New frontiers

WITH INVESTORS ALLOCATING GREATER SUMS TO PRIVATE ASSETS, WE ASK OUR PANEL OF SPECIALIST FUND ADMINISTRATORS IN LUXEMBOURG ABOUT THE GREAT WEIGHT OF INSTITUTIONAL CAPITAL SAID TO BE HEADING THEIR WAY.

PANEL

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MODERATOR *David Blackman*

Funds Europe – Flows into private markets funds are growing and numerous surveys suggest the growth in allocations will continue. What do you see as the most popular types of fund structures being employed to absorb this capital?

Bruno Bagnouls, Alter Domus – We've seen in Luxembourg a sharp increase in GPs [general partners] setting up Luxembourg funds. We are seeing GPs coming mostly from Europe and the UK, but we are also noticing growing interest from managers in the US and Asia, especially those targeting European investors. These GPs are setting up feeder funds or parallel funds in addition to the type of fund they usually raise.

Unregulated fund structures are capturing the attention of the vast majority of managers. The different suites, range of funds and unregulated types of vehicles in Luxembourg's fund toolbox are extremely attractive. While the Channel Islands continue to attract managers and the UK and Ireland are emerging as fund domiciles, Luxembourg is still clearly the number-one location of domicile.

David Kubilus, US Bank Global Fund Services – We see quite a bit in private debt and private equity as well as infrastructure if we want to consider that a different asset class. At the beginning, we had a great demand out of American clients. Almost all of them had a Delaware/Cayman type of structure, wanting to raise assets in Europe. They were looking to Luxembourg to do that, generally through a RAIF [Reserved Alternative Investment Fund] in some type of limited partnership structure – SCSp, SCA or whatever they're most comfortable with.

Whether it's a feeder, a parallel, an open-end fund or a closed-end fund, Luxembourg still remains very well positioned to gain the flows. It's clearly the domicile of choice, at least for the time being, for those clients in those specific kinds of asset classes.

Yves Cheret, CSC – We have more interest in debt and loan funds. The type of structures, as my two colleagues said, are the SCSp and the RAIF, which are easy to set up where the timeline is short. That's basically the type of structures we see, but it's mainly driven by our contacts in the capital market space at CSC.

Stéphane Pesch, LPEA – This is a no-brainer. SCSps and RAIFs: those are the structures which hugely contributed to Luxembourg's success and competitiveness.

We have also seen recently a lot of appetite for venture capital. Due to the crisis, technology has become really one of the hottest things in town to invest in. That also emerges via young VCs [venture capitalists] joining Luxembourg and structuring everything here.

There is more venture capital

coming in and because they don't have the same long history as the biggest players, they can come with the entire team, take the investment decisions and implement their vehicles in Luxembourg.

Funds Europe – In the past year there's been a lot of attention on SPACs – Special Purchase Acquisition Companies. How would you define the SPAC and why is there quite so much attention towards it now?

Cheret – The purpose of a SPAC is to acquire a private company, so the advantage is when you buy that private company, you don't need to go through the whole IPO [initial public offering] process.

The advantage is also the time to market and access to capital. On the other hand, that acquired company has to undergo some changes because it has to adapt to more complex accounting, financial reporting and registration requirements due to the fact that it is publicly traded.

Kubilus – Our experience in Luxembourg is a bit more limited with the SPAC, since we haven't seen tremendous demand, at least to date. However, our team in the United States has been successfully servicing SPACs, so we're ready when they come to Luxembourg.

Cheret – There was one example two days ago, where one of the major well-known Luxembourgish law firms published on LinkedIn that they have helped a Luxembourgish-based GP to set up a SPAC. That was a good example and good publicity for Luxembourg.

Bagnouls – We have relatively limited exposure to SPACs opportunities at Alter Domus. From what we have seen, the Dutch exchange with the Euronext Amsterdam is the leading market for SPAC listings. It's an efficient way for a business to go public in a short period of time, taking only an estimated 18-24 months.

In Europe, there were around 50 SPACs that were incorporated last year, so the market will be watching closely to see how these businesses perform this year. Demand for SPACs in Luxembourg is still relatively low, especially when compared to the SCSp and RAIF, for which there is a big market here. SPACs still make up only a limited part of the activity here in Luxembourg.

Pesch – We have exposure thanks to our two VCs. Some of Luxembourg's advantages for having more SPACs potentially is as usual the reliable corporate law environment, the stability and the cross-border expertise.

Funds Europe – Do you see potential for Luxembourg to become a hub for SPACs within the European Union?

Pesch – That's a good question. It depends also on the appetite. You need to be careful and should have a precise objective, then it could be an interesting 'exit route' for a private company.

Cheret – It only works if you want to take a company public. If the GPs want to have some secondary deals and do some other investments and want to keep it private, the SPAC will not work because it's an IPO by definition: it's a public traded company. In the end, the question is: what potential do we see for huge IPOs in Europe? This is more the question, and then you need to find the right targets.

Bagnouls – Time may tell later this year based on the capacity for those already incorporated SPACs to actually make acquisitions. Luxembourg's comprehensive fund toolbox certainly gives it the potential to become a hub for SPACs.

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Funds Europe – Given how this has taken off in the US, do you see similar conditions for the growth of this type of vehicle in Luxembourg and the EU generally?

Kubilus – I haven't lived there for a long time, so I'm relying on discussions with my colleagues, despite the accent, which never goes away. Obviously, there's a real culture around taking things public there. It certainly exists here: maybe the scale is not quite as great. There'll be a couple of hubs that will probably wind up being winners in this. Amsterdam seems to have done well in terms of getting a lot of listings, they also have a bit of an ecosystem.

Luxembourg certainly has all the tools to play in this space. I don't think it's going to be a situation where you're going to have three or four different domiciles really competing. There's going to have to be one or two winners in the game to service this type of vehicle, but it doesn't seem to me that the conditions vary that greatly – it's just a question of appetite and desire of the VCs.

Funds Europe – Do specialist fund administrators have anything left to do in order to make themselves attractive to fund managers who want to attract pension funds and insurance companies as limited partners, as opposed to managers that focus on private banks and family offices?

Kubilus – That's been a lot of what we've looked at in the last year, particularly insurance companies within continental Europe. There are two things that are very important to them – one is the strength of the partners their GPs are dealing with. When you look at balance sheet, scale, size, ownership structure potentially is one piece you have to fill that gap. The second important piece is the ability to really provide some level of bespoke reporting. There's certain regulatory reporting, Solvency II being an obvious example for insurance companies, that needs to happen, each with unique requirements around balance sheet reporting, reporting to subsidiaries, etc. The ability for a provider to flex their solution to really meet specific needs is going to appeal to these large institutional investors outside of the traditional family offices and ultra-high-net-worth.

Cheret – For pension funds and insurance companies, the reporting requirements will differ from what is needed for private banks or for family offices because of regulation. As a specialised fund administrator, it is important that we are able to cover these LPs' [limited partners'] requirements. At the same time, we have no impact on the selection of the LPs: that is done at the level of the GP. That's why it's important that we as fund administrators are able to cope with these different requirements. Then, based on the type of LPs, we need to accommodate the different requirements.

Bagnouls – There are effectively two elements. GPs seeking to attract insurance companies and pension funds must conduct a significant level of due diligence on a fund administrator to ensure they are working with a reliable partner. It's critical for these GPs to not only conduct an initial review of the fund administrator, but perform regular ongoing due diligence throughout the life of the fund. The geographical coverage of a fund is key as well because some LPs have conducted their own due diligence, so they are more inclined to work with certain types of fund administrators when they allocate assets or make commitments to certain GPs.

Technology also plays a crucial role, as access to data and information on LPs is even more important for pension funds and insurance companies.

We are already providing comprehensive services to GPs that are attracting and working with large pension funds and insurance companies. It's clearly a journey and given the ecosystem in Luxembourg, we are going to see a further growth in that area.

Pesch – We would never oppose reporting dedicated to institutional investors versus professional and private investors. Even if you don't choose the underlying investors, they are interested by that increased appetite for reporting and transparency.

"OVERCOMING THE IMMENSE COSTS ASSOCIATED WITH ONBOARDING RETAIL INVESTORS WILL REQUIRE AUTOMATION. BUT THE KEY POINT IS DEFINING MORE EFFECTIVELY THE TYPE OF FUNDS AND MINIMUM TICKETS TO COMPLY WITH REGULATION"

Bruno Bagnouls, Alter Domus

Funds Europe – Do you find that it's more burdensome to comply with the regulations for the institutions rather than the retail or vice versa?

Cheret – There is more requirement, there is more work to do. They also expect more tailormade reporting from the administrator, so there are more requirements on the side from the pension funds or the insurance companies, but at the same time, these LPs bring the bigger tickets for the GP.

Funds Europe – As specialist fund administrators, do you envisage yourselves ever being able to help private capital managers make these investment strategies available to retail investors and wealth managers?

Pesch – We would call that not retailisation but rather democratisation of private equity. As an association, this could represent lots of new opportunities for GPs and VCs in the future, but we should remain careful, this should not happen at all costs or without a clear strategy.

Just to highlight a few solutions out in the market now, for example private bank and wealth managers can structure in-house vehicles and then invest into private equity via those and so serve their clients. You have other solutions where the private bank and wealth managers use external vehicles, for example feeder funds which then afterwards get that exposure to private equity. Another solution would be to use digital platforms, which have also been on the rise recently.

The important element here to keep in mind specifically from the GPs' perspective is how important that new category of investors is or could be.

Cheret – If we open up these types of structures to retail, there is also the challenge with the number of investors we will have in these structures with small tickets. The challenge is on the AML (anti-money laundering)/KYC (know your customer) side, because as an administrator, you have to onboard each LP separately, and then you need to generate capital calls and distribution notices. If you generate for 20 or 200 investors, it's quite different. Because they will come in with small tickets, what you are calling is not really significant for each of these retail investors. The cost of service will increase if you open it up to real retail investors.

Kubilus – We have platforms for other reasons to service retail investors. I see 20 to 200 as manageable, but 20 to 2,000 or 20 to 20,000 becomes a very expensive proposition. At what point does it not make sense commercially for the investor and the GP to try to democratise this product? That said, we are going to see broader proliferation, broader distribution, and the question is, where is that line going to stand?

Bagnouls – The change is this retailisation or democratisation where you effectively have either traditional asset alternative investment players focusing on this source of investors, or specialist organisations targeting private investors with a digital platform with 50, 120, 200k tickets and setting up a feeder fund.

Overcoming the immense costs currently associated with onboarding retail investors will require automation. We need to develop an efficient automated solution that complies with our obligations for onboarding investors and other processes such as cash reconciliation and book entries. But the key point is defining more effectively the type of funds and minimum tickets to comply with regulations.

Pesch – We are all aware that in a good strong portfolio you need diversification and should also have exposure to private equity specifically since you have seen this asset class's strong performance and resilience over recent years, and specifically around Covid. It would certainly be a pity not to benefit from that chance but in the end, what needs to be clearly defined is your expectation, the return produced by this asset class, and how to get access to it.

Kubilus – As the industry automates AML/KYC processes and takes away some manual intervention, the point of entry for people to participate in these types of vehicles will naturally be lowered.

Bagnouls – I fully agree in terms of streamlining the collection of data, but you will still need a manual check. With the volume of activity, that's something we are all working on.

Pesch – If you need to change your operations from a GP perspective because you cannot handle capital calls as you would with professional institutional investors, you need to draw the capital directly in the beginning, like some players are trying to do now. Again, that is changing a little bit the performance and the way your set-up has worked in the past, so some adaption is also required.

Funds Europe – Do specialist fund administrators have a particular role to play in the evolution of cryptoassets exposure for traditional investors?

Cheret – From our side, there is no exposure at all for the moment. The CSSF [Commission de Surveillance du Secteur Financier] has been giving some guidelines recently. They are putting a framework in place where they say investments into the virtual assets is reserved for professional investors and is always subject to authorisation from the CSSF, so it has to go into a more regulated framework. It also says the management of these virtual assets has to be approved by the CSSF, so it will become quite regulated, but here, we at CSC have no exposure for the time being to this type of asset.

Bagnouls – It's probably a little too early to tell, at least for us at Alter Domus. Our colleagues in the US are a little more advanced on this topic. In Luxembourg, it's too early for us to comment. I'm sure that the upcoming CSSF guidance on virtual assets will be very helpful and provide a clearer understanding on the role fund administrators will play in the evolution of cryptoassets.

Kubilus – Our journey with crypto started around 2017 where we actually had funds with exposure to crypto – US funds, to be clear. We started examining how you reconcile against those funds, how you value those funds and eventually how to move into a position where you could have investors that want exposure to crypto but who don't want to use the same channels for exposure that others want to use.

Now we're at the point in the US and Cayman where we actually hold crypto in custody, because people want the entire ecosystem, and Luxembourg will evolve in a similar way. It'll be a journey. Obviously, the regulator will have to put the parameters or the guidance around how we're going to proceed.

In other jurisdictions, we've seen there's a group of individuals that want access to cryptocurrencies. They don't necessarily want to open up a digital wallet to do it, they want to be able to do it through the same channels that they do the remainder of their fixed income or equity investments. If Luxembourg can do that, then I think they're well positioned to continue to grow their business through the channels that exist already.

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Cheret – One of the challenges will lie on the depo side with safekeeping and ownership of the assets. This is where I would expect some challenges as well on the pure depo side of the structures.

Pesch – We are very happy that the CSSF came out with the FAQ on virtual assets, specifically dedicated to funds and the depositaries. This is more a challenge for them and for the AIFMs because we know about some specific risks around cryptoassets, be it volatility, liquidity, technological risk, counterparty and reputation risk.

You need to be cautious here in order to have the robust, adequate internal control functions and constantly adapt to the AML/KYC again, because it is always important to know where the money is coming from. You also have a proliferation of risks which can also happen very quickly with virtual assets, so you need to mitigate it and be careful. But to say that it has no future would be completely wrong. We really believe in blockchain and DLT [distributed ledger technology] because they will be very interesting for our friends the service providers in the future.

Sometimes the market decides. If you are not able to cope with new technologies and innovation, the clients will look for another player able to serve that kind of demand, so in the end you need at least to consider very seriously how to adapt. People were waiting for some guidance. Practice will also help out in the future, but you needed to start somewhere.

Cheret – There will be some challenges on the operations and regulatory side. It's just starting slowly, but these are the problems that have to be addressed over time as well.

Funds Europe – What do you see as the key trends in your field or the key topics in this sector in the next year or two?

Cheret – It's having the right tools, having the right technology for our clients, and to streamline and automate as much as possible. This is something where we have to invest as administrators. It will become very much IT-driven. If we push it far, the technology and IT will become more and more important. There will be a

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mix between accountants and IT guys because the accountant needs to identify the need, and we need IT guys to translate that and come up with technological solutions for us to help us to serve and automate what the client expects from us.

Bagnouls – You have a growing market, so effectively you have more and more allocation by asset owners to the private market which requires more transparency and more access to data and documents. Automation and the capacity to have real-time access to data and documents is really key for the different types of vehicles where you may be doing the fund administration. Developing the capabilities to increase access to this information is a key trend.

The second trend we see is the crucial role automation will play in building the capacity to administer growing volumes of funds. At Alter Domus, we are reviewing the way we work, our target operating model and how we can cope and adapt our capacity to the growth of the market. We are very positive and optimistic about the market here in Luxembourg, but also in Europe and North America, and want to ensure we are prepared for the growing demand for alternative investments.

Kubilus – Luxembourg has always been positioned very well to continue to grow, in many ways because of its flexibility around legal structures, especially when we look at the private capital structures we talked about earlier. Once these large firms create one fund, then they continue to create new vintages, and it's kind of a nice annuity income for everyone and for the market.

Technology is critical. As a new entrant to the market, we're trying to use that as an advantage to say we don't have legacy processes, we don't have legacy technology. Let's automate from day one wherever we can and be lean in our processes. With all the volume, there is going to be a flight to quality in this market. There is a number of specialist administrators. There are going to be winners, and the number-one word you're going to hear is quality.

The final thing is how do you do the work? Hiring and maintaining the right talent is difficult in the market and we need to always keep our mind on our people, keep them focused, make sure we have career paths for them. Having an international organisation often comes with the benefit of having more opportunities for people. It's quality, it's automation and it's people.

Bagnouls – It's not just a Luxembourg point of consideration, it's for the whole industry wherever you operate, but I fully agree with you.

Pesch – Our roadmap certainly contains many of those very important missions. We mentioned democratisation of private equity: let's see what is feasible. We have started that digitalisation journey together. We should reach a more automated ecosystem specifically for private equity, which was a bit more manual in the past.

For the association, it's key that Luxembourg nurtures its toolbox and remains as competitive, efficient and business-friendly as possible, meaning we can always implement new directives, new structures in order to be able to attract new GPs and VCs to Luxembourg.

We are really moving away from a pure back office to a 'middle office-plus' status, meaning we are focusing on new tasks like risk management, valuations, compliance, fundraising, investor relations and global reporting. But we also have more transversal teams working on deals with the deal teams, which are abroad. That's very important because in the end, they have a clear understanding of what's happening and their added value.

Talent attraction is very high on our agenda too. The goal is to have the best-in-class education to train those persons in Luxembourg or when we attract them from abroad, and then give them the right exposure to the right files and clients. That's really helping to build that ecosystem even one step further. We should all put our efforts together and do common job fairs, looking at which regions we have not tapped into. But, you know, if you start in Luxembourg for one year, normally 20 years after you are still here. **f**e