INVESTING IN PRIVATE EQUITY VIA ALTERNATIVE INVESTMENT FUNDS

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THE CHANGING INVESTMENT LANDSCAPE

COVID-19 has shaken many aspects of life, including the global economy, and had a profound impact on the investment landscape throughout the world. Against this backdrop, wealth management firms and investors are pondering its short- and long-term impact on the industry and considering how to position themselves to thrive in the 'new normal'.

Despite traditional asset classes fairing quite well in this climate, alternative asset classes have also gained in popularity as a means of future-proofing and diversifying portfolios. Alternative investments are financial assets that do not fall into the traditional asset classes of equities, fixed income or cash; they range from private equity and hedge funds to real estate and commodities, and to tangible assets such as precious metals, stamps, wines and vehicles.

The European Union is one of the most diverse alternative investment markets in the world. According to the *European Securities and Markets Authority (ESMA) Annual Statistical Report on EU Alternative Investment Funds of 2021,* the size of the alternative investment fund universe at the end of 2019 reached €6.8 trillion in net asset value. Despite ongoing uncertainty, European alternative assets under management are projected to stay on a growth trajectory. The *Preqin 2020 Alternative Assets in Europe* report found that the allocation of capital to alternative asset classes continues to gather momentum as we navigate through the second year of the pandemic. It is expected that alternative funds will continue to raise significant amounts of capital and managers will continue to invest in them.

THE GROWING POPULARITY OF PRIVATE EQUITY INVESTMENTS

An important segment within the alternatives market in Europe is private equity. ESMA has reported that private equity funds experienced the largest growth of all alternative asset classes between December 2018 and December 2019. According to the aforementioned Preqin report, this trend will hold in the years to come. In fact, it is predicted that the private equity segment will grow at a compound annual growth rate (CAGR) of 6.5% through to 2025, to reach an impressive 36.8% of total Europe-based alternative assets under management.

Private equity is a broad family of alternative investing in non-publicly traded companies. Common investment strategies include growth equity funds, venture capital funds and mezzanine capital. According to ESMA, private equity investment strategies are diver-

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INVESTOR INTEREST IN ALTERNATIVE ASSET CLASSES CONTINUES TO FLOURISH AND THE ALLOCATION OF CAPITAL TO THEM CONTINUES TO GROW, WITH PRIVATE EQUITY LEADING THE WAY

sified, with 41% of the net asset value (NAV) invested in growth capital, followed by venture capital (13%) and mezzanine capital (4%). A large part of the NAV (41%) is related to other unspecified strategies. This residual category arises because of classification issues and, in particular, because private equity fund types do not include leveraged buyouts, which account for a significant proportion of the segment.

The adaptability and resilience of the private equity market has made it appealing to investors who are looking for more attractive risk-adjusted returns, hedges against possible market downturns, considering positive performances as well as looking to ensure that they will be well-positioned to take advantage of the new opportunities that will emerge in the post-pandemic world. The agility of this segment has been evident throughout the pandemic. A recent publication by Invest Europe *(The insight: Europe's private equity industry during COVID-19 and beyond)*, has revealed that private equity investment's focus is shifting as the new reality is being shaped, with some verticals such as biotech, medtech, life sciences and healthcare, deep tech and information and communication technologies, gaining significant momentum and attention from private equity fund managers. This has also been true, albeit to a lesser extent, of renewable energy and agribusiness verticals. At the opposite end of the spectrum are tourism and leisure, automotive, professional real estate and aerospace and defence (especially the airline industry), sectors that have admittedly experienced the most adverse effects of COVID-19.

THE AIF AS A VEHICLE FOR PRIVATE EQUITY INVESTMENTS

Investors can tap into the private equity market through direct investments or indirectly via Alternative Investment Funds (AIFs). An AIF is a collective investment undertaking that raises capital from investors, who become the AIF's unitholders, aiming at investing the capital raised in accordance with a pre-defined investment policy for the benefit of the unitholders. AIFs provide institutional investors and High Net Worth Individuals with a viable route and opportunity to generate superior returns through customised investments in private equity. Investors in the EU can choose among a vast number of existing private equity funds or explore the possibility of launching a new fund.

Promoters of new funds in Europe need to consider the jurisdiction under which they will domicile their Fund. The location will determine the country-specific legal requirements and entity types that apply and which fund structure options are available to them. Nonetheless, through the European Union's Alternative Investment Fund Manager Directive (AIFMD), managers of AIFs can benefit from a passport to manage and market Funds to professional investors throughout the EU. The process of AIFMD Marketing enables cross-border AIF distribution in Europe. As a result, more than three-quarters of the alternative funds in Europe today, are registered for the EU passport.

While a number of EU jurisdictions have a robust fund regime, Cyprus is emerging as an ideal investment fund hub for the alternative segment in Europe, following the strengthening of the sector through the advent of the new AIF Law in 2018. Of particular importance is the introduction, in the new Law, of the Registered Alternative Investment Fund (RAIF), which allows for a speedy introduction of the new Fund to the market via registration as opposed to an authorisation process by the Cyprus Securities and Exchange Commission (CySEC). RAIFs are always externally managed by an authorised AIF Manager (AIFM) and even though they are not subject to authorisation by CySEC, AIFMs intending to manage a RAIF are required to submit a notification to CySEC for the inclusion of the RAIF on CySEC's RAIF registry prior to distributing RAIF units to possible investors and are also required to make periodical regulatory submissions on behalf of the RAIFs they manage.

It should be noted that Cyprus has an efficient ecosystem of support in this sector. This includes the availability of qualified people who are up to date with developments in the industry, a range of consultants who can provide effective and competitive solutions, a regulator understanding the business and aiming at facilitating authorisations and at effectively supervising them, training academies that can support continuous professional development, reskilling or upskilling of people in areas of interest, the essential infrastructure and an efficient tax system.

THRIVING IN THE 'NEXT NORMAL'

It is encouraging to see that, despite the significant challenges of the pandemic, investor interest in alternative asset classes continues to flourish and the allocation of capital to them continues to grow, with private equity leading the way. It will be intriguing to witness how this sector is shaped in the coming years, through this increased demand. It seems that in the 'next normal' that is being formed, the sector will not only grow in size but it is expected to mature with issues such as Environmental, Social, and Governance (ESG) sustainability, diversity and other non-financial factors playing an increasingly important role in investors' decision-making processes.

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