

GREAT FUND INSIGHTS

Spotlight on opportunities in alternative investment in the Middle East

Kamar Jaffer

Welcome, and thank you for joining us on the fifth of our series, Great Fund Insights, Opportunities in Alternative Investments.

I am Kamar Jaffer, Counsel at Allen & Overy's Funds and Asset Management practice in the Middle East.

In this episode I'm delighted to be joined by Nick Smith, my partner based in Dubai, to spotlight opportunities in the Middle East and, in particular, the Gulf Corporation Counsel States, the GCC.

Nick is a co-head of our Middle East Asset Management and Financial Services Regulatory practice. He acts for numerous fund managers, sponsors and financial institutions, on the establishment and management of investment into funds, including Shari'a-compliant funds. Nick's clients include multiple sovereign wealth funds and he has a particular expertise in real estate funds and REITS.

Nick, thank you for joining.

Nick Smith

Pleasure, Kamar.

Kamar Jaffer

It's great to have you. We are keen to hear what you are seeing in the markets in the Middle East, so let's kick-off.

What are the current trends you are seeing in the fundraising environments in the Middle East? How have managers navigated the challenges of Covid-19?



Nick Smith

Well, since around March 2020, fundraising through investment funds in the Middle East has certainly been negatively impacted by the Covid-19 pandemic and the resulting market volatility but on the bright side, I do believe long-term positive investor and manager sentiment to the Middle East continues.

Larger, more established managers, or managers with whom investors have pre-existing relationships, are looking to, or are already in the process of, raising successive of funds, although it may be taking longer to complete a raise, say around 18 months.

They're also looking to raise, not only from investors in the Middle East, but also specific institutional investors, including DFIs in the U.S., Europe and Asia, that have allocations to the region and that broader, non-regional spread is a new broader horizon, for at least some managers here.

The picture's different, though, for new emerging managers. We have seen some are able successfully to raise funds in the current environment. For example, because they have an anchor investor or are focusing on a particular exciting area, such as VC or credit that people are interested at the moment or otherwise; it has been rather a tough environment, frankly, and some managers have indeed been putting fundraisings on hold or are looking at alternative models to raise capital, for example deal-by-deal structures or pledge funds.

Kamar Jaffer

Shifting gear, what are you seeing in terms of Middle East sovereign wealth funds and other institutional investors' appetite. What are some of the investment strategies and opportunities that these investors are focusing on?

Nick Smith

We see Middle East sovereign wealth funds and other institutional investors continuing to seek to build a robust portfolio of investments, in order to generate returns and drive their economies' non-oil growth, for example, given the context of the low oil price environment.

In terms of the regional asset management landscape, the ten largest investors in the Middle East reportedly manage a combined around USD3.7 trillion of assets and the domestic investor landscape is really dominated by the sovereign wealth funds, which comprise seven of the top ten investors and account for nearly 50% of the assets under management here.

In terms of sectors, we are seeing a lot of interest in new distressed debt, special situations and dislocation funds, as well as successor funds in private equity, growth capital, buyouts, private credit and venture capital. At the same time, there is interest in logistics, broadband and digital infrastructure assets. There is also renewables, and technology is also a big one.

Kamar Jaffer And what are you seeing in terms of the demand for Shari'a-compliant funds?

Nick Smith Well maybe around half of the funds that we establish as a firm in the region are Shari'a-compliant and we see this area, it continues to evolve and develop over time.

Currently what we see, it's a range of structures from conventional funds, with simply Shari'a excuse rights sitting in side letters, to sort of more complex Shari'a-compliant parallel funds, next to the conventional fund, as well as Shari'a-compliant feeder funds, going into conventional master funds.

Kamar Jaffer Managers have a number of options to domicile fund in the region, including financial centres, such as the Dubai International Financial Centre (the DIFC) and the Abu Dhabi Global Market (the ADGM). What are you seeing in terms of choice of domicile and vehicle?

Nick Smith Historically, Middle East fund managers have tended to establish many of their funds in the Cayman Islands, and that's due in large part to strong investor familiarity, but in current times, we are seeing regional managers looking closer to home, to the local financial services centres that you've mentioned, such as the DIFC and ADGM, for their fund and fund manager establishments.

The DIFC and ADGM, for example, they've got a range of fund vehicles and that itself continues to evolve, but it does include limited partnerships for the PE-style funds, which we frequently work on as a firm, while their regulatory landscape is based on international standards. I do see the trend for regionally based fund managers and their funds to grow, and this is combined with the attraction of the building-out of the international double-tax treaty networks accessible by the DIFC and the ADGM, for example. At the same time, we do continue to work as a firm with managers and their funds domiciled in other parts of the GCC, such as Saudi Arabia.

Kamar Jaffer Nick, which areas are managers focusing on, in terms of governance and economics, to provide the flexibility they need to navigate this challenging and uncertain market environment?

Nick Smith Well, Kamar, a lot of this is LP-driven for me. We are seeing increased LP focus on investment guidelines, with sometimes greater input and controls allowed to LPs by GPs. We are seeing greater LP focus on investment periods, for example, extensions, follow-on investments, the ability to recycle distribution proceeds and limitations on borrowings.

There's also LP scrutiny of a funds valuation methodology, as well as a greater look at conflicts of interest policies and related party transactions by a GPs and their affiliates, and I would say, in general terms, there's a greater kicking of the GPs' tyres by the LP community.

Kamar Jaffer Covid-19 has sharpened the focus on ESG, how are you seeing managers approach ESG in this part of the world?

Nick Smith Well, similar to global trends really, I think, in that the pandemic accelerated engagement with ESG. Sovereign wealth funds and other investors, they're starting to focus on tangible ESG objectives and, at the same, time certain investors of extensive questionnaires, and ask managers to put forward case studies, but it's still, I think, fairly early days regionally, with a range of approaches in the market. Partly the question is the commitment that managers are willing to make that they are for sure having to enhance their ESG lens, in part in response to investor sentiment. The breadth, depth and quality of manager reporting is increasingly important here, I think.

So, in short, ESG, it's an area that will certainly continue to develop both in the region and elsewhere, and regional managers certainly cannot simply choose to ignore it.

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

Nick Smith We're seeing interest in a range of structures, including co-investments, separately managed accounts, funds of one, long-term strategic partnerships, as well as hybrids across these various structures, such as funds of one to build a [seat] portfolio and then morphing into multi-investor funds once a critical mass has been reached, so the market continues to be creative here around the structures.

Kamar Jaffer And what is your outlook for 2021 and beyond, Nick

Nick Smith Well, Kamar, I'm pleased to say it is a positive outlook for at least the immediate future from where I am standing here at Allen & Overy in the UAE.

As a firm, we are seeing an uptick in both fundraising and investments. I expect that only to be a growing trend during 2021, so the future for Middle East funds is a bright one for 2021.

Kamar Jaffer Thank you, Nick, I really appreciate you sharing all these insights with us.

For me, there are three key takeaways:

One is that the structures that are being used in the Middle East are becoming more and more sophisticated in order to attract investor capital. So we are seeing separate manager account, co-investment, fund of ones that are being used and those are also being used as part of a programme going forward, for managers to attract different pools of capital.

Two is that Shari'a-compliant funds continue to be an important feature of the region and, in order to tap investors in that space, there are different structures that are being put in place.

The third point is that ESG is becoming an important aspect of fund investments in this part of the world. Investors are increasing their focus on this and managers are looking at the type of commitments they are going to make in this space.

Thank you for listening, stay healthy and stay safe.