

## GREAT FUND INSIGHTS

# Spotlight on opportunities in alternative investments in the U.S.

**Kamar Jaffer**

Welcome and thank you for joining us on the second of our series 'Great Fund Insights, Opportunities in Alternative Investments'. I am Kamar Jaffer, a Counsel in our Funds and Asset Management practice in the Middle East. In this episode, I am delighted to be joined by Jillian Ashley, my partner based in New York, to spotlight opportunities in the U.S. Jillian advises fund managers on the structuring for nation marketing and financing of private investment funds as well as institutional investors, investing into private investment funds, co-investments and direct investments. She has considerable experience in the energy and infrastructure sectors. Jillian was also an executive director with JPMorgan Asset Management's Infrastructure Investments Group. She'll be sharing with us her insights from both the manager and the investor perspective. Jillian, thank you for joining us.

**Jillian Ashley**


Thank you for having me, Kamar.

**Kamar Jaffer**

We are seeing a lot of interest from international investors to invest in funds in the U.S. In fact, we are working together in representing Middle Eastern investors investing into funds in the U.S. So, to kick off, since the onset of Covid-19 what are some of the trends you have been seeing in the U.S. fundraising environment? How have managers been navigating the challenges of Covid-19?

**Jillian Ashley**

It's actually been a remarkably good story for fundraising during Covid-19, particularly for the larger, more established fund managers. Fundraising has really held up quite well. I think at the outset of the pandemic, there was quite a bit of uncertainty about how and if fundraising could work without the traditional road show full of in-person meetings but it turns out that, as we lawyers and many others have found in 2020, we can do a lot more remotely than we ever imagined. That said, while the amount of capital raised has been quite respectable compared to recent years, the number of funds receiving those commitments is down significantly. Investors are flocking to known quantities, so the major players have had huge raises and there have been far fewer new entrants. I have seen some of my smaller, more middle market clients decide to put fundraising on hold to pick it up again later this year when hopefully it's easier to get in front of new prospects.



**Kamar Jaffer** So the fact, I guess, is that institutional investors' appetite remains undiminished for alternative investments. What are some of the some of the investment strategies and opportunities that these investors are focusing on in the U.S.?

**Jillian Ashley** We are most definitely seeing an increased emphasis on ESG. A few years ago that was driven by a handful of European investors but we are seeing this emphasis spread increasingly to U.S. institutional investors as well and fund managers ignore it at their own peril. It's especially pertinent to the energy and infrastructure investing where investors are focussed on climate change. They are keen to put their dollars towards renewable energy and other green initiatives and have been committing their funds accordingly. Based on data from Preqin there is currently over USD96bn in dry powder sitting with specifically renewable focused funds and USD242bn in dry powder in infrastructure focussed private investment funds, a good portion of which you can expect to see fund managers deploying in green investments in response to investor demands for environmentally sustainable investment.

Another unsurprising trend to note is investor interest in buyout funds and funds focussed on distressed debt and special situations. In the current stressed economy, there is clearly significant opportunity in that space and it's offering some potentially very good returns. And finally, in a time of global uncertainty, institutional investors worldwide seem to be focussing on investing their dollars in the core established markets of North America, Western Europe and Asia Pacific with less interest in emerging markets, with the exception of those institutional investors that have a policy-driven mandate, so are impacting investing goals in those regions. I expect that trend will continue at least until we are at a point where we all have better sights on what a post-Covid world looks like than we do at this moment.

**Kamar Jaffer** Biden is coming into office later this month, January 2021, what are your thoughts on the impact of the new administration in this space? Are there any legal and/or regulatory developments to watch out for?

**Jillian Ashley** Well, in general, we can expect increased emphasis on regulation and enforcement. With a Democratic administration and Democrats controlling both houses of Congress we can also expect another swipe at the so called 'carried interest loophole'. In other words, a push for carried interest to be taxed at the higher rate for ordinary income under the U.S. tax code. Currently, the rate is 20% for capital gains, which carried interest qualifies for under current law, and can be up to 37% for an ordinary income. Both Democrats and Republicans have tried to change this before without success but it is a perennial favourite to target up progressives so we will see if it gains traction this time around. Change in this area would be a fundamental change in terms of the economics of private funds. You can expect senator Elizabeth Warren, in particular, to be vocal on this point. This is a major concern of hers.

**Kamar Jaffer** And we are also seeing a heightened scrutiny of managers in the current environment. What are the areas that institutional investors are focussing on in their discussions with managers?

**Jillian Ashley** Again, ESG. I've already spoken on the environmental aspect so here I'll speak to the social and governance aspect. Institutional investors are focussed on good citizenship and governance both at the fund level and at the portfolio company level and want to see a commitment from fund managers that the fund and its portfolio companies are being run in accordance with best practices with appropriate checks on fund manager discretion and an emphasis on fund managers fiduciary duties to investors. There is also a distinct diversity and inclusion aspect to this. Investors are demanding to see more minority and female representation on investment committees and boards.

**Kamar Jaffer** And we are working together on a number of mandates from Middle Eastern investors investing into funds in the U.S., so the market uncertainty has prompted creativity amongst managers. What are you seeing in terms of the models that are being used to attract investor interest?

**Jillian Ashley** Both co-investments and separately managed accounts. Co-investment arrangements were growing in popularity pre-pandemic and they remain a key tool for managers to manage fund exposure levels while also attracting institutional investors who want that direct exposure. I have definitely witnessed, together with you, Kamar, an uptick in SMAs and funds of one coming across my desk in recent months. These structures give institutional investors the opportunity to tailor investment strategy to their needs and get personalised attention from fund managers, which allows fund managers, if they have the bandwidth and interest in providing that personalised attention, to bring more assets under management. This can be a particularly good strategy for fund managers below the top tier who are maybe having more difficulty fundraising in Covid times. I should also mention fund managers' creativity in fund financing. I am seeing financing facilities for funds that stray far beyond the traditional subscription line, including NAV and hybrid facilities as well as creative HoldCo financing structures that look, in part, to portfolio assets and, in part, to fund level guarantees as security. Fund managers are keen to have the liquidity they need on hand in these uncertain times and are taking steps to ensure they won't get caught flat footed. These are all areas where we can really help our clients structure and implement bespoke solutions, tailored to what they are aiming to achieve.

**Kamar Jaffer** What about economics and fund terms? Is the pendulum swinging in favour of investors?

**Jillian Ashley** Yes, I think so. I've seen some significant concessions on these in recent deals as well as on key fund terms relating to governance such as key person events and investors' removal rights over the GP.

**Kamar Jaffer** And what is happening in the secondary space?

**Jillian Ashley** Secondary deals slowed down significantly in 2020. We saw very little activity on that front but what that means is there is a lot of pent up dry powder out there for the strategy and we may see some significant uptake in 2021 as pricing rebounds. GP-led deals are expected to be a growing trend in this space. I am interested to see how that plays out.

**Kamar Jaffer** And returning to ESG. So it's clear that there is an increased emphasis on this in the U.S. Biden promised to spend USD trillion on clean energy projects and infrastructure. What measures are you seeing in the industry in this regard?

**Jillian Ashley** Well, ESG is the calling card of the day across the board and the Biden administration's emphasis on clean energy and infrastructure investments should play into that for sure. I just hope that the Biden administration recognises the win-win that comes from opening up opportunities for private investors to deploy capital alongside federal dollars to maximise the investments in this sector, which is desperately needed both to shore up America's aging infrastructure and expand renewable energy sources and to boost U.S. economy coming out of the Covid crisis.

**Kamar Jaffer** And what is your outlook for 2021?

**Jillian Ashley** I think we'll see an uptake in fundraising and investment in all the trends that we have discussed here today. A green investment, buy out and distressed funds, creativity, I think those will all continue. I am feeling hopeful and upbeat across the board. There is much private capital to be deployed and many economies globally in need of the investment as we all try to get back on our feet. Here's to a great 2021.

**Kamar Jaffer** Thank you, Jillian, for sharing your insights. I think this is very timely given the changes that are coming through in the U.S. For me there are three key takeaways. One is that fundraising is expected to pick up in 2021 with institutional investors continuing to allocate alternative investments. Two, is that investors are placing greater emphasis on all aspects of ESG. So we can see this with a focus, for example, on climate change, good citizenship and governance at both a fund and portfolio company level. And, three, is creativity. I think we are seeing a lot more creativity from managers in structuring co-investments and SMAs to attract institutional investor capital. Thank you for listening and stay safe.

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