

GREAT FUND INSIGHTS

Spotlight on opportunities in alternative investments in Australia

**Kamar
Jaffer**

Welcome and thank you for joining us on the third of our series 'Great Fund Insights, Opportunities in Alternative Investments'. I am Kamar Jaffer, a Counsel in Allen & Overy's Funds and Asset Management Group in the Middle East. In this episode I am delighted to be joined by Jason Denisenko, my partner based in Sydney, to spotlight opportunities in Australia. Jason is a partner in Allen & Overy's Funds and Asset Management Group. He advises major fund managers on the structuring, establishment and promotion of listed and unlisted funds and in relation to capital raisings and fund restructures. He also advises Australian and foreign institutional investors on their participation in a wide range of funds and investment arrangements. Jason, thank you for joining. It's great to have you.

**Jason
Denisenko**

No problem. It's great to be here. Thanks for having me.

**Kamar
Jaffer**

We are keen to hear what you are seeing in the Australian markets. What are the current trends you are seeing in the fund raising environment? How have managers navigating the last 18 months?

**Jason
Denisenko**

Sure. So why don't I start with some of the local dynamics that have played out here and how that has impacted on funds and fund raising. One of the big things that happened during 2020 as part of the government's Covid-19 measures here was to allow Australian workers to essentially access their pension savings if they were suffering financial hardship given everything that was going on during last year. And, at an individual level, what that meant was that people could request up to 10,000 dollars each from their pension or retirement funds during last year. But in aggregate, what that meant was that over AUD36bn was withdrawn from the savings system here locally during 2020. And what that did, and what we saw in the number of transactions we were involved in, is that it did slow some fund raising activity because fund managers who were looking to raise new capital and deploy it, including from their historic sources of capital, those Australian superannuation funds, were unable to call on that as quickly as they would have liked in a normal environment because there was a short term liquidity squeeze for those funds as they scrambled to realise liquidity to fund that early access measures and before they could rebalance their portfolios. So that was one local dynamic that was playing out here but, at the same time, we saw credit funds becoming increasingly more active as the banks looked to, I guess, limit their exposure in the loan market and so that's played out well for the credit funds. And as I mentioned, whilst there was some pause to fund raising in, say real estate and infrastructure as a result of these Covid-19 measures for the superannuation funds locally, many of the local managers were still seeking sources of capital from offshore and, generally speaking, Australia was seen to be a good place to invest. Partly because of the way in which the local market here handled the pandemic during 2020 and based on the strength of the Australian economy. So still being a good market to raise capital.

**Kamar
Jaffer**

Great and I understand that the private funds have historically been established as unit trust and venture capital limited partnerships. What type of fund vehicles are being used in Australia?

**Jason
Denisenko**

So that's right. So the traditional model here is the unit trust structure which is different to many markets around the world which obviously rely on limited partnership structures and that can be a little bit unusual for foreign investors to get their heads around, particularly if they haven't invested here before, in terms of the nature of the fund raising vehicle. The venture capital limited partnerships you mentioned are a newer creation in this market and they are focused specifically on venture capital investing activity so not for all assets. So what you are seeing here is that, generally speaking, fund managers depending on their strategies, using a combination of those vehicles. So they might be using a unit trust structure together with a VCLP as an alternative investment vehicle if there might potentially be venture capital assets as part of their portfolio so they can put the VC assets into the limited partnership and get the benefit of the concessional tax treatment that's available to those vehicles. We do have a third proposed regime, and I say proposed because it hasn't quite made it through the law reform process which was the Corporate Collective Investment Vehicle regime or CCIV, and that is a regime which has become popular in other markets in Asia, particularly in Singapore, but that's effectively stalled for the time being with law reform. So we are not holding our breath to see that emerge at the moment.

**Kamar
Jaffer**

And shifting gear now, what about institutional investors' appetite. What are you seeing in terms of Australian and international investors' appetite?

**Jason
Denisenko**

So, historically Australia has always been attractive for inbound investors in particular as a real estate investment market and that has continued over the last 18 months/two years. Infrastructure has continued to be very strong. Private equity increasingly becoming more prominent. Venture capital, which we've talked about, is becoming more well established in this market. Historically it wasn't a big venture capital market but because of the emergence of those fund raising vehicles we are seeing more capital being attracted to that asset class which is great to see. And then finally credit funds are again becoming more prominent in this market which is consistent, obviously, with what is going on in other parts of Asia and the world.

**Kamar
Jaffer**

And horizon scanning, you mentioned a possible new fund vehicle coming up. What are some of the other legal regulatory policy developments we should take into account?

**Jason
Denisenko**

Sure. So like many other markets Australia is heavily regulated and increasingly the rules and regulations that apply to financial institutions are being applied to funds and we are continuing to see that theme play out in Australia. So some of the big changes that are in the pipeline here are continued focused on conduct and disclosure regimes and governance regimes and that's coming through what we call the 'BEAR' regime, the banking executive accountability regime, which is much like accountability regimes which apply to banks in other markets. That is proposed to be extended to other financial institutions. We are just waiting for the law reform on that and that has been delayed as part of Covid-19. There's new fund raising rules that are principally focused on retail fund raising which is the design and distribution obligations which are coming into force in October this year which will give the regulator more power in relation to the way in which products are designed and promoted and who they are promoted to.

But again, that's focused on the retail aspect of the industry. And then there's other issues like cyber security and data privacy which continue to be quite high profile and where we are seeing aspects like that play out are managers needing to make sure that their cyber security measures are robust in relation to their client information or their investor information but also their trading information and that they have appropriate protections in place. So those sort of regulatory reforms that are coming through, they tend to focus on, as I mentioned earlier, the banks and the bigger financial institutions and then they get applied to funds, sometimes indirectly. So, for example, many of the pension funds, that I mentioned earlier, in this market subject to outsourcing and cyber security type requirements and so when they turn to funds and look to invest in funds, they'll expect the funds they invest in to have similar standards and compliance controls to apply to their own business so that their invested capital is not at risk. So that continues to be a theme in terms of the knock on effects of rule and regulations that might not directly apply to funds coming through because the investors are regulated. And I guess the last big thing that's happening in Australia is we have got a significant change to our licensing regime which applies to foreign fund managers or we call them foreign financial service providers. So that really means either a fund or a manager who is looking to promote a fund into Australia or to take a mandate from Australian clients and those managers have historically relied on regulatory equivalence relief. So if they were regulated in a recognised foreign jurisdiction, for example the UK or the U.S., or parts of Europe and Asia, they could rely on their foreign licence to get an exception from the fund raising rules in Australia. We are going through a two-year transitional period. We have just ticked over the first year so we've got 12 months left for those managers to look to transition their arrangements to either essentially a new foreign financial services licence in this market or look at other relief that they can get in order to continue to promote their activities, particularly to the ... and this is limited to institutional market here so generally speaking the big superannuation funds in this market and institutional investors. That's an aspect that a lot of the foreign managers are looking at very very closely now because they've only got just under less than 12 months to transition their arrangements.

**Kamar
Jaffer**

And which areas are managers focusing on in terms of governance and economics to provide themselves with the flexibility to navigate this challenging and uncertain market environment?

**Jason
Denisenko**

It's a good question. I think it really just depends on the scheme and the asset class. So we talked earlier about unit trusts so they come two forms in this market, regulated funds which are generally promoted to retail investors and unregulated funds but many institutional investors still want the security of investing in regulated funds and those regulated funds, we call them registered schemes in this market, have prescribed liquidity provisions which means that whether or not you can access liquidity out of the fund depends very much on the terms of the funds constitution or governing documents. And in practice what that means is that we have seen for funds that historically you would traditionally consider to be illiquid like real estate and infrastructure, they may provide their investors with redemption or withdrawal rights but those redemption rights are heavily qualified so they might be 18 months or 24 month redemption periods. And so when you have a market shock or a situation like we had last year, despite the fact that you can call for your capital back, there might be a very long lead time to actually access that capital so many managers have spent the last 18 months or so focusing very much on their redemption queues, who is joining that queue, are those queues getting bigger, what assets they can off load, how quickly can they off load them and looking at alternative sources of finance. So that's where fund financing becomes much more important than I think it has been historically. So we are seeing a lot more interest in that in this market.

**Kamar
Jaffer**

And Covid-19 has sharpened the focus on ESG. How are you seeing the managers approach ESG in Australia?

**Jason
Denisenko**

So we have had a focus on ESG here for many years in Australia but in some ways I don't think it's been as advanced or it hasn't kept up with developments that have been occurring in other markets. So if I look at what is going on in Europe, for example, it feels like the degree and extent of regulation is three to five years ahead of where we are. So for many managers their focus on ESG has been through voluntary activities and signing up to the various codes and so forth and the UN PRI was obviously one of the first there and there's many local examples of that as well. But it's not something that I think has become mainstream in this market, even though there is a huge amount of interest in it. So I expect we will follow the European developments fairly closely but that might take some time.

**Kamar
Jaffer**

And in a competitive fund raising environment, what are you seeing in terms of the models being used by managers to attract institutional capital?

**Jason
Denisenko**

Yeah it is a really interesting question. So mandates, so separately managed accounts, continue to remain very popular for equities, in particular in other forms of liquid assets, but we do see funds of one being set up occasionally. That was obviously very popular post-financial crisis many years ago and we tend to see less of that now but I think the real focus, or the real action if I can describe it that way, has been a lot of interest in real estate and in particular warehouses and so forth and that's really as a result of the focus on e-commerce and so there's no real surprises there, and logistics and credit. And what we have seen, for those who aren't aware, is we had a very significant investigation, called a Royal Commission in Australia, into the banking industry here a few years ago and that was very much focused on conflicts of interest and, as a result of that, we have seen Australian banks simplify their operations and sell out of wealth management operations. And that's one thing that's really led to the development, as one aspect to that, of credit funds as a new form of funding and partly because the banks were also looking to simplify their lending portfolios as well and de-risk them.

**Kamar
Jaffer**

And, Jason, what is your outlook for this year, 2021 and beyond?

**Jason
Denisenko**

Well I think, fingers crossed, Australia will still be a popular destination for institutional investment, inbound institutional investment. So I think we will continue to see a lot more of that. Governance and conduct are going to continue to play a role. We've got quite proactive regulators in Australia who have had some very significant enforcement action over the last few years that's really made people focus on the importance of compliance and governance in a way they haven't before. So I think that's going to continue to be a focus here in this market and it's just a very dynamic place. So if things change fast, and I think as everyone repositions as a result of the foreign licensing regime that I mentioned earlier, it might actually also create new opportunities because what it does mean in practice is that foreign managers who are looking to access capital here really need to rethink their business models for Australia and work out if they are going to be fully in or partly in and how committed they are and that can be very exciting. In particular if many decide to become more committed to the Australian market going forward.

**Kamar
Jaffer**

Thank you Jason. I really appreciate you sharing your insights with us. For me, there are three key takeaways. One is there are many opportunities in real estate, infrastructure, private equity, venture capital and credit. Secondly, I think there are a number of regulatory developments that investors and managers need to keep an eye on relating to governance, conduct, retail fund raising and the foreign fund managers licensing regime. And the last one is, as you mentioned, the commitment that needs to be shown by foreign managers to Australia to exploit the opportunities in that market. So thank you very much for listening. Stay healthy and stay safe.

**Jason
Denisenko**

Thank you.