

GREAT FUND INSIGHTS

Spotlight on opportunities in alternative investments in France – Paris

Kamar Jaffer

Welcome and thank you for joining us on the 5th of our series “*Great Fund Insights Opportunities In Alternate Investments*”. I’m Kamar Jaffer, a Counsel in Allen & Overy’s Funds and Asset Management practice in the Middle East. In this episode, I am delighted to be joined by Antoine Sarailler, my partner based in Paris, to spotlight opportunities in France. Antoine advises French and international financial institutions on the structuring, setting up and marketing of funds across asset classes. These include private equity, real estate, infrastructure, debt and hedge funds. In addition he supports institutional investors on fund investments and secondary transactions. Antoine, thank you for joining.

Antoine Sarailler

Thank you very much for inviting me on this podcast.

Kamar Jaffer

It’s great to have you. We’re very keen to hear what you’re seeing in the market in France, so to kick off I would like to ask the question as to looking back at 2021, Antoine, is there any notable transaction that you would like to highlight?

Antoine Sarailler

Yes. We advised in 2021 Air Liquide and TotalEnergies on the creation and structuring of the world’s largest investment fund exclusively dedicated to the development of clean hydrogen infrastructure solutions. This initiative aims to accelerate the growth of the hydrogen ecosystem by investing in large strategic projects and benefitting from the alliance between industrial and financial players. The hydrogen infrastructure fund will invest in the entire renewable and low carbon hydrogen value chain in the most promising regions of America, Asia and Europe. Total commitments to the fund have already reached EUR800m out of a target of around EUR1.5bn at signature. The fund will be managed by Hy24, a new joint venture equally owned by Ardian, a world-leading private investment house, and Five Hydrogen, a clean hydrogen enabling investment platform.

This is a huge achievement for us. We have assisted the two investors leading the fund in the structuring of the fund, selection of the investment managers, Ardian and FiveT Hydrogen, as part of a tender procedure, drafting and negotiating the documentation with fund’s managers until the final closing. So this is a great achievement for us and a transaction that is a symbol of what we want to develop in the future for the funds to a joint platform.

What are the trends that you have been seeing since the onset of Covid-19 in the French fundraising environment? How have managers navigated the challenges of Covid-19?

Antoine Sarailer

The pandemic has not slowed down fundraising in France and despite the initial uncertainty in 2021 we have observed intense activity on both the LP and GP sides. We believe that managers overall have successfully navigated the challenges deriving from Covid-19. The numbers speaks for themselves. A recent study regarding French private equity and infrastructure funds in France published by the main PE professional association, France Invest, indicated that EUR18.4bn was raised in the first semester of 2021. France Invest notices a strong increase in capital raising in the first half of 2021 - plus 35% versus first semester 2020 - in the context of economic recovery. In terms of trends, we observed that institutional investors invested massively in France during the year and funds managed by large managers reached record sizes.

Kamar Jaffer

And in the pre-Covid-19 world institutional investors' appetite remained undiminished for alternative investments. What has been the impact of the pandemic in this regard? What is the current state of play?

Antoine Sarailer

As mentioned before the pandemic has not diminished institutional investors' appetite for alternative investments. Quite the contrary. The current state of play is that the Covid-19 crisis has in fact favoured investments by French and European public institutions as a vector of the economic recovery. These institutional investors have been contributing significant amounts in funds supporting in particular start-ups, unicorns and more generally unlisted SMEs and mid-cap companies. For example, Bpifrance, which is the most powerful French public pension fund, has launched a fund dedicated to the tourism sector (named Fonds Avenir Soutien Tourisme), particularly affected by the pandemic. Another example is with Caisse des Dépôts, the oldest public French financial institution, and the French Insurance Federation (FFA) representing the main insurance companies, which have also launched a fund in the sectors of research, infrastructure, logistics and health services. For example the name of the fund is Nov Dette Santé Non Cotée.

More impressively, the FFA, the French Banking Federation and the French ministry of the economy and finance have also set up a fund of participatory loans guaranteed by the French state amounting to EUR11bn. Finally, the main insurance companies have recently launched a fund issuing guaranteed bonds. The objective of this initiative is to support and strengthen the financial situation of French SMEs and mid-cap companies.

Kamar Jaffer

And what are the investment strategies and opportunities that institutional investors are focussing on in France and Europe?

Antoine Sarailer

We first observed that certain sectors in France benefitted from the Covid-19 crisis. A good example is technology. Ecommerce in particular and more generally the digital sectors. They have represented 17% of the investment of French capital and infrastructure investment funds during the first semester of 2021. Real estates, renewables and also healthcare which represented 21% of the investments of the French capital and infrastructure investment fund during the first semester of 2021. Pretty impressive results. In addition, we have undeniably observed a major interest for ESG. This is a demand primarily from public institutional investors but also from corporate and financial investors for whom ESG has become a major concern. They have all adopted an internal ESG policy that shall apply in any transaction. The recent adoption of a package of European legislation in this respect, in particular the SFDR and taxonomy regulations along with the French gold-plating, despite its complexity and the new challenges it brings for managers, may facilitate investments for ESG conscious investors. We noticed that funds are becoming increasingly transparent with regard to the green and social impact of their investments. This trend also allows managers who have now been active in ESG for a number of years to perform well and to attract more and a wider variety of investors in funds with a strong environmental focus. This is particularly positive for a French market where both many managers and investors have been at the forefront of ESG initiatives and display a proven track record in that respect.

Kamar Jaffer

And taking a step back, what are your thoughts on the upcoming French election and the political environment generally?

Antoine Sarailer

As the upcoming French elections are set to take place during the months of April and May it is difficult to assess at this point the possible impact on our activities. However, what we know for certain is that the impact should rather be minimal. Contrary to jurisdictions such as the U.S., where from one administration to another, rules may be enforced quite differently, in France our financial framework relies heavily on the European set of rules. So as long as a president supportive of Brexit is not elected (even the main extreme rights candidates are not in favour of that), rules should remain quite the same. However, even if that were the case we have seen with Brexit that the exit process can be quite lengthy and does not immediately imply regulatory divergence, so we are pretty confident.

Kamar Jaffer

We are seeing heightened scrutiny of managers in the current environment. What are the areas that institutional investors are focussing on in their discussion with these managers?

Antoine Sarailer

As mentioned, lately the main area of focus has undoubtedly been ESG. It has been for some time already a focus on the environmental aspects and it only gets more important but we now also notice an increased emphasis on the social and governance aspects. Institutional investors are focused on good citizenship and governance both at the fund level and at the portfolio company level. They want to see a commitment from fund managers that the firm and its portfolio companies are being run in accordance with best market practices with appropriate checks on the fund managers' discretion and an emphasis on fund managers' fiduciary duties to investors.

There is also a distinct diversity and inclusion aspect to this. Investors are increasingly demanding to see more minority and female representation on investment committees and boards. Although in France this last focus is not yet as pronounced as it is in the Anglo-Saxon countries such as the U.S. and the UK. However, it should be noted that, due to the current success of fundraising activities, bargaining power is more favourable to the GPs. LPs' requests during negotiations are most often limited to standard side letters clauses (for example prohibited sectors, application of UN PRI, ESG standards, AML clauses ...) Only few investors have the power to really renegotiate the funds LPAs.

Kamar Jaffer

And the market uncertainty has prompted creativity amongst managers. What are you seeing in terms of the models that are being used to attract investors' interest?

Antoine Sarailer

We are definitely seeing both co-investments and separately managed accounts as well as the use of equity bridge financing sometimes. Regarding co-investment arrangements, they were growing in popularity pre-pandemic and they remain a key tool for managers to manage funds exposure levels while also attracting institutional investors who want direct exposure. These structures are very attractive because they give institutional investors the opportunity to tailor investment strategy to their needs and to get personalised attention from fund managers, and in turn fund managers are able to bring more assets under management. It is a win-win situation. This can be a particularly good strategy for fund managers below the top tier to adopt this strategy as they often may have more difficulties raising funds in Covid times. However, these co-investment arrangements represented a significant additional workload for the GP, which is not necessarily very profitable as investors often negotiate it on a no-fee and/or no carry basis.

We also note that managers are increasingly inclined to use equity bridge financing in order to manage their liquidity needs instead of the traditional subscription lines. However, the set-up of financing lines is limited to large funds due to the costs generated by such arrangements. Below a certain size between EUR100-200m, it's not worth it. This is also a question of transparency in terms of performance. More and more investors consider that the funds' performance will be artificially increased by a bridge financing. They often request for the gross and the net IRR performance meaning without taking into account the bridge in their reporting. Or at least the elements to calculate it if the investors have the necessary means.

Kamar Jaffer

So you mentioned that there were a raft of changes that have been made regarding ESG, which are now being more widely adopted. Do you expect to see more emphasis on this and are there any concerns on green washing?

Antoine Sarailer

Yes. As mentioned before ESG is now a major concern for French investors. Green washing is a key concern for the AMF, the French regulator, which published a doctrine in 2020 aimed at subjecting the ESG communication of French fund managers to the consideration of minimum ESG standards in their investment decisions. The rationale of this doctrine is therefore different from that of the SFDR, the latter being based on the transparency of the manager's approach toward investors notably through detailed reporting obligations. However, the AMF doctrine is only applicable to French funds open to retail investors and is particularly difficult to apply to the private sector. The AMF should in principle adapt its doctrine once the SFDR/taxonomy package has fully entered into force but has not yet communicated a particular deadline. With regard to SFDR, the requirement of detailed reporting on funds' activity, which has not yet entered into force, should discourage green washing given that managers will be directly accountable to investors in this respect.

Kamar Jaffer

And what is your outlook Antoine for 2022 and the trends on the French market?

Antoine Sarailer

I am optimistic that 2022 should be a continuation of 2021, ie. rich in terms of fundraising, fund structuring. As we have seen, the economic recovery will require massive investments in the real economy and the focus on ESG will certainly keep on. So investments in the development of a green economy should also intensify. In addition, I will point out two trends that will continue to support the French market. First is the creation of specialised thematic funds (for example we are working on spatial or quantum physics technology focused funds), and the second trend is "retailisation" of alternative funds distributed to investors via new channels. The most interesting example is the repackaging of funds in the form of unit-linked life insurance products. This is a huge development for us.

Kamar Jaffer

Thank you Antoine. I really appreciate you sharing all these insights with us. From me, there are three key takeaways. The first is that there was a strong fundraising environment in 2021, which we will continue into 2022. Secondly, there are opportunities to invest in technology, eCommerce, the digital sector, real estate, renewables and health care. Thirdly, we've structured the biggest hydrogen fund in 2021 and we're looking to develop similar complex fund structures going forward. Thank you for listening. Stay healthy and stay safe.

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