target UK investors may benefit from a high-level understanding of the regime being developed in the UK, as it may allow future-proofing of their offering and align their internal ESG / Sustainable Finance Disclosure Regulation (SFDR) compliance.

At present, there are two primary regimes for fund managers to grapple with: the UK Sustainability Disclosure Requirements (SDR), and the EU SFDR. Managers must understand the key practical differences between the two to make good decisions about how they market funds in the UK, the EU, or both.

SFDR and SDR: an overview

SFDR

The EU's Sustainable Finance Disclosure Regulation (SFDR), introduced by the European Commission in 2018, outlines sustainability disclosure requirements for investment firms and managers. SFDR applies to entities established in the EU and products marketed in the EU, regardless of the marketing entity's location.

SFDR aligns with the UN General Assembly's 2030 Agenda for Sustainable Development, which includes a broad scope of still-developing ESG indicators and metrics, including the Sustainable Development Goals (SDGs). SFDR also introduces Principal Adverse Impacts (PAIs), which take into account the impact of respective firms on the wider society, even when those matters may not impact the investment value.

PAIs are also used for a 'do no significant harm' test for 'sustainable' investments, so that such investments do not cherry-pick certain sustainable objectives while causing societal harm. SFDR further offers the possibility of aligning products to a taxonomy, thus aiming to create another level of assurance for sustainability focused investors.

*SDR is expected to come into effect in **Q3 2023**, along with clarifications on greenwashing. Funds that make sustainability claims should review their marketing prior to Q3 and ensure that it is clear, fair and does not mislead investors.*

Large EU-based companies and all companies with securities listed in an EU-regulated market also fall within the scope of the Corporate Sustainability Reporting Directive (CSRD), a set of corporate sustainability reporting rules initially designed for large firms. Companies in scope of CSRD will soon be required to report on their sustainability-related impacts, risks and opportunities, including those represented by their value chain.
SFDR has been in effect since 10 March 2021, but with significant changes unfolding at the time of writing.

SDR

The UK's Sustainability Disclosure Requirements (SDR), aims to provide investors with more accurate, consistent and easily comparable sustainability information and is currently in consultation with the Policy Statement due in the third quarter of 2023. It has as its starting point the recommendations of the international Task Force on Climate-Related Financial Disclosures (TCFD), a globally standardised framework focused solely on climate-related metrics.

However, SDR goes beyond climate and also embeds other ESG considerations. SDR does not contain a 'do no significant harm' test, which the FCA views as too restrictive, nor does it reference reporting of PAIs. SDR also does not include references to taxonomy alignment, though this will likely change when a UK taxonomy is developed.

SDR is expected to come into effect in Q3 2023, along with clarifications on greenwashing. Funds that make sustainability claims should review their marketing prior to Q3 and ensure that it is clear, fair and does not mislead investors.

Post-Brexit divergence

There's no 'chicken or egg' about it - in the world of sustainability disclosures, SFDR came first, enabling the FCA to make deliberate policy decisions based on lessons learned from its rollout. SDR also received more industry-wide engagement than EU regulators had available before SFDR was rolled out. Because of that timeline, SDR enjoys some of the advantages of hindsight. On the other hand, significant uncertainties remain for the brand-new regime, such as a lack of clarity on whether non-UK funds will be within the scope of SDR.

In many ways, SFDR and SDR are each the inverse of the other. SFDR began as a disclosure regime that ultimately became known as a hierarchical labelling regime. UK regulators thus started SDR as a labelling regime, eliminating the hierarchy - but there's a good chance that it will ultimately become a disclosure regime.

At their core, SFDR and SDR are both designed to increase investor trust, combat greenwashing, increase transparency around sustainable finance, and empower investors to make better-informed decisions.

For the first time since Brexit, UK-based fund managers have a choice about the sustainability disclosure regulations they will adhere to. They have no obligation to comply with SFDR unless they are marketing funds to European investors under the National Private Placement Regime (NPPR). Managers who opt to market funds in the EU will need to adhere to the requirements of both jurisdictions.

Key differences between SFDR and SDR

At their core, SFDR and SDR are both designed to increase investor trust, combat greenwashing, increase transparency around sustainable finance, and empower investors to make better-informed decisions. However, the mechanisms they employ to achieve those ends differ in a few keyways.

SDR will employ three labels: focus, improvers, and impact. These labels do not correspond to the three categories in SFDR (Article 6, Article 8 and Article 9). Through SDR, the FCA is working against *"exaggerated, misleading or unsubstantiated claims"* within sustainable investment products. Consumer-related disclosures are meant to help investors understand the key sustainability features of an investment product and compare different products to each other.

Importantly, SDR's labels are not hierarchical. Instead, they are reflective of consumer preferences:

- **Sustainable focus:** Funds that mainly have an environmentally or socially sustainable focus. This label suggests a high standard of sustainability, particularly as it comes with a minimum threshold of sustainable assets (70%) in which the fund must invest

- **Sustainable improvers:** Funds that may not currently be sustainable but aim to make a positive environmental or social impact in future. This label highlights the concept of *stewardship* and making measurable improvements to underlying ESG performance

- **Sustainable impact:** Funds that invest in real-world problems and achieve measurable real-world contributions to ESG outcomes. There is no minimum sustainable investment required under this label, which includes products with a specific ESG outcome as an objective

SFDR classifies funds as Article 6, 8 or 9, depending on their characteristics. These categories are not labels as such, but instead represent the level of disclosures that the fund must make.

- **Article 6:** Funds without a sustainability scope
- **Article 8:** Funds that promote ESG characteristics
- **Article 9:** Funds with sustainable investment as their core objective

Sustainability remains a bright spot within a tumultuous global economy.

SFDR's Article 8 category does not currently include minimum criteria for a percentage of assets with ESG characteristics, which at times may provide an easy ESG label for firms and could lead to greenwashing. Proposed changes to SFDR include stricter guidelines, such as minimum safeguards based on Paris-aligned benchmarks, an 80% investment threshold for funds with ESG and related terms in the name, and a 50% threshold for funds named with sustainability-related terms.

How should managers navigate?

The FCA has provided mapping to SFDR in a consultation paper, but mapping pathways are not always clear. A firm could offer an investment product that qualifies as Article 8 or 9 under SFDR but does not meet the qualifying criteria for investment labels under SDR, which may create market confusion.

Regardless of where UK-based managers intend to market, firms with *green funds* should undertake a structured greenwashing review of client communications to show regulators that they have acted with due care, skill and diligence under PRIN 2 of the FCA Handbook, identifying sustainability-related claims and controls in place to ensure consistency with the fund profile. This will prepare them for SDR and will help pave the way for SFDR disclosures, should funds choose to market to European investors.

On the whole, the post-Brexit landscape brings with it some strategic decision-making for managers of green funds. SFDR is the more onerous regime in terms of disclosures and compliance, but it also enables access to European investment capital. However, SDR is as yet untested, and time will tell whether it, too, has unforeseen consequences that require additional rulemaking. (The initial implementation has already been pushed back and the FCA are committed to a consultation on overseas funds.)

Wherever managers opt to market funds, one point is clear: sustainability remains a bright spot within a tumultuous global economy. Though sustainability regulations differ, fund capital is primed to support ESG initiatives throughout the UK and Europe.

IQEQ

Know how Know you

Fund focused People centric

An investor services group that brings together that rare combination of global expertise with a deep understanding of the needs of fund managers.

Our expertise

- Private Equity
- Venture Capital
- Real Estate
- Debt
- Credit
- Hedge
- Energy
- Infrastructure
- Digital Assets
- Hybrid Funds

www.iqeq.com/funds

For information on the regulatory status of IQ-EQ companies, visit www.iqeq.com/legal-and-compliance

Dan Ornstein
Partner
Simmons & Simmons

Lauren Dickinson
Supervising Associate, Employment Solicitor
Simmons & Simmons

The D&I data imperative

Asset managers are taking the diversity and inclusion (D&I) of their people more seriously than ever. Some are recognising the business value of a diverse workforce and leadership, others want to get ahead of predicted regulatory scrutiny, many are responding to institutional investor questions about the D&I of employees and leaders.

Whatever combination of factors are driving a firm to address its D&I strategy, or simply take stock of its current composition, data is likely to be one of the early areas of focus. D&I data is, broadly speaking, information about the diversity characteristics of the people who make up the organisation. This might include information about characteristics such as race, ethnicity, sex, gender identity, disability, caring responsibilities and socio-economic background. Some firms might also include measures of employee sentiment about whether people feel the environment is inclusive and whether they feel able to express their whole identity in the workplace.

There are a number of reasons why data is such an important part of the broader focus on D&I amongst asset managers:

- Firms need to understand their current position to set D&I strategy and identify areas of focus. It can be tempting to rely on industry generalisations such as there being fewer females in asset management. But this might not be the most pressing issue at any particular firm.

- Regulators are increasingly scrutinising diversity in the financial services industry and are likely to start requiring disclosure of certain metrics within the next couple of years. In the UK for example, at the time of writing the imminent release of the Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA) and Bank of England (BOE) consultation on D&I is expected which is likely to include a requirement for firms over a certain size to disclose diversity data about their boards, senior managers and employees. It remains to be seen whether such requirement will be a public disclosure.

- Asset managers will need to disclose certain diversity data in some countries, now and or in the near future. For example, any firm with 250 or more employees must report its gender pay gap. The EU Directive on Pay Transparency will also within the next few years require firms with 100 or more employees in an EU country to report the pay gap between male and female employees. Certain firms will also be subject to other diversity reporting requirements depending on the type of entities they operate from.

- Institutional investors are regularly asking for information about D&I composition in due diligence (DD) questions and are declining to invest where minimum criteria is not met. There is a significant focus on board diversity in this respect.

- Firms who have or are putting diversity initiatives in place will need D&I data will for evaluating success of D&I strategy and communicating that success externally.

International issues

For asset managers with international operations, it can be challenging to even get off the starting block and decide what questions to ask employees about their diversity characteristics and what optional answers to provide.

Often, D&I data collection will be led from HQ. This presents challenges in other international locations. Diversity characteristics tend to be categorised differently or have different terms in different countries. One of the most challenging areas in this respect is asking about race and ethnicity. Most diversity surveys give respondents a range of options to choose from as to their race and/or ethnicity (as well as having a free text option and an option for employees who prefer not to say). That list will usually include the major racial and ethnic groups represented in the country in which it was devised.

Firms can come unstuck when they try to apply that same list of options in response to a race and/or ethnicity question to every country in which they have employees. Doing so has the superficial attraction of gaining a consistent data set internationally. But it is unlikely to be an effective approach overall. There's a high risk that people in other countries will not recognise their own racial identity or ethnicity in the list. This can in itself lead to a feeling of not being included and alienated. On a micro-level, this might put someone off filling in the survey and lead to under-reporting of employees from minority groups. More significantly, it can leave individuals and whole groups of employees feeling that they are not recognised by the firm.

Diversity characteristics tend to be categorised differently or have different terms in different countries. One of the most challenging areas in this respect is asking about race and ethnicity.

Often, the best approach will be to adopt government guidance in each country where the survey has been carried out. Usually, it will be good practice to use the options given in the national census as these should reflect the general population.

Firms are also increasingly asking employees about the socio-economic background of employees as this is being recognised as a key piece in the D&I picture. In the UK, it is expected that the FCA, PRA and BOE consultation on D&I in financial services will include some draft requirements in relation to collecting data about socio-economic background. Such questions are however inherently country specific so international firms will need to consider how they are applied in different countries.

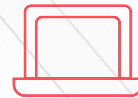
There are also country to country differences in what diversity information employees are asked to provide. In some countries, certain questions are considered particularly intrusive, such as asking about sexuality or marital status. There are also outright restrictions on asking for certain information in some countries.

Data protection

In almost any country in which a firm intends to collect D&I information about employees, it will need to consider data protection and privacy issues. Much of the data is likely to be specially protected in law. For example, in the UK and in EU countries, data about racial or ethnic origin, religion, health and sexual orientation are special category personal data and more stringent rules apply in relation to collecting it.

One option some firms take to reduce data protection issues is to collect data anonymously. This can be appealing because it is in many ways a more straightforward and easier option. There are a few drawbacks firms should be aware of:

- It can be difficult to ensure true anonymity. In small to medium sized organisations, there may be certain characteristics which only one individual possesses and therefore can be identified – for example they may be the only person of a particular race. This challenge is amplified if certain types of diversity are already low.
- It is increasingly recognised that understanding intersectionality is important in understanding and addressing diversity and inclusion issues. Intersectionality refers to the interaction of two or more diversity characteristics and the unique dynamics this may create. It is difficult to do this on an anonymised basis as it would likely lead to identification of individuals.
- The most effective D&I initiatives are likely to address how certain diverse characteristics impact career progression, talent retentions and pay. It is very difficult to track this on an anonymous basis.



In almost any country in which a firm intends to collect D&I information about employees, it will need to consider data protection and privacy issues.

Much of the data is likely to be specially protected in law.

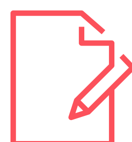
The outlook

Asset managers will realise value in getting their D&I data collection in order sooner rather than later. Collecting data regularly (annually), in a carefully considered way and reporting back to employees on areas that are being addressed creates a virtuous cycle of engagement and improvement. Firms may find themselves in a difficult position if they have to provide hastily collected data to a regulator or investor which shows a lack of diversity.

Investor Insights

Investor Insights allows you to create tailored reports including only the specific prospective investors you are planning to market investment funds and investment management services to. This way you can plan your marketing activities in the Middle East in advance in a targeted and user-friendly way. This service leverages the many years of experience we have in the Middle East, a diverse and ever-changing region.

Expertise plus technology
A combination of our legal expertise and technology means faster responses to your requests. We can also provide secure online access to this service.



Bespoke reports
We'll tailor your reports to only cover the specific prospective investors you are interested in marketing to.

Tailored training
We can help your people get the most out of our service with a tailored training and development programme.

Backed by decades of experience in the Middle East
We've advised clients on the Middle East for more than 40 years. We have developed Investor Insights based on this experience and are constantly expanding and refining our guidance.

Interested? Get in touch.

Muneer Khan
Partner, Dubai
T: +9714 709 6600
E: muneer.khan@simmons-simmons.com

simmons-simmons.com

© Simmons & Simmons LLP and its licensors. All rights asserted and reserved. This document is for general guidance only. It does not contain definitive advice.

Simmons & Simmons LLP is a limited liability partnership registered in England & Wales with number OC352713 and with its registered office at CityPoint, One Ropemaker Street, London EC2Y 9SS, United Kingdom. It is authorised and regulated by the Solicitors Regulation Authority and its SRA ID number is 533587. The word "partner" refers to a member of Simmons & Simmons LLP or one of its affiliates, or an employee or consultant with equivalent standing and qualifications. A list of members and other partners together with their professional qualifications is available for inspection at the above address.

Regulatory convergence sees proposed SEC rules echo FCA outsourcing standards

Dan Campbell
Director, US Regulatory Advisory
ACA Group
Email Dan Campbell

Andrew Poole
Director, UK Regulatory Advisory
ACA Group
Email Andrew Poole

In November 2022, the US Securities and Exchange Commission (SEC) released its proposed rule, Rule 206(4)-11, which prohibits registered investment advisers from outsourcing certain services or functions without first meeting minimum requirements. The proposed rule requires investment advisers to ensure that critical third-party service providers have the competence, capacity, and resources necessary to do their job before engagement and periodically confirm that this is still the case. The proposed rule also states advisers would need to maintain certain books and records evidencing due diligence efforts.

Service providers may perform several functions that relate to an adviser's business. Supporting functions may include investment research and data analytics, trade and risk management, fund administration, outsourced IT support, and compliance. This new rule is set to introduce requirements concerning diligence and oversight of certain critical service providers that perform key functions, have access to sensitive information, and may store certain required records on behalf of the adviser.

Regulated firms in the UK have long been required to document the due diligence performed on vendors when considering outsourcing functions and, under certain circumstances, must inform the Financial Conduct Authority (FCA) of such outsourcing arrangements. These arrangements are defined as *"material outsourcing"* arrangements and are similar to those within the proposed SEC rules.

Key elements of the proposal

The proposed SEC rule applies to service providers that perform a 'covered function', which is defined as:

1. A function or service that is necessary for the adviser to provide its investment advisory services in compliance with federal securities laws.

2. Those functions that, if not performed or performed negligently, would be reasonably likely to cause a material negative impact on the adviser's clients or the adviser's ability to provide investment advisory services.

In the proposed rule, the SEC provided the following examples for service providers that would and would not be performing covered functions:

1. An adviser that enters into a written agreement with a valuation provider to value all of its clients' fixed income securities would be considered a serviced provider under the proposed rule to perform a function necessary for the adviser to provide its advisory services.

2. The proposed rule would not cover a custodian retained through a written agreement directly with a client because the adviser is not retaining the service provider to perform a function necessary for the adviser to provide its advisory services.

These definitions echo of the definition of *"Material Outsourcing"* in the FCA Handbook, namely being duties that a weakness or failure of the services would cast serious doubt upon the firm's continuing satisfaction of the threshold conditions. i.e., If the functions aren't performed, a firm probably is not up to the required regulatory standards.

For a list of functions and related topics potentially covered under the SEC's proposed rule, please see the "Recordkeeping and Form ADV" section below.

Regarding the second element of the proposed SEC definition, advisers should consider their service providers and determine potential material impacts if the service provider didn't perform its functions or services adequately. The following example was provided:

> *"If an adviser used a service provider for portfolio management functions that experience a cyber-incident that caused an inability for the adviser to monitor risks in client portfolios properly, it would be reasonably likely to cause a material negative impact on the adviser's clients and its ability to provide investment advisory services."*

The basic framework requires an initial determination to outsource, onboarding due diligence and ongoing monitoring, a process for ending the service provider relationship, and recordkeeping.

Due diligence

As with FCA requirements, an SEC registered adviser will have to "reasonably identify and determine" that outsourcing the covered function would be appropriate, addressing the following areas in their due diligence:

1. Nature and scope of services;

2. Potential risks resulting from the service provider performing the covered function, including how to mitigate and manage such risks;

3. Service providers' competence, capacity, and resources necessary to perform the covered function;

4. Service providers subcontracting arrangements related to the covered function;

5. Coordination with the service provider for federal securities law compliance;

6. The orderly termination of the service provider's services.

The adviser must then determine that the service provider it selects is appropriately performing its function(s). This means periodically monitoring the service provider's performance and reassessing if performance is as expected.

The FCA also requires an assessment of the service provider's financial stability and expertise.

Recordkeeping and Form ADV

The proposed rule includes changes to the recordkeeping rule to include:

1. A list of covered functions outsourced and service providers used;
2. Records documenting initial diligence and monitoring of each service provider; and
3. Advisers must obtain reasonable assurance that the service provider can meet four standards specific to recordkeeping:
    a. Adopt and implement internal processes or systems for keeping records that meet the requirements of the recordkeeping rule applicable to the adviser;
    b. Maintain records that meet the requirements of the recordkeeping rule applicable to the adviser;
    c. Provide access to electronic records; and
    d. Ensure the continued availability of records if the third party's operations or relationship with the adviser ceases.

The proposed rule also includes amendments to Form ADV that require firms to disclose their outsourced service providers, indicating the functions the SEC considers covered.

Challenges for hedge fund managers

Smaller advisers will likely bear a greater burden as annual time and cost estimates for small advisers to comply with the new rule are thought to be close to 196 hours, with an aggregate cost of US$27,698,987(US$58,808 per small adviser). Small advisers have the greatest incentive and need for outsourcing, benefitting the most from it. Conversely, they also have fewer resources to comply with these prescriptive requirements.

Interestingly, the SEC acknowledges that determining whether an outsourced function is covered by the rule is complicated to do this initial analysis has a cost. Moreover, if advisers interpret covered functions too conservatively, they may spend more money performing extensive due diligence than required.

> *"This analysis may be particularly costly for certain functions for which it may require thorough investigation to evaluate whether the function is necessary for the adviser to provide investment advisory services, or for which it may require thorough investigation to evaluate whether there would be a material negative impact on the adviser's clients or on the adviser's ability to provide investment advisory services if the function was not performed, or if performed negligently."*

One cost driver is analysing the performance of covered functions. Because this term is vague, firms will engage outside parties and experts to determine which third-party service providers meet this definition. The rule also includes other ambiguities, such as what it means to "reasonably identify and determine" the appropriateness of outsourcing the covered function. Advisers will also need to identify the risks involved in hiring the service provider and how to manage such risks. In addition to paying experts for advice on these issues, managers will remain at risk of incorrect interpretations.

The proposed rule includes reasonable language, similar to the Compliance Program Rule (Rule 206(4)-7); however, as shown by some SEC settlements citing violations of the Compliance Program Rule, the SEC has trended towards applying a stricter liability standard. There are other similar minefields to be considered, including whether a firm has sufficiently identified potential risks from the service provider performing the covered function and how to mitigate and manage such risks.

Another issue for advisers would be service providers providing *"reasonable assurances"* that they have processes or systems for keeping records meeting the Advisers Act recordkeeping requirements. Service providers may be reluctant to agree to such terms or would have to implement additional controls and procedures ultimately recouped through higher costs and fees passed onto managers. Service providers may also charge advisers to access records after the relationship is terminated.

Key takeaways

In the event of the SEC adopting these proposed requirements, managers will need to create an inventory of current service providers and rank them based on their function within the investment management process. Firms would also need to include third parties that provide the following services:

- Assistance with monitoring investment guidelines and restrictions
- Client servicing
- Cyber security
- Fund administration
- Investment risk monitoring
- Portfolio accounting
- Portfolio management
- Reconciliation
- Regulatory compliance
- Subadvisory
- Technology that drives portfolio decisions
- Trading
- Valuation

Managers will have to document why these services were outsourced and the criteria for selecting the specific providers.

In addition, a review of books and records maintained by third-party service providers will be required, and a determination if they would be able to produce records during an SEC examination. Moreover, firms would have to consider options should a service provider be terminated. Will the service provider download the records in a format accessible to the adviser prior to termination? Should the adviser consider periodic downloads of records to ensure its recordkeeping obligations are met? Managers will need to know the answers to these questions prior to SEC staff conducting examinations.

Finally, managers should consider if altering or removing clauses in investment agreements seeking to limit the liability associated with acts and omissions of an engaged third-party service provider puts them at odds with the intent of the proposed rule.

Working with a trusted and established outsourced provider with extensive policies, procedures and controls will be key to helping to address regulatory concerns and minimise potential issues.

Will the service provider download the records in a format accessible to the adviser prior to termination?

Should the adviser consider periodic downloads of records to ensure its recordkeeping obligations are met?

Ready to reimagine your governance, risk & compliance?

Geopolitical tensions, macro-economic pressures, and a global pandemic heralded sweeping changes to the ways financial services firms operate.

Compliance and risk leaders must embrace change and modernization to reimagine their operational functions and to drive cost savings while maintaining effectiveness.

We are here to help you:

» transform and streamline your compliance and risk functions with our smart regulatory technology

» reinforce your compliance team's responsibilities through our advisory services, outsourced resources, and staffing solutions

» drive operational resilience to optimize cyber, business continuity, and third-party risk management

Speak to our dedicated GRC specialists to learn more about our wide range of solutions designed to help you protect and grow your business.

www.acaglobal.com

info@acaglobal.com

U.S. +1 212.951.1030 | UK +44 (0) 20 7042 0500

From risk disclosure to risk prevention: Up-levelling compliance for private fund advisers

Geraldine Gibson-Dautun
CEO
AQMetrics

Introduction

Regulators are moving the onus on private fund advisers away from risk disclosure and towards risk prevention. To date in 2023 the regulatory burden faced by private fund advisers in the United States has grown significantly. This article examines why the burden has increased and how private fund advisers have to become more data savvy than ever before in order to comply with emerging regulatory change and move on from risk disclosure to risk prevention.

A whole new world of risk and compliance automation for private fund advisers

There is no doubt that the pace of innovation in private markets and the potential for disruption has accelerated. Investors and regulators alike expect frictionless compliance processes characterised by streamlined and digitised approaches. Automated compliance management and transparent data management are essential. New platforms and AI technologies are changing how private fund advisers do business; in turn, this changes the way private fund advisers have to comply with financial services regulations.

Regulatory changes afoot in the USA

The new world of compliance for private fund advisers is not solely due to new platforms and AI technologies, regulatory change is impactful too. Form PF was launched by the Securities and Exchange Commission (SEC) twelve years ago and in May 2023 Form PF regulatory change was confirmed by the SEC. In May 2023 the SEC finalised the Form PF rule changes.

Amendments to Form PF aim to improve transparency and the ability of the Financial Stability Oversight Council (FSOC) to improve their ability to assess systemic risk. As a result, the regulatory burden for private fund advisers has increased significantly and the operational challenges the amendments bring cannot be underestimated.

In accepting the amendments, the SEC implemented Title IV of the Dodd-Frank Act, which authorises the SEC to require private fund advisers to file reports if *"necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systematic risk by FSOC".* The result of all this new and emerging regulatory change is a requirement for near real-time data and new internal reporting mechanisms. Meeting deadlines for regulatory filings will be evermore challenging for firms with regulatory reporting now required in hours rather than months.

The SEC has also proposed a rule that will require registered private fund advisers to share quarterly statements with investors, including detailed records of all fees and expenses and performance. This will further increase the regulatory burden faced by private fund advisers.

Furthermore, the Commodity Futures Trading Commission (CFTC) and SEC are jointly working on another private fund reporting rule. This other private fund reporting rule broadens disclosure on items such as large hedge funds' investment exposure or private equity groups' fund performance. It remains to be seen how the CFTC rule will coexist alongside the Form PF amendments. Notwithstanding, the rule will likely challenge private fund advisers even further.

Private fund advisers and the increased need for data transparency

The use of private fund advisers is on the rise. The quest for performance and diversification has further increased the use of unlisted assets by asset owners and asset managers which in turn is fuelling the need for more transparent data management and risk monitoring tools. There is little data available on the private equity, infrastructure, real estate and corporate loan fund assets typically held in private funds compared to listed assets.

Transparent management of the data that exists and simulation of the missing data is key to full data transparency across liquid and illiquid asset classes in order for private fund advisers to analyse their investment risk and returns and to move on from risk disclosure to risk prevention. Full data transparency is hindered by challenges private fund advisers face when classifying instruments.

When one looks at a private fund and assesses the array of instruments that exist it is clear that ancillary data required for amended SEC regulatory reporting such as Form PF is a challenge faced by private fund advisers.

Simulation of the missing data related to asset-backed securities, bad debt loans, collateralised debt obligations, commercial mortgage-backed securities, credit-linked notes, deposit and loan claims, financial leases, loans, non-negotiable debt instruments, non-tradable loans, profit participating notes, reverse repos, securities borrowing, securitised loans and tradable loans is challenging but key to full data transparency across liquid and illiquid asset classes in order for fund managers to analyse their investment risk and returns lies.

Situations exist whereby a reclassification of data is required. These include the following: change of counterparty country of residency; change of counterparty sector; restructure of assets or liabilities (e.g., maturity extension). Transparent data validations support reclassifications and ensure that calculations are robust and not dependent on historic classifications. When a counterparty changes its country or sector, for example when re-domiciling or after the revocation of a banking licence, the new country/sector has to be recognised. The challenge is that the data for risk management and regulatory reporting may require a historic classification for data aggregation purposes. This is why date-stamped and audited data reclassification is a must-have.

Situations exist whereby a reclassification of data is required. These include the following: change of counterparty country of residency; change of counterparty sector; restructure of assets or liabilities (e.g., maturity extension).

Further complexity occurs when a restructuring such as a maturity extension takes place, the appropriate action is to transact down the previous position and transact up the new position. End-to-end data automation rules are required to ensure that this happens each time a restructuring takes place.

How can private fund advisers best prepare for the Form PF amendments and data management challenges that lie ahead?

At the heart of any solution to meet new and emerging regulatory requirements lies data governance planning and automation of data management. Neither of these two areas has previously been the focus of private fund advisers. Private fund advisers now have to turn their attention to data management and all of the ancillary challenges that brings, including but not limited to cyber security. The only way to ensure that these challenges can be met is to engage with experts in the field of data management and automated technology specifically built for private fund advisers. The embedded domain knowledge will ensure that emerging regulatory change is managed from within the technology built by design for private fund advisers.

Private fund advisers now have to turn their attention to data management and all of the ancillary challenges that brings, including but not limited to cyber security.

Conclusion

In conclusion, as the regulatory landscape for private fund advisers undergoes significant changes, there is a clear shift in regulatory focus from risk disclosure to risk prevention. The increased regulatory burden faced by private fund advisers has fueled the need for more transparent data management and risk monitoring tools. However, challenges that arise in achieving full data transparency must not be underestimated by private fund advisers. To navigate these regulatory changes and data management challenges, private fund advisers must prioritise data governance planning and automate data management processes. Seeking expertise from professionals specialised in data management and automated technology tailored for private fund advisers is key. Technology solutions that incorporate domain knowledge and ensure effective compliance with emerging regulatory changes will ultimately assist private fund advisers in up levelling their compliance practices and embracing risk prevention.

Disclaimer

At AQMetrics, we provide a managed services platform that helps our clients address their most complex regulatory challenges. As a global software company, we bring multi-jurisdictional knowledge and high-quality technology to our clients.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from acting on any of the contents of this publication. AQMetrics accepts no liability for any loss occasioned by any person acting or refraining from action as a result of any material in this publication.

AQMetrics is a limited liability company registered in Ireland with registered number 518969. AQ Metrics Limited UK Branch is registered in the UK with registered number BR019692. AQ Metrics PTE. LTD. is registered in Singapore (Company Registration No. 202118696H) and AQ Metrics Inc. (identification number 35-2569563) is a wholly owned U.S. subsidiary of AQ Metrics Limited.

© 2023 AQMetrics. All rights reserved.

AQMETRICS

The platform for risk, compliance and regulatory reporting.

EU

UK

USA

APAC

Book a Demo

aqmetrics.com/demo

Trend-following: What's not to like?

Graham Robertson
Head of Client Portfolio Management
Man AHL

Introduction

Trend-following strategies perform as well as equities in the long term, yet get there with lower risk, smaller drawdowns, and do best when equities are at their worst.

What's not to like about that?

Trend-following should be at least as popular as equity investing, right? Well, given equity markets are nearly 300 times the size of trend-following's assets under management,[1] either these facts are not well known, or there is some other issue.

In this short article, we touch on both possibilities.

Trend-following performs as well as equities in the long term. Really?

Since inception in 1986, the Barclay BTOP50 Index (which comprises of mostly trend-following strategies) has returned 7.0% annualised, only 0.7% shy of world stocks (Figure 1, page 37). Trend-following's risk is significantly lower, however, whether risk is measured in terms of volatility (9.6% versus 14.4%) or maximum drawdown (-16% versus -50%).

---

1 CTA assets under management: https://www.barclayhedge.com/solutions/assets-under-management/cta-assets-under-management/cta-industry/. Bloomberg: World Exchange Market Capitlisation.

Figure 1. Trend-following performance versus world stocks since inception of BTOP50 index

	Trend-following	World stocks
Annualised return	7.0%	7.7%
Volatility	9.6%	14.4%
Sharpe ratio	0.37	0.29
Max drawdown	-16.1%	-50.4%

Source: Man Group, BarclayHedge, Bloomberg; between 1 January 1987 to 31 March 2023. Trend-following represented by Barclay BTOP50 Index; world stocks represented by MSCI World Net Total Return Index hedged to USD.

At face value, trend-following is a remarkably simple strategy. Buy something that is going up; and sell something that is going down. Finance 101 says that trends should not exist; markets are efficient, and information is instantaneously reflected in prices. Of course, this ignores the fact that decisions lag news flow, that economic cycles play out over years, and that humans get emotional; we hate losses more than we love gains, and in doing so we make irrational choices (see, for example, Kahneman & Tversky (1979)).

Try and earn a crust off trend-following one market, however, and you might end up hungry. There's only a slight edge, which is why managers run the strategy over tens, if not hundreds, of liquid markets to eke out consistent returns. They use computers for repeatability and because computers don't get emotional.

Genuinely diversifying

Since its inception, the correlation of the BTOP50 to world stocks and other traditional markets is effectively zero (Figure 2, page 38). Intuitively, this is because trend-followers seek to capture trends in all these markets simultaneously, either up or down. Our correlations also show just how little diversification is obtainable within asset classes. World stocks correlate to US stocks at 0.97, world bonds to US bonds at 0.86. The real surprise is that world stocks correlate to a diversified '60/40' portfolio at 0.99.

...decisions lag news flow, economic cycles play out over years, and humans get emotional; we hate losses more than we love gains, and in doing so we make irrational choices.

Figure 2. Trend-following strategies are highly diversifying

US stocks: Highly correlated to world stocks

US bonds: Highly correlated to world bonds

60/40: An equity proxy!

	Trend following	World stocks	US stocks	World bonds	US bonds	60/40	Commodities	Dollar index
Trend following	1.00	-0.08	-0.08	0.16	0.18	-0.06	0.15	-0.05
World stocks	-0.08	1.00	0.97	0.07	-0.20	0.99	0.36	-0.21
US stocks	-0.08	0.97	1.00	0.12	-0.13	0.96	0.36	-0.27
World bonds	0.16	0.07	0.12	1.00	0.86	0.21	-0.02	-0.17
US bonds	0.18	-0.20	-0.13	0.86	1.00	-0.07	-0.10	-0.19
60/40	-0.06	0.99	0.96	0.21	-0.07	1.00	0.35	-0.23
Commodities	0.15	0.36	0.36	-0.02	-0.10	0.35	1.00	-0.44
Dollar index	-0.05	-0.21	-0.27	-0.17	-0.19	-0.23	-0.44	1.00

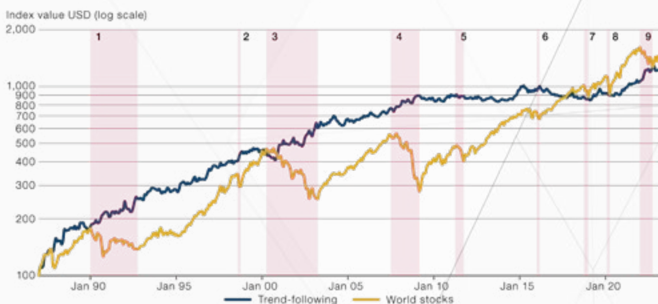
Trend-following: Low correlation to other asset classes

Source: Man Group, BarclayHedge, Bloomberg; Between 1 January 1987 and 31 March 2023.
Trend following represented by Barclay BTOP50, World stocks represented by MSCI World Net Total Return Index, US stocks represented by S&P 500 Index (Local Currency Gross Dividend Total Return, World bonds represented by Barclays Capital Global Aggregate Bond Index Hedged USD, US bonds represented by Bloomberg/EFFAS Bond Indices US Govt 5-10 Yr TR monthly return, 60/40 represented by 60% World stocks + 40% World bonds, Commodities represented by Dow Jones-UBS Commodity Total Return Index, Dollar index represented by US Dollar Index Spot.

Performs best when equities are at their worst

Long-term low correlation is one thing, but trend-following strategies have another trick up their sleeve; negative correlation to risk assets in times of crisis. Coined 'Crisis Alpha' (see, for example, Greyserman & Kaminski (2014)), it relates to trend-following's historic positive performance during sustained equity market weakness. As Figure 3 (below) illustrates, the BTOP50 returned 37% when the tech bubble bust and 17% during the GFC. Both of these episodes lasted years. During shorter periods such as the COVID-19 episode, however, performance is more mixed (Figure 3). This is because trend-following strategies take time – typically 3-6 months – to discover, and trade into, a new trend.

Figure 3. Trend-following's 'Crisis Alpha' credentials



	Total return over the period	Trend-following	World stocks	Crisis length (months)
1	1990 recession 1 Jan 1990 to 30 Sep 1992	41%	-22%	33
2	Russian crisis and LTCM 1 Aug 1998 to 30 Sep 1998	10%	-14%	2
3	Tech bubble burst 1 Apr 2000 to 31 Mar 2003	37%	-46%	36
4	Credit crisis 1 Jul 2007 to 28 Feb 2009	17%	-49%	20
5	European sov. debt crisis 1 Apr 2011 to 30 Sep 2011	0%	-15%	6
6	China crisis 1 Jan 2016 to 29 Feb 2016	5%	-7%	2
7	Q4 2018 Sell-off 1 Oct 2018 to 31 Dec 2018	-2%	-13%	3
8	COVID-19 Pandemic 1 Feb 2020 to 31 Mar 2020	-2%	-20%	2
9	Inflation / Rate rise 1 Jan 2022 to 30 Sep 2022	19%	-21%	9

Source: Man Group, BarclayHedge, Bloomberg; Between 1 January 1987 and 31 March 2023

Trend-following represented by Barclay BTOP50 Index; world stocks represented by MSCI World Net Total Return Index hedged to USD.

The periods selected are exceptional and the results do not reflect typical performance. The start and end dates of such events are subjective and different sources may suggest different date ranges, leading to different performance figures.

So why aren't trend-following strategies more popular?

The performance of a traditional equity portfolio is fairly simple to understand, particularly if it is well-diversified. It hopefully goes up in the long term, but if there is a negative headline, a global pandemic for example, you might anticipate some losses. As we show in Figure 2 (page 38), diversification across regions, or even a 40% allocation to bonds doesn't help too much here.

Performance of a trend-following strategy is far less intuitive. Trend-following strategies trade many markets across multiple asset classes, not just equities. Indeed, a positive beta to equities, or risk assets in general, could originate from places other than equities; long emerging markets FX or short gold, for example. Complicating things further, this positioning can change as trends in different places emerge or dissipate. A trend-follower's beta to any asset is dynamic.

So how can an investor get comfortable with the performance of a trend-following strategy? The key lies in knowledge of positioning. That this is published in fact sheets is a given, but potential investors should understand what trend sensitivity is in their investment. 'Medium-term' trend-following space spans managers with trend sensitivity between two and six months, in our view. At the shorter end of that spectrum, a manager may be able to shift position quickly, being more responsive in a crisis. At six months trend sensitivity, on the other hand, the manager may respond slower to a change in market direction, but should have improved longer-term performance (see 'The Need for Speed in Trend Following' for more detail). Market choice can also be a factor in understanding performance (see, for example 'Gaining Momentum').

Trend-following strategies are often portrayed as 'black box', inferring opaqueness or mystery, which could originate in lack of knowledge of positioning, or because of the use of computers. But trend-following strategies use rules which can be written down, are based on understandable inefficiencies in markets, and computers are utilised for scalability and to remove human emotion. Surely this is a 'transparent' box?

A reason we frequently hear for not liking trend-following is that performance was flat for an extended period post 2008. Indeed, as Figure 1 (page 37) illustrates, the BTOP50 index returned zero between 2009 and 2019 when equities returned around 200%.[2] Here is that direct comparison with equities again. This may be true, but how bad is 'flat' in comparison to the 50% or so lost by equities twice since 2000?

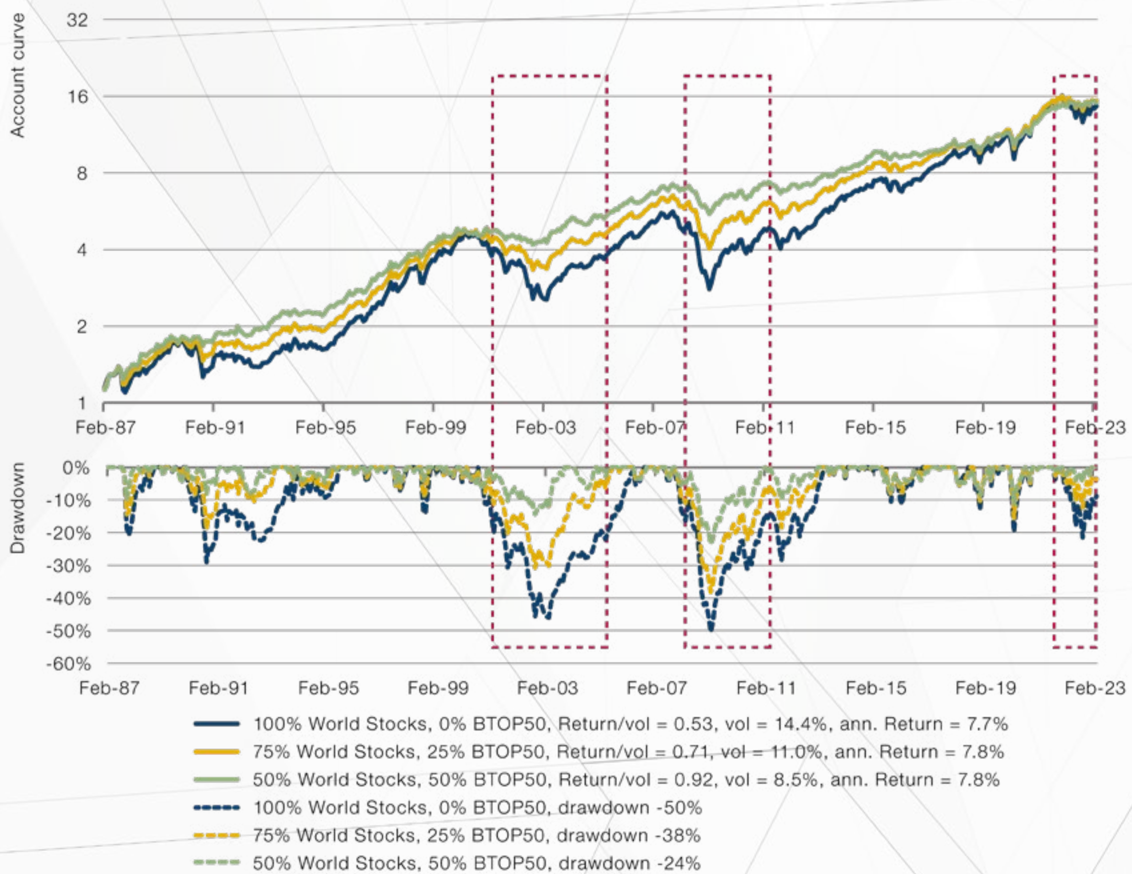
Some parting comments

We are sympathetic to the argument that it is hard to hold an investment that doesn't make any money for 10 years. We might argue that the 'Fed put' was detrimental to trends and beneficial to equities over the period, but that is by-the-by. Every strategy has its day in the sun.

But think about the portfolio. If you hold a trend-following strategy alongside your traditional equity portfolio, in the long term, history suggests that both should be profitable. Further, during crises, trend-following can potentially help cushion losses. Holding the two together gives higher risk-adjusted returns and lower drawdowns than traditional assets alone. As we highlight in Figure 4 (page 40), over the last four decades or so, substituting up to 50% trend-following to a traditional portfolio preserves return, but substantially reduces volatility and drawdowns. While it is fresh in our memories, notice how a 50/50 blend eradicates 2022's drawdown.

2 From 31st January 2009 and 31st May 2019, MSCI World Net Total Return Index, Hedged USD

Figure 4. Allocation to trend-following can enhance risk-adjusted returns (upper panel) and drawdowns (lower panel) of traditional equity portfolios



Source: Man Group, BarclayHedge, Bloomberg; Between 1 January 1987 and 31 March 2023
Trend-following represented by Barclay BTOP50 Index; world stocks represented by MSCI World Net Total Return Index.

Conclusion

If you want to buy a house, you might listen to your estate agent / realtor with some degree of scepticism. They are interested parties, after all. Man AHL has been running trend-following strategies for over three decades, so we are interested parties in this discussion too. But we have tried to be objective in writing this article; all performance numbers are at the index level.

It remains a surprise to us that trend-following strategies are not more popular than they are. To finish where we started, trend-following performs as well as equities in the long term, is lowly correlated, has better risk-management properties in the long term, and generally works well when equities don't. It works particularly well in conjunction with equity portfolios.

What's not to like about that?

Bibliography

1. *Greyserman, A., & Kaminski, K. M. (2014). "Trend Following with Managed Futures. The Search for Crisis Alpha". Wiley.*
2. *Kahneman, D., & Tversky, A. (1979). "Prospect theory: An analysis of decision under risk". Econometrica, 47, 263-291.*
3. *Mackic, A. (2023), "The Need for Speed in Trend-Following Strategies', Man Institute, Available at: https://www.man.com/maninstitute/need-for-speed-trend-following*
4. *Robertson, G. (2022), "Gaining Momentum: Where Next for Trend-Following?", Man Institute, Available at: https://www.man.com/maninstitute/gaining-momentum-trend*

Spot the signals. Follow the trends.

Discover Trend-Following:

Marketing Communication

For Institutional Investors, Qualified Investors, and Investment Professionals. Not intended for retail investors.

CAPITAL AT RISK

This material is for information purposes only and does not constitute an offer or invitation to invest in any product for which any Man Group plc affiliate provides investment advisory or any other services. Unless stated otherwise this information is communicated in the **European Economic Area** by Man Asset Management (Ireland) Limited, which is authorised and regulated by the Central Bank of Ireland. In **Australia** this is communicated by Man Investments Australia Limited ABN 47 002 747 480 AFSL 240581, which is regulated by the Australian Securities & Investments Commission (ASIC). In **Austria/Germany/Liechtenstein** this is communicated by Man (Europe) AG, which is authorised and regulated by the Liechtenstein Financial Market Authority (FMA). Man (Europe) AG is registered in the Principality of Liechtenstein no. FL-0002.420.371-2. Man (Europe) AG is an associated participant in the investor compensation scheme, which is operated by the Deposit Guarantee and Investor Compensation Foundation PCC (FL-0002.039.614-1) and corresponds with EU law. Further information is available on the Foundation's website under www.eas-liechtenstein.li. In **Hong Kong SAR** this is communicated by Man Investments (Hong Kong) Limited and has not been reviewed by the Securities and Futures Commission in Hong Kong SAR. In **Japan**, this is communicated by Man Group Japan Limited. In **Switzerland** this information is communicated by Man Investments AG which is regulated by the Swiss Financial Market Authority FINMA. In the **United Kingdom** this is communicated by Man Solutions Limited which is authorised and regulated in the UK by the Financial Conduct Authority. In the **United States** this material is presented by Man Investments Inc. ('Man Investments'). Man Investments is registered as a broker-dealer with the US Securities and Exchange Commission ('SEC') and is a member of the Financial Industry Regulatory Authority ('FINRA'). Man Investments is also a member of Securities Investor Protection Corporation ('SIPC'). Man Investments is a wholly owned subsidiary of Man Group plc. ('Man Group'). The registrations and memberships in no way imply that the SEC, FINRA or SIPC have endorsed Man Investments. In the US, Man Investments can be contacted at 1345 Avenue of the Americas, 21st Floor, New York, NY 10105, Telephone: (212) 649-6600.
MKT007983/NS/GL/W/190424

Ramesh Kashyap
Managing Director, Group Head, Alternative Income Group
Ninepoint Partners

Piyush Arora
Vice President, Alternative Income Group
Ninepoint Partners

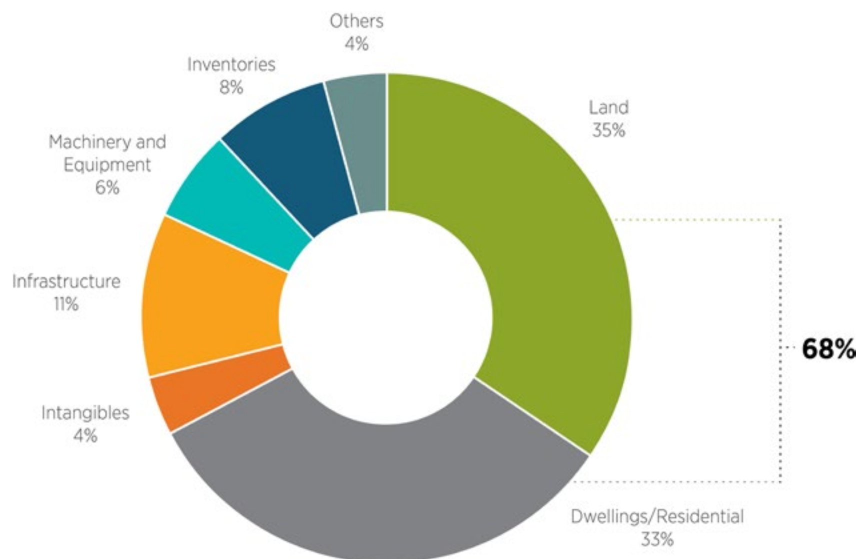
Michael Kam
Associate, Alternative Income Group
Ninepoint Partners

Investing in real estate

The oldest asset class dominating modern wealth allocations

Real estate is one of the oldest asset classes in the world with the first records of transactions in the US dating back centuries. What is more interesting is that it continues to remain the largest portfolio allocation amongst real assets accounting for ~68%[1] of the total global net worth.

Figure 1. Distribution of real asset, 2020 (%)

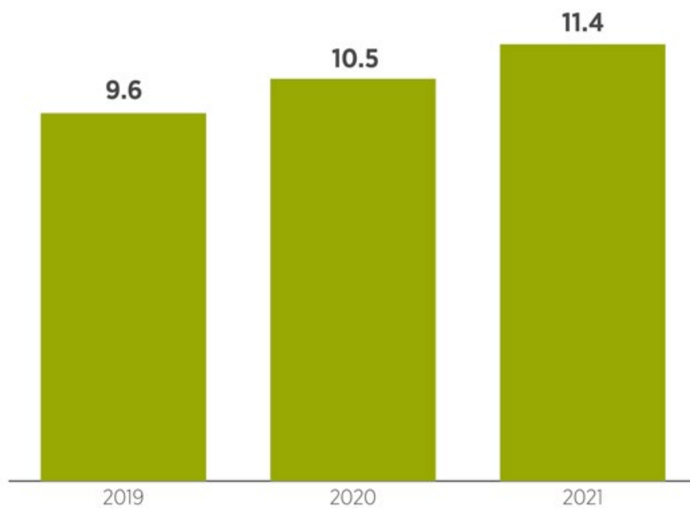


Source: McKinsey Global Institute

The global real estate market (public and private) has grown from US$9.6tn in 2019 to US$11.4tn in 2021. Geographically, the Americas lead the pack accounting for 40.2% of the market or US$4.6tn.[2] The US alone contributes US$4.1tn to the US$4.6tn total Americas market. The Americas is also the fastest growing region with 12.9% growth in 2021. The US market grew by 13.1% in the same period.[3]

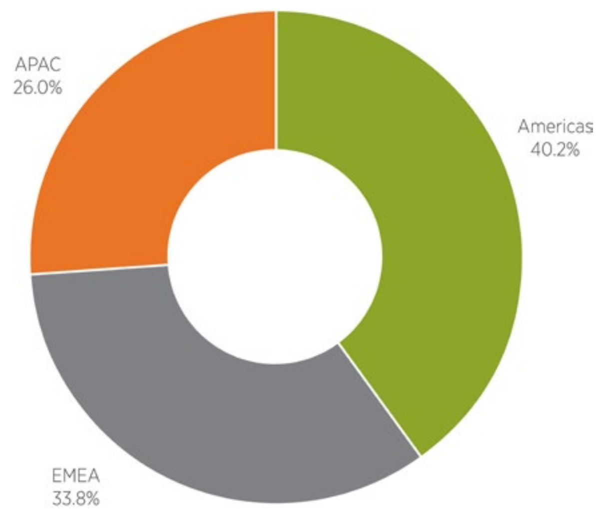
1 McKinsey Global Institute: The rise and rise of the global balance sheet.
2 MSCI – Real Estate Market Size 2021-22.
3 MSCI – Real Estate Market Size 2021-22.

Figure 2. Market size (US$tn)



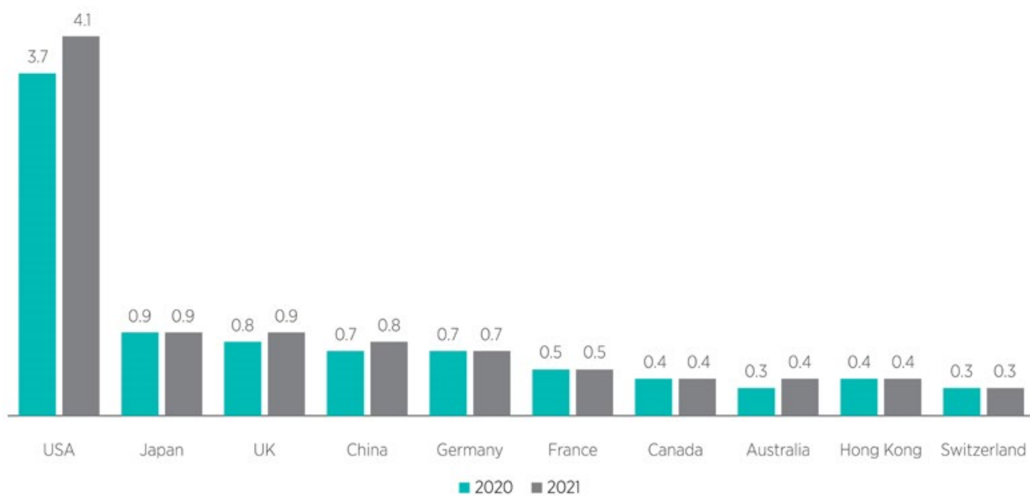
Source: MSCI Real Estate Report

Figure 3. Market share, 2021 (%)



Source: MSCI Real Estate Report

Figure 4. 10 largest real estate markets in US$tn (2021 vs 2020)



Source: MSCI Real Estate Report

The US has long remained the most attractive market due to a variety of factors including economic size, (relative) housing affordability, growing population, and government regulation/stability. These factors make it the most ideal candidate to chart a V-shaped recovery once yields stabilise post the recent correction driven primarily by higher interest rates.

Current trends in real estate

Industrial: Strong fundamentals attracting investor interest

The year 2021 saw the rapid expansion of light industrial facilities including warehousing, fulfilment centres, and cold storage. These segments grew in response to shifting customer behaviour from offline to online. We have not seen a large portion of those sales return to offline retailers once they re-opened in 2022. This structural shift in the way consumers shop has given a new impetus to the light industrial sector.

Despite economic headwinds, industrial real estate absorption remains high in 2022 and is expected to cross pre-pandemic levels. This spread offers embedded net operating income growth for the foreseeable future.

According to research from MSCI Real Assets of surveyed US industrial managers, in-place rents were 22% below spot market rents.

The imbalance of supply and demand has not only pushed leasing rates on existing properties higher but new developments as well. Combined with all-time lows in vacancy, the industrial space is poised to benefit from numerous tailwinds.

Housing: Demographics, affordability and customer preferences supporting long term demand

A four-generation surge of household formation and housing preferences could buoy fundamental apartment demand through and beyond 2030. With 1.3 million new US households projected each year through 2035, apartment industry trade groups—the National Multifamily Housing Council (NMHC) and the National Apartment Association—calculate that the United States needs 4.3 million newly built apartments between now and then. That level of new development would work out to 331,000 new multifamily rental units annually. This would expand the existing apartment rental stock in the United States by more than 20% in just over a decade.

Another factor to consider is the increasing unaffordability trend in developed nations where property values are rapidly outpacing household income. In Canada, the Housing Affordability Index, which measures the share of income needed to cover housing related expenses, has recently peaked at 0.48. This is even higher than housing affordability preceding the Great Financial Crisis. A similar situation is growing in the US, where there is a far larger market. As a result of growing unaffordability, there is growing acceptance to rent amongst the middle-income, middle-age demographic. For investors, this could represent an attractive tailwind for residential opportunities.

The emergence of rent-by-choice segment (discretionary rental households who can afford buying a home) has increased the demand for multifamily housing. According to Harvard's Joint Centre for Housing Studies (JCHS), the number of renters making at least US$75,000 jumped by 48% over the decade ending just before the pandemic, to 11.3 million in the US. With this increase, the share of renter households in this income group rose from 20% to 26%.[4] The supply side of the equation has not caught up to the high demand leading to higher rentals across markets.

Retail: Flight to high-quality grade-A assets

Given the outsized challenges that retail has faced in recent years and with economic uncertainty on the horizon, the outlook for the retail sector in the immediate future differs significantly for different segments and property types.

Grocery in the US remains white-hot, with growth bolstered by aggressive expansion plans from newer market entrants like Aldi and Lidl. Athleisure and new digital- native apparel brands have ramped up brick-and-mortar growth even as department stores and many legacy players are still facing challenges. Perhaps most surprising of all is the massive surge in restaurant growth. Fuelled by QSRs and new fast-casual concepts, major chains were poised to add as many as 7,000 units through midyear 2023.[5] Retail banking continues to deal with digital disruption, driving less need for overall branches and smaller footprints. Drugstore chains are reducing store counts, though online pharmacy has yet to emerge as a major disrupter. Department stores, particularly outside of the luxury sphere, still largely need to downsize and evolve their models to remain relevant.

4 McKinsey Global Institute: The rise and rise of the global balance sheet.
5 Urban Land Institute & PwC – Emerging Trends in Real Estate 2023

Nowhere is the bifurcation in performance greater than in the mall world. Class A and trophy malls account for roughly one-third of the inventory, but 80% of the sales. Those properties have benefited from the flight to quality and have been the focus of nearly all the growth from new clicks-to-bricks (digital-native brands opening physical stores) and experiential concepts, as well as a substantial influx of food and beverage concepts.[6]

Office: Medical offices and life sciences facilities opening new growth avenues

The traditional office sector is struggling with pandemic-induced behavioural changes with complete work from home and hybrid arrangements still being the norm across corporates. The high-quality properties within the traditional office space continue to retain high occupancy and command rentals as corporates continue to renew.

While the traditional office demand outlook remained uncertain due to lagging return-to-office momentum, the pandemic accelerated the growth of a few segments within the overall office sector including medical offices and life sciences laboratories. These sectors proved to be non-cyclically correlated as they grew at a higher pace during the pandemic and continue to exhibit high growth.

Figure 5. Medical office transaction volume and cap rates, 1Q 2015-2Q 2022

Source: PwC's Emerging Trends in Real Estate 2023 Report. Note: Transaction volume is for trades valued at US$2.5 million or more; figures are trailing 12 months, indicating annualised volume. Cap rate is average, trailing 12 months. Data believed to be accurate but not guaranteed and is subject to future revision.

Tenants of medical office buildings tend to sign much longer lease terms than tenants of other types of commercial real estate—sometimes up to 15 or 20 years—and are much more likely to renew since moving too far away would jeopardise their local patient market share. Transaction activity over the last year has grown to an average annual run rate exceeding US$20 billion, with institutional private equity accounting for most of the activity. Looking ahead, medical office transaction activity will face the same headwinds— rising interest rates, inflation, and a potential recession—as other real estate sectors. However, with so many entities interested in investing and solid sector fundamentals, future activity will likely remain strong.

Top real estate asset managers in North America

Through both public and private vehicles, the top 10 real estate asset managers in North America manage an aggregate AUM of ~US$1.4tn with ~67% invested in North American markets. Six of these managers are in the top 10 global real estate managers list with all of them ranking in the top 20 among global real estate managers.

6 Urban Land Institute & PwC – Emerging Trends in Real Estate 2023

Figure 6

Asset Manager	Total AUM (U.S.$Bn)	North America AUM (U.S.$Bn)
Brookfield	215.8	148.8
PGIM	145.6	120.6
Hines	160.9	118.7
Blackstone	319.4	98.1
Nuveen	133.0	96.0
MetLife	106.8	94.1
KKR	88.3	83.4
Principal	88.2	77.3
JP Morgan Asset Management	74.6	63.9
Invesco	82.8	58.5
Total	**1,415.4**	**959.4**

Source: Institutional Real Estate Inc.'s Global Investment Managers 2021 Report

Outlook

We remain positive on the real estate sector overall and see most sectors reacting differently as we move through the high inflation-interest rate environment. Real estate is a core contributor to a diversified portfolio and may provide reliable income generation. Paired with its ability to function as an inflation hedging vehicle and low correlation to traditional securities, it is clear why real estate is a popular alternative asset among investors. Overall, we believe there is opportunity in the near to medium term to invest in quality Grade-A real estate assets in developed economies. Low valuations in an increasingly tightening liquidity environment coupled with stable income yield can help generate significant upside once cap rates compress as the economic cycle turns around.

Disclaimers

The opinions, estimates and projections ("information") contained within this report are solely those of Ninepoint Partners LP ("Ninepoint") and are subject to change without notice. Ninepoint makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, Ninepoint assumes no responsibility for any losses or damages, whether direct or indirect, which arise out of the use of this information. Ninepoint is not under any obligation to update or keep current the information contained herein. The information should not be regarded by recipients as a substitute for the exercise of their own judgment. Please contact your own personal advisor on your particular circumstances. Views expressed regarding a particular company, security, industry or market sector should not be considered an indication of trading intent of any investment funds managed by Ninepoint Partners LP. These views are not to be considered as investment advice nor should they be considered a recommendation to buy or sell. The information contained herein does not constitute an offer or solicitation by anyone in the United States or in any other jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation. Prospective investors who are not resident in Canada should contact their financial advisor to determine whether securities of the Funds may be lawfully sold in their jurisdiction. Materials may not be delivered or made available to individuals or entities that are not classified as (i) "Non-United States Persons" within the meaning of Section 4.7(a)(1)(iv) of the rules of the CFTC or (ii) permitted clients (as defined in section 1.1 of Canadian National Instrument 31-103). This document is for information purposes only and should not be relied upon as investment advice. We strongly recommend that you consult your investment professional for a comprehensive review of your personal financial situation before undertaking any investment strategy. Information herein is subject to change without notice and Ninepoint is not responsible for any inaccuracies or to update this information.

Ninepoint Partners LP: Toll Free: 1.888.362.7172.

Arbitrage for improving the performance of fixed income portfolios

Julian Klymochko
CEO and Chief Investment Officer
Accelerate

Warren Buffett once said, *"Give a man a fish and you will feed him for a day. Teach a man to arbitrage and you will feed him forever."*

While arbitrage has been a long-time favourite investment strategy of the world's greatest investor, it is often overlooked as a fixed income alternative.

Merger arbitrage is an investment strategy that involves buying securities of companies involved in a merger or acquisition. Arbitrage aims to profit from the price difference, or 'spread', between the current market price of an M&A target company's stock and the expected acquisition price.

When a merger or acquisition is announced, the stock price of the target company often rises, but it may not immediately reach the acquisition price. Arbitrageurs take advantage of this price differential by buying the stock of the target company at the current market price and then selling it at the expected acquisition price once the deal is completed.

A simple example: Vandelay Industries announces the acquisition of Acme Corporation for US$100 per share, closing in 6 months. An arbitrageur buys Acme Corporation stock for US$95 per share and holds the stock until the deal closes. Upon closing, the arbitrageur receives US$100 for an approximate 5% return in six months for a 10% arbitrage yield (annualised return).

If buying at 95 and receiving 100 upon maturity reminds you of a zero-coupon bond trade, you would be right. Arbitrage is fixed income investing in disguise.

The arbitrage yield earned from an arbitrage investment in analogous to a bond yield earned from a bond investment.

However, arbitrage features several key differences compared to bonds as a fixed income alternative:

- **Investment return** - Historically, arbitrage has generated higher returns than the global bond index and with lower volatility.
- **Duration** - Arbitrage has a significantly lower duration, measured in months, compared to bonds' duration, which is typically measured in years.
- **Tax-efficiency** – Arbitrage generates yield via capital gains, which can be more tax efficient for certain investors compared to interest income from bonds.

The past several years have been challenging for fixed income investors. Bonds have been nearly a pure-play bet on the direction of interest rates. Accordingly, when interest rates rose, bonds produced poor results for investors.

Arbitrage is a fixed income alternative investment strategy that, given its lower duration and higher expected returns, can do well in a rising rate environment.

A common Wall Street maxim is that diversification is the only free lunch in investing.

Diversification is not just for stock portfolios. Diversifying a bond portfolio can work wonders for fixed income investors.

For example, adding arbitrage to a bond portfolio can increase return while reducing risk and improving tax efficiency.

Over the past three years[1], the Canadian bond index has struggled, losing -1.8% per year. If a bond investor were to complement their bond portfolio with half allocated to arbitrage, that -1.8% annual loss would turn into a +5.1% annual gain. Adding arbitrage to a bond portfolio improved the return by 6.9% annually since 2020.

In addition, adding arbitrage to a bond portfolio increased its pre-tax and after-tax yield.

Arbitrage vs Canadian Bonds - 2020[1] to Present

	Arbitrage	Canadian Bond Index	50% Bonds / 50% Arbitrage
Annualised return[1]	12.2%	-1.8%	5.1%
Total return[1]	38.3%	-5.0%	14.9%
2022 return	-1.5%	-11.8%	-6.7%
Distribution yield[2]	3.1%	2.9%	3.0%
After-tax distribution yield	2.3%	1.4%	1.8%
Underlying portfolio yield	5.3%	4.2%	4.8%
Risk rating	Low	Low	Low
Duration (years)	0.1	7.3	3.7
Distribution	Capital gains	Interest income	Mixed

1 Since 20 April 2020
2 Assumes Ontario top marginal tax rate of 53.3%

Source: Accelerate, iShares, Bloomberg

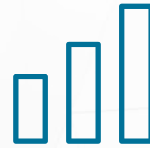
Many people wonder, have they missed the opportunity in arbitrage? Can it still benefit a fixed income portfolio now that bond yields are more attractive?

While a protracted decline in interest rates would tip the scale in favour of long-duration bonds, the key tenet of diversification is to provide the highest return with the least amount of risk. Therefore, it is prudent to spread ones' bets to account for any scenario. A diversified investor should have a well-performing portfolio whether rates go up or down.

Nonetheless, investors have not missed the boat on arbitrage. It still offers a higher underlying yield compared to the Canadian bond index. For example, a 50% allocation to arbitrage would boost a bond portfolio's underlying yield from 4.2% to 4.8%.

Free lunch or not, it is time that investors diversify their fixed income portfolios for higher potential returns with lower expected risk through arbitrage. Nevertheless, don't take my word for it – listen to the Oracle of Omaha.

50%
allocation to arbitrage would boost a bond portfolio's underlying yield from 4.2% to 4.8%



The investor relations challenge

Investor relations resources are stretched by increasing client demands for information

Fiona Sherwood
CMO
Dasseti

Many investor relations teams are at breaking point. Investor demands for data are at an all-time high. IR teams are inundated with requests via requests for proposals (RFPs), requests for information (RFIs), due diligence questionnaires (DDQs), monitoring questionnaires, consultant databases and various client templates.

Every request is different, and most are complex and lengthy, getting longer every year. We conducted research into the questions and answers that passed through our platform over the past three years and found that DDQs had increased in length on average by 20% between 2019 and 2022.

Investors are not only asking for more information, they also want it more frequently, with regular monitoring and oversight moving up investors' priority list.

Our research also found that each DDQor RFP takes on average, 16 hours to complete. All of this contributes to an increased workload for investor relations and client services teams within manager firms.

What is driving the increase in requests for data?

There are a few reasons why allocators and consultants are requesting more data. From our experience, we know they want more quantifiable data so that it can be tagged, flagged, scored and analysed in digital platforms like ours more easily. The driver behind more quantitative questioning is often the allocator or consultant's desire to benchmark. But, when asking a Yes/No question, most are followed up by clarifying questions or further documentation.

However, there is also a growing demand for qualitative data. This could be to combat manipulation or numbers but also provides valuable context and reasoning. This combination of questioning adds more complexity to the response process and places a greater burden on IR and client services teams.

Regulations are also driving complexity

Alongside allocators and consultants requesting more data for benchmarking or risk management purposes, there are also regulatory drivers that force them to ask more questions.

In 2022, the US Securities and Exchange Commission (SEC) put forward proposals to prohibit Registered Investment Advisers from outsourcing certain functions and roles to third parties without conducting and proving that effective due diligence and monitoring processes were in place.

The SEC's recent cyber security rule proposals may have also driven an increase in cyber security related questions. The long form version of AIMA and AITEC's cyber security DDQ now stretches to 53 pages covering areas such as policies, standards, controls, data security, physical security, access controls, business continuity and more.

In Europe, increasing regulation around ESG disclosures have led to increased questioning of fund managers and general partners. On average, ESG questions featured 10 times more frequently in 2022 than they did in 2019, when evaluating the questions and answers passing through Dasseti's platforms.

Due diligence volumes ebb and flow, making it hard to maintain consistency

Our research found that requests for information peaked in volume at certain points during the year, annually and quarterly in many cases. Ad hoc requests could come at any point and teams could be overwhelmed.

Consistency and quality can naturally suffer at peak times and clients report that less care and time is spent completing RFPs, DDQs and RFIs at busy times. This can lead to inconsistencies in responses, lower quality responses or the difficult choice to ignore certain new mandates if they not certain to win, or if the values are below a certain threshold.

Investor relations teams have competing priorities

As we know, manager marketing, client services and investor relations teams tend to be lean, with some comprising just a single individual, but the remit for those teams is broad. Existing client requests take up a large proportion of team resource, with regular DDQs, client requests, quarterly questionnaires and surveys to complete.

During busy fundraising periods, marketing and IR teams are responsible for RFPs, RFIs, pitchbooks, factsheets and other marketing materials, plus ad hoc requests.

The hiring dilemma

Hiring additional resource often seems like the only way to meet resource shortage, but fee transparency means that teams cannot always justify additional headcount. Where we see teams growing, many are adding junior teams who lack the experience, knowledge or expertise to craft high quality, consistent responses to requests.

What is the solution?

Firms must look at their processes to identify ways of making them more efficient. Or finding ways to help their current teams do more.

Technology can help

Many managers and general partners (GPs) know that technology that can automate and streamline processes is out there. But is it tailored to their exact requirements and will it meet the specific needs of the investment sector?

The challenge – Question & Answer banks can be time consuming to manage and become out of date quickly

Many RFP tools solve one part of the problem. They may provide a central repository for standard questions and answers for use in DDQs, RFPs and RFIs. But maintaining those can be hard work and they may not allow easy creation of marketing materials or client reports.

Can the current solution automate reminders for subject matter experts to update data points? This feature could allow Q&A banks to stay current with little to no involvement from the investor relations or marketing team.

Can the current solution scan previous responses to find the best fit, or will it only search the Q&A repository? Searching past responses could reduce the time needed to populate and maintain a response repository.

The challenge - Many managers and GPs we speak to have already invested in one or more software tools and replacing those would be costly and disruptive

Look for software that works in harmony with existing software, that can plug capability gaps. Integrate using application programming interfaces (APIs) or extract data to use in different places.

The challenge - Current solutions may be too prescriptive and inflexible

There are solutions on the market that aim to address the challenges faced by managers and GPs when sharing company and fund data with investors and prospective investors, but they can be inflexible and prescriptive. In an industry where competitive edge is everything, sharing your customized firm and fund data is imperative.

Coupled with this, investors are often unable or unwilling to work with data sets that don't meet their requirements. Look for a solution that works with the investors' preferred formats, or one that is flexible enough to accommodate custom fields that may be unique to a manager of fund.

The challenge – Stretched IR and marketings teams don't have time to undertake lengthy onboarding processes or learn complex new software

Look for solutions that are turnkey or include a managed onboarding. User friendly interfaces and intuitive controls are a must.

Post onboarding, what support is available? Is this an additional cost or is it included in the license cost?

For significant efficiency gains, automation is a must have to speed up processes and maintain consistency across teams, regions, strategies, or clients. Automation can help in creating an early draft RFP or DDQ or automating alerts and updates.

The challenge – many software platforms are industry agnostic and not designed for the investment sector. Terminology is different and workflows don't fit the investment process

Industry-specific toolsets are a big plus point. There are many variations in terminology, e.g., AUM to assets under management and it is helpful for systems to recognise and accommodate these variants.

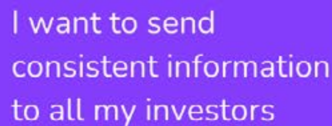
The final point to remember is that technology is a business enabler and should mould to fit your unique internal processes, but it is also important to flex to meet the needs of investors. Expecting them to adapt processes to meet your systems and platforms will not work.

For more information or advice on selecting software to support an investor relations or marketing team, get in touch with the team at Dasseti.

DASSETI

Engage your investors more efficiently

Dasseti Engage: the only industry specific investor relations solution offering more than RFP and DDQ responding



I want to know which investors have read the information I shared

I need a search engine that understands asset management and alternatives

I want to update my data once and share it everywhere

RESPOND to DDQs and RFPs faster

PUBLISH up-to-date information in recurring client and consultant custom templates

DISTRIBUTE tailored client information smartly and securely

FIND OUT MORE

AIFMD 2.0 – The negotiations begin

Angelo Lercara
Partner
Dechert LLP

Patrick Goebel
Partner
Dechert LLP

Colin Sharpsmith
Partner
Dechert LLP

Philippa List
Professional Support Counsel
Dechert LLP

Introduction

The European Commission (the **Commission**) on 25 November 2021 adopted a package of measures[1] intended to deliver on several key commitments in the 2020 Capital Markets Union action plan, including a proposal to review the Alternative Investment Fund Managers Directive (**AIFMD**)[2] (the **Proposals**),[3] and (where relevant) the Directive relating to Undertakings for Collective Investment in Transferable Securities Directive (**UCITS**).[4]

The Council of Europe (the **Council**) formalised its position with regards to the Commission's proposals in June 2022,[5] and on 24 January 2023 the European Parliament's Committee on Economic and Monetary Affairs (**ECON**) voted to approve the position taken by the Parliament regarding the Proposals.[6] The next stage is for the Council, Commission and Parliament to debate the various points via the Trilogue process. The first Trilogue meeting took place on 8 March 2023 and the second on 9 May 2023. The Swedish Presidency of the Council has indicated that it hopes the Trilogue process will be completed by the end of its term in June 2023. Once the co-legislators have come to agreement, the changes to AIFMD would be made by a directive (**AIFMD 2.0**) that EU Member States would have 24 months to transpose into national law. AIFMD 2.0 is unlikely to take effect until 2025.

This article examines the positions taken by the Council and Parliament on some of the key areas the Proposals focus on. It is based on the current positions taken by the co-legislators as they commence the Trilogue process, and the final AIFMD 2.0 legislation may ultimately differ from what is outlined below.

Delegation

The AIFMD delegation structure currently allows alternative investment fund managers (**AIFMs**) to delegate certain tasks if prescribed conditions are met. The core requirement of the AIFMD is that an AIFM must not delegate its functions to the extent that, in essence, it is no longer the manager of the relevant AIF.

The Commission proposed that where an AIFM delegates portfolio management or risk management functions to entities located in third countries, competent authorities would be required to notify ESMA on an annual basis of all such delegations. The Council and Parliament have not taken this proposal forward.

The Council and Parliament agree that when applying for authorisation, an AIFM must provide information about the people effectively running the business, a program outlining the organisational structure and how they plan to comply with regulations, as well as details on delegating functions to third parties.

1 The package of measures is available here.
2 Directive 2011/61/EU
3 The Proposals for AIFMD are available here.
4 Directive 2009/65/EC
5 The Council's position is available https://data.consilium.europa.eu/doc/document/ST-9768-2022-REV-1/en/pdf
6 The Parliament's final report setting out its position with regards to the Commission's Proposals is available https://www.europarl.europa.eu/doceo/document/A-9-2023-0020_EN.pdf

The Parliament suggests that when providing information about delegation, the AIFM should also explain how it benefits the investor. The Council proposes that Member States mandate authorised AIFMs to keep their provided information up to date with their competent authority.

The Parliament proposes expanding Annex I and requiring AIFMs to report any significant changes that could impact their authorisation, including changes to delegation arrangements with third parties, and that ESMA should develop regulatory technical standards (**RTS**) specifying the information required for AIFM authorisation applications, including the programme of activity and situations where alternative investment funds (**AIF**) names could be misleading. They also propose a comprehensive peer review analysis of competent authorities' supervisory activities regarding delegation 12 months before the review of AIFMD 2.0, allowing more time for the new delegation provisions to become established and avoid ongoing policy uncertainty.

Loan origination funds

The Commission's proposals include new retention requirements for AIFs to retain an economic interest of 5% of the notional value of loans they grant and sell off, a requirement for AIFs that originate loans exceeding 60% of their net asset value to be closed-ended, a concentration limit of 20% of capital for loans to a single borrower with a financial or collective investment undertaking, and new reporting requirements for AIFMs to report the portfolio composition of originated loans to investors under Article 23.

The Council has proposed a leverage cap of 150% for loan-originating AIFs, but there is no clear explanation for why it is needed or why the cap is set at that level. The AIFMD framework already allows for managing leverage, and neither the Commission nor the Parliament support the introduction of a cap.

The Parliament proposes defining a *"loan originating AIF"* as an AIF whose primary activity is originating loans and whose notional value of originated loans exceeds 60% of its net asset value, similar to the Commission's proposal to ensure that the loan origination provisions apply to AIFs that engage significantly in loan origination and not to funds that issue only a few loans, which would otherwise be subject to additional rules and restrictions.

The Council and Parliament both propose that a loan originating AIF may be open-ended provided that its liquidity risk management system is compatible with its investment strategy and redemption policy. The Council position also proposes that ESMA develop a draft RTS to determine the requirements with which a loan-originating AIF must comply to maintain an open-ended structure.

The 20% concentration limit included in the Proposals is retained in both the Council and Parliament positions.

Like the Commission's Proposals, the Council proposes that under Article 23 information be provided on the originated loan portfolio. The Parliament requires information on the portfolio composition of originated loans.
The Council proposes introducing five-year transitional arrangements for

The Parliament suggests that when providing information about delegation, the AIFM should also explain how it benefits the investor.

The Council proposes that Member States mandate authorised AIFMs to keep their provided information up to date with their competent authority.

loan origination funds with a derogation for existing AIFs that do not raise additional capital, however, it is important to note that the five-year time starts from the date of adoption of AIFMD 2.0, not the date of transposition.

Liquidity risk management

The Commission's proposals include provisions for liquidity risk management, addressing recommendations from the European Systemic Risk Board and ESMA for harmonising rules on the use of liquidity management tools (LMTs).

The Commission's proposals include provisions for liquidity risk management, addressing recommendations from the European Systemic Risk Board and ESMA for harmonising rules on the use of liquidity management tools (**LMTs**). The proposals also allow competent authorities to require AIFMs to activate or deactivate relevant LMTs, even for non-EU AIFMs. LMTs are widely used but not explicitly referenced in AIFMD or UCITS.

The Parliament and Commission propose a new Article 47(4)(d) that gives ESMA the power to require non-EU AIFMs marketing AIFs in the EU or EU AIFMs managing non-EU AIFs to activate or deactivate an LMT. In contrast, the Council does not support the Parliament and Commission, and its position would allow the AIFM to decide whether to activate or deactivate an LMT.

There is a question of whether ESMA should develop guidelines or RTS on the characteristics and selection of LMTs. The Council supports ESMA developing guidelines for selecting and using appropriate LMTs for liquidity risk management, including disclosures to investors, and RTS to specify the characteristics of LMTs. The Parliament favours ESMA developing RTS on disclosing information related to the selection and calibration of LMTs to competent authorities and investors, as well as guidelines for best practices regarding the characteristics of LMTs.

Depositary services

The Commission's proposals include an interim measure allowing cross-border sourcing of depositary services, pending further review. The Council and Parliament propose that Member States should be able to authorise AIFMs and AIFs to appoint depositaries located in other Member States on a case-by-case basis. Depositaries must cooperate with competent authorities in both their home state and the AIF's and AIFM's home states. Depositaries in non-EU jurisdictions should not be established in high-risk third countries under Article 9(2) of the Anti-Money Laundering (AML) Directive.

The home Member State of an AIF may allow its national competent authorities to permit depositaries established in another Member State to be appointed on a case-by-case basis, provided that the competent authorities receive a motivated request from the AIFM demonstrating the lack of relevant depositary services that can meet the needs of the AIF. The depositary market of the home Member State of the AIF must meet certain conditions, such as having fewer than seven depositaries providing depositary services to EU AIFs with assets safekept below a certain threshold, or an aggregate amount of assets safekept not exceeding a certain amount. These thresholds vary between the Parliament and Council proposals.

Reporting

The Commission's proposals for a new Article 23(4)(e) include quarterly reporting of all fees and charges directly or indirectly incurred or allocated to the AIF or its investments. The Council and Parliament propose annual reporting, but their positions differ on what should be reported. The Council and Commission are more aligned on what should be reported under Article 24, while the Parliament's proposals are more open-ended. Overall, the reporting obligations under Articles 23 and 24 are likely to be significantly expanded in AIFMD 2.0.

Other items

The Parliament proposes that if an AIFM manages an AIF marketed to retail investors, at least one member of its governing body should be a non-executive director. The Parliament had previously proposed expanding the definition of "professional investor" to include those who commit to investing a minimum of €100,000 and have stated in writing their awareness of the risks and/or have listed senior staff, portfolio managers, directors, officers, agents or employees of the manager or its affiliate with sufficient knowledge of the AIF. However, this expanded definition is not included in the final Parliament position.

Conclusion

The co-legislators are largely aligned on LMTs and delegation, but there is disagreement on technical matters such as reporting delegation arrangements. Reporting obligations will be expanded. Loan origination is an area of disagreement, particularly regarding risk retention. Negotiations and debate are expected to continue, with the Council working party meeting on 26 May and political Trilogues scheduled for 13 and 27 June. Time is short for resolving outstanding points before the end of the Swedish presidency in June.

Cross-border made coherent

With a leading bench that spans the USA, UK, Ireland, France, Luxembourg, Brussels and Germany, as well as the Middle East and Asia, we advise on all major asset classes, fund domiciles and investment structures, collaborating for the benefit of our clients at every stage of the investment life cycle. **dechert.com**

1000 lawyers | 10 time zones | one firm

Dechert
LLP

ELFTIF 2.0: Reforms set to drive significant growth in European private markets

Alison Arthur
EMEA Alternatives Solutions Specialist, VP
State Street

Andrew Allright
EMEA Alternatives Solutions Specialist, Managing Director
State Street

Steven Halmaghi
EMEA Alternatives Solutions Specialist, Officer
State Street

Introduction

The European Commission's (EC) recent amendments to the European Long Term Investment Fund (ELTIF) rules have the potential to significantly increase both the volume and source of capital flows into European private markets.

ELTIFs were initially met with a slow uptake, followed by criticism that the investment governance was too prohibitive to achieve their aim of giving retail investors access to a wider range of more illiquid asset classes.

Under ELTIF 2.0 a series of new proposals were created aimed at broadening the appeal. By increasing the range of potential holdings and reducing barriers to retail investors, we could see €100 billion of inflows in the next five years, according to the Alternative Investment Management Association (AIMA).[1]

The amended proposals were announced in late 2021, following a process of consultation and consideration by European lawmakers and received political agreement from the European Parliament in October 2022.[2] ELTIF 2.0 was formally adopted on the 15 February 2023 with a nine-month early adoption, opt-in grace period for existing ELTIFs, with a deadline period of five years until the 11 January 2029 to formally adopt the 2.0 regime.[3] New ELTIFs under the 2.0 regime can launch as of 10 January 2024.

In the agreement announcement, the EC cited retail inflows as a key part of the proposals: "*ELTIFs ultimately democratise finance by granting citizens access to new investment opportunities currently only available to professionals.*"

In addition to meeting political demand within the European Union to direct more investment into infrastructure projects and growth industries, the ELTIF is also in sync with investor sentiment within the region.

In a survey of institutional investors conducted on behalf of State Street in the fourth quarter of 2022, 50% of European respondents said they saw 'strong demand' for access to private markets from individual investors.[4]

1 https://www.aima.org/article/press-release-aima-and-the-acc-applaud-positive-progress-on-eltif-regulation-reforms.html
2 https://finance.ec.europa.eu/news/capital-markets-union-political-agreement-review-european-long-term-investment-funds-eltif-2022-10-20_en
3 https://www.europarl.europa.eu/doceo/document/TA-9-2023-0040_EN.html
4 https://www.statestreet.com/us/en/insurer/insights/future-of-private-markets-2022-23

The movement to provide access to private market long-term investments to non-institutional investors is not new or specific to Europe. In North America, business development companies (BDCs), interval funds and REIT structures, have looked to bridge the gap for some time. For example, BDCs have operated in the US market since the early 1980s, however after several structural and regulatory updates have proven themselves as very effective format, with many new entrants and significant capital raised from institutional as well as non-individual investors. BDCs have shown that there can be an effective vehicle to bridge the gap in the market, as indicated by their substantial growth from 2014 to 2022, from US$50 billion to US$265 billion, with majority of the investment strategies most suited to private credit and debt portfolios.

After years of discussion and planning, the latest ETLIF regulation (2.0) was formally adopted by the European Parliament on the 15 February 2023.

With the latest changes, the European Parliament is forecasting the size to be €100 billion by 2028.

ELTIFs history and overview

ELTIF was introduced in 2015 by the European Union to help fund the union's digital, social and sustainable transition. It was intended as a way to democratise the private market industry and aimed at facilitating the raising and channeling of capital towards long term investments in the real economy. Since its launch there have only been 84 funds registered and marketed, raising less than US$10 billion amongst them, which is significantly lower than forecasted. The original intention of the legislation was too rigid to allow full adoption, and a clear need for update (2.0) was presented. After years of discussion and planning, the latest ETLIF regulation (2.0) was formally adopted by the European Parliament on the 15 February 2023. With the latest changes, the European Parliament is forecasting the size to be €100 billion by 2028.

This growth can be attributed to the growing attractiveness of private markets and the desire of further diversification in the portfolio of professional and retail investors. ELTIFs are viewed to be the investment vehicle of choice in the private market space.

Problems with ELTIFs in their original form

- Lack of pragmatism or feasibility when it came to eligible assets
- Diversification and concentration requirements that were considered too stringent
- Barriers for marketing their products to retail investors
    - E.g., ELTIFs were required to have facilities in place in member states where retail investors targeted were located for the purpose of subscriptions, payments and information

The new regulation has not tackled every issue, but 2.0 is still an important step to making ELTIFs an attractive investment vehicle and we expect further improvements to be made in the future.

Updated ELTIF rules

- Broader definition of real assets
  - Under 2.0:
    - Broader scope of eligible assets such as listed companies with market cap of up to €1.5 billion (up from €500 million), fintech companies, simple transparent and standardised securitisation (STS), green bonds, etc.
    - Broader definition of a real asset, which is now simply "an asset that has an intrinsic value due to its substance and properties"
      - Example: communication, environment, energy, transport infrastructure, social (retirement homes, hospital), education and intellectual property
    - Removal of the required minimum value of a real asset an ELTIF can invest in, thus broadening the options available

- Diversification/distribution rules and target funds
  - ELTIFs are now authorised to invest in Undertaking for Collective Investment in Transferable Securities (UCITS) or other EU Alternative Investment Funds (AIF) managed by EU Alternative Investment Fund Managers (AIFM)
    - Provided that these AIF are investing in eligible investments for ELTIF, allowing ELTIFs to deploy fund of funds strategies or master feeder structures
    - Differentiated regime between ELTIFs that will be solely be marketed to professional investors and those that can be sold to retail investors
      - Retail investors should benefit from a higher level of protection than professional investors
      - Borrowing limit has been increased to 50% of the NAV for retail ELTIFs and 100% of NAV for professional ELTIFs
        - Gives ability to provide liquidity and to pay costs and expenses as needed

- Co-investment
  - ELTIFs under 2.0 are allowed to make minority co-investments
    - Provides additional flexibility to implement investment strategies and attract more promoters of investment projects and increase the range of possible eligible target assets.

- Investor rules
  - Only the MiFID suitability test will have to be performed in relation to retail investors. No additional ELTIF-specific suitability test is required.
  - Minimum investment requirements have been removed.
    - The original regulation requirement whereby the financial instrument portfolio of a retail investor does not exceed €500,000, the ELTIF manager must ensure that the potential retail investor invests at least €10,000, but not more than 10% of their financial instrument portfolio in ELTIFs has been removed.

- Investment rules
  - ELTIFs can now invest the majority of their assets in investments located in third countries
    - The reference to the European nature of the long-term investment has been removed, lifting an uncertainty on the possibility to have assets that are located outside of the EU. As a result, investments in third countries can now benefit the economy of the EU.
    - Examples include, the development of boarder regions, subsea fiber optic cables connecting Europe with other continents, construction of LNG terminals, renewal energy installations that contribute to the resilience of the electrical grid and energy security of the EU.

- Education
  - The suitability test for retail investors is still required, but there is no longer an obligation to provide investment advice, with the possibility for a retail investor to bypass a negative conclusion to that test by giving express consent to proceed with the transaction.

Conclusion

The recent 2.0 updates have been met with optimism. The changes create a promising runway for increased visibility and uptake of ELTIFs. The welcomed simplifications and ease of accessibility is expected to open ELTIFs to a broader audience.

Disclaimer

The information provided does not constitute investment advice and it should not be relied on as such. It should not be considered a solicitation to buy or an offer to sell a security. It does not take into account any investor's particular investment objectives, strategies, tax status or investment horizon. You should consult your tax and financial advisor. All material has been obtained from sources believed to be reliable. There is no representation or warranty as to the accuracy of the information and State Street shall have no liability for decisions based on such information.

To learn how State Street looks after your personal data, visit: https://www.statestreet.com/utility/privacy-notice.html. Our Privacy Statement provides important information about how we manage personal information.

No permission is granted to reprint, sell, copy, distribute, or modify any material herein, in any form or by any means without the prior written consent of State Street.

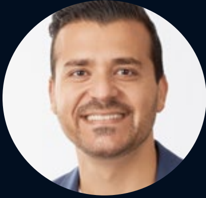
©2023 State Street Corporation
All Rights Reserved

61% investors said that maximizing the potential of their data is a top priority, our study informs.

Gain deeper perspectives to inform your strategy.

LEARN MORE

STATE STREET®


Kareem Sadek
KPMG in Canada
Email Kareem Sadek

Gautam Ganeshan
KPMG in the Cayman Islands
Email Gautan Ganeshan

Anthony Tuths
KPMG in the US
Email Anthony Tuths

Crypto as an asset class: Seeing past the volatility

Despite the turmoil of the past few years, asset managers continue to pile into crypto assets. This article explains why and – perhaps more importantly – how they are striving to reduce their risks and maximise their opportunities.

The rapid development and adoption of an entirely new asset class was never going to be smooth. In the early days of crypto assets, the risks were all about the newly developed technology, immense price volatility and uncertain government policy. As the investment world started to embrace crypto as an emerging investable asset class, the risks became more systemic and governance focused.

The past year was certainly tumultuous on that front. The collapse of the Terra Luna ecosystem and the UST stablecoin in May 2022[1] reminded investors about the importance of assessing the underlying collateral quality and liquidity. The demise of FTX taught investors about the value of robust due diligence and governance. The downstream implications of these – and other governance oversights – brought intense scrutiny to the crypto asset trading ecosystem.

Emerging stronger

As has been the case in past financial crises, lessons are being learned and practices are improving. On the asset side, governance is being enhanced and strengthened. Investors are conducting more robust due diligence and monitoring. Regulators are exploring what guidance they can provide to help reduce the governance risk. Everyone – investment teams in particular – are taking much longer to scrutinise assets and investment opportunities.

The 'crypto winter' also helped stakeholders better understand the roles and responsibilities of the different players in the crypto ecosystem. Unlike the traditional financial system where functions like processing, settlement and custody are very well defined and segregated, crypto ecosystem players may fulfil multiple roles through vertical integration of responsibilities. Greater familiarity with the risks and counterparties has allowed investment managers to create better diligence frameworks and controls, thereby enabling them to take a more informed approach to investing in crypto assets.

Testing the waters

While a healthy dose of scepticism remains, KPMG professionals' conversations with asset managers across segments suggest that many recognise the important role crypto will play in helping them achieve their long-term investment objectives. And that is driving more asset managers to dip their toes into the crypto waters.

At the very basic end of the spectrum, asset managers are using centralised exchanges to place buy and sell orders much like they would on a traditional equities exchange. This approach has enabled investment exposure to crypto assets while limiting the need to build specialist technical knowledge. Players are also gravitating towards the services side of the equation, creating crypto-based ETF products and offering crypto prime brokerage solutions. Many venture capital funds have been busy investing into companies on the leading edge of Web3 ecosystem development.

Adoption appears to be on the rise. More recently, mainstream financial institutions are starting to relax their cautious approach to crypto markets, with some major banks and investment firms launching or exploring their own crypto asset products and services. Moreover, the use cases for many of the underlying technologies (particularly digital ledger technology) are expanding beyond just financial transactions, with applications in areas such as real-world asset (RWA) tokenisation, digital identity, collectables, supply chain management, and decentralised social media. With the potential for innovation and growth in the crypto space expanding, more investors and entrepreneurs are flocking into the field.

Betting on crypto

There are three main reasons that asset managers are keen on crypto. The most common is to build capabilities and experience. Whether or not you believe crypto is the future, the reality is that it is a growing and increasingly investable asset class that is clearly here to stay. They recognise that crypto models are increasingly being used to tokenise traditional assets to enhance liquidity and improve operational efficiencies. The sooner investment managers start working in the space and understanding the nuances, the sooner they will be able to spot and take advantage of new and emerging opportunities.

1 The Alternative Investment Management Association Limited (AIMA) (2023, May). Digital Asset Trading - An AIMA Industry Guide. In https://www.aima.org/compass/practical-guides/digital-assets/digital-asset-trading.html.

The second reason is to capture early advantages in the emerging Web3 landscape. Venture capital players in particular, are hunting around to find the solutions and technologies that will unlock the next iteration of the internet. They are looking at crypto assets, marketplaces, and the underlying technology infrastructure. Others are looking to simply establish their credentials in the burgeoning new marketplace.

The last (but certainly not least) reason is for returns. There are examples of investors achieving staggering returns through savvy investments in crypto assets. The risks are likely higher than other traditional asset classes, albeit with heightened risk and price volatility. Typically, these investors have a time horizon of an investment cycle, which includes a period of low activity and adoption that precedes periods of intense speculation and mania.

Time for orientation

Regardless of your reasoning, your approach or your ambition in this market, KPMG professionals' advice to all asset managers is to get educated. Crypto is still relatively new, very fast moving and evolves at innovation speed. It is complicated, with many new players, roles, products and opportunities. And the regulatory environment (where one exists) is largely inconsistent globally.

Investors need to be aware of the many nuances associated with crypto assets before they step into this market.

They also need to know why they are doing it. They need a coherent strategy that supports the organisational strategy and the investment strategy. They need to be clear about where they intend to play and what rules and guidelines they are setting for their investment teams. They need to be sure they have robust governance processes and controls before moving forward.

Here's where the focus should be:

KPMG professionals' experience helping asset managers develop and execute their crypto asset strategies suggests there are four key areas where asset managers and investors should want to focus:

- **Enterprise risk management.** Trading in crypto adds some additional layers of risk over top of the traditional risk categories – in particular, cyber risks, technology risks, operational risks and custody risks. The challenge is that the pace of innovation and change in crypto markets make monitoring and mitigating risks much more difficult. Familiar risk management tools may not translate. New market participants, trading processes and market structures may lack the historical data required for traditional risk assessments. New technologies and security protocols are expected to be required. And all of these risks are compounded by a lack of clear regulation or process standardisation. KPMG professionals' view suggests those investing into crypto assets will likely want to assess their risks conservatively.

- **Regulatory considerations.** Regulatory responses to the increased use of digital assets varies by jurisdiction. Some have forged ahead by embracing digital asset regulation and others have chosen regulation by enforcement. While the EU currently sports a hodgepodge of different approaches, a new comprehensive regulatory regime (the Markets in Crypto-Assets or MiCA regulation) is expected to create harmonisation when it is passed sometime in early 2025. Other markets are also moving ahead – the UAE, for example, has created the world's first authority with a mandate to focus solely on digital assets (the Virtual Assets Regulatory Authority or VARA). In this environment, asset managers should assess the current and future regulatory regimes that might impact their crypto strategy going forward.

- **Service offering considerations.** Institutional investors and asset managers should develop a clear strategy for crypto that aligns with their values and risk appetite. They will likely need to develop their ecosystem to allow them to rapidly scale their operational and technology infrastructure. When onboarding new trading counterparties or venues, they will likely want to engage in robust due diligence that appropriately reviews not just the counterparty's risk controls but also their management team and corporate structures. And they should consider their approach to market access and the types of trading tools their teams will likely require in order to be effective.

- **Technology risk considerations.** While many of the technologies used in the crypto world derive base principles from blockchain technology, the specific implementation may differ significantly. It is important for asset managers to understand key risks associated with the technology used by various crypto products across underlying protocols, smart contracts, and custody.

Seeing past the volatility

As one might expect with the introduction of any new asset class, crypto has had its share of trip ups and stumbles. Some might argue that these are normal events in the maturation journey; their long-term impact may have been to make the markets more resilient, more transparent and more regulated.

Indeed, those able to look past the recent volatility to see crypto as an asset class may also see a long-term source of value. And many asset managers seem keen to increase their exposure to that.

Acknowledgements

George Djuric
KPMG in Canada
Email George Djuric

Mitchell Nicholson
KPMG in Canada
Email Mitchell Nicholson

Pramod Achanta
KPMG in the US
Email Pramod Achanta

James Suglia
KPMG in the US
Email James Suglia

Resiliency in Asset Management in a changing landscape. Getting fit for the future.

As we live through challenging times, inspiring leaders in the asset management industry are guiding their organizations through significant change at a rapid pace. From sharpening focus on high opportunity areas, adapting to new ways of working, implementing innovative technology, integrating ESG into investment decision making — KPMG professionals have the passion and expertise to help you make decisions about your business. We can make better decisions together to thrive in a changing landscape.

KPMG Asset Management practice
kpmg.com/resiliency

© 2023 Copyright owned by one or more of the KPMG International entities. KPMG International entities provide no services to clients. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Five operational challenges facing the modern family office

Darren Berkowicz
CPA – Managing Director and Head of SS&C Family Office Services
SS&C Technology

Advancing technology, cyber security threats, increased financial complexity, talent issues and generational change make running a family office today particularly challenging. This article explores how family offices can master these challenges and deliver high-quality service to family members.

The growth of wealth worldwide has been accompanied by a proliferation of family offices, the primary vehicle for protecting, preserving, and growing family wealth for the benefit of future generations. Much of the commentary on family offices has been devoted to the evolution of investment strategies and asset diversification. Less attention has been paid to the increased operational complexity family offices face. While wealth management is their traditional focus, family offices must also keep pace with complex tax, regulatory and accounting requirements. A family's growth with each succeeding generation adds more complexity, creating a larger clientele with diverse expectations and demands.

This growing complexity puts pressure on family offices to modernise their operations. The question is how to achieve greater efficiency and control internal costs while delivering a level of service family members expect and demand. To respond, family offices must address five key operational challenges:

1. **Increased accounting and reporting complexity**
   Family office portfolios today are far more diversified than those of a typical wealth manager. Along with traditional equity and fixed-income instruments, family offices are likely to invest in global markets, hedge funds, private equity and other partnership vehicles. Direct investments in businesses and ventures are increasingly popular. Assets also include real estate holdings and hard-to-value collectables ranging from art to automobiles. Meanwhile, managers must maintain sufficient liquidity to meet impromptu demands for cash from family members for big-ticket purchases.

   Moreover, family offices need to account for multiple investment entities, which multiply as the family grows. The growing number of separate entities and the complexity of services they entail are the chief drivers of internal costs.

   Add to these challenges the variety of tax and regulatory regimes around the world, and you get an extremely complex environment for accounting and reporting. Unfortunately, many offices are stuck in spreadsheet-and-calculator mode or have built proprietary systems which cannot easily adapt to the proliferation of investment types or entities. Technology exists today to support multi-asset class strategies, streamline and automate complex workflows and deliver a holistic picture of each client's wealth.

2. **Data security**
   Wealth owners place a premium on personal privacy. Family offices have a responsibility to protect not only their clients' assets, but also their confidential information. This is a major challenge in our interconnected world, where virtually every endpoint is a potential target for cyber criminals. In the 2022 RBC/Campden Wealth North American Family Office Report, 37% of family offices globally reported they had experienced one or more cyberattacks over the preceding year, while 31% said they do not have a cyber security plan in place. [1]

   Considering the amount of wealth family offices control, and the many electronic connections they have with financial institutions, they are likely to be targets of hackers and thieves. Are your security controls adequate to protect clients not only from existing threats, but from increasingly sophisticated and nefarious emerging schemes?

3. **Generational change**
   According to the Family Office Exchange, generational transition is a top concern of family offices today, yet fewer than one-third have a formal succession plan.[2] As families grow, their wealth cascades over increasingly large and diverse generations. Besides creating more entities and

1 Campden Wealth Ltd & Royal Bank of Canada, The North America Family Office Report 2022 (https://www.rbcwealthmanagement.com/_assets/documents/cmp/the-north-america-family-office-report-2022.pdf)

2 2022 FOX Foresight – The 3Ts: Critical Forces Disrupting Our Future (https://www.familyoffice.com/public-resources/3ts-critical-forces-disrupting-our-future)

increased accounting complexity, family office executives face differing generational attitudes and expectations. Younger family members may be far removed from the founding generation that first created the family wealth. They likely have very different ideas about wealth and money. Many are interested in steering their wealth to good works through impact and ESG-driven investments.

They certainly have different ideas about how they receive and consume information. Where older generations may prefer periodic paper or PDF reports, the younger generation has grown up with real-time, interactive information at its fingertips on demand. Family offices must be equipped to satisfy this range of expectations, with the flexibility to deliver reporting through the preferred channel of each family member.

This flexibility is especially important for younger family members who may question the direction of the family office or choose to leave the fold entirely and seek wealth management counsel elsewhere. To retain these clients and their assets, the office must be able to demonstrate it is technologically up to date and can readily deliver the information younger members want in the way they want to receive it.

4. **Keeping pace with technology**
   Technology can play a crucial role in addressing each of these challenges. However, a comprehensive portfolio management, accounting and reporting platform represents a substantial investment – not to mention add-on solutions for trading, analytics, risk management, compliance and other functions. Moreover, given the pace of technology, offices must constantly review their systems to ensure they are not at risk of falling behind or outgrowing their capacity.

   Family offices need to ask if it makes sense to own and maintain their own technology infrastructure, or if they should find an outsourcing partner to take on that burden so they can focus on the family financial objectives.

5. **Scaling staff resources**
   Family offices also need to determine the different skills and expertise they need within their own walls. Pressure to keep headcount low means focusing on the core mission of wealth management. Yet running a complex wealth environment frequently calls for specialised tax, accounting, compliance, systems and operational expertise, as well as in-depth knowledge of specific investment instruments and markets. In the wake of the pandemic of 2020-21, the investment industry has experienced a talent shortage and difficulty filling key positions, from portfolio management to operations and IT.

   In addition to their internal resources, family offices must have access to trusted professionals whose knowledge and capabilities complement and augment the strengths of the in-house team.

The outsourcing option: what to look for

In the face of these challenges, many family offices are choosing to outsource some or all of their core technology, as well as their middle- and back-office operations. On the technology side, outsourcing can produce cost savings

compared to traditional software licensing, implementation, training, maintenance and upgrading, while also reducing the need for IT staff. On the operations side, outsourcing can deliver significant efficiency gains without the need for additional back-office staff or specialised expertise in operational functions.

Not all outsourcing providers are the same, however. When evaluating providers, it's important assess whether they have the resources and industry expertise to serve as an extension of your office as a true partner. Key characteristics to look for include:

State-of-the-art technology: The systems and solutions the provider operates on your behalf should be of industry-leading calibre and reflect an in-depth understanding of your business needs.

Commitment to continual innovation: A key reason for outsourcing is to relieve the need to keep current with technology – which means your outsourcing provider must assume that responsibility. Does the provider have a track record of continual reinvestment in technology?

Dedicated service and support: Be sure the provider offers 24/7 support with people who are thoroughly trained on the inner workings of the solutions you depend on.

Comprehensive accounting and reporting: Can the provider handle all your calculations and information requirements, including tax, partnership allocations and performance, and deliver a complete, accurate picture of each family member's wealth?

Flexible reporting options: The provider should have hard-copy, web-portal and even mobile reporting capabilities to satisfy the requirements of different family generations.

Security: The provider should be able to demonstrate audited security controls complying with the highest industry standards for protecting data at rest and in transit.

Comprehensive operational services: Does the provider have the breadth of capabilities to take on any or all of your operational needs? Ideally, you want to be able to outsource to a single provider.

Customisable co-sourcing options: You may have reasons for wanting to control certain operational processes in-house. The provider should have a flexible, client-focused service model easily adaptable to your preferences.

Complementary expertise: Look for a provider to augment your staff resources with experts in accounting, tax and compliance issues as well as operational best practices.

The good news for family office executives is they do not have to go it alone in building out their operational infrastructures to satisfy the increasingly complex demands of multi-generational family wealth. The key is finding an outsourcing provider with the breadth of capabilities, depth of expertise and proven infrastructure to serve as your partner in delivering outstanding service to family clients.

Driving the Future of Hedge Fund Administration
Intelligent Technology

Technology. Servicing. Expertise.

Investment operations is what we do and we do more than anyone else. For every fund, portfolio, strategy, asset class and tax regime. Talk to SS&C today.

For more information, visit
ssctech.com

Prime broking in a new era: Helping funds adjust to turbulent times

Andrew Rae-Moore
Co-Head of Europe TD Cowen Prime Services

Interest rates in major economies have risen dramatically in the past year, in a number of cases reaching levels not seen since before the 2008 financial crisis. As a result, portfolio managers face a radically different market dynamic, one where the assumptions that were built into a range of investment approaches no longer automatically apply.

At the same time, many fund managers, until last year, had little experience with this kind of environment. Before interest rates started to climb, equities had enjoyed a nearly two-year bull run. But the past year and a half have been much choppier, as the risk-on trade has ceased to be the default position.

Andrew Rae-Moore, Co-Head of Europe TD Cowen Prime Services, Europe provides insight into how a prime broker can help during such turbulent times and the key factors to consider when selecting which prime brokers to have in your stable, given the current economic climate.

1. Consulting

One of the main ways a prime broker can provide support is through consulting. At TD Cowen, we see a big part of our role as being there to explain situations that might be novel to some fund managers, particularly in the case of emerging funds. For instance, the upward shift we've seen in yield curves has created fresh incentives to do more than keep excess cash in money market accounts. But not every manager will know what opportunities there are, or what might be involved in seeking to tap into them. Also, not every prime broker has the bandwidth to engage in such in-depth conversations with all of their clients.

2. Added value

A proactive approach is vital. As most funds had grossed down exposures since the latter part of last year, many began to carry meaningful credit balances more consistently. As an example, this provided us with the opportunity to engage with our clients, alert them to the better rate spreads, and add value with our capabilities and service-oriented approach.

Select a prime broker that prides itself on providing added value. If they have a large team of veteran traders, you will be able to draw on their knowledge, experience and trading capabilities. One of the ways in which a prime broker can provide even greater support for in-house trading desks is through outsourced trading – a service which is on the rise as a proven, quick and cost-effective way for fund managers to source expertise, experience, global reach, deep liquidity and cutting-edge technology.

3. Service levels & capabilities

A key question that managers – whether they are large or small funds – should be asking as they consider adding a new prime broker is what kind of service does the prime broker provide? They should also check whether the prime broker has the right suite of services to help a firm take advantage of opportunities as they arise.

Bulge bracket providers can obviously perform well on both of these counts, but they may face constraints in terms of high-touch service provision due to the sheer number of clients they have to support. They may not always be able to provide the level of TLC that some fund managers would want. Smaller prime brokers, however, may perform well in terms of service but not so well on the breadth of offering. The sweet spot is when a prime broker fits the bill with regards to both aspects. For new funds with less-experienced managers, the combination of service and expertise can help them explore unfamiliar terrain quickly and with minimum fuss.

All prime brokers will undoubtedly talk positively about their focus on customer service, but the service a fund receives can vary, depending on the size, personnel, culture and business model of the provider. For instance, large bulge bracket providers may have to reserve more of the personalised service for their biggest clients. Many of them simply don't have the bandwidth to handle detailed, time-consuming questions from all of their clients. To put the numbers into perspective, when Credit Suisse exited the prime brokerage market, it had about 1,800 clients. At the other end of the spectrum, some smaller prime brokers may not necessarily have the experience or expertise to deal with every request and scenario.

What's changed?

Why does this matter more now than before the past year's upheaval? Because so many managers, particularly those who have been focused on equities for the past decade, have incentives to look more seriously at other asset classes and could benefit from having a prime broker that can answer their questions and facilitate new types of trades. Most of the larger prime brokers are unlikely to spend the time required to discuss with all of their clients, for example, the pros and cons of something as simple as switching into very short-term treasuries from cash or money market funds in the current environment, how that would impact their workflows and how it may benefit their fund.

These kinds of questions may be obvious for funds that are familiar with interest rate products and strategies, but there are plenty out there that don't have that experience. Having the capability to then facilitate the transaction for the client in an efficient and cost-effective manner completes the service.

Stay a step ahead

Last year was marked by a sudden jump in inflation, putting strong upward pressure on global interest rates. At the time of writing, the inflation situation appears to be calming in many developed economies, which in theory takes some of the pressure off. But no one has a crystal ball.

More to the point, there is a sense that the interest rate genie is out of the bottle. After short-term rates hovered close to zero in the United States for many, many years, yield curves around the world have now shifted. That creates both new possibilities and new pitfalls for funds. Managers looking to exploit the former and avoid the latter can benefit from a prime broker that knows its way around the credit markets.

TD Cowen
a division of TD Securities

TD

GLOBAL FULL-SERVICE PRIME BROKER

Comprehensive Solutions and Exceptional Service Levels

TD Cowen Prime Brokerage is growing rapidly worldwide, with clients benefiting from our comprehensive expertise and suite of services.

Prime Brokerage | Electronic & High-Touch Execution | Outsourced Trading
Portfolio Financing | Securities Lending | Middle & Back Office Support
Capital Introduction | New Launch & Business Consulting | Commission Management

150+ PRIME BROKERAGE TEAM | 10 OFFICES WORLDWIDE
20+ YEARS OUTPERFORMING | CONSISTENTLY RANKED AMONG THE TOP 10 BEST PRIME BROKERS GLOBALLY*

* Global Custodian Annual Prime Brokerage Survey

TDCOWEN.COM | TD COWEN | TD COWEN | COWEN AND COMPANY, LLC | MEMBER: FINRA/SIPC

Cowen Inc. and its affiliates are wholly owned, indirect subsidiaries of The Toronto-Dominion Bank. ®The TD logo and other trade-marks are the property of The Toronto-Dominion Bank.

Richard Langdon
Head of Asset Management UK, Risk & Broking
WTW
Email Richard Langdon

Samita Kaur
Claims Analyst, Financial Institutions
WTW
Email Samita Kaur

Mitigation and insurance

Do you have cover?

What is mitigation from an insurance perspective?

Mitigation provisions in insurance policies are important when a problem or error arises which could prove costly to a business. It should be unsurprising that in this moment the questions of how to contain the problem, or how to stop it from turning into a crisis, arise.

From an insurance perspective, these questions may point you in the direction of mitigation cover under Professional Indemnity (PI) policies. Mitigating a loss is typically described as a payment made by an insured (including costs and expenses being potentially incurred) to investigate, prevent, mitigate, rectify, or compromise any 'wrongful act' (which may be defined under the policy), event, matter, or circumstance that could give rise to a loss/claim.

How can mitigation cover help in respect of trading errors? Insureds can look to seek indemnity for costs they may incur to correct an error before it develops into a crisis. Most importantly, eliminating the risk and cost associated with a third-party claim as well as protecting business interests is key to any risk management strategy. It may also be to the benefit of insurers as swift action can reduce the costs and potential liability incurred.

Mitigation and trading errors in the spotlight

It is not unusual to see businesses having to explain the correction of a trading error to mitigate significant consequences, such as mass customer complaints, reputational damage and, most importantly, third-party legal action. There are many scenarios in which mitigation provisions can (subject to policy terms and conditions) provide cover. A review of WTW claims records illustrates that a scenario might include execution/process errors such as input and *'fat finger'* errors, missed deadlines, miscommunication, and collateral management failures, each of which can result in significant losses that need to be avoided or corrected.

Errors can take shape in the form of an incorrectly categorised client in the system resulting in erroneous charges or the discovery of a hedging error, causing a loss to the fund and customers.

Mitigation cover in practice

In 2012, mitigation coverage was put into the spotlight as a result of a life insurer who made a payment of £100m into a pension fund to mitigate its risk of mis-selling claims. They looked to recover the payment into the fund under its mitigation provision. This went before the court as Insurers argued that it did not make the payment 'in taking action to avoid a third-party claim', but questioned whether the cash injection into the fund was done to protect the firm's reputation and avoid the potential brand damage, rather than with the motive of avoiding or reducing a claim.[1]

The Commercial Court's decision went in the life insurer's favour and upon appeal by the Insurers, the Court of Appeal further upheld the Commercial Court's decision that the policy in question did not apportion the coverage in this way and that as long as the payment was made to avoid or reduce third-party claims, and that they were of a type that would have been covered by the policy, the Insured's motive was irrelevant.[2]

Separately, in 2020, an Investment Manager paid US$105 million after it discovered and corrected an error regarding the quarterly rebalancing of funds. In short, the Manager discovered there was a delay in rebalancing the funds which affected their value and therefore announced the US$105 million contribution to the Funds to compensate them for the performance difference that arose from market movements as a result of the delay.[3] Although, it is unknown whether the manager was indemnified by their PI insurers, this is another good example of why mitigation coverage can be useful.

We can see that for execution and process errors, there is a high frequency of claims in which the error involved a missed deadline/delivery failure.

Insureds may want to consider their policy as to what coverage is available to them in these scenarios and to also take care to follow policy provisions in relation to notification.

Are these claims frequent?

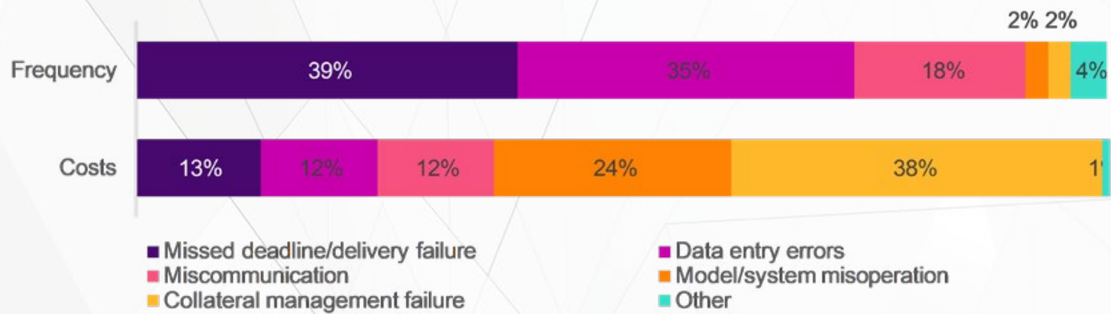
WTW proprietary data demonstrates the frequency of trading error claims from 2007 to January 2023. We can see that for execution and process errors, there is a high frequency of claims in which the error involved a missed deadline/delivery failure. However, although these types of errors may be more frequent, the costs of the claims are typically low. In contrast, although collateral management failure claims are less frequent, when they occur, they are the costliest.

Model/system errors are also costly claims despite being less frequent. The data serves as a reminder to insureds that errors that may seem like a rare occurrence can prove costly and cause a more significant financial impact than other more frequent errors. Therefore, in these circumstances, mitigation cover becomes an important asset in crisis containment.

1 Standard Life Assurance Ltd v ACE European Group – financial mis-selling claims
2 https://cms-lawnow.com/en/ealerts/2013/01/liability-insurance-court-of-appeal-upholds-first-instance-decision-on-apportionment
3 Invesco pays $105m in compensation after rebalancing errors on two US-listed income index funds

Execution / process errors

There are several different types of process failure that we see relating to the transactional execution of trades.



Conclusion

Insureds may come across scenarios or events similar to those discussed in this article in which they are faced with events or circumstances which require them to act quickly in the interests of crisis control for the business. As demonstrated, these decisions can prove costly and therefore it is important to incorporate a review of your insurance policy for coverage, as well as reviewing trade error and risk management protocols. Should mitigation coverage be available, Insureds should be mindful of any limitations as to what costs can be covered or potential preconditions that must be met, for example seeking the insurer's prior consent before incurring mitigation costs.

How do you move from complexity to clarity? From the unknown to the untapped?

At WTW, we provide data-driven, insight-led solutions in the areas of people, risk and capital that make your organization more resilient, motivate your workforce, and maximize performance. We work shoulder to shoulder with you, bringing diverse points of view and a deep commitment to your success. By challenging one another, we achieve breakthroughs because only the best ideas survive. The result? Innovative solutions that meet your needs — informed by the global view and the local understanding of our colleagues around the world. Together, we broaden your horizon and sharpen your focus. Transform your toughest challenges into actionable opportunities. And set your path for sustainable success.

This is perspective that moves you.

Henry Keville
FINEX GB Head of Financial Institutions
+44 20 3124 6445
henry.keville@wtwco.com

Richard Langdon
Lead Relationship Manager – Asset Management
FINEX Financial Institutions
+44 20 3124 8485
richard.langdon@wtwco.com

wtwco.com

NAV facilities gain momentum

Shiraz Allidina
Managing Director
Citco Capital Solutions Inc.

As the United States turns the page on the COVID-19 crisis, it suddenly finds itself facing a new predicament relating to the liquidity and solvency of a small number of its regional banks.

Though crises cause upheaval, they often catalyse the spread of technological, cultural, or financial innovation. An example of the latter is a little-known institutional financial product which has increasingly gained industry acceptance: the Net Asset Value (NAV) credit facility.

A NAV facility is most often a loan to an alternative investment fund that is secured by the fund's investments. Collectively comprised of its Net Asset Value, such investments may consist of private equity, venture capital, infrastructure, credit, real estate, or holdings in other investment funds.

Why do these funds seek to borrow? Typically, they desire flexibility to deploy additional capital after the commitments from their investors have been exhausted. This may be due to an unforeseen extreme event (such as a pandemic, or a banking crisis), requiring them to play defence and support existing investments – alternatively, they may seek to take advantage of a lucrative follow-on investment opportunity.

As central banks worldwide have tightened financial conditions, capital markets, as well as banks, have followed their lead, reducing both the volume and pricing of asset sales. Indeed, PitchBook estimates the exit (sale of assets) to investment ratio for private equity firms hit a 10-year low in 2022 as investors continue to find new opportunities or refuse to exit at valuations they deem too low.[1] As a result, private equity and other alternative investment funds have been seeking other avenues to generate liquidity – and chief among these are NAV facilities.

A NAV loan may also be used when institutional investors seek incremental leverage on their Limited Partnership (LP) holdings in alternative funds. Typically, the institutional investor submits a subset of their alternative investment holdings to a lender as collateral for a NAV loan, thus creating liquidity. Historically, institutional investors have tended to use this type of loan in order to generate liquidity when the cash flow from their LP portfolio is expected to slow. At times, institutional investors have also used NAV loans in lieu of a sale of assets on the secondary market, allowing them to avoid having to book a potential loss. By using the NAV loan for interim liquidity, the fund may later realise the assets in an orderly manner over time.

Lenders who extend NAV facilities include banks, insurance companies and specialtiy private lenders. The Fund Finance Association – a non-profit industry association in the fund finance market – estimates the current size of NAV facilities globally to be less than US$100 bn, which represents well under 1% of the estimated value of private capital investments. 17Capital, a private lender, projects the NAV market to grow to US$700 bn by 2030.[2]

1 PitchBook, 'Q3 2022, US PE Breakdown', page 16
2 17Capital, 'NAV Lending – the emerging opportunity for Private Debt Investors', page 10-11

The innovation behind NAV facilities

NAV lenders tend to be conservative in their structuring and underwriting and rely on several features of the facilities to protect themselves.

First and foremost, NAV facilities are low leverage, usually between 5% and 25% of the fund's value. By looking at historical data, including investment performance during and after the great financial crisis (GFC), lenders size facilities with a requisite margin of safety to ensure the borrower can withstand a severe systemic downturn.

Second, unlike a leveraged loan to a company sponsored by a private equity firm, a NAV facility's collateral consists of a diversified pool of investments, typically a dozen or more individual positions. This diversification protects the lender against idiosyncratic shocks at the portfolio level.

Third, the NAV loan is fully committed by the lender at closing, and maturity of the facility is typically matched with the expected liquidation timeframe of the underlying assets. Unlike products such as repo loans, which engage in maturity transformation, there is little risk of a 'run on the bank'.

NAV facilities are low leverage, usually between 5% and 25% of the fund's value.

Lastly, these facilities benefit from a structural alignment of interests: both the fund sponsor (the asset manager) and its investors are fully subordinated to the NAV lender in priority of payment. For an asset manager to continue its main business of raising future capital, it would be disastrous to default on a NAV facility. Though private equity managers are notoriously clever game theorists when dealing with lenders, every manager understands that fundraising is a repeated game. Similarly, the fund borrower shares an alignment with the lender in that a default would create a number of structural and reputational issues for its investors.

For these reasons, NAV loans are an innovation which can increase financial stability, acting as a safety net for alternative funds, allowing them to generate liquidity without selling assets at inopportune values. Meanwhile, capital providers benefit from stable funding and low Loan-To-Value (LTVs) ratio and are thus able to act in a countercyclical manner, improving the resilience of their borrowers.

The historical evidence is also encouraging: during the GFC, NAV facilities were primarily used for fund-of-funds – investment vehicles that pool capital and invest in underlying strategies managed by third-parties. Unlike leveraged loans, high-yield bonds or residential mortgages, NAV facilities enjoyed favourable credit outcomes during the crisis, with minimal defaults and losses.

This is why further growth in NAV lending is likely from here. They offer alternative asset managers a prudently structured solution, providing liquidity and helping the manager fulfil its fiduciary duty to its investor clients. For lenders, they provide a secure, low loan-to-value credit structure with a diversified collateral pool and favourable alignment of interests. Systemically, these facilities serve as an important source of stability for alternative investment vehicles, facilitating the efficient allocation of capital which underpins the global economy.

Noah Shipman
Partner
Vistara Growth

Mind the gap:
Who will fill the void left by SVB in tech lending?

For those who work in venture lending, it was a surprise to see Silicon Valley Bank (SVB) collapse due to incompetent risk management at the bank level when it had done a diligent job of managing the risk in its loan book through cycles for over 40 years. Like the venture equity market which saw crossover funds and other new entrants write big cheques into marginal deals and then suddenly vanish, the venture debt market also had its share of 'tourists' aggressively bid to win deals by providing increased leverage on looser terms. As such, most tech investors would have bet that a more recent entrant rather than a stalwart like SVB would be the first domino to fall. Yet, SVB toppled first, and other regional banks have fallen or are teetering, leaving an undeniable void that has remained unfilled since March.

A gap worth filling? Diverging views on venture lending

Investors who are bearish on venture lending are correct that some lenders, especially those who pushed for market share late in the cycle, and blindly followed venture capital (VC) equity sponsors into deals, will at best earn debt-like returns for taking equity-like risk. Others incorrectly confuse SVB's lending practices with their irresponsible treasury operations which have nothing to do with the risk-reward of lending to technology companies.

Other investors are bullish and see a generational opportunity, especially for non-bank private debt funds, to replace SVB's position in the market. In addition to the suddenly wider market opportunity and low loan losses, investors are also encouraged by strong economics available relative to other forms of direct lending via floating rates with high floors, multi-year no-call provisions (minimum years of interest), and upside with added convexity from end-of-term payments, strong equity warrant coverage or convertible features.

Moving money was (too?) easy. Refinancing SVB's loans is proving difficult for borrowers

Those already inside the ecosystem investing in and lending to technology companies have slowly recovered from the initial shock and endless stories of how the bank mismanaged its own affairs. Instead, the industry is squarely focused on answering: who will fill the gap left by SVB, by far the largest and most active lender to technology companies?

SVB had a very loyal following among entrepreneurs and venture equity funds, and the bank made loans on the basis of those relationships. During the bank run, it was estimated that nearly all deposits that fled SVB landed at systemically important too-big-to-fail banks like JPMorgan or digital challenger banks like Brex. With deposits safe, companies turned their attention to replacing their loans from

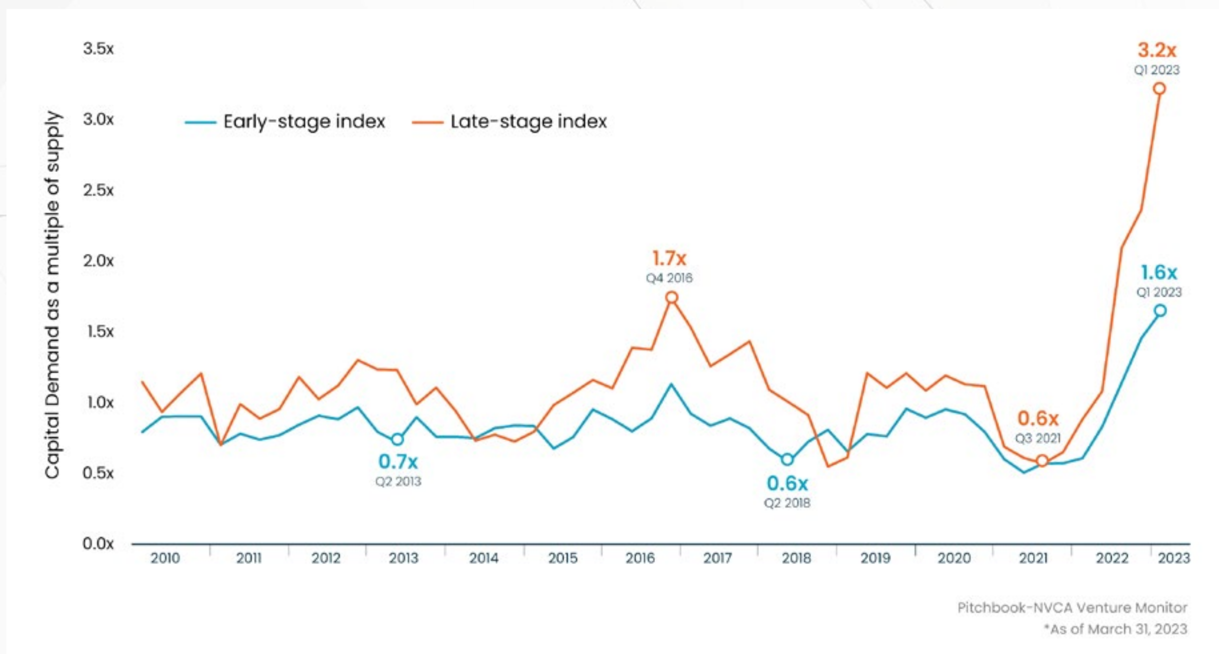
SVB. These were typically annually revolving facilities or term loans with 12-18 months of interest only payments followed by relatively short repayment periods. Most technology companies never intend to service and fully pay down debt principal but rather refinance before they reach the amortisation cliff. With fast-approaching maturities or the onset of amortisation, boards realised they needed to act quickly. Unfortunately, the big banks and their digital challengers which were so keen to accept the deposits of technology companies weren't willing to extend them any credit.

Regional banking aftershocks add insult to injury for tech companies raising growth capital

For technology companies trying to raise growth capital, now also faced with refinancing their loans from SVB, it couldn't come at a worse time as venture equity supply has dropped precipitously, resulting in dramatic cost cuts to try to extend cash runway. Pitchbook and the National Venture Capital Association (NVCA) track investing activity and have suggested that there has never been a larger supply-demand imbalance. This is most acute at the later stage, where Pitchbook-NVCA estimates that there is US$3.24 of demand for capital for every US$1.00 of supply.

Late-stage capital-demand-to-supply ratio reaches decade high

Growth capital sought by tech companies relative to venture capital supply



It is not lost on venture lenders – including bank and non-bank funds lending to both sponsored and non-sponsored companies – that the later-stage companies who are the most established and creditworthy ironically seem to be having the most difficulty raising growth capital due to a disconnect on valuations. The entire technology investment ecosystem also recognizes that the financing gap which had already widened with rising rates and lower equity valuations, has now widened considerably further with the collapse of SVB. Who will fill this gap, both to refi SVB and potentially help fill some of the equity gaps to support growth?

The candidates who might fill the gap

Will it be the too-big-to-fail banks where most of SVB customer deposits were moved? Rapidly growing businesses without hard assets nor historical positive cash flows are far from these banks' ideal customers so only a select few will qualify for a material amount

of credit. Tech companies are no longer hot IPO candidates for a capital markets division, and the once big private company paper gains of tech entrepreneurs are no longer the attractive wealth management clients that these banks were trying to win by providing credit.

How about the digital challenger banks where many startups moved their deposits? These entities provide cash management and investment accounts, credit cards, and spend management solutions, but have small, if any, lending operations. They have onboarded many new clients, but by design and regulation, they cannot replace any meaningful amount of SVB's lending activities.

How about the regional banks, SVB's traditional competitors? The stock market punished banks with even modest tech concentration in their loan book. They remain active, and a few banks have notably poached senior SVB personnel, but there doesn't seem to be a rush to grab market share. In many cases, these banks have had margin compression and are trying to optimise their loan books based on static or shrinking deposits (many customers are demanding to hold material deposits in investment accounts or outside their bank lenders accounts limiting capital and hurting margins), still leaving a very large gap.

...funding from non-bank growth debt funds increased to try and fill the gap.

Wait, what about the bank itself, now 'SVB (a division of First Citizens)'? To the surprise of some, they remain active in the US (much less so in other regions; in the UK SVBs operations were bought by HSBC and in Canada these are currently being auctioned) but are subject to stricter underwriting with less capital available while battling to regain the trust of customers, still leaving a big gap.

Have the venture equity funds stepped up? Very much case by case, but as mentioned above Q1 2023 showed a continued deceleration of activity and a worsening shortage of venture equity availability for early, growth, and late-stage technology companies. If anything gaps between supply and demand for traditional equity and bank venture debt both widened.

While data is still limited, it appears **funding from non-bank growth debt funds increased to try and fill the gap**, at least for growth and later-stage companies. In fact, several private fund platforms have quickly increased target fund sizes on the basis of the suddenly larger size of the addressable market.

The changing landscape and rise of non-bank growth debt funds

We believe the 'non-bank' segment of the market will expand to fill the gap now left by SVB and other regional banks. Vistara Growth has been operating in this market since 2015 and has witnessed steady growth in participants looking to fill gaps from small tax credit-backed loans and revenue royalties to early-stage start-ups, to mid-stage companies looking to extend runway, out to later-stage companies looking for a bridge to achieve that last leg of growth before an IPO or exit. Despite the increased competition, demand has consistently outpaced supply of debt capital for technology companies, and with recent events that imbalance has widened considerably. We welcome the continued competition and maturation of our asset class, validation of the opportunity we have seen throughout our careers and continuing long into the future.

Simon Hopwood
Partner
Maples Group

Tim Morgan
Partner
Maples Group

Jersey funds in bespoke transaction structuring

There are many things for managers to consider when they are looking for bespoke structuring in their funds or portfolios, where increasingly diverse and sophisticated structuring techniques are used.

Of course, Jersey has been a key fund structuring jurisdiction for many years, and flagship funds continue to be routinely set up both for long-established and new sponsors, covering the range of asset classes from buy-out, private equity, venture and technology, through to credit and real estate but also including more liquid strategies.

While the core of fund activity continues to be comprised of such blind pool structures, we will instead look at recent experience of deploying Jersey funds and related vehicles in bespoke situations. In the context of significant volatility and swings in market conditions due to a variety of macro factors, many sponsors and managers have increasingly looked to innovative structuring to achieve their strategies – in an echo of the phenomenon of convergence which was witnessed between asset classes in previous economic cycles.

Much of the present activity also derives from changes in investor bases. Liquidity issues are at the forefront of recent trends such as GP-led restructuring deals. These are often accompanied by a widening into new investor groups who may have differing liquidity, as well as regulatory or eligibility requirements.

Designing a flexible structure

Once the need for liquidity or additional capital has been identified, jurisdiction selection may not immediately spring to mind but, there are compelling reasons why many transactions use Jersey structures.

Regulatory flexibility, tax neutrality, track record, speed to market and cost efficiency (factors offered by a centre such as Jersey) are always high on the list when raising capital in a new fund but these qualities take on renewed significance where there is a complex deal driving the structure.
This may arise from having a historical Jersey fund in the structure or may also be relevant even where the fund in question is domiciled elsewhere, but where Jersey can provide a quicker or less complex solution.

In relation to co-investment and parallel funds, typically investor preferences will drive the location of the vehicle through which they invest. These can vary from levels of regulatory fee burden or reporting (often a driver for a Jersey parallel to an EU fund which would otherwise have full Alternative

Investment Fund Managers Directive (AIFMD) obligations) as well as eligibility (often a driver for a Jersey parallel to a Caribbean or North American vehicle).

The Jersey Private Funds (JPF) regime provides a sophisticated and light touch approach to regulation for professional investors, with regulatory approval being obtained quickly and efficiently. The JPF regime can apply to any legal structure, for example:

- Jersey limited partnerships have been enhanced by recent partnership law changes in 2022 and the ability to provide for the migration into Jersey of partnerships established in other jurisdictions which can be helpful in restructuring deals.

- Corporates, and particularly cell companies, have been used in a number of recent single managed account structures in relation to credit funds. The attractiveness of the ability to deliver different cells for consecutive series of underlying credit strategies have become a common route for investors requiring an easily replicable model.

- There has also been a return to the well-established vehicle of the unit trust, which for real estate investment by global investors has retained momentum, particularly since the UK tax elections regime (introduced in 2019) has become the market standard for real estate in that jurisdiction.

JPFs can be open or closed-ended, meaning JPFs can be designed with characteristics to suit many hybrid structuring situations.

At the same time, many hybrid structures will not need to be treated as funds and, accordingly, many co-investment or AIV structures may be able to be treated as investment holding or JV structures which do not require fund treatment.

Finally, many of these deal structures sit alongside financing packages. A wide mix of financing facility types (e.g., subscription line, NAV or asset-based financings or hybrid combinations of these) are regularly seen in the Jersey market.

Deal structures that have recently been popular include the following:

Continuation funds

Continuation funds are now being widely used by institutional investors across closed-ended funds as a tool to actively manage and strategically realign their portfolios. They have also become a means for managers to realign investor bases. This surge has been accelerated by a shortage of reasonably priced, quality assets, incentivising managers to find ways to delay or reset exits for star portfolio assets.

While these manager-led transactions can take a variety of forms, typically the existing fund will sell its existing portfolio, or a strip of that portfolio, to a newly established special purpose vehicle (the continuation fund). Existing investors will have the option to either rollover their interest and/or invest additional capital alongside the new investors in the longer life continuation fund (to the extent of wishing to participate in a longer hold period) or to cash out and gain liquidity, with incoming secondary buyers underwriting the transactions and any corresponding purchase price.

These deals involve a range of stakeholders with differing, and often conflicting, interests, and short timetables, which places operational pressure to manage regulatory processes on top of the commercial deal.

Often deferring the legal/regulatory process for the new vehicle until it has more certainty regarding the deal, by taking advantage of the fast-track Jersey formation and regulatory approval processes can be helpful. This means that managers can focus on transaction mechanics, without front loading regulatory and establishment costs.

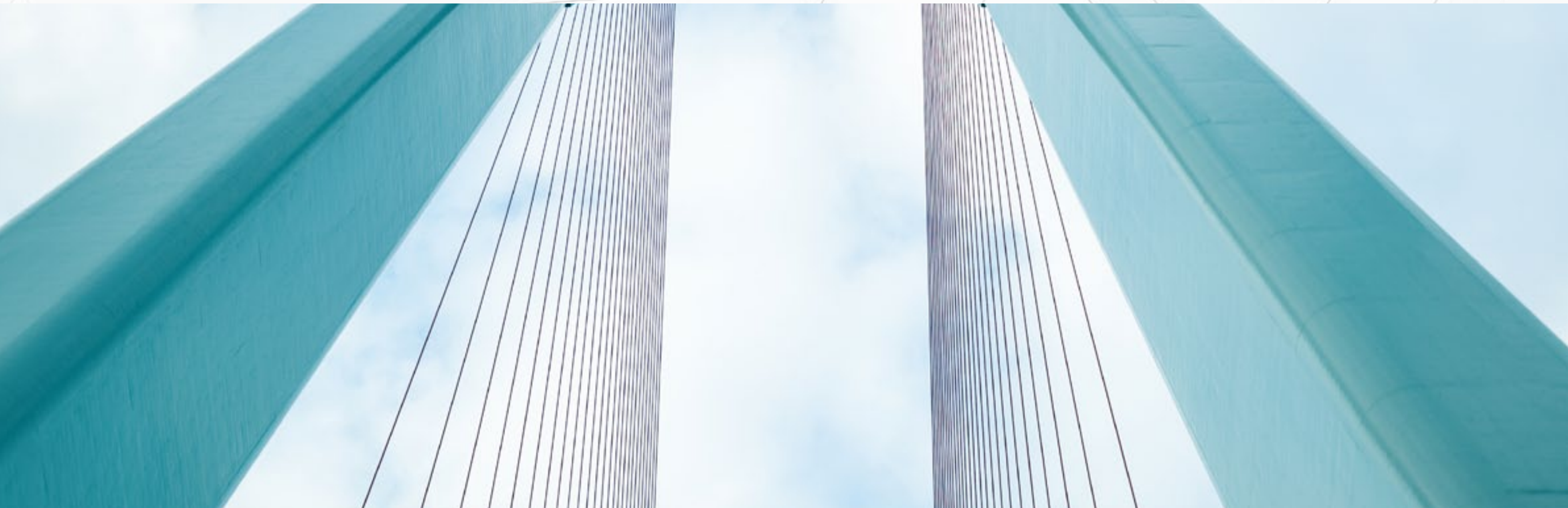
The ability to establish vehicles on a 'same-day' basis combined with a 48-hour regulatory turnaround for fund approval can assist with this approach.

Annex funds

A further derivative is an annex fund being a newly formed vehicle (normally a partnership), often funded on an accelerated timeline, to inject new capital into investments held by the existing fund. Annex funds are typically raised after the main fund's investment period and are formed to support follow-on activity in certain existing portfolio companies.

Preferred equity

Preferred equity deals involve a preferred equity provider contributing additional capital to a fund and, in return, being granted priority over the distributions from a defined asset (or group of assets) held by the fund. The priority will typically expire once the investor has received proceeds equal to capital plus a minimum return or multiple. A preferred equity deal is typically structured by transferring relevant asset(s) to a newly established special purpose vehicle, which then issues preferred shares.



Co-investment vehicles

Useful where an investment opportunity is not suitable for a manager's existing fund, either by reason of liquidity profile of the asset or as a result of concentration limits or other restrictions in an existing fund. It can be particularly relevant in the case of a distressed or special situation deal, or where fund investment periods have expired but there are some years until the fund is due to terminate, but where mechanisms in the fund documents such as re-investment and follow-on provisions are unavailable.

Provided that there is no need to actively market the vehicle to investors in the EU, AIFMD compliance can be avoided for a Jersey co-investment fund.

Typically, a co-investment vehicle generally will not be subject to fund regulation in Jersey and there would be no regulatory requirement for an offering document or other formal disclosure documents.

Even if there is a need for EU marketing to certain investors, a Jersey vehicle can again take advantage of cost-effective and targeted marketing to select EU jurisdictions through relevant national private placement regimes.

Parallel funds and separate managed accounts

We have also seen an increase in parallel funds, allowing participation in the same investment opportunities as the main fund while offering flexibility to tailor the terms and conditions to meet specific requirements. There are overlaps with separate managed accounts (SMAs) which can include variations in fee structures, investment minimums, lock-up periods, or different levels of risk exposure. In some cases, certain investors may have regulatory or legal restrictions that prevent them from investing in the main fund.

Parallel funds and SMAs can also be structured to accommodate these restrictions, allowing investors to participate without violating any regulations. Parallel funds can also streamline the fundraising process by targeting specific investor segments or strategies, i.e., according to criteria such as investor type, geographic location, risk appetite, or investment size. We also see parallel funds enabling managers to customise strategies including fee structures, investment minimums, risk profiles, or regulatory compliance requirements.

There are overlaps with separate managed accounts (SMAs) which can include variations in fee structures, investment minimums, lock-up periods, or different levels of risk exposure.

Often a Jersey parallel sleeve will offer familiarity to global investors, but also comfort from a European investor base perspective. For example, Jersey is eligible from an Organisation for Economic Cooperation and Development (OECD) perspective for certain institutional investors.

Conclusion

Many of the elements above are often combined, but generally, this represents an ongoing trend in tailoring elements for different investor dynamics.

This requires a high level of 'transactability' as often various corporate and transaction experiences are required, drawing from different asset classes and deal flow experience, but also deploying experience from finance and security as well as restructuring deals.

As the pattern of widening types and requirements of investors into alternative asset classes continue, we anticipate that this trend will continue.

Thank you for reading the Edition 134 of the AIMA Journal.

If you would like to contribute to future editions, please email Caterina Giordo

PUBLICATION PLAN 2023

- Q3 Edition 135

Deadline for submission 5pm UK time Monday 24th July | Publication Monday 18th September

Please note the deadline to reserve a spot for the Q3 edition of the AIMA Journal is 5pm UK time Friday 7th July. Please note that availability is limited, and we cannot accept any additional contributions once all the spots have been filled.

- Q4 Edition 136

Deadline for submission 5pm UK time Monday 23rd October | Publication Monday 20th November

Please note the deadline to reserve a spot for the Q4 edition of the AIMA Journal is 5pm UK time Friday 6th October. Please note that availability is limited, and we cannot accept any additional contributions once all the spots have been filled.

Visit aima.org for more information and to read our editorial guidelines.

Important, please read:

The Alternative Investment Management Association Ltd (AIMA) holds the sole copyright for the AIMA Journal and all items therein for the purposes of controlling the copying, editing and re-distribution of all items by any other parties.

All those wishing to utilise part of all of any item within the AIMA Journal are required to obtain written permission from both AIMA and the author which will specifically outline the elements to be utilised together with the full distribution purpose and coverage.

CONTACT US

Bermuda
usa@aima.org

Brazil
info@aima.org

Brussels
38/40 Square de Meeus, 1000
Brussels, Belgium
+32 2 401 61 46
info@aima.org

Cayman Islands
cayman@aima.org

Hong Kong
Unit 1302, 13/F, 71-73 Wyndham
Street, Central, Hong Hong
+852 2523 0211
apac@aima.org

London (Head Office)
167 Fleet Street, London EC4A 2EA
+44 20 7822 8380
info@aima.org

Middle East
info@aima.org

New York City
12 East 49th Street, 11th Floor.
New York, NY, 10017, USA
+1 646 397 8411
usa@aima.org

Singapore
1 Wallich Street, #14-01 Guoco
Tower, Singapore 078881
+65 6535 5494
apac@aima.org

Shanghai
Suite A10, 28th Floor SWFC, No.
100 Century Avenue, Pudong,
Shanghai 200120, China
+86 136 1191 9817
apac@aima.org

Sydney
+61 (0) 412 224 400
apac@aima.org

Toronto
500 - 30 Wellington Street West,
Box 129, Commerce Court,
Toronto, ON M5L 1E2, Canada
+1 416 364 8420
canada@aima.org

Tokyo
+81 (0) 3 4520 5577
apac@aima.org

Washington
2001 L Street NW, Suite 500,
Washington DC 20036, USA
+1 202 919 4940
usa@aima.org

THANK YOU TO ALL OUR SPONSORS

ALLEN & OVERY

CITCO

CLIFFORD CHANCE

Dechert LLP

K&L GATES

KPMG

Man

RFA

RSM

simmons + simmons

SS&C

STATE STREET

TD Cowen
a division of TD Secu

aima.org