Private Funds CFO

October 2020 • privatefundscfo.com

PLUS
12-page special report on fund domiciles

How will we manage Main Street?

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Private Funds CFO

ISSN 2632-6418 • ISSUE 14 • OCTOBER 2020

Insight

Events **Carlyle, BlackRock, EQT join the CFOs & COOs Europe Virtual Experience in October**

Leadership from the operations of Carlyle, Macquarie, BlackRock and EQT will be among more than 50 speakers at the CFOs & COOs Europe Virtual Experience on October 12-13, ***writes Adam Smallman***.

Artificial intelligence, infrastructure, debt, real estate, valuations in a pandemic, and environmental, social and governance issues will be on the agenda at the first event of the season for operational leaders at alternative investment firms.

Attendees can log on from home or the office and join any of the panels covering tax, technology, operations and finance. There will also be streams on the operational challenges to private equity and three other asset classes.

Keynote speakers include Professor Al Naqvi, CEO of the American Institute of Artificial Intelligence, and Ersilia Molnar, COO at Muzinich & Co, who will be focusing on ESG performance measurement. We at *Private Funds CFO* will also be chairing sessions and look forward to seeing you.

The speaker line-up includes Erica Herberg, CFO of investment solutions at Carlyle Group; Steve McGoohan, EMEA COO at BlackRock Alternatives; EQT's CTO Mattias Hindfelt and global head of IT strategy Petter Weiderholm; Jamie Lyon, European CFO and COO at LaSalle Investment Management; Fiona Cooper, tax director at Starwood Capital Europe; Apwinder Foster, COO at DRC Capital; Christian Hinze, COO, Europe, at StepStone Group; and Joshua Cherry-Seto, CFO at Blue Wolf Capital. ■

OakNorth

Challenger bank joins PE subscription line market

OakNorth Bank, a UK lender focusing on small and medium-sized enterprises, has become the latest to join the growing market for alternatives fund finance, ***writes Adam Le.***

The London-headquartered bank, which has approved more than £650 million ($860 million; €721 million) in loans since March, has completed a revolving subscription credit facility with consumer-focused private equity firm Bluegem Capital Partners in what is the bank's first such deal.

It is understood the facility relates to Bluegem Secondary fund, a vehicle created in 2018 through a GP-led secondaries process in which assets from the firm's debut 2006-vintage fund were moved into a continuation vehicle.

"There is an underserved space in the fund market between £5 million and £25 million," Mohith Sondhi, senior director of debt finance at OakNoarth, told sister publication *Private Equity International*.

Bluegem chose OakNorth because the bank was able to offer a bespoke facility and be comfortable with the high concentration of one LP in the fund, Sondhi added. "For us, if you have a high-quality investor behind [the fund], concentration risk doesn't bother us so much," he said.

For OakNorth Bank, working with a private equity firm was an efficient experience.

"They are seasoned negotiators… they know what they're looking for and you must be on top of your game," said Sondhi. ■

They said it

"You can never be complacent with the status quo, even if you were responsible for building it." ***Matt Skurbe****, chief financial officer of CC Capital Partners*

"Everyone knows CFIUS as a regulator, but I think the next wave is CFIUS as an enforcement agent." Kirkland & Ellis partner ***Mario Mancuso*** *says the regulator is showing a renewed vigor in pursuing its remit*

"We are likely to see increased challenge to leaver determination… as the market becomes more competitive and there is simply less to go around." ***Catriona Watt****, partner at London law firm Fox & Partners, on how to manage leavers*

Moments in the sun

These are the stories that *Private Funds CFO* subscribers spent the most time reading over the summer. What does that tell you?

20

Subscription credit – A shifting landscape: Based on dozens of interviews with more than 20 market participants, this is among our most-read stories ever.
https://www.privatefundscfo.com/the-shifting-landscape-for-subscription-credit/

56%

Data snapshot – Where LPs want transparency: Intertrust's survey of 150 private equity fund managers shows what LPs are demanding more transparency on. Fifty-six percent said they are prioritizing technology that gives LPs anytime-access to financial information via dynamic portals.
https://www.privatefundscfo.com/data-snapshot-where-lps-want-transparency/

$3.5bn

NAV lenders to the rescue: A relatively new form of financing faces its moment of truth. 17Capital in London saw $3.5 billion in NAV loans and preferred equity dealflow in three-and-a half weeks.
https://www.privatefundscfo.com/nav-lenders-to-the-rescue/

60%

Gen II – Sponsors expect Q2 to hurt valuations more: A study reports that more than 60 percent of fund managers plan to treat the impact of the pandemic as a normalization adjustment to EBITDA but were unsure how they would calculate it.
https://www.privatefundscfo.com/gen-ii-sponsors-expect-q2-to-hurt-valuations-more/

Editor's letter

Beneficiaries at the gate

Graham Bippart
graham.b@peimedia.com

Whether you're excited by, apathetic toward or even upset about the prospect of private equity getting more exposure to retail investors via defined contribution plans, the moves this summer by the Department of Labor and the Securities and Exchange Commission represent two more steps toward what would seem an ineluctable future for the asset class.

Private equity, in particular, is only growing in its systemic importance as public markets shrink in theirs. Amid eternally low interest rates and relentless, market-shaking volatility, investors of all kinds need access to yield, and they need access to hands-on managers of real assets who have the agility and operational expertise to navigate these turbulent times.

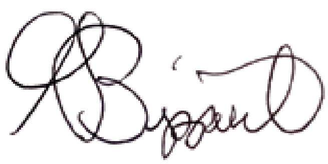
> **"Perhaps PE, and other private markets, are heading toward some brave new world"**

The recent allowance of defined contribution plans into PE and the broadening of the accredited investor definition are less revolutionary leaps along the path to PE's growing prominence among markets than signifiers of it.

In this month's cover story, we look at these developments out of the DoL and SEC from a plethora of angles – from what they portend (and don't), to how CFOs can prepare for the availability of these new pools of capital, to the political and regulatory risks of greater retail investment, and more.

Perhaps PE, and other private markets, are heading toward some brave new world implied by these developments. Or perhaps not: already increased regulatory oversight and public scrutiny are likely hints of what's to come.

The future is, in many ways, already here.



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Private Funds CFO
Published 10 times a year by PEI Media. To find out more about PEI Media visit **thisisPEI.com**

Printed by Hobbs the Printers Ltd
hobbs.uk.com

Regulation of foreign investment **CFIUS's 2019 report heralds the arrival of a new enforcer in town**

The Committee on Foreign Investment in the United States' report for the 2019 fiscal year details a more vigorous and focused body, according to lawyers. ***Connor Hussey reports***.

Although some of the biggest regulatory overhauls came with the enactment this year of CFIUS's Foreign Investment Risk Review Modernization Act of 2018, the latest annual report outlines a highly charged committee with increased budget and resources and a stronger emphasis on enforcement.

"CFIUS is working faster, it's working with more resources and, frankly, more streamlined internal processes," says Mario Mancuso, partner at Kirkland & Ellis and head of its international trade and national security practice. "Everyone knows CFIUS as a regulator, but I think the next wave is CFIUS as an enforcement agent."

CFIUS's 2019 report to Congress came early, considering the 2018 report came out in May. Mancuso says this was a feat for the committee, whose year-end report is usually issued late in the following year, and proof that CFIUS is hitting its institutional stride.

Judith Alison Lee, partner and co-chair of the international trade group at Gibson Dunn & Crutcher, says the apparently new CFIUS has emerged after years of concern about the growth of Chinese investment in the US. "CFIUS is responding to Congressional criticism in the past about not following up on non-notified transactions, as well as criticism about transactions that do go through the committee process and result in clearance, but clearance that is conditioned on a mitigation agreement," she says. "There's been a lot of criticism that that service hasn't really followed up."

Notification required

CFIUS has established an office this year with the sole focus of targeting companies it thinks should have notified the committee of transactions but never did. Ama Adams, partner at Ropes & Gray, says: "CFIUS is definitely taking the opportunity of increased resources and budget to reach out to a range of companies and institutional investors about particular investments that were not notified to them."

She adds that CFIUS appears to be getting results from its new, more proactive stance: "The report shows that investors in US businesses are generally not willing to take the risk and would prefer to get clearance for transactions on the record, rather than leave the door open for CFIUS to come knocking after a transaction has closed."

Mancuso says the report includes two mitigation measures that had never been identified in previous versions: a condition whereby CFIUS had to be notified in advance of an increase or change in the ownership rights of the foreign buyer, and a requirement for companies to only use authorized vendors to supply certain products and services. "That's new and interesting and underscores one theme of CFIUS, which is a focus on supply chain, security and resilience," he says. Lee adds that CFIUS also issued its first penalty against a party for not complying with a mitigation agreement.

However, the regime is not becoming stricter or capturing more kinds of transactions. Adams says: "The report continues to show that it does clear the majority of transactions that come before it, which I think is a positive." ■

> "Everyone knows CFIUS as a regulator, but I think the next wave is CFIUS as an enforcement agent"
>
> Mario Mancuso
> Kirkland & Ellis

CCO responsibilities **How many hats have you got?**

More than three-fifths of private fund CCOs are wearing multiple hats on the job, according to an analysis of Securities and Exchange Commission data. ***Bill Myers reports***.

There were 4,561 private fund advisors registered with the SEC in the first quarter of this year, Form ADV data show. Of those, at least 2,819 CCOs had more than one job at their firm.

The actual number of multi-hatted CCOs might even be higher than this – hundreds of private fund registrants did not indicate a title for their designated compliance person. At least seven, in fact, entered "Mr" in the spot marked for title, and only one labeled their CCO "Ms".

Of those firms that did offer a title, only 622 (17 percent of the discernible cases) were solely compliance officers.

It has become an article of faith in the industry that the bigger a firm gets, the more important it is to have an independent CCO. The SEC has even examined firms to determine how multi-role compliance officers prioritize their jobs.

Q1 2020 data suggest that this gospel has been slow to spread among private fund advisors.

"In a perfect world, you would have a dedicated CCO," says Kurt Wolfe, a lawyer with Troutman Pepper. "But there is a range of possibilities for building an acceptable compliance function that might include a CCO that wears multiple hats, or a compliance team that reports to a dual-hatted CCO, or even outsourcing aspects of the compliance function to a third party. The key is to make sure your compliance function grows with the firm."

This has been something of a breakthrough year for private funds

"In a perfect world, you would have a dedicated CCO. But there is a range of possibilities for building an acceptable compliance function"

Kurt Wolfe
Troutman Pepper

Most private funds CCOs have other responsibilities

Source: SEC

in the US. The Trump administration has opened up pensions to private offerings and reformed the Volcker Rule so that banks can back private equity and venture capital.

At the same time, regulators have made clear that private funds have a lot of compliance work in front of them – especially on conflicts, fees and insider trading risks – and some reform advocates have even argued there are structural problems in the way private funds do business.

"Building a solid compliance component requires devoting adequate resources – whether that's funding for software solutions, retaining third-party consultants or hiring compliance resources in-house," Wolfe says.

"And it is imperative to periodically reassess your compliance resource allocation. Growth can be a good thing, but with it comes additional compliance burdens."

A violation mirage?

We do not lack for horror stories about what can happen when a fund's compliance and business lines get crossed. But SEC data suggest they might be just that – stories. Of the firms that registered with the SEC, only 277 said they had any kind of regulatory violation in their pasts.

Of those, 118 had multi-hatted compliance officers, and 74 of them sole practitioners.

Of the CCOs with multiple titles, CFO or another top financial designation was the most common, with 808 CCO/CFOs. General counsel was the next most common, with 521 compliance officers sporting that title, followed by 470 chief operating officers or top operations executives. At least 90 firms' CEOs, founders or top executives were also compliance officers, the data show. ■

Tech solutions

New data and analytics platform for GPs, portcos promises efficiencies and value

Technology solutions provider RFA recently launched Managed Data Services, a data warehousing service allowing GPs and portfolio companies to communicate company data and analytics efficiently, ***writes Connor Hussey***.

The fully managed service offers data warehousing, ingestion and analytics guarded by the firm's disaster recovery capabilities.

Data sharing has given GPs "unparalleled insight into the operations of the portfolio companies, and ultimately, the performance of their fund," says Mark Alayev, chief data officer at RFA, who was promoted to spearhead the Managed Data Service offering.

Separated offering

The platform is comprised of a single data warehouse built to facilitate all the major public cloud platforms, including AWS, Azure, Snowflake and Google Cloud Platform. It completely separates the data-processing and storage layers, allowing firms to independently share data with their portfolio companies instead of having to pay for data service providers to help both parties do so.

"For the first time, you have the proper separation of what is called a data economy," says Alayev. "Because the computing and data layers are separated properly, you can now share your data, and the person that's paying for the analysis of that data is the company that wants to run it.

"In the past, if [a portfolio company] wanted to pass data to a private equity firm, it had to drop it off in an SSDP [self-serve data preparation], and the GP needed to pick it up, process, then ingest it. So, both sides were processing the data in order to set up the link. With the new model, you're going to have the portfolio companies share it with the GP and the GP is paying for the compute."

That GPs would pay for data warehousing is only a recent phenomenon, according to Alayev. "Private equity firms wouldn't typically invest in a platform this large [because] traditional data warehousing was very expensive," he says. "I think what we're seeing is that the barrier to entry has reduced significantly." ■

> "What we're seeing is that the barrier to entry has reduced significantly"
>
> Mark Alayev
> RFA

Virtual AGMs A GP's checklist from a placement agent's point of view

Expert commentary by **Lori Campana** of Monument Group

Programming

Expectations: LPs expect a virtual AGM, and expectations are just as high as for in-person events as it relates to information.

Timing: Most LPs are prepared to set aside up to four hours depending on the number of funds covered. Wrap it up in less time if possible.

The whole show: A virtual AGM is a full-blown AGM. Start with the most recent fund and latest deals, and highlight the thesis that informed each investment, key operational initiatives, and the challenges and catalysts that will influence future returns.

Show the team: Introduce all participants on the screen. If possible, show all partners on one screen, but keep an image of the speaker as an inset box at the bottom. It is imperative listeners know who is speaking.

'Info-tainment': If past AGMs featured a keynote speaker or portfolio-company CEO, investors will notice their absence.

Mix it up: Video case studies keep the programming dynamic, while offering presenters a break to gather themselves. CEO updates can also be pre-recorded to manage uncertainty around executive presentations.

Recess: Include a 10-minute break for every hour-and-a-half of programming. Some GPs use these interludes to showcase portfolio-company imagery or highlight new personnel.

Process

Format: This depends on the chosen video-conference vendor. The most effective format emphasizes the presentation on screen, but includes a smaller window featuring either the speaker or a live feed of their remarks.

Technology ground rules:
1 No logging off during a break (to avoid subsequent delays)
2 Control the visibility of the participant list
3 Silence is golden (auto-mute all LPs with their video off)
4 Mute all non-speaking presenters

Presentation materials: To familiarize investors with the presentation, the finalized deck should be shared via a secure site well in advance.

Reminders: GPs should alert LPs about the event via timely reminders.

Questions: These should be solicited in advance, particularly those that might involve metrics or harder-to-access financial data. Just as important is that a Q&A session should conclude each major section of the AGM. Having audience members submit written questions, with a moderator filtering inquiries, is better than allowing verbal questions.

Dress the part and respect the speaker: It is important to 'dress up' in business attire. Participants should remember their assigned roles and play nice and share in the virtual world: never interrupt another speaker.

Replay: GPs should offer investors a 'playback' recording of the presentation via a secure site to prevent improper sharing between parties that have not registered and been approved. Consider adding a directory so LPs can efficiently review materials that matter to them.

Details matter: If the video-conference platform sounds an alert when someone joins the call, take steps to eliminate these distractions.

Better next time: Digital surveys at the end of the event can provide instantaneous feedback for future programs.

Preparation

Designated drivers: Digital AGMs benefit from having specific people assume discrete duties. For instance, a designated moderator can facilitate a rhythm that keeps the presentations running at a steady pace. Someone else should be tasked with 'clicker' duty to advance the slides. A member of the IR staff, or CFOs in smaller firms, can intermediate audience questions. And tech experts familiar with the video-conference platform should be on hand to resolve problems.

Practice makes perfect: Before going live, GPs must test camera angles, lighting, and speaker and segment transitions. Create talking points to ensure alignment on key messages. Mock questions help to assess readiness to address any LP inquiries. (Be ready to answer the question you least want to receive.) Fund managers should plan on doing at least two dry runs to reach a comfort level that exudes conviction and instills confidence in LPs. ■

Lori Campana, CFA, is a partner at Monument Group, a global independent private placement agent. See https://www.privatefundscfo.com/virtual-agms-a-gps-checklist/ for the full version of this article

Carry crunch **A bonus for GP interest firms**

For most private equity firms, exits were not high on the agenda in H1, ***writes Isobel Markham.*** According to consulting firm EY, PE owners sold $123 billion of business in the first six months of the year, a 47 percent decline on the same period in 2019.

One of the ramifications of this is on carried interest. As exits slow and holding periods increase, the expectations for carry diminish – both in terms of how soon it will come and how much it will be.

Apollo Global Management, for instance, expects gross realized performance fees to be "very modest over the course of 2020" as portfolio companies manage the impacts of covid on their operations, per chief financial officer Martin Kelly.

Indeed, 60 percent of PE professionals expect carry to decrease in value, according to a survey by Private Equity Recruitment in May. Of these, 85 percent also expect payments to be delayed.

'Wipeout' in profit sharing

"One consequence of the covid-19-induced collapse in asset values will be the wipeout of profit sharing for many managers," wrote Antoine Dréan, founder and chairman of Triago. He added that those with heavy exposure to the hospitality, travel and energy sectors are likely to see permanent impairment.

"Even at firms where hopes of getting back into carry are reasonable, it may take years of hard work to return to these levels," he wrote. Dréan also argued that this could encourage partners and junior staff to found their own firms.

But there is another likely consequence of this carry crunch: a spike in PE firms selling off minority stakes to raise cash.

In an analyst note published in July on the GP stakes competitive landscape, PitchBook wrote that mid-market firms (those that have raised between $2 billion and $8 billion in the past decade) could be more compelled to take on outside financing to help them bridge the gap between delayed carry and the need to commit to new funds.

The market for GP interests has grown in the past few years, with a handful of managers successfully raising funds to invest in other PE franchises. The latest firm to enter the space in the mid-market is RidgeLake Partners, a partnership between alternatives manager PA Capital and RDV Corporation affiliate Ottawa Avenue Private Capital.

> "As exits slow and holding periods increase, the expectations for carry diminish"

Speaking to sister title *Private Equity International* about mid-market firms' need for such a cash injection, OAPC's Michael Lunt says the capital could be used for all growth capital purposes, including helping fund the GP commitment.

With plenty of capital in the hands of GP stakes managers and a growing acceptance of the benefits of taking on outside support, we expect this to be an active segment of the market. ■

Corporate VCs **How to steal a march on compensation**

Expert analysis by **Nigel Mills**, director, MM&K, a Global Governance and Executive Compensation Group member

Corporate-owned venture capital businesses break down into three categories, but two compete with the independent VC market for talent, leading to interesting discussions about compensation.

The first comprises integrated units typically staffed almost entirely by individuals seconded from the parent organization. They invest only in businesses and technologies that have some strategic interest or relevance to the parent company's business.

Their raison d'être is not to make financial gains from realizing investments, but to find technologies that will improve the parent's existing business or that will enable the parent to branch out into new, but connected, business areas.

The businesses they invest in, if successful, tend to be subsumed into the corporate structure.

The second category is strategic accelerants. These tend to focus on identifying and making investments in businesses and technologies that are expected to have some strategic interest or relevance to the parent company's business.

An almost equally important requirement of these investments is to achieve, in some cases significant, capital value enhancement opportunities while under the ownership of the parent business.

In these types of businesses, for the most part, the CVC will expect to realize the value of its investments by a sale to a third party (including via an initial public offering) or back to management (ie, probably with the backing of another VC or PE investor) rather than to its parent.

Finally, standalone VC firms invest their parent company's money in venture capital opportunities with the main purpose of realizing financial gains.

Whether any such investments may be of strategic value or interest to the parent is a secondary consideration.

Comp mismatch

For the most part, the standalone and strategic accelerant models look to compete with the independent VC market for talent, although in most cases they do also second people from the parent entity's business. This dual recruitment and deployment strategy will then often lead to sometimes thorny internal talks about how to pay and incentivize the individuals who are working in the CVC.

Of the 11 CVCs we surveyed, almost all said they believed their short-term comp was competitive and, in some cases, more attractive than is typically found in independent VC houses.

Our experience, from advising CVCs and from seeing the data they report in our annual compensation survey, suggests otherwise.

The reality is most CVCs tend to be required to keep their salary and bonus levels closely aligned to equivalent grades in the parent organization.

This often means that while the salaries may be competitive, bonus levels are not.

Beneficial arrangements

There is, however, one important area where the CVC's compensation policy is usually more attractive, and that is in its provision of employee benefits.

Big corporates tend to provide better benefits, and this is particularly true in the case of pension provision, death-in-service, private medical insurance and permanent health insurance.

Other areas where the corporate HR policy may be more attractive in CVCs than in independent VC houses is in the area of employee wellbeing, such as job security, holiday entitlement, and maternity or paternity leave.

Perhaps the most important factor in determining whether a CVC can attract or retain talent when competing with an independent VC is whether it has a carried interest plan for its investment professionals and, if it does, whether the terms of the plan are attractive.

Of the 11 CVCs we surveyed, seven had a private equity-style carry plan and four did not. Of those four, we at MM&K would say that three of these were, in reality, integrated units. It is not surprising that they did not have carry plans. The remaining CVC was clearly not an integrated unit and it was considering putting such a plan in place.

> “I'm not optimistic about companies having successful CVC businesses. There are too many mismatches with comp issues, people issues, reporting, investment committees, capital, ability to interact, and relationships”

Executive at CVC business

A concern for a parent organization with a carry plan in its CVC is that it can encourage some undesirable behaviors.

The way carry plans are structured at present in most independent VCs encourages participants to look for exits early in order to help the carry plan to achieve its 8 percent or 6 percent annual internal rate of return hurdle rate.

Multiple benefits

This appears to be what LPs still want to see, although we are starting to see a few VCs moving over to a money multiple hurdle for the carry on their latest funds.

This type of carry structure is a win-win for CVCs to help ensure that the right behaviors are being encouraged among their participants and to make the plan more attractive to potential new hires.

Having a money multiple hurdle of, say, 1.33x or 1.25x, rather than an IRR-based hurdle, should encourage a more long-term view from carry participants, which is typically what is needed in a CVC environment.

One other way in which some CVCs are making their carry plans more attractive to their investment professionals is by basing the carry on one- or two-year vintages rather than on a five-year or whole-fund type structure. This makes huge sense.

With a vintage carry structure, one can ensure that the right people are in the carry plan for each particular vintage by introducing new hires and rising stars quicker and by being able to phase out sunset stars more easily.

This takes the pressure off having to make (possibly poor) investments in a particular time period, and it should mean that carry distributions will start coming through earlier than they typically do in a more conventional 10-year closed-end VC fund.

> “Most CVCs tend to be required to keep their salary and bonus levels closely aligned to equivalent grades in the parent… salaries may be competitive but bonus levels are not”

Nigel Mills, MMK

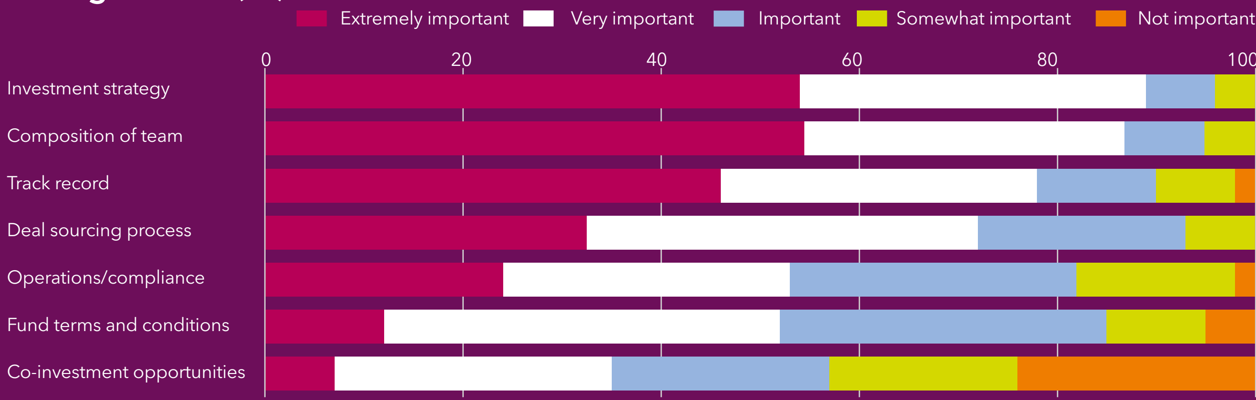
“I'm not optimistic about companies having successful CVC businesses,” a senior executive from a CVC told us. “There are too many mismatches with comp issues, people issues, reporting, investment committees, capital, ability to interact, and relationships.”

We acknowledge that there needs to be a really supportive culture among the parent company organization for there to be a successful CVC business.

And the one area where we think a CVC can steal a march on an independent competitor VC in the area of compensation is in having an attractive carry plan that will appeal to the sort of VC talent that the CVC is wanting to bring in and retain over the longer term. A money multiple-based hurdle and a relatively short vintage carry structure is the answer. ■

MM&K has launched its 25th annual Compensation Survey for the European Private Equity and Venture Capital Industry. If you believe your firm might like to participate, contact Nigel Mills: nigel.mills@mm-k.com
Tel: +44 20 7283 7200

As an LP, how important are the following factors when evaluating an emerging manager fund? (%)



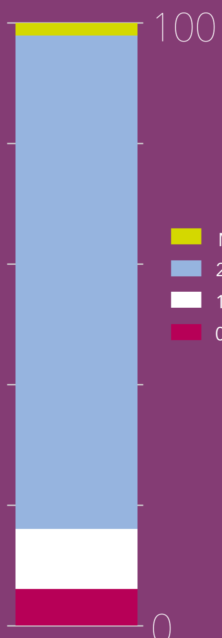
Mind the gap

Emerging managers in North America will need to sharpen up their middle office if they are to attract investors in a competitive and tough market

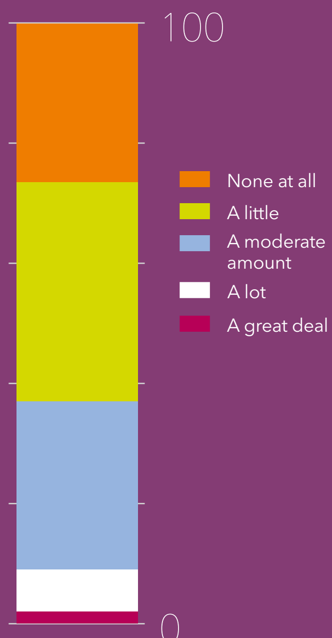
There are significant gaps in understanding between GPs and LPs, alongside some encouraging alignments of interest, according to the new *Emerging Manager Survey 2020* from sister title *Buyouts*. The survey, carried out in partnership with Gen II and sponsored by Withum, highlights that what LPs care about – a strong middle office, terms and conditions, co-investment opportunities – appear to be valued less by GPs. The good news? Most investors are still willing to back first- or second-time funds and agree on LP advisory committees. ■

Fees

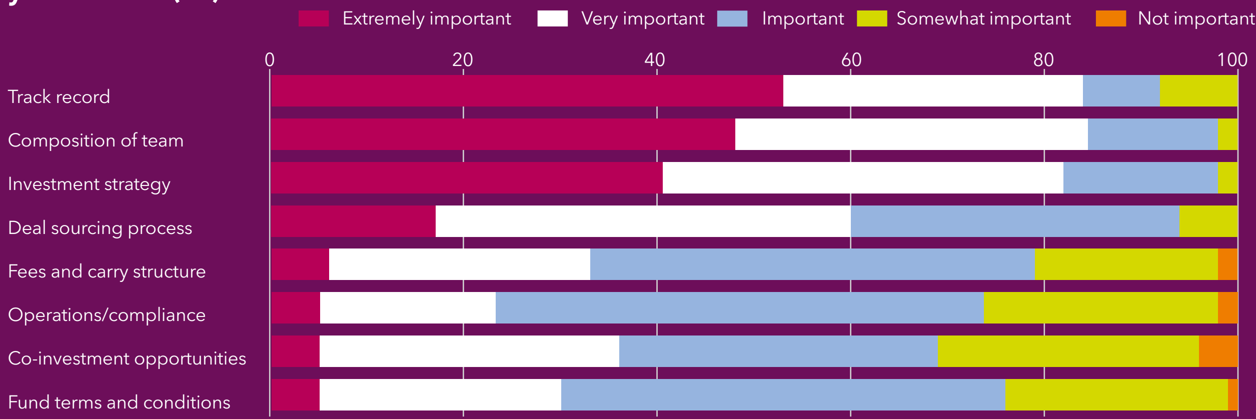
What management fee have you asked for in your fund? (%)



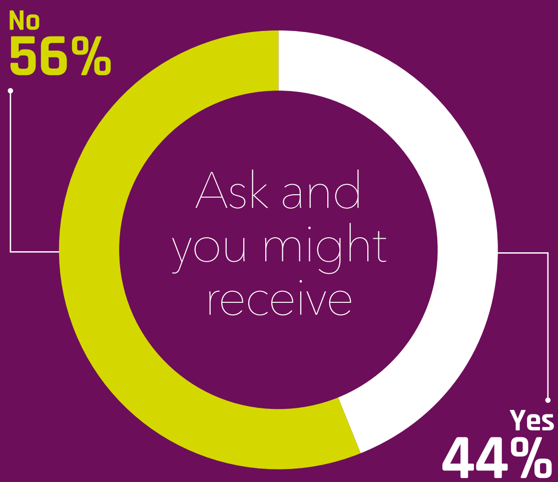
Do you receive pressure from investors regarding fees? (%)



As a GP, how important do you believe the following factors are for LPs evaluating your fund? (%)



Did you have an anchor investor with more favorable economic terms?



The good news

60%
Family offices, wealth managers and wealthy individuals dominate the emerging manager investor pool, up from 43% last year

79%
Investors who haven't changed their allocation to emerging managers since the pandemic started

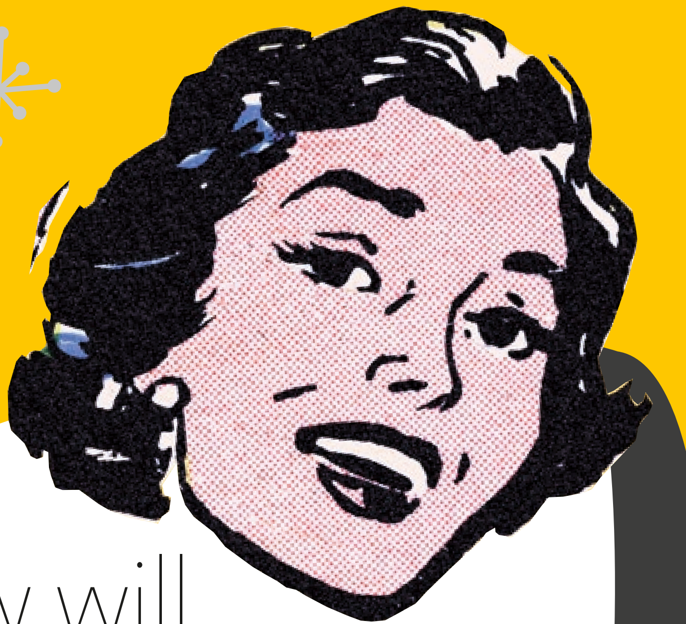
89%
Investors willing to back a first- and second-time fund

LPs want…

What kind of terms do you try to negotiate with emerging managers? (Multiple answers allowed)

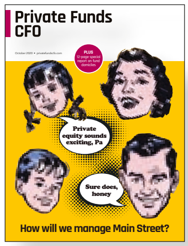
Know more

Over 100 fund managers and more than 60 institutional investors contributed to the *Buyouts US Emerging Manager Report 2020*, in partnership with Gen II. You can download more data and insight for free by visiting https://www.buyoutsinsider.com/emerging-manager-report-download/



How will we manage Main Street?

The ground being laid in the US to welcome retail investors into alternatives is rocky, writes Bill Myers. Where mid-market managers fit is an open question



Cover story

In the late 1990s, Lawrence Calcano, then an executive with Goldman Sachs, was passing through LaGuardia Airport when he met a fellow investor. This was a heroic phase of capitalism when airports in wealthy cities had kiosks with QuoTron terminals for the walk-in mom-and-pop investor. A baggage handler on his break was one of the many in line and was especially keen on a Texas big box store that Calcano himself had invested in.

When he asked the baggage handler about the company, however, the man shrugged. "He didn't know what the company did," Calcano recalls. "He just knew it was a hot internet stock."

The company, of course, eventually went bust.

Calcano survived the loss and he's now the CEO of iCapital, a business that automates the alternative investing process for private funds and advisors and their high-net-worth investors.

Today, the average American has to work nearly 128 hours before she can afford a single stock in an S&P 500 company. When Calcano hears jubilation over Washington, DC's recent, tentative efforts to bring more retail investors into private funds, he tells everyone to pause for breath.

"This is a long-term process," he says. "The CFOs should not expect that they're going to snap their fingers and $100 million is going to show up."

American regulators seem to agree with Calcano. This summer, the Department of Labor and the US Securities and Exchange Commission each made gestures that were at once dramatic and muted: DoL in June by issuing guidance allowing certain Employee Retirement Income Security Act pension plan managers to invest in some private funds; the SEC in August by widening, if marginally, the definition of accredited investors.

Those gestures were pockmarked with provisos, caveats and addenda, giving weight to the Washington cliché that "the process is the punishment." They weren't, however, just symbolically important: the ERISA market, for instance, is valued at $7.1 trillion.

Still, it's important to grasp what DoL's June guidance letter did not say: that retail investors could invest in private funds.

It did say that pension fund fiduciaries may offer some private funds "as part of a multi-asset class vehicle structured as a custom target date, target risk, or balanced fund" and not be sued for it.

Further, "each asset allocation fund with a private equity component would have a sufficient pool of assets to diversify the exposure of plan participants to the private equity investments with other investments in a range of asset classes with different risk and return characteristics and investment horizons."

At the same time, regulators have been signaling that they have worries about the private funds industry (see p. 20). The day that the SEC expanded the definition of accredited investors, it also unsealed a complaint against a Florida private fund advisor who regulators say swindled millions from… accredited investors.

In June, two weeks after DoL issued its ERISA guidance, the SEC released a first-of-its-kind risk alert for private funds, warning that the industry was rife with problems in most corners of its business, from allocations and valuations to side letters.

The scale of it

Beyond the regulatory risks, there are also financial, cultural and even structural problems for private funds to consider as they weigh the costs and benefits of courting Mr and Ms America.

"How do you market to this asset class? How do you manage the asset class?" Calcano asks. "You've got an infrastructure, presumably, set up for institutional investors. You're set up for small numbers of large checks. In retail, it's a totally different inflow. You're moving to small checks from large numbers of people, and for each one of them there are anti-money laundering requirements, there are know-your-customer rules, there are investor relations, and a lot of the GPs just aren't set up to do it."

Before they clean up, in other words, private funds will have to clean house.

DoL's letter was addressed to Pantheon Ventures and Partners Group, who spent the better part of a decade working on a narrow, defined contribution-with-private-funds-element plan they thought might win DoL's blessing.

"There will be a very high bar for the administrating of these vehicles," Doug Keller, head of private wealth and defined contributions at Pantheon, tells *Private Funds CFO*.

"All this has very big regulatory components. That's sort of what makes the operational, administrative burdens so difficult – there's a heavy overlay."

Some experts see DoL's guidance as a kind of back-door regulation: by making plan fiduciaries responsible for the investments, regulators all but guarantee that private funds will have to satisfy fiduciary requirements in the Investment Company and Investment Advisers Acts.

Any fund hoping to woo retail pensioners will certainly have to reassure fiduciaries that they are capable of limiting litigation risks, particularly over fees and liquidity, Keller says.

"Liquidity, just intellectually, doesn't fit into the minds of the 401(k) community," he says, since 401(k)s mostly invest in liquid stocks and bonds. "And the vast majority of litigation is over fees."

The good news, he adds, is that private funds managers can read DoL's guidance as a road map to check if they're in the right area for retail pensioners. Retail investors aren't new to private funds. Defined benefit plans, many of them state and local government pensions, now have years of experience in private fund investments.

Government pensions' investments in private equity and other alternative assets amounted to 13 percent of asset allocations last year, according to data tracked by National Conference on Public Employee Retirement Systems, a Washington, DC-based non-profit advocacy.

"We're a lot further along than people think, than the markets think," says Jonathan Epstein, founder and president of the Defined Contribution Alternatives Association, or DCALTA, a trade group that helped put together the lobbying meeting that resulted in DoL's June guidance letter. "I think private equity is extremely teed up to enter the marketplace."

Given pension fiduciaries' worries, there may be market pressure for private funds to sacrifice some of their privacy. (See p. 23.)

"There is such a big element of trust," says Robert Blecher, a consultant at PwC's strategy consulting unit Strategy&. "By their very nature, private investments aren't the most transparent."

On the plus side, private funds that are open and frequent in their disclosures may have a distinct market advantage, Blecher adds.

"It's something that could be changed and could be very enticing for people."

"Liquidity, just intellectually, doesn't fit into the minds of the 401(k) community … and the vast majority of litigation is over fees"

DOUG KELLER
Pantheon Ventures

Blecher is among those who argue that the biggest barrier between retail investors and private funds is "the knowledge gap." In his brief, retail investors and their fiduciaries just aren't familiar enough with who private funds are, and how they work.

Larger, brand name funds, then, have an early advantage because they already have recognition. Blackstone and Apollo have been mustard-keen on bringing more retail investors into the market, sending their top lobbyists to an SEC roundtable just last year.

That advantage, however, is neither decisive nor permanent, Blecher says. Mid-sized private equity real estate firms with exchange traded funds, for instance, might be in just the right spot for retail pensioners "because people understand what ETFs are and what indexing is … and it's already used in retail real estate investments."

Calcano says that funds' first step should be to put "ambassadors … into the field, looking for partnerships."

He adds: "It could be the CFO spends a little of his or her time meeting … with custodians, meeting with administrators, meeting with some of the constituents.

"Try to get on the phone with one of those larger managers who have actively embraced the HNW advisory channel and say, 'How did you go about this? What have you learned?'"

Dancing on platforms

As regulators take the long and winding road to bringing Main Street into private funds, new sprouts are springing up along the shoulder in the form of third-party web platforms that may help freshen private funds' scents for pension plan fiduciaries.

"With GPs, we're not quite there yet to say, 'These are our terms, take it or leave it,'" says Jens Beyrich, associate general counsel and head of regulatory and compliance for Moonfare, a Berlin-based company that connects ordinary investors in Europe and Asia with private funds. "These GPs want

to figure out ways to approach the retail markets. These conversations with GPs are very bespoke."

Founded in 2016 by former KKR executive Steffen Pauls, Moonfare today traffics about $300 million in assets, most of them directed to private funds in Luxembourg.

It promises that it can take on the regulatory burden for parties – and Europe's regulations and laws are even more complex than the US – while still easing tensions over secrecy and disclosures.

Among other things, Moonfare offers investor questionnaires tailored to each of the jurisdictions in which it does business. It hasn't been easy, but it seems to be getting better as the parties become accustomed to one another.

"We, of course, want to provide as much as transparency and disclosure to our investors as we can. But you can't go from zero to 100, certainly not in two years," Beyrich says. "There have to be compromises."

A manager could, he adds, say "maybe I'm not disclosing every single name on that portfolio, but I can disclose things such as the types of deals this fund pursues." The industry has to get regulators "comfortable with the level of information we're providing to investors, more than what's strictly required under the law."

The good news, though, is that private funds CFOs have time to take the measure of their own business before they start to approach retail investors.

Those measures are "capacity, existing relationships … liquidity structure … valuation structure," says DCALTA's Epstein. "If I'm starting out as a CFO, my simple take-away is, how much room do I have, how much do I want, and what are my existing relationships in the 401(k) ecosystems?"

That doesn't mean the sky is the limit, iCapital's Calcano warns, with his LaGuardia baggage handler in mind. Missteps by private funds could well be paid for by the entire market.

"I think this is a great thing. Investors should have the ability to invest in this asset class," he says.

"But I'd love to see everybody go about it the right way." ■

Where defined contribution pensions can currently invest in private equity

There are countries that show including alternatives in DC pension plans is achievable, but not without pain points, reports Alex Lynn

MEXICO

Mexico's defined contribution pension funds, known as Afores, can invest in alternatives through structured equity securities – or CKDs – effectively listed private equity, real estate or private debt trusts that invest domestically.

Around 19 percent of CKDs were focused on private equity as of October, according to Preqin.

Afores can gain international private equity exposure via CERPIs, listed vehicles introduced in 2016 that involve the marketing of certificates to qualified institutional investors in a restricted public offering. KKR, for example, raised $183 million in 2018 through a CERPI that commits to other KKR investment vehicles and co-invests in Mexico-based companies, per an EMPEA statement.

Afores oversaw roughly $191.6 billion of assets as of June 2020, of which around 5.84 percent was held in CKDs and CERPIs, according to Mexican pensions regulator Consar.

CHILE

Chile's state pension system, which switched from defined benefit to defined contribution in the 1980s, has opened up as a potential source of capital for international private equity funds.

In 2017, Superintendencia de Pensiones, the pensions regulator, issued new regulations permitting the country's schemes – known as AFPs – to invest directly into foreign private equity funds and co-investments.

The framework permitted AFPs to invest up to 15 percent of their total assets in alternatives, with between 2 percent and 7 percent in foreign PE depending on the pension fund type, per a note from law firm Alessandri.

There are strict hurdles for general partners hoping to raise capital from AFPs: they must have 10 years' experience in the asset class, manage at least $5 billion and be approved by a Chilean ratings agency.

UK

Defined contribution schemes accounted for 18 percent of the UK's total pension assets in 2019, according to Willis Towers Watson. Around 13 percent of the UK's DC assets are allocated to alternative investments, per the British Business Bank.

But, private equity's high fees remain a constraint. Schemes are subject to a 75-basis point cap on the total charges attributable to an individual member in the default fund, which can be difficult when accounting for carried interest payments.

A BBB study from 2019 found a DC scheme allocating 5 percent of its default fund to venture capital or growth equity funds would not be expected to breach the charge cap under normal circumstances. However, schemes are at risk of breaching the cap if, for example, an investment delivers top-quartile returns that far exceed the rest of its portfolio, or in the event of an equity market crash.

The UK's Department for Work and Pensions launched a consultation in June seeking input from the DC industry on whether the charge cap is appropriate and if other fees should be included.

NIGERIA

Nigeria is home to five mandatory, defined contribution retirement savings accounts, representing around $21 billion of pension assets as of 30 April, according to the country's National Pension Commission (PenCom).

Last year, PenCom released amended investment regulations stipulating that RSA Fund I, II and V must have at least 2.5 percent of pension fund assets under management invested in alternatives.

Fund II is the largest, overseeing the equivalent of around $12 billion of pension assets, and the only RSA with private equity exposure: it had invested $47 million through funds as of 30 April.

GPs seeking RSA capital are subject to certain requirements, including registration with the US Securities and Exchange Commission and 10 years' experience in managing third-party capital, of which five applied to private equity. Funds must invest at least 60 percent of their capital in Nigerian companies or projects.

AUSTRALIA

Australia hosts more than 200 superannuation funds with at least four members, according to the Association of Superannuation Funds of Australia. These oversaw around A$2 trillion ($1.5 trillion; €1.2 trillion) as of 31 March, of which 5 percent is allocated to unlisted equities.

Australia's schemes differ from their US counterparts because they have a stable asset base and focus on multi-asset pools, rather than providing a menu of asset class options, which enables them to invest in alternatives, per an October 2019 research study from the Defined Contribution Alternatives Association and the Institute for Private Capital.

However, superfunds are somewhat hamstrung by Australia's Regulatory Guide 97, which requires them to disclose fees and costs paid on investments. This can pressure supers to compete on fees charged to members and eschew costly asset classes like private equity.

The Australian Securities and Investments Commission further modified this regulation in November to simplify how fees and costs will be reported from 30 September 2020.

"ASIC's revised regime sought to remove confusion about fees for mums and dads, but in doing so it has created a fixation on fees charged," James Woods, a Sydney-based partner at Hogan Lovells, told sister title *Private Equity International*.

"The regime is missing a way of assessing fees relative to performance, so it would be sensible to develop a uniform reporting system that compares like-for-like costs, such as management fees, for different asset classes, as well as their returns. It's a question of educating consumers."

Industry bodies such as the Australian Investment Council are among those lobbying for changes to RG 97.

Mid-market is skeptical of retail prospects

For large asset managers, the attraction of retail investors could mean an expanded wealth management bench. Others aren't so sure, writes Connor Hussey

The Securities and Exchange Commission's change to its accredited investor definition may only help those with established wealth management channels, CFOs of mid-market firms tell *Private Funds CFO*.

"I don't think it really impacts fairway managers, it's more large asset manager platforms that have a deep wealth management bench," says Joshua Cherry-Seto, chief financial officer and chief compliance officer for Blue Wolf Capital Partners.

This recent change widens that pool of investors marginally to include investment professionals and other individuals qualifying as "sophisticated investors", but still represents a very small portion of main street.

"Instead of being the top 1 percent of the 1 percent you're giving better access to the top 2 percent," Cherry-Seto says.

"I wouldn't expect many people who did not fall within the previous definition of accredited investor to suddenly decide the invest in such products," says Dimitri Korvyakov, CFO of Sandton Capital.

For mid-market firms it's seen as a political move meant to signal the maturity and increasing harmonization of the alternatives industry.

However small it may be, there are new investors gaining access to private markets, and investment managers involved should expect some degree of oversight in these transactions.

"The relaxation of rules often come with more requirements from investment managers, so the next step is to see what implications it will have … in terms of reporting, and whatever else falls within the concept of regulatory compliance [for this new pool of investors]," says Korvyakov.

The rule change comes in tandem with the Department of Labor guidance green-lighting defined contribution plans to invest in alternatives.

For firms with large wealth management practices and large teams of compliance professionals, this could mean a welcomed new source of capital. But

Regulatory, political risks make retail experiment fragile

Federal politics/regulators

Any regulatory actions taken since June – and that includes the Department of Labor's ERISA guidance and the SEC's widened definition of accredited investors – are subject to Congressional review … in the next Congress. It is possible that these baby steps will falter under a President Biden.

Private funds seem to have gleaned the same point: through their PACs, they've donated tens of millions to more conservative Democrats so far. That may well help soften the blows, but it won't prevent them from coming.

If the Dems win the Senate, Sherrod Brown, D-Ohio, will chair the Senate Banking Committee and Elizabeth Warren, D-Mass, will chair its subcommittee on financial institutions and consumer protection. The raspy and rugged Brown is an old-school union Democrat who used to dominate his party. The American Federation of Labor and Congress of Industrial Organizations has lobbied fiercely against expanding private funds to retail investors. At a minimum, they'll have a veto on any regulatory and Cabinet nominations from a President Biden.

State regulators

State regulators hate the moves by the SEC and DoL. They can't reverse them but can certainly pursue private funds enforcements. "When we come across big enforcement cases, we're going to make sure folks hear about that," says Chris Gerold, chief of New Jersey's Bureau of Securities and president of the North American Securities Administrators Association, a Washington, DC-based advocacy group.

"We're going to do our best to track these changes. It's not that we think that all private funds are frauds. It's that we have concerns that we don't know if they're frauds, and determining it is very difficult."

State politics

States' ongoing pension crises have created a lot of political pressure, and private funds could find themselves as America's next top public enemies.

In July, Kentucky attorney-general Daniel Cameron, a Republican, revived a lawsuit by retired public employees against hedge funds run by Blackstone, PAAMCO and Prisma Capital Partners.

The suit alleges that the funds' sales representatives misled trustees of the commonwealth's public pension systems by pitching them up to $1.5 billion in fund-of-funds investments.

The suit focuses on hedge funds and may go nowhere, but funds could make a tempting target for ambitious politicos in cash-strapped states.

International regulators

In July, barely a month after DoL issued its ERISA guidance letter, Federal Reserve vice-chairman Randal Quarles issued a letter of his own, on the stationary of the Financial Stability Board he chairs. Many saw it as a whiff of grapeshot aimed at PE.

Among global regulators' top priorities, Quarles said, should be "reinforcing resilient non-bank financial intermediation" – ie, hedge and other private funds.

"The impact of the covid event on credit markets has highlighted vulnerabilities in the NBFI sector related to liquidity mismatches, leverage and interconnectedness, and investor behavior related to certain funds that they may treat as cash equivalents during economic calm but not during crisis," Quarles wrote. "Understanding risk, risk transmission and policy implications for the NBFI sector is more important than ever."

The FSB has formed its own study group on the matter and its report is due before a G20 meeting in November.

for mid-market firms with a smaller in-house team, the compliance burden isn't worth the risk.

"We're not interested in taking 401(k) dollars right now because of the risks of oversight and compliance, which they have not simplified yet," says Cherry-Seto.

"In fact, it's become more complicated in terms of compliance requirements for small pools of capital, like a 401(k)'s, as opposed to our LPs that are ERISA dollars."

It will likely be years before 401(k) plans have wide access to private markets, but regardless of whether the industry is ready to help facilitate the inclusion of these new investors, regulators and other officials are moving forward.

"These newly minted accredited investors are not your typical mom-and-pop retail investors, a fact that should assuage the concerns of those that fear any expansion of the definition," Republican commissioner Hester Peirce said in announcing her support for the new rules.

"It does not assuage my concerns. Why shouldn't mom-and-pop retail investors be allowed to invest in private offerings? Why should I, as a regulator, decide what other Americans do with their money?"

Pantheon and Partners Group's US offerings

The investment firms' defined contribution products for the US market include evergreen private equity funds mingled with liquid reserves, reports Carmela Mendoza

Pantheon and Partners Group, the two private markets firms that sought guidance from the Department of Labor in 2017, have over the years developed private equity strategies that can accommodate defined contribution plans in markets including the US, UK and Australia.

But what's actually included in their US offerings? Both firms' DC products in the US are offered as a collective investment trust – an investment vehicle similar to a US mutual fund but that is available only to qualified retirement plans such as 401(k) plans – and structured as a custom target date, target risk or balanced fund. These CITs invest in PE and have a liquidity component to manage the participant's deposits and withdrawals.

Pantheon and Partners Group's DC products offer features such as liquidity, daily pricing, transparency and investment options with competitive fees.

For Partners Group, the largest component of their CIT portfolio is an evergreen PE fund which, per an SEC filing, is now $5.5 billion; a smaller part of the portfolio is in liquid securities and cash.

Robert Collins, managing director and head of the firm's US distribution practice, told sister title *Private Equity International* that the firm's offering is a hybrid structure, with an "overwhelming majority in a core, evergreen and highly diversified PE portfolio."

The firm's PE offering for the DC market is designed to be adopted by professionally managed or advised DC plans and incorporated in structures such as target-date funds.

Pantheon's CIT, Pantheon Private Equity Select Fund, is understood to be an evergreen fund that invests in PE via secondaries, co-investment and primary investments and includes a portion allocated to liquid securities.

The CIT has a target PE allocation of around 70 percent, subject to

Privacy and the providers

The Department of Labor's release of guidance greenlighting DC investment in private equity has caused some market participants to wonder if the market can retain the prized privacy that comes with not being publicly traded or listed on an exchange, ***writes Connor Hussey***.

"While there is a desire to have a new source of funds from consumers, they'd rather do that without the transparency," says Justin Miller, managing partner at Bain & Company.

Pantheon and Partners Group, two of the large private market participants who have actively sought guidance from the DoL on this matter in recent years, have developed private equity strategies that can accommodate DC plans, which take the form of target-date funds.

Allowing DC plans to invest in private funds doesn't translate to additional regulatory disclosure requirements. But Douglas Keller, head of private wealth and defined contribution at Pantheon, believes that as the DC market evolves, it is possible that Pantheon may offer other, customizable strategies to the US DC market, depending on what plan sponsors want exposure to.

That's where the disclosure picture may change.

"If they were to suddenly let retail investors into private funds generally, I'm sure the disclosure would be pretty much the same as a public offering, which would be onerous," says Marie DeFalco, fund formation and structuring partner at Lowenstein Sandler.

But there are other ways for GPs to tap into retail money on a broad scale, which wouldn't immediately require additional disclosures, and much of it would likely begin by offloading the complexity to banks or other related service providers.

"The most likely way for all but the very biggest firms will be to work with an intermediary, and that intermediary will handle and absorb the complexity of dealing with a retail investor or 401(k) plan," says Miller. "But you have to pay for that."

Administrators cool

Plan sponsors such as Vanguard, Schwab, Fidelity and others who manage these plans could perform their own sub-accounting and internal division of shares among participants, should they offer allocations to PE, says Miller.

But a disconnect exists between the managers and deal professionals who could benefit from billions of dollars of new capital streams, on the one hand, and the service providers and financial intermediaries that would likely have to manage much of the operational burden around reporting and document-keeping, on the other.

"We have a scenario here where everyone thinks it's a great idea, people want to do it and none of the people that actually have the technology to record-keep these plans are interested in providing that service," says Miller.

Outsourced record-keeping service providers such as Empower, Alight, or Ascensus do provide these services to a small number of clients, but adding potentially millions of 401(k) users and tracking illiquid investments may require significant effort and additional investment.

"I've talked to one or two administrators that do record keeping and administration, and they are not excited about having to deal with an illiquid investment at all," says Miller.

Many of the CFOs and managers speaking with *Private Funds CFO* expressed concern at the risks the development poses down the line, and the inevitability of heightened reporting requirements should the industry see broad allocations among plan sponsors.

"The moment you have a crash or a market dip and people's 401(k)s get plundered because they were all heavily allocated to PE, and PE takes a hit, you can imagine what the social response would be," says one CFO.

fluctuation over time, per Douglas Keller, head of private wealth and defined contribution: "Pantheon's private equity strategies are generally weighted heavily to the US and Europe, with a lower allocation to Asia – largely reflecting the evolution and maturity of the global PE market."

Keller added the CIT focuses on the mid-market with diversification across stage, vintage year, sector, and, most importantly, manager. Both noted, however, that fiduciary oversight is important. Collins said Partners Group's offering is overseen by fiduciaries on three levels: at the target date fund, the CIT level and at the evergreen structure within the CIT.

Pantheon may yet offer other customizable strategies to the US DC market depending on what the plan sponsor community may want exposure to.

The significant challenge for plan sponsors is getting invested and staying invested while the DC market is growing, Collins said.

"Pension plan sponsors need a product that is able to grow and scale, as there have been meaningful net positive inflows of these 401(k) plans into target date funds, even during downturns like the global financial crisis and even this year." ■

KEYNOTE INTERVIEW

Mastering the next phase

CFOs are entering a period that demands planning and fresh thinking on strategies, valuations, tax and compliance, says Citrin Cooperman partner Alexander Reyes

Q How has the pandemic affected CFOs in private equity?

Understandably, private equity CFOs are seeking insight and practical help to manage through a period of great uncertainty. A crisis brings out the best and the worst in humanity. The same holds true for business – it puts to the test a portfolio company's business model, strength and ability to adapt and transform.

It becomes necessary to go back to basics, understand and evaluate your business operations and priorities, understand cashflow, liquidity and budget forecasts, and make key – and sometimes difficult – decisions.

We have a covid-19 response unit, which brings together our collective knowledge on tax developments, the preparation needed for any potential recession, and industry-specific alerts and webcasts. Working from home is an interesting challenge for CFOs and the middle office. Many companies have discovered that staff being at home is now going to be far more common than when compared with working life before covid-19.

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However, as companies move away from viewing the physical office as the only – or even the best – collaborative workspace, implementing the right remote work technology to enable seamless communication and productivity over the long haul is important. This raises questions about cybersecurity and privacy that were there before the pandemic hit but which have now become very critical.

The good news is that we bring a suite of advisory services to help them come to terms with these new work patterns. Our Technology, Risk Advisory, and Cybersecurity (TRAC) Practice, for example, is currently working overtime with clients, as you would imagine. For me, the most interesting thing has been to see how quickly clients have pivoted to accommodate the new world we are in.

Q Are CFOs thinking beyond the here-and-now and looking further ahead?

I think companies have a better sense of how the pandemic has impacted them and they are now beginning to enter a different phase and rethink both the strategies and the industries that they want to invest in.

History has proven that the key to a successful recovery is preparation. CFOs understand that the time to prepare is now, to put yourself in the best position to come back faster and stronger.

Deal-making fell off sharply when the global financial crisis hit in 2008, and this pandemic has also triggered a contraction. However, PE funds have over $1 trillion in uncalled capital. This will force GPs to stay on the lookout for deals, especially as valuations retreat.

Funds are also adjusting strategies to reflect the new world we live in. An example? A fund that was focused on healthcare may now look at virtual care, remote care and telemedicine.

How do you think through that? How do you price it? And, of course, there is a host of tax implications to consider in this environment.

So, I hope it is clear that we're not just helping CFOs in the short term because that certainly isn't how they're thinking.

Q What are the tax, accounting and regulatory issues in the US?

For tax, there are always new developments. Recent tax developments include those related to carried interest. Specifically, the Internal Revenue Service's proposed rules that would restrict a workaround in the 2017 tax overhaul that has allowed some fund managers to avoid a three-year holding period to qualify for preferential capital gains rates on carried interest.

This would disallow the use of S Corporations and PFICs to avoid the requirement that the carried interest must be held for at least three years, instead of one year as under previous law, for taxation under preferable long-term capital gains tax rates, rather than ordinary income rates.

There is also the issue of the limitation on business interest expense under Section 163(j). Prior to an amendment of Section 163(j), the deductibility of investment interest expense by partners in private investment funds was subject to limitation at the partner level.

Under these rules, partners could deduct their share of the investment interest expense of a private fund up to the amount of their investment income. This limitation applied to partners regardless of whether the fund was a "trader" or an "investor" in securities for federal income tax purposes.

The 2020 Proposed Regulations changed its application. Investors who do not actively participate in the trading activity of the private investment fund would not be subject to the limitation on business interest expense. However, investors who do actively participate would be subject to it.

Another tax issue relates to state reporting and filing where investors are or where the work is done. With much of the workforce working from home in 2020, if employees live in a different state than the entity, should the entity file in that state?

From a regulatory perspective, the Office of Compliance Inspections and Examinations in June looked at conflicts of interest, fees and expenses, and material non-public information.

The OCIE's alert underscores the need for CFOs to look closely at their firms' controls and policies and procedures. The pandemic does not ease that pressure and may compound it with staff working remotely.

Lastly, for certain offshore funds that did not previously need to register with the Cayman Islands Monetary Authority (CIMA), registration requirements have changed.

The Cayman Government enacted the Private Funds Law in January, which gave closed-ended fund vehicles, previously exempt, until August 7, 2020 to register with CIMA and comply with Cayman's investment funds regime.

Under these rules, private funds have to be audited annually by a CIMA-approved auditor.

Q What is happening with valuations?

Historically, there have been some very standard models around valuation such as a discounted cashflow model. This pandemic, however, has forced companies to rethink some of the inputs and key assumptions. For example, what is the expected revenue in 2020 resulting from the impact of social distancing and stay-at-home orders, the expected shape ("V," "U," "L" or "W") of the recovery, and the duration of suppressed performance?

Answers to these affect your assumptions on revenue, earnings and cashflow, expense structure and net working capital needs.

Our valuations team can help on that. They will tell you: the methodology may not change but the assumptions could, depending on how covid has impacted the portfolio company today and in the future.

Q You are more than an accounting firm, right?

Yes, well beyond the assurance and audit that you would expect. We are truly a full-service accounting and consulting firm.

Our tax group has broad capabilities beyond traditional federal state and local tax compliance services. We also have mergers and acquisitions tax consulting, transfer pricing, tax research and planning, international tax as well as Private Client Services such as trust and estate and succession planning.

We also have a suite of advisory solutions including strategy and business transformation, business management and family office, healthcare advisory, forensic and litigations team, and the TRAC group.

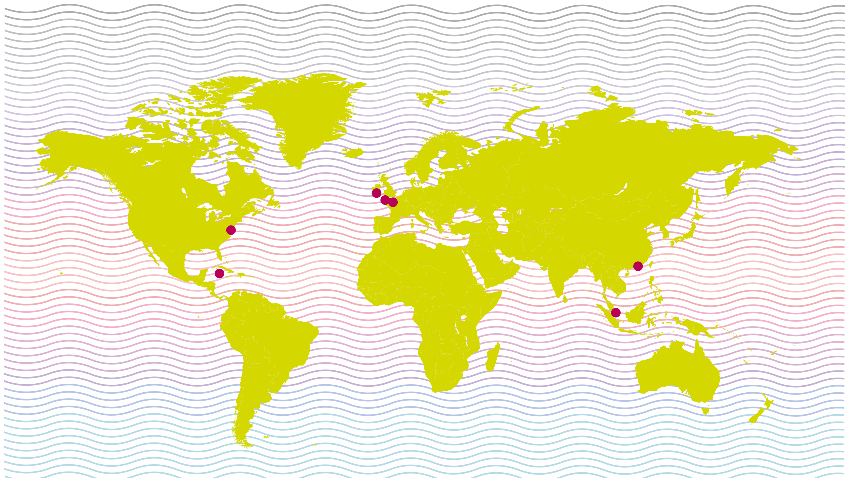
Our teams are assisting clients in cutting-edge areas like AI, robotics process automation and blockchain.

And to round things out, we have a Transaction Advisory Services Practice offering buy-side and sell-side services and a Valuation Advisory Services Practice team. It means a CFO can open the door to us and pretty much all his or her challenges can be met with our help. ■

Alexander Reyes is a New York-based partner at Citrin Cooperman, leading its Financial Services Practice

FUND DOMICILES

A 12-page special



Settling down

Predictability and stability are what managers look for when selecting a jurisdiction for their latest vehicle. But that does not mean the domicile universe is set in stone, writes Victoria Robson

There are currently a number of intersecting cross currents buffeting established manager and investor attitudes toward which jurisdiction best suits their fund formation needs. Here are some top considerations.

Fragmentation

In Europe and the US, managers' historical preference for establishing real estate asset holding companies in Luxembourg and Delaware, respectively, has meant it has made sense for them to also set up funds in those jurisdictions. However, as the tax landscape changes, it is firing up a trend to establish special-purpose vehicles in local jurisdictions. In turn, this could influence where funds choose to domicile.

"In recent years, the market has moved against establishing holding structures purely based on tax treaties," says Greenberg Traurig shareholder Steven Cowins. "Now, for instance in Europe, if you are investing in Italian property, you'll use an Italian structure. And the UK has just overhauled its tax regime, so the benefits for an offshore [ie, Channel Islands] vehicle aren't there anymore as property holding vehicles. In future, it will be interesting to see how that factors into choosing where to domicile the fund."

Alternative sources of capital

Investor preference is a primary consideration when choosing a domicile. The "flavor of the month," as one market participant refers to popular domicile choice, is often a reflection of a herd mentality among managers not wishing to stand out from the crowd. But it also mirrors the relative volumes of capital raised from particular geographies.

Asia is a case in point. Hong Kong and Singapore are cementing their role as global fund centers rising with the tide of new regional capital targeting alternatives. As competition to provide a home for that capital heats up, Hong Kong has enacted a new limited partnership law and Singapore has launched a variable capital company product to attract funds looking for a home.

At the same time, Middle East money from the likes of Qatar and other Gulf states – which in the past has favored the

Channel Islands' structures as vehicles to invest in London real estate – has receded, redirected into local infrastructure schemes, says IQ-EQ group funds and institutional director Stuart Pinnington: "That has changed the dynamic over the past two years and could change where people domicile funds as they look at a new investor base."

London calling?

The UK's decision to leave the EU has been a boon for Luxembourg and Ireland as fund centers providing access to European investors, including expanding capital pools from the likes of the European Investment Bank. The current uncertainty on the terms of the prospective EU-UK relationship and when they might be agreed mean that unless you are a UK fund tapping UK-only investors, London is off the table.

But the future might look quite different. In apparent recognition of the opportunity to position itself as a competitive global domicile, in March the UK government announced a review of its funds regime, including VAT on management fees. In the same month, it launched a consultation on the tax treatment of asset holding companies in alternative fund structures, which is widely viewed as difficult to implement in its current format.

Market participants have welcomed both initiatives. "It's a really positive move that the UK government is consulting on amendments to the UK asset holding regime and how to better compete with Luxembourg," says Greenberg Traurig shareholder Charles Case. "If they can solve some of those practical problems, there is huge potential for the revival of UK fund structures and the UK as a domicile. That is particularly attractive for UK real estate and would provide a good hub for European real estate, too."

BEPS impact

While not the deciding factor when selecting where to form a fund, implementation of the OECD's Base

> *"In recent years, the market has moved against establishing holding structures purely based on tax treaties"*
>
> **STEVEN COWINS**
> **Greenberg Traurig**

Erosion and Profit Sharing actions and their impact need to be incorporated into any domicile assessment. Different jurisdictions interpret the 15 BEPS actions differently and are at varying stages of implementation.

"We are watching how tax treaties interact with BEPS to ensure funds can operate in the way they have in the past and to see whether there are any changes needed," says IQ-EQ group head of funds Justin Partington. "The big picture question is whether BEPS will change or rewrite those rules entirely. Luxembourg, Ireland, Guernsey, Jersey and the Cayman Islands are all adopting substance requirements into their rules. It would be helpful if BEPS didn't undo all that work in the way it is implemented."

ESG essentials

The EU regulation on sustainability-related disclosures in the financial sector was published at the end of last year and will apply from 2021. Across private markets, environmental, social and governance issues have been rising up the list of manager and investor priorities. In future, new ESG regulatory obligations and opportunities could influence where funds choose to domicile.

"We don't know where the ESG agenda is going and how it will influence where investors invest or where fund structures will be based," says Robert Mellor, PwC private funds partner.

One outcome might be that, as governments seek huge amounts of financing to meet sustainability commitments, they could create an "ESG-advantaged" vehicle with certain tax incentives, Mellor notes. Government initiatives and reporting requirements "could become the next factor to take into account when you're deciding on fund design, location and efficiency," he adds, noting that for domiciles, that would create "a whole new battleground."

In response, service providers are "pivoting to look at providing the right ESG reporting products for clients in the right domiciles," says Intertrust Group global head of product, Patrick O'Brien. "As the investment market grows, you will see allocation to domiciles with the right ESG environment."

As the amount of capital allocated to private equity continues to grow and domiciles compete to capture that funds business – not just regionally but globally – the funds environment, with its laws, regulations, products and structures, will continue to evolve. While jurisdictions on our list rise and fall in relative prominence as a result, a core feature of the landscape remains the same – barriers remain high to new entrants.

In addition to rule of law, tax efficiency, cost and ease of doing business, managers and investors will continue to be guided by reputation, credibility and track record.

For other jurisdictions seeking a slice of the global private funds business, these attributes will be hard to come by if they cannot get their foot in the door. ■

KEYNOTE INTERVIEW

The regulatory landscape can be confusing for US funds crossing the Atlantic for the first time. David Rochford and Cliodhna Murphy of MUFG Investor Services explain where to start

EU priorities for US funds

As the economic effects of the pandemic ripple in multiple directions, we asked David Rochford, MUFG Investor Services' head of private equity, real assets and hedge funds, and Cliodhna Murphy, the firm's executive director of product development, what US managers looking at setting up a European vehicle need to know.

Q What's the first priority for US managers looking to expand in Europe?

David Rochford: The first thing a manager needs to consider is where they plan to raise capital. Managers interested in marketing across Europe and setting up a pan-European structure or a fund over a certain size threshold have a number of choices but, generally speaking, Ireland and Luxembourg take the lion's share of new fund set-ups. Although they both sit under the Alternative Investment Fund Managers Directive and share the same oversight through the European Securities and Markets Authority, it's important to explain to managers the nuances between jurisdictions.

SPONSOR

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In recent times, Luxembourg has attracted a lot of capital, particularly for the private equity market. This is because Luxembourg offers both regulated and unregulated LP solutions depending on the needs of the manager and its investors. Ireland is struggling to keep pace and this is unlikely to change until it passes its new Irish Limited Partnership law, which will make it a more competitive domicile. If a manager is looking at tapping investors from one specific European country, then they need to assess the flexibility of the marketing rules in that jurisdiction, the national private placement regime, and whether that solution works for the size of their fund.

Q The AIFMD regime is far-reaching. What are the key things managers need to know?

DR: We spend a lot of time explaining the complexities of AIFMD, in particular the responsibilities played by each of the key parties: the management company, depository and fund administrator. In Luxembourg, the available options include the manager (AIFM) being regulated while the fund – typically a RAIF (reserved alternative investment fund) – is not. This is a familiar structure to US managers. But they need to get clear on the management company obligations – for instance, regulatory compliance, delegated oversight, risk management and distribution – and understand that the depository role is to ensure assets are kept in good title and that they need an administrator to keep accounts and records. This might be entirely new to them.

Q Once they've selected the jurisdiction and are familiar with AIFMD, what comes next?

DR: Engaging a lawyer to manage the document process and interacting with the regulator as well as service providers to establish the fund structure. Then comes appointing service providers to act as the management company delegates in charge of the core functions: investment management, administration and distribution. Larger US managers that already have a presence in Europe would have appointed existing service providers to conduct these activities. But many US managers typically undertake administration work in-house and aren't used to the complexity involved in using third parties. Generally, they don't want the headache of co-ordinating multiple providers and love the idea of a platform solution that services all these requirements. From our perspective, as the impact of covid plays out, the more supportive we can be of our clients, the better. Funds in general want more from their asset servicer. Of increasing significance is access to data and the technology to collect, aggregate, analyze and report it in a meaningful way that provides transparency.

Q What other issues come up with US managers?

DR: A big one is Brexit. During the pandemic, the negotiations between the UK and EU appear to have taken a backseat, but they will resume. Will there be a deal? And how will that play out in terms of manager access to capital? US managers want that process to be as easy as possible and not to face additional requirements or costs relating to the jurisdiction of the fund. A no-deal scenario, looking more likely, would mean US clients targeting the UK, and the EU would have to establish different vehicles for UK and EU investors. It would open up real concerns and additional costs. For instance, the European Securities and Markets Authority recently completed a review of AIFMD and one of the key points raised was delegation. ESMA wants to ensure the management of European AIFs is subject to the same regulatory standards. If there is delegation to third countries (eg, the UK) can they be effectively managed?

Q Within the EU, is there anything pending on the regulatory front that US managers should be aware of?

Cliodhna Murphy: In the European context, the principal one is the EU regulation on sustainability-related disclosures, which is due to come into force in March next year, and the Taxonomy Regulation, which will apply from January 2022. The taxonomy refers to the common language around environmental factors and characteristics that will enable firms and investors to identify what activities are sustainable. In its current form it includes 50 data points that would apply to private equity.

The EU Disclosure Regulation outlines the information managers need to update on their website, such as policies and the integration of sustainability risks into their investment decision-making processes; information on how remuneration policies are consistent with the integration of those risks; and a statement regarding their due diligence policy that considers the adverse impacts of investment decisions on sustainability factors. At the product level, in the prospectus, managers will need to disclose the impact the product will have on sustainability factors; explain disclosure on environmental, social and governance integration; and the impact on returns.

Q That's a lot more reporting. Overall, how receptive have your clients been?

CM: Very receptive. In isolation, managers may find it difficult to decide what information to collect from a portfolio company and which standard to adhere to, and that's a key area of focus for us. They will need to work with specialists to gather the granular-level data required about, for instance, carbon emissions and footprints and energy consumption. We can assist them with finding appropriate experts to source the various data points and then help categorize that information, provide independent verification and reporting, as well as facilitate collaboration between GPs and LPs. Part of this shift to increased ESG disclosure is investor-driven. They want to see more sustainability-related disclosures to avoid green-washing. We can provide them also with independently prepared and verified ESG transparency reporting.

Q Are managers prepared for these new requirements?

CM: I would say at present not that prepared. The EU disclosure regulation should be the initial focus – that has been more clearly defined, as the taxonomy and the regulation is still evolving. We are engaging with our clients and industry bodies to provide feedback to regulators about what data to collect and how it can be standardized. One potential initiative I find very interesting is that the EU is considering making what managers report publicly available, which would be very beneficial for ESG transparency. With US managers specifically, any additional requirements are always a concern. But if they want to market into Europe, they will have to start preparing for these regulations.

Q Longer term, what impact will these new ESG disclosure rules have?

CM: Once these regulations are finalized, we see a huge opportunity for managers to launch new products that clearly disclose their ESG impact, dispel investor concerns about green-washing and subsequently attract LPs. Where the EU is leading, other regulators aren't going to be too far behind. The US Securities and Exchange Commission has already started to make positive noises about new sustainability disclosures. ■

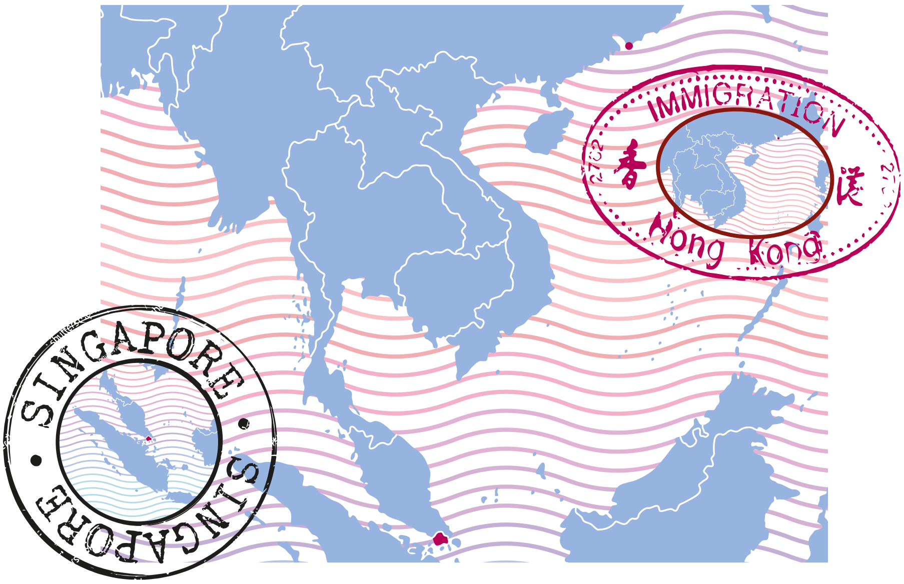
Asia-Pacific: Hong Kong and Singapore

The launch of new structures in both cities is fueling competition to be the regional funds hub

Given their history as regional financial centers, it is no surprise that Hong Kong, as a gateway to China, and Singapore, a commercial nucleus serving the rest of South-East Asia, are the two pre-eminent fund centers in Asia-Pacific. In addition to location, both boast – Hong Kong's recent political upheaval aside – stability, continuity, convenience and an established ecosystem of fund service providers that support a host of Asian, pan-Asian and international managers, as well as access to an expanding pool of regional capital.

"Hong Kong and Singapore are friendly competitors," says Gavin Anderson, Hong Kong-based partner at Debevoise & Plimpton. "Singapore has done well at selling itself as a sophisticated and attractive funds center and has put pressure on Hong Kong, which in turn has been encouraged to up its game."

While useful as bases for management offices and asset-holding special-purpose vehicles, they are not typical picks for fund domiciliation. Until now, capital raised or targeted for investment in Asia has usually been held by funds established either in the historically popular Cayman Islands or in Delaware or Luxembourg. But that could be about to change.



The race is on

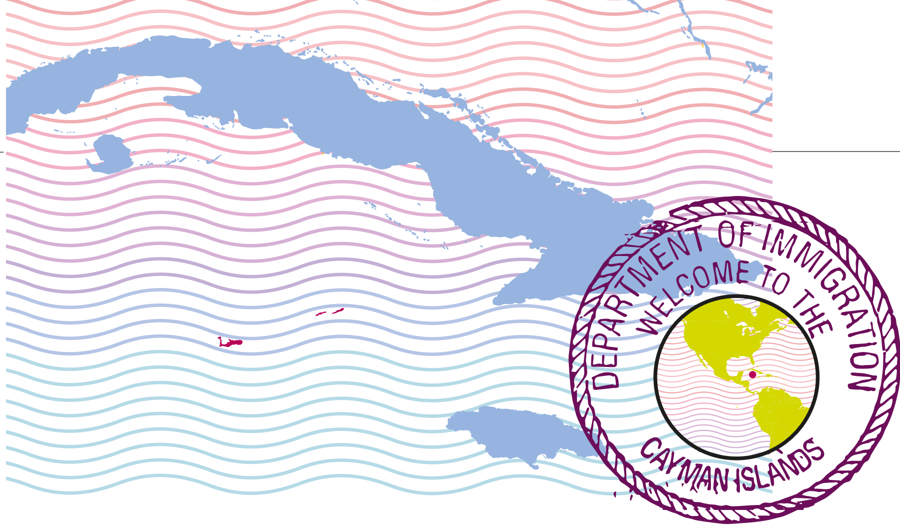
Both the Hong Kong and Singapore governments have moved to introduce new structures to encourage managers to bring their funds onshore. Hong Kong's brand-new Limited Partnership Fund Bill, published in March, was due to come into force at the end of August. The new structure marks a significant step forward in the race with Singapore – which already offers a limited partnership structure, tax incentives and government grants – to capture fund business.

By itself, the pull of a Hong Kong limited partnership might be weak when set against the upheaval and cost of switching jurisdiction. But coupled with any potential revision of carried interest taxation mooted by the Hong Kong government earlier in the year, it could tip the scales. "Lack of clarity over tax on carried interest in Hong Kong and Singapore has been a source of discomfort," says Anderson. "If the Hong Kong government addresses that and, even better, introduces a beneficial tax rate for using a Hong Kong limited partnership, that could drive a lot of people to use it."

For its part, in January, Singapore, with its longstanding commercial focus on attracting asset management business, implemented a new structure: the variable capital company. Its key appeal is its flexibility. The VCC can be used by both open- and closed-end funds, including private equity and real estate, to establish a standalone vehicle or an umbrella for sub-funds.

Although it is still early days and its corporate structure may not obviously appeal to private equity funds, there is already an example of a high-profile investor using Singapore for its latest vehicle.

The $2.3 billion Allianz Real Estate Asia-Pacific Core I fund, launched in June in partnership with the National Pension Service of Korea, is domiciled there. "In real estate, there's a massive focus on Asia," says Stuart Pinnington, group funds and institutional director at IQ-EQ. "A lot of EU or US managers targeting Asia are looking to domicile in Singapore." ■



Cayman Islands

As the onshore/offshore debate intensifies, the Caribbean jurisdiction has issued new private fund legislation to align itself with its peers

US and Asian managers have long used the Cayman Islands as an offshore base for funds and feeder vehicles. Close to the US and with a limited partnership law similar to Delaware's, the Caribbean jurisdiction is also popular with Middle Eastern investors.

"Asian investors have been comfortable with Cayman for a long time," says PwC private equity funds partner Robert Mellor. "Cayman and China have a tax treaty. Chinese investors are happy there. That's why it remains on the global stage."

Elsewhere, its appeal is more muted. In Europe, the addition of Cayman to the EU's list of non-co-operative jurisdictions in tax matters has automatically excluded some investors from allocating funds to vehicles based there. According to Proskauer partner Leith Moghli, "non-European managers and US funds marketing to European investors are looking at alternatives, like establishing Europe-only vehicles in the Channel Islands or Luxembourg."

Regulators in Brazil are also discouraging domestic managers from forming new funds in Cayman by requiring them to disclose ultimate beneficial ownership information. Many Brazilian funds receive local capital channeled through a nominee bank. As a result, Charina Amunategui, executive director of business development at MUFG Investor Services, says that "many of Brazil's investment managers have explored opening a Canadian feeder as an alternative to a Cayman offshore feeder, as Canada is not on the CVM's [Comissão de Valores Mobiliários – Brazil's securities and exchange commission] blacklist."

However, Moghli describes the EU blacklisting as a "blip." And while some observers remark wryly that the designation benefits Luxembourg, others expect it to be lifted in due course. Only days after the February decision, Cayman enacted its Private Funds Law 2020, which introduces a new framework to monitor closed-end vehicles and addresses EU oversight suggestions.

"Cayman has enhanced its substance requirements," says IQ-EQ group funds and institutional director Stuart Pinnington. "From August, all closed-end funds will need to be authorized, appoint an anti-money-laundering officer and fulfill other statutory requirements in place in other jurisdictions like Luxembourg. Related costs have soared. Many fund managers that have used Cayman before are looking at other jurisdictions, including onshore in their home market."

> *"Previously, the choice was automatically Cayman. Now we are discussing alternatives"*
>
> **GAVIN ANDERSON**
> **Debevoise & Plimpton**

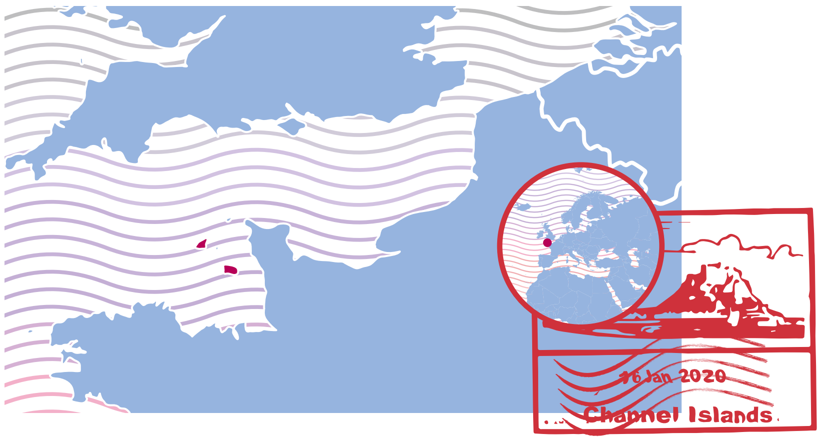
The changes bring private funds within the remit of the Cayman Islands Monetary Authority and align the jurisdiction with its international peers. They also impinge on the expediency and cost efficiencies of the light-touch regime, though it remains to be seen whether talk of fund managers moving onshore will translate into action.

"Previously, when [an Asia-based] client came back with a new fund, the choice was automatically Cayman," says Gavin Anderson, a partner at Debevoise & Plimpton in Hong Kong. "Now we are discussing investor sentiment and alternative options – Singapore, Hong Kong and onshore Europe – if they wish to market there."

However, he adds that most of the managers that have historically based their funds in Cayman are staying. ■

Channel Islands: Jersey and Guernsey

Both offshore jurisdictions are charting a new course into a post-Brexit world



Jersey and Guernsey have served as trusted and stable domiciles for private funds for decades. Well used by UK managers and familiar to investors globally, both jurisdictions enjoy reputations as proven, predictable, light-touch regulatory regimes with the credibility that comes from hosting funds over several vintages.

As a real estate hub, Jersey offers a "flexible, cheap and quick set-up," says Jersey-based IQ-EQ group funds and institutional director, Stuart Pinnington. "In the past, there's been a lot of traction from Middle East and US managers buying UK real estate. A lot of the property is already held in Channel Island SPVs, and those managers use a local fund aggregator to pool cash."

However, in light of Brexit and uncertainty around what a future relationship between the UK and EU might look like, it seems increasingly unlikely that Jersey or Guernsey will receive an EU Alternative Investment Fund Managers Directive marketing passport, says Pinnington. "Years ago Jersey and Guernsey were flavor of the month for private equity," he says. "Now there is some uncertainty due to Brexit."

> *"There are many years of private funds expertise in Jersey and Guernsey and fund regimes that continue to evolve"*
>
> **JUSTIN PARTINGTON**
> **IQ-EQ**

At the same time, in ongoing conversations about onshore versus offshore, the Channel Islands can be unfairly grouped in with less vigilant jurisdictions. "There is a spectrum from the likes of Jersey and Guernsey to somewhere like the British Virgin Islands, which is less well-worn," says Greenberg Traurig shareholder Steven Cowins. "Continental institutions prefer not to use Channel Island structures as they are not in the EU."

Stepping up

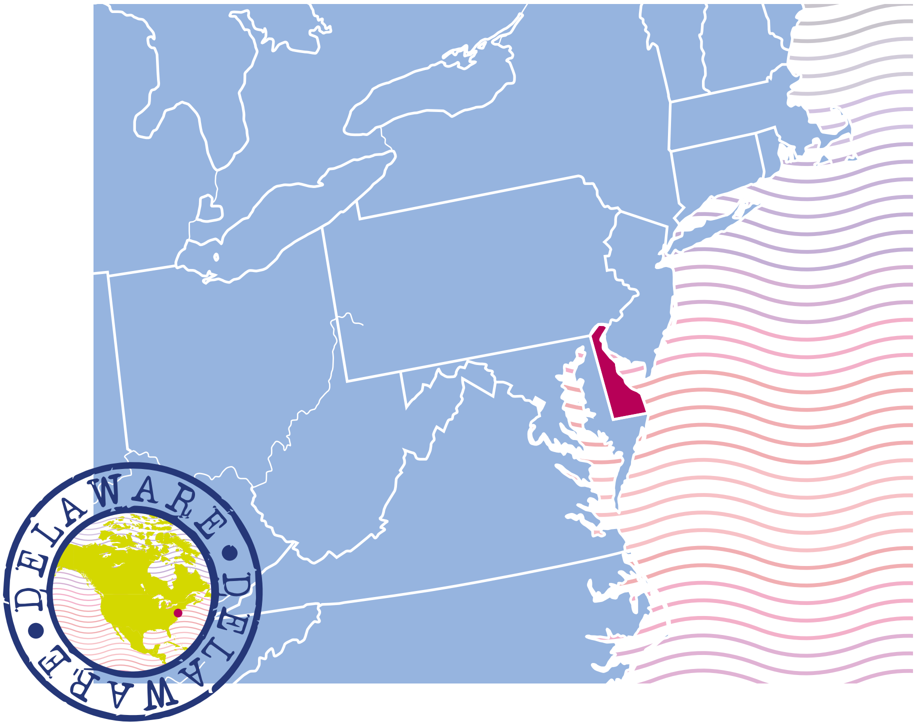
However, both jurisdictions are seeking to capitalize on their differences from other offshore jurisdictions, namely the Cayman Islands, which as of August, still sat on the EU's list of non-co-operative jurisdictions for tax purposes (ie, its blacklist). In July, Jersey amended its limited partnership law to facilitate inbound migration of vehicles seeking a new home. The previous month, Guernsey introduced a fast-track application process for overseas collective investment schemes looking to migrate.

Guernsey is also looking to tweak its private investment funds rules. In July, the Guernsey Financial Services Commission launched a discussion paper on new private fund 'formation options' aimed at making the process more efficient.

"There are many years of private funds expertise in Jersey and Guernsey and fund regimes that continue to evolve," says IQ-EQ global head of funds Justin Partington. "They attract new fund managers that don't want a fully AIFMD-compliant solution. That's contributed to growth over recent years."

Looking to the future and a post-Brexit world, some local service providers may fear competition from London as a newly revamped fund center outside the EU. PwC private equity funds partner Robert Mellor sees it another way: "They could sit in between the EU and UK with preferential access to both. We don't know yet."

In the meantime, both jurisdictions are focused on keeping competitive. ■



US: Delaware

The second smallest state in the US is a powerhouse for fund domiciliation

Surrounded by Pennsylvania, New Jersey and Maryland, and occupying almost 2,000 square miles of land on the Eastern Seaboard, Delaware has carved itself a deep niche as the US fund domicile of choice. Its limited partnership structure, which does not require a promoter to have a substantive connection to the state or disclose fund investors, is the primary vehicle for US managers and therefore managers globally. "Delaware ranks high because of the number of US funds investing in US real estate," says IQ-EQ group funds and institutional director Stuart Pinnington.

Unlike its international counterparts, which need to keep a keen watch over the competition, Delaware faces no significant challenger within the US. Fred Steinberg, SANNE Group's New York-based managing director, notes that the tax-friendly state is so entrenched as the leading US domicile that while sometimes funds set up in New York, Nevada and other states, he does not envision these jurisdictions displacing Delaware as the leader.

"Delaware has built up its specialism," agrees Intertrust Group global head of product Patrick O'Brien. "Past rulings and the regulatory and tax environment mean it's a hub for products."

$3.4trn

Value of US professionally owned real estate

Source: PERE/MSCI

Delaware serves as the default because of its "advanced pro-business and enterprise-friendly laws [and] a long history of court precedents," says Charina Amunategui, executive director business development, MUFG Investor Services. Other jurisdictions that funds have considered include New York and Texas – and even Alberta or Ontario in Canada, driven by the anticipated investor pool (ie, Canadian pension plans).

Uncomplicated

For its part, setting up in Delaware is uncomplicated – the secretary of state's office is widely perceived as efficient – and the regime is flexible.

"The beauty of Delaware for funds is a clean slate upon which managers can build an entity that works," says Ellisa Opstbaum Habbart, founding partner, The Delaware Counsel Group. "Everything may be customized in the contract. The challenge is you need to know what you are doing. Drafting the documentation can be complex."

An established pool of third-party service providers is on hand to help, including "an entire infrastructure and network of legal counsels, registered agents, tax preparers, auditors, banking providers and fund administrators that are well established and seasoned [when it comes to] working with Delaware funds," says Amunategui. "A new manager can easily leverage this network's experience, enabling a seamless fund start-up process in a matter of weeks and straightforward fund maintenance operations in the future."

And should a dispute arise, a key advantage is the bench of appointed judges that sit in Delaware's juryless Court of Chancery, which Habbart says has substantial experience in commercial matters.

He also highlights the role of Delaware's Corporation Law Council of 26 lawyers, which keeps an eye on possible annual updates to the Delaware Revised Uniform Limited Partnership Act. ■

Ireland

Long-awaited amendments to the country's limited partnership legislation could reshape the international fund domicile landscape

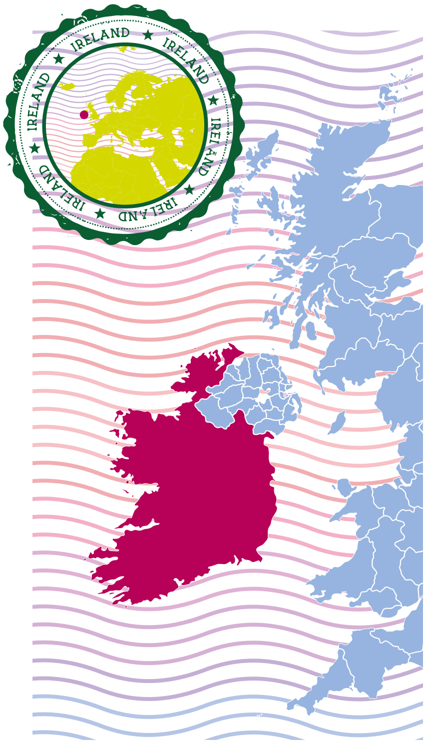
In the competition to be the leading European fund domicile, it pays to be quick, as Ireland has learned. The country, which does not benefit from the luxury of being exclusively focused on developing its finance sector, has come a solid second to Luxembourg as the chosen center for fund formation. Serving as a longstanding hub for fund administration, Ireland offers a full suite of third-party service skills but, unlike its continental competitor, currently lacks the legal framework to support modern fund structures.

Revising the existing limited partnership law has been discussed for years. The government has highlighted updating it as a strategic priority as it seeks to boost Ireland's position. However, passage of the latest version, the Investment Limited Partnership (Amendment) Bill 2019, has been slow, putting a brake on private funds setting up there.

"It is still in the legislative process and has been for several years, with slower-than-expected progress," says Justin Partington, group head of funds at IQ-EQ. "Ireland's legislature has chosen to focus on other priorities over the past two years and, as a result, some business that may have gone there – for example from the US, with its affinity for Ireland – has chosen to go to Luxembourg."

Ready for impact

The sentiment is echoed across the market. "There are a number of deficiencies with the existing legislation," says Proskauer partner Leith Moghli. "When Ireland changes its legislation, that will have a meaningful impact on the private equity landscape."



"US inbound clients like Ireland because of the shared language, the legal system is similar to the UK, and there are direct flights between Dublin and most cities in the US"

ROBERT MELLOR
PwC

The proposed changes to the existing 1994 Investment Limited Partnership Act, which governs regulated funds, include allowing a partnership to be structured as an umbrella fund with sub-funds underneath that hold segregated liability.

The amended legislation would also extend investor safe harbor provisions, permit investors to vote on changes to partnership agreements without losing their status and update the provisions on investor contributions and returns of capital.

Partington notes that when new legislation does arrive, there will still be space on the international funds landscape for an Irish structure. "Choice is really important," he says. "It keeps the market healthy. We don't see a future where only one domicile attracts all private funds. And the industry itself is growing."

As of April, the total number of Irish Registered Qualifying Investor Alternative Investment Funds stood at just over 2,700 and holding €695 billion of net assets. Within this, a number of European private credit strategies have targeted Ireland as a base, exploiting the country's talent pool, multi-currency capabilities and cross-border expertise, as well as the terms of its double tax treaty with the US.

"The tax analysis for private debt is more complex than for private equity," says Moghli. "Ireland is considerably more tax-efficient for direct lending funds than Luxembourg." It is a strong foundation to build on. ■

Luxembourg

Sitting at the heart of Europe, the Grand Duchy is the king of European domiciles

As a financial services hub, Luxembourg has a lot at stake in the race to become the domicile of choice for European private funds. It is currently at the head of the pack. Acting swiftly to meet the requirements of the EU's Alternative Investment Fund Managers Directive by establishing the Reserved Alternative Investment Fund – a flexible and speedy option – and expanding its product offering to include the Luxembourg Special Limited Partnership, the Grand Duchy outstripped its closest competitor, Ireland, to scoop up business that was swerving around London in the wake of the UK's 2016 Brexit referendum.

Popular choice for private real estate

Grabbing first-mover advantage puts Luxembourg front-of-mind for managers selecting a domicile. According to the Association of the Luxembourg Fund Industry, as of May, more than 600 private equity and venture capital funds, holding €105 billion of assets, and 320 real estate funds, with €88 billion of assets, had been set up in the country.

"Part of the rationale of where to domicile is to look at how you hold your [real estate] assets," says Steven Cowins, shareholder in Greenberg Traurig. "A lot of managers have used Luxembourg structures. It's a logical next step to domicile their fund there as they already had substance and they would only have to deal with one regulator."

Justin Partington, group head of funds at Luxembourg-based IQ-EQ, says the Grand Duchy is also the preferred choice for large continent-wide investors such as the European Investment Bank and the European Infrastructure Fund, which are looking to allocate increasing amounts of private capital funds.

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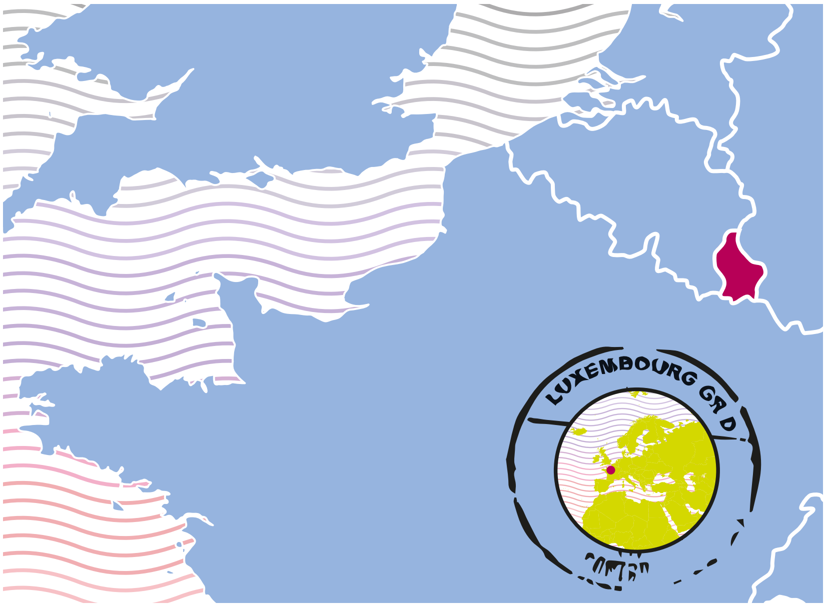
Reserved Alternative Investment Funds established since their launch in 2016

Source: Association of the Luxembourg Fund Industry



With 52 double tax treaties, a reputation for cross-border facilitation, including multi-currency operations and access to foreign exchange hedging, and a wealth of third-party service providers in close proximity, Luxembourg is an efficient choice as regional base – something real estate investors like CBRE and Schroders have recognized.

Consider the downsides

However, the Grand Duchy has a reputation for being expensive. It makes sense as a home for large non-EU funds marketing across the continent. However, for vehicles collecting capital from a small number of specific European markets, obtaining an AIFMD passport is costly.

PwC private equity funds partner Robert Mellor notes that while the product range grants flexibility, local particularities – for example, the requirement for a Luxembourg notary to authenticate certain documents – add time and cost. Competition for talent, wage inflation and staff turnover are also considerations, he notes, as is the uncertainty created by continuing competition challenges to Luxembourg's tax regime.

As more real estate managers opt to establish local holding structures rather than a Luxembourg special purpose vehicle, "it'll be interesting to see if that factors into choosing the domicile for a fund," notes Cowins.

Like all jurisdictions, Luxembourg cannot rest on its laurels. ■

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Q&As

iCapital chief Lawrence Calcano

Calcano, who features in this month's cover story, has spent the last five years building a platform with the aim of 'democratizing' investments in alternatives. The chief executive of iCapital has overseen the company's acquisition of some $60 billion in client assets (once recent deals close) from bank feeder fund platforms, and recently partnered with PGIM Investments to augment its distribution and servicing capabilities. ***Carmela Mendoza*** spoke with Calcano about the firm's grand plan, the prospect of retail investment in private equity, and more.

Read the Q&A at ***https://www.privatefundscfo.com/why-your-next-lp-could-come-via-icapitals-platform/***

ALFI chairwoman Corinne Lamesch

Luxembourg, the 'king' of European fund domiciles (see p. 38), achieved record growth in assets under management in 2019, hitting almost €4.8 trillion in AUM – then covid-19 struck. Connor Hussey spoke with the Association of the Luxembourg Fund Industry chairwoman, Corinne Lamesch, about how the pandemic affected that trend, what the Grand Duchy's outlook is for the rest of 2020, and why she thinks alternatives "is the most vibrant asset class in Luxembourg at the moment."

Read the Q&A at ***https://www.privatefundscfo.com/luxembourg-domicile/***

Deep cover

Look deeper into the topic of this month's cover story, with these must-reads on our site:

'PE must prove it's worth the fee'
Some believe 401(k) money may someday replace, not supplement, existing dry powder, as banks pull out of the market and defined benefit schemes are phased out. This makes it all the more important that PE be able to justify two layers of relatively high fees, ***writes Rod James***.

'Divided Commission updates accredited investor definitions'
The passing of a rule widening the definition of accredited investors was a win for Securities and Exchange Commission chairman Jay Clayton. ***Bill Myers reports*** on the content of the rule, why one Republican commissioner didn't think it went far enough, and the content of Democratic commissioners' criticism.