KEYNOTE INTERVIEW

Preparing for global growth

US alternative fund managers are growing and diversifying their businesses, which is leading to a rise in outsourcing and the popularity of EU domiciles, says RBC I&TS's Cyril Schopfer

Many US-based alternative investment managers have grown rapidly over the past few years and expect further growth from new markets and new investor audiences. Larger managers with more international business are turning to domiciles in the EU in order to keep in line with regulations and to meet investor demand, says Cyril Schopfer, director of client coverage at RBC Investment & Treasury Services (RBC I&TS). Meanwhile, demand for outsourcing is both increasing and being refined by managers looking for a one-stop solution for many of their back and front office needs.

Q The survey shows Delaware, Luxembourg and the Cayman Islands as the most preferred domiciles. What are your thoughts on this and some of the other popular domiciles with regard to US managers?

Firstly, over time we have seen that managers and structures have become more global and complex. Historically, from a US perspective, we witnessed investment structures mainly domiciled in Cayman and Delaware. However, it has evolved dramatically over the last few years with a sustained trend towards Luxembourg, and what we typically see now are parallel structures that are being established in Luxembourg, which are then co-investing alongside Delaware or Cayman entities, for example.

We see this reflected in the survey, with the results showing Luxembourg overtaking Cayman with respect to the intention of managers for the domicile of their next fund. This is happening despite significant efforts by the Cayman Islands to enhance their regulatory framework.

In addition, Ireland has recently put itself on the map with the amendment of the Investment Limited Partnership Act, establishing Ireland as a solution for private funds, which was previously lacking. I believe we could expect some of that capital flow being redirected toward Ireland in the future as we have already seen some first movers launching ILPs. Drawing the parallel with UCITS and liquid alternatives, US-based asset managers tend to prefer Ireland because of the cultural alignment and the language. We should also not underestimate the time difference. Ireland is one hour closer to the US, which makes a difference in a day, especially if the manager sits in the Central or Pacific time zone. Ireland has a long history of servicing alternative funds, using well-established leading service providers, including RBC.

These trends are also driven by investor demands and regulations. Europe continues to offer an attractive fundraising opportunity for private vehicles. With the right partner, setting up and managing a vehicle in Europe is easier than it previously has been. In the US, the alternative investment marketplace has become very crowded and highly competitive, therefore US-based asset managers are looking for additional channels and additional source of capital. However, there are two ends of the spectrum: at one end we are seeing some US-based asset managers still operating in the Cayman Islands and Delaware with intentions to continue doing so.

There is investor demand for more regulated structures that offers better transparency and investor protection. Therefore, on the other end we are witnessing some of the larger managers selecting Luxembourg as their domicile of choice. At RBC I&TS, we specialize in consulting with managers to support their future offshore ventures from an early-stage of providing insightful knowledge to execution. We evolve and partner with managers as they continue to become more global and diversified.

Q The survey found that nearly three quarters of managers intended on leveraging capital call facilities over the next 12 months. Were you surprised by this?

No, there was an overwhelmingly positive response to that question! This is aligned with what I have stated about the need for that one-stop shop, where the provider can support the fund manager with balance sheet as well as their fund servicing needs. A capital call facility has become the norm, whereas a few years back this wasn't necessarily the case. It is the exception when a manager doesn't use a capital call facility as it provides speed to market and provides operational efficiencies.

You might think that a capital call is an easy process, but where there is a global investor base, a capital call can be a complex operation. Since its 2015 inception, our fund finance team has provided in excess of 250 facilities. The team provides multi-currency subscription capital call facilities, NAV/hybrid facilities, liquidity redemption facilities and manager/ManCo financing to global private capital managers across buyout, infrastructure, real estate, credit and secondaries strategies and other alternative asset managers. We have built a global platform with expertise in lending to structures domiciled in and across geographies including Asia, EMEA and North America.

Q The Channel Islands domiciles of Jersey and Guernsey didn't emerge as preferred locations – Guernsey wasn't picked at all – despite having the same time zone as Ireland. Why is that?

Guernsey has been very popular for British and European asset managers, but not as popular for US-based asset managers. Before the Alternative Investment Fund Managers Directive regulation, European asset managers were operating offshore from EU jurisdictions, and would operate and set up funds in the Channel Islands, whereas US managers would have set up funds in Cayman and Delaware.

The Channel Islands offers a fast, efficient and commercially-minded financial environment with strong regulators, however they are not in the EU therefore they do not offer the European passport like Luxembourg or Ireland. The Channel Islands are doing a lot of work to promote their jurisdictions to US managers.

Jersey and Guernsey are considered "third party" countries from an EU perspective. Therefore, the full scope of AIFMD does not apply and they can provide third-country access to EU investors through the National Private Placement Regimes.

Q What are the options for US managers looking to set up in Europe?

To be successful with a European launch, a manager needs to familiarize oneself with the European regulatory framework and the operational differences that it creates. We spend a lot of time talking to managers to help them understand the options and the impact for their operating model. The intention is always to add value and to be an extension of the existing operating process and to not change the way they operate today. Many US managers believe launching in Europe is complicated and difficult, but the reality is that the European market is simpler, faster and easier to enter than many US managers may think.

It is very important to get the right partners from the outset such as the right fund lawyer, the right fund administrator, depository, auditor and, if the company decides to outsource the alternative investment fund manager function, to get the right AIFM. Two important requirements of AIFMD for US managers are the necessity for a designated AIFM and a depositary.

One of the first things to consider is whether the manager wants to launch their own AIFM or whether they want to outsource. Many US managers would initially go for the outsourcing option with the intention, for some to bring it in-house at some point in the future. I think it's a good model because it means you immediately work with a partner who has local expertise. Once appointed, the third-party AIFM can delegate some functions. It's normally the case that the AIFM delegates the portfolio management back to the asset manager in the US.

Taking the in-house option means the manager must file an application for authorization with the relevant regulator. Furthermore, it must demonstrate local substance to design and implement the required frameworks of oversight, governance, compliance and risk as per the directive.

It is also important that managers targeting Europe have access to the markets they wish to access, which may be difficult as European regulations are continuously changing.

For example, with the implementation of the Cross-Border Fund Distribution directive in Europe, there is a change in the definition of pre-marketing, which means previously one could test the waters, however now one needs to be registered. There are different outsourced models which deal with this, for example chaperoning, which works well where the manager is targeting a set number of investors. The model provides regulatory cover and the service provider is involved in activities and interaction between managers and investors. If the manager wants full access to Europe, a tied agent model is the preferred option.

We are also seeing an increase in fund managers working with a credit institution, which provides the security, stability and reliability a bank can offer, back the depositary liability while increasing investor confidence and supporting a manager's financing needs, whether that is at the fund level or at the asset level.

Q How do you expect outsourcing as a solution for managers to develop? Will we see more of it?

Outsourcing already has momentum and is only going to grow in future. Europe has been slightly ahead of the US because demand for outsourcing has been driven by local regulation, but the US is catching up.

There is a strong culture of conducting activities in-house but I think the cost of technology, digitalization, demand for data to meet investor demand and the rapid evolution of regulatory framework are all factors driving outsourcing. Fund administration or anti-money-laundering/know-your-customer, for example, are two of the main areas where managers are considering outsourcing.

Managers are at different stages of their respective journey. Some have a fully outsourced model and others are doing most things in-house, but I think they are all looking at optimizing and organizing their operations. What has happened with some of those largest managers, with the significant amount of capital that they have raised in recent years, is that some of them have added providers on an ad hoc basis. Subsequently, this results in 10-15 service providers across the board, which is certainly not the optimal model.

We are also seeing an increased demand for a one-stop shop solution, where managers are looking for partners who can support investment activity as well as fund administration and investor services. A partner that can support capital deployment by providing financing solutions at the fund or asset level. As a large global bank, we offer an end-to-end solution leveraging RBC's breadth of expertise and services with the ability to support them throughout the fund life cycle across all levels of the structure, for example by providing a capital call facility and fund administration at the fund level, by acting as an adviser on a deal at the asset level and by supporting the financing needs, which is closer to the individuals.

Q There appears to be a considerable amount of optimism among managers, with most forecasting strong, and in some cases very strong, growth in assets under management in the next 10 years. Does this chime with what you see in the market?

The survey came up with some astonishing expectations for future growth, with more than a third of managers expecting in excess of 20 percent growth over the next 12 months and more than half expecting more than 20 percent growth over the next three years. That shows that these managers are delivering the performance investors are looking for – the track record is there to support their fundraising. The largest managers are getting a big share of the cake and they are achieving it by acquiring teams, diversifying, launching new asset classes and new products, and entering new geographies.

There are also new distribution channels where we are witnessing diversification of the investor base. An increasing amount of family offices are investing in private assets, and high-net-worth individuals want to have the ability to benefit from the performance of those investments. Managers are also looking at the retail space, and we are seeing an increasing amount of institutional investors allocating more to private assets. ■