ALLEN & OVERY

Private Markets: It's June 2022
Let's take stock. Global insights to note

01
Strong private market fundraising

Despite the continuing impact of the pandemic and ongoing economic uncertainty, managers are continuing to successfully and more quickly raise mega funds, expanding into new strategies and targeting a diversified investor base.

Additional demand for mega funds is also driven by investors re-upping with established managers they know as part of relationship consolidation and higher allocations to alternatives.

2022 had a great start to the year, although there are concerns that macro issues may lead to headwinds and extended fundraising cycles.

02
Investment strategies

Growth funds are attracting interest. Specialist funds are emerging where classic funds once were. Credit funds are becoming more diverse. We're also seeing investors focus on tech-related and specialised strategies (e.g. cryptocurrency, blockchain, NFTs, etc.).

In response, managers continue to expand investment strategies or offer specialist strategies and the boundaries between private equity, venture capital and hedge funds are blurring.

We're seeing hybrid structures come into play, which is benefiting large diversified asset managers as well as fund managers that are right in the middle of the action in hot sectors like software, healthcare, or fintech, as well as fund managers that offer an innovative way to tap a specific market.

03
Rise in co-investments

Investors continue to be focused on securing co-investment rights when negotiating their side letters, as they plan to invest directly alongside their GPs. First time managers, in particular, are offering co-investments to investors. In addition, co-investment funds are being established by managers to streamline the co-investment process (including in the venture capital space).

Key drivers of this include investors seeking higher returns in private markets, the growth in investable opportunities at the late stage of venture, and an increasing number of managers competing to retain or establish relationships with more investors.

Hedge funds have recently started to use co-investments too.

04
Challenging political, economic and regulatory landscape

Investment returns face the threat of recession, increase in interest rates and higher inflation. The ongoing effect of Covid-19 and its variants, the impact of US-China relations and China regulatory uncertainty (such as the focus on the tech sector) continue.

Managers need to skilfully navigate a challenging political, economic and regulatory landscape. Investors are tactically eyeing cash, real estate, real assets, and private debt as an inflation hedge.

05
Increase in fund finance activity

Managers are putting in place subscription lines, net asset value (NAV) and hybrid facilities more frequently and earlier in the life funds, secured against the undrawn commitments of limited partners.

This has been the trend for the super funds and large global fund managers to provide working capital where there is evidence of greater deal sophistication and evolution in borrower-driven bespoke terms.

NAV financing will become an asset class of its own and will be the new direct lending in the future.

06
Diversity, equity and inclusion

Investors are engaging more with managers on DE&I; however, this is an area where views vary and are nuanced.

The conversation will evolve with time and vary from region to region, but the catalyst in the funds and asset management space is very much linked to the ESG and sustainability agenda.

Regulators are likely to engage with the industry on its own diversity as well as how it approaches diversity in portfolio companies it invests in.

07
ESG and global shift to responsible, sustainable and impact investments

ESG is at the top of the agenda, with managers grappling with disclosure and transparency requirements in the EU and soon in the US. This is an evolving area, with a range of themes, including climate change.

Funds focusing on healthcare, renewable energy/energy efficiency and clean technology are continuing to gain attention. There are also new ways of investing emerging and firms are looking at AI technological solutions to enable them to manage sustainable investments. Pressure from investors and regulators is increasing for ESG aligned products. Many investors have made ESG a part of their investment policies, with a specific ESG policy related to private equity allocations, and those policies affect a significant portion of their private equity assets under management.

Regional differences remain. However, a lack of specific data standards and best practices related to ESG is hampering investors' ability to consistently evaluate ESG performance across their portfolios. Even where high-quality data exists, firms and institutions may lack the capacity to collect, analyse, and report on it. The industry has started to focus on addressing standardisation of metrics to assess ESG performance. Watch this space!

08
Tax

The UK has introduced tax reforms to attract asset holding companies.

In the US, carried interest discussions are still ongoing. Headline tax rate changes are on the horizon.

BEPS 2.0 is being introduced to address taxation of digital economies. ATAD 3 will come into play to address “shell” companies in fund holding structures.

Economic substance regulations are being focused on (e.g. the EU). Upfront consideration of the upcoming tax developments is required when structuring funds.

09
Technology

Tech funds across sectors prospered given the digital acceleration driven by Covid-19. Tech firms are much more likely to look at private funding now that public markets are not as an attractive option.

Anything connected to the metaverse is likely to be attractive to funds, such as gaming infrastructure funds, with other notable tech categories including biotech, fintech, enterprise SaaS and foodtech.

Prime assets, such as data centres, telecom towers, and fibre assets, are being increasingly fought over, with the sector holding up strongest among all infrastructure sectors.

This is likely to continue for the foreseeable future as telecoms is a sector that can benefit from capital inflows from both infrastructure and real estate funds.

10
Secondaries

An increase in GP-led secondaries, including single asset continuation vehicles. In addition, LP portfolio transactions are also coming to the market. Secondary focused funds are raising significant capital, due to a combination of factors including LPs being overallocated to the asset class following record performance post-Covid and an unprecedented wave of re-ups with LPs citing that successful, core GPs are fundraising faster and with larger fund sizes.

Firms are also buying up secondary funds or building secondary expertise to increase their exposure to what is emerging as a new asset class. Private debt secondary investing is a rapidly evolving segment that is increasingly in demand as a liquidity solution for both investors and credit fund managers.

Although still representing a small portion of the entire universe, secondary managers increasingly provide an outlet for investors with shortened time horizons.

11
Regulatory focus

AIFMD review, EU marketing (Cross Border Distribution of Funds), antitrust, ESG (SFDR and taxonomy), increasing transparency, conflicts of interests and disclosure (e.g. fees), tighter controls on foreign investment, and cybersecurity to name a few.

Managers need to carefully manage the myriad of cross-border fund distribution regulation in Europe and other markets.

12
Expanding investor base

Both managers and regulators are focused on the democratisation of the alternative investment funds space to target retail investors.

There’s also interest in blockchain technology tokenisation. Blockchain technology could allow the investors with smaller amounts to access the underlying assets.

Despite regulatory challenges, there is an increased interest in the ‘retailisation’ of private market strategies among US and European fund managers. The US SEC looks set to allow private capital firms to accept allocations from retail investors that do not qualify as so-called “wealthy investors”.

The landscape is definitely changing!

Interested in hearing more?
Let’s connect

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