

GREAT FUND INSIGHTS

Spotlight on opportunities in alternative investments in North Asia

Kamar Jaffer

Welcome and thank you for joining us for the fourth in our series Great Fund Insights, opportunities in alternative investments. I am Kamar Jaffer, a counsel in Allen & Overy's funds and asset management practice in the Middle East. In this episode, I'm delighted to be joined by James Ford, my partner based in Hong Kong, to spotlight opportunities in North Asia and in particular in China. James is a partner in Allen & Overy's funds and asset management group. He focuses on clients active in private equity and other alternative assets, where he has a broad range of experience covering traditional fundraisings, secondary transactions, M&A, strategic investments and capital markets transactions. He regularly guides clients in structuring funds and transactions to address a wide range of regulatory, tax and transactional issues. James, thank you for joining us.

James Ford

It's great to join you today.

Kamar Jaffer

We are very keen to hear what you are seeing in the market in North Asia, so to kick off, what are the current trends you are seeing in the fundraising environment in North Asia? How have the managers navigated the challenges of Covid-19?

James Ford

I think we have seen a fairly strong fundraising environment across the region in the last year or so over the first and second quarters of 2020, there was probably something of a slowdown whilst everyone absorbed what was happening around them and focused on the real time health issues that that were rife, but since then we've seen a resurgence in the fundraising market across all sectors and pretty much all geographies within the region. Virtual fundraising has come on strong and the institutional investors looking at the region as part of their allocation programmes have rapidly adapted to being able to commit to funds virtually rather than via in-person meetings.

Kamar Jaffer

And what are the managers focusing on, I mean in terms of country and specific sectors, and is there a distinction between international and domestic managers?



James Ford

China is always the great driver for the alternatives market in North Asia and that remains very much the case. We are seeing a lot of interest sectorally in technology and healthcare as you would expect, but across the board, fundraisings remain active. We've seen fundraisings everywhere from special situations through real estate, mainstream private equity through to more tech and healthcare-focussed VC. I think country-specific managers tend to be sectorally specific and the international managers looking across the region probably more sector-agnostic, but that's no different to anywhere else in the world. I think there is a continuing trend for domestic managers from China to look towards international capital, and we are seeing fund restructuring transactions from time to time, and evermore frequently, supporting that trend, with international investors buying into previously domestic portfolios.

Kamar Jaffer

And we've seen the introduction of the Hong Kong limited partnership fund regime, what are the trends in terms of fund domicile and what are your expectations in this regard?

James Ford

Our region has been dominated by Cayman funds for a very long time. Increasingly, we've seen European structures emerge as parallels, where needed, to address European investor requirements, and we are now seeing an element of onshoring of fund vehicles, both with Hong Kong LPF and also further south with variable capital companies and other regimes in Singapore. I think global tax regulation and trends are driving onshoring of fund vehicles and we will probably see that increasing, but I suspect that for many managers, Cayman, Luxembourg or other European domiciles will remain very strong as jurisdictions for their funds, but I do expect to see an ever-increasing take-up of the onshore vehicles in both Hong Kong and Singapore as time goes on and that's also been in part, there's something of a push factor with substance requirements and private fund registrations in Cayman as well which is adding friction to what was previously a very easy jurisdiction to locate your fund.

Kamar Jaffer

So focusing on Hong Kong, as you have said as one of the fund financial centres, we've read about the proposed introduction of tax concessions for carried interest distributions. What are the reforms that the Hong Kong regulators and others in the region are considering to enhance the attractiveness of the actual region as a location for asset management and funds?

James Ford Being an attractive jurisdiction for funds has been a focus for the Hong Kong regulators, in particular the HKMA and the market development people there, for a long time and in my role as a member of the HKVCA's technical committee, we've been closely involved in each of those initiatives, starting first with what we call the unified funds tax exemption which came in two to three years ago which ensures that funds that are managed from Hong Kong aren't subject to Hong Kong tax at the fund level, followed up with the LPF regime which is a genuinely competitive limited partnership fund regime for Hong Kong replacing a previous limited partnership ordinance, at least as far as funds are concerned, that dated back as long as the old legislation in the UK. More recently we are seeing the carried interest tax concession passing through our legislative council, and that will be an exciting development for Hong Kong-based carried interest tax recipients where they are investing in qualifying assets and should really reinforce Hong Kong's position as a great jurisdiction for asset management professionals to be based in.


Kamar Jaffer And shifting gear, what about institutional investors' appetite? What are the investment strategies and opportunities that they are focusing on in North Asia?

James Ford The appetite remains very strong. I think I would qualify that by saying the appetite remains strong particularly for fund managers whom they already know well and who have solid track records. Strategy-wise, as I mentioned earlier I think we are seeing just about everything, certainly seeing a lot of capital going into growth in the tech and healthcare space, and at the same time perhaps unsurprisingly we are also seeing very successful fundraises in the special situations area. Anecdotally, we are also seeing strong fundraising in funder funds which I think represents mid-size institutional investors' recognition that, at least in the short term, it is going to be very very difficult for them to develop a direct investing programme from outside of the region given the potential for ongoing travel restrictions.

Kamar Jaffer And which areas are managers focusing on in terms of the governance and economics to provide them with a flexibility to navigate the current challenges of the market?

James Ford I think in this area it is very much the same as the rest of the world. We are seeing the usual focus on alignment. Managers are looking for increased flexibility in terms of fund financings. The Asian market probably lags the rest of the world a little bit in terms of fund financing technologies, but we are seeing ever-increasing ranges of fund financings come into the market in this region led by some of the international managers with regionally focused funds and then that flows down into the more local managers as the banks and others get familiar with the products as well. As ever, key man is critical, manager removal provisions are always a topic of a lot of discussion between investors and sponsors, but I think as ever in private equity and private funds generally, alignment is king and we spend a lot of time focusing on that on both sides of the table.

Kamar Jaffer And we have seen Covid-19 sharpening the focus on ESG. How are you seeing managers in the region approaching ESG?



James Ford With a lot of variants some managers are very very resistant to take on any ESG requirements via their fund documents whilst at the same time telling their investors and conceivably their portfolios that they are extraordinarily focused on this, particularly at the environmental level. But the larger institutional investors, particularly government, sovereign wealth funds and multilaterals, have always had a very strong focus on ESG as part of their investment strategies in the region, and that's flowing through into fund documents whether it be by way of requiring sign up to UNPRI or much more detailed provisions, particularly as I say around environment and damaging industries.

Kamar Jaffer And in this competitive fundraising environment, what are you seeing in terms of the models that are being used by managers to attract institutional capital?

James Ford We are seeing everything from blind pool funds to co-investment and overflow funds. We do see a fair number of single managed accounts and funds of one. We are seeing project funds for managers who perhaps don't have blind pool capital but are looking to build relationships with investors via single asset vehicles. Across the board I think in this space the trends are very much similar to the rest of the world.

Kamar Jaffer And what is the action that you are seeing in the secondary space?

James Ford Historically what we saw was mostly distressed and stress-related. These days we are seeing a much more asset management focused approach in the secondary space, both from an investor perspective in terms of actively managing portfolios and from a sponsor perspective, particularly where the natural lifespan of an investment exceeds the life of the fund that made that investment we are seeing a real interest in terms of GP-led restructurings and in particular single asset restructurings. We are also seeing, and this trend probably kicked off two to three years ago, increasing numbers as I mentioned earlier of Chinese managers looking to internationalise their investor base by doing RMB to US dollar restructurings of their portfolios which bring in international investors and offer the portfolio companies alternative exit strategies.

Kamar Jaffer So James you seem to be very busy across the spectrum on the alternative investment side. What is your outlook for 2021 and beyond?

James Ford

I think the balance of 2021 will remain very active. I think clients have a lot of investment demand. There was some lag in the early part of 2020 and there is still some catching up to do there. Some of the international sponsors in particular who may have slowed down their investment activities in the region over that first half and maybe even third quarter of 2020 now are very focused on finding the right investment opportunities for that capital in the region whether it be institutional investors looking for fund investments or secondaries buyers looking for the right opportunities in that space. Beyond 2020 we are also seeing a real pipeline of interest in the Hong Kong LPF vehicle for local fund aises and in the structuring of sponsors' portfolio investments. Beyond 2021 looking into the crystal ball I think onshoring is a trend that we will continue to see amongst some sponsors although I suspect that many will stick with the structures they are already familiar with. I think the Asian market is developing very very quickly and will continue to grow as an alternative destination of choice for global capital. Over the last couple of years we have really seen the geographical spectrum of institutional investors investing into Asia growing enormously and I suspect that that is only going to continue.

Kamar Jaffer

Thank you James. I really appreciate you sharing all these insights with us. For me there are three key takeaways. One is that fundraising has rebounded in the second half of 2020 and into 2021. Two is that we are seeing a lot of opportunities in special situations, mainstream PE, growth, tech, healthcare, VC, as well as secondaries. We are seeing managers using various models including blind pool funds, co-investments, and funder funds to attract capital. And finally we are seeing the regulators looking continue to enhance Hong Kong as a financial centre to attract global capital into the region. Thank you for listening. Stay safe and stay healthy.