Three key trends for alternative asset managers

Emerging managers' fund terms, extending credit in a rising interest rate environment, and the supervisory regime for third-party AIFMs are among the topics discussed by Peter D. Greene, Stephanie R. Breslow, and Joseph A. Smith from Schulte Roth and Zabel

What are the trends in structuring and terms for launches of well-pedigreed emerging managers?

Peter D. Greene: In the past few years, it's certainly been a more competitive and challenging landscape for well-pedigreed emerging managers, but funds are launching successfully. From a terms perspective, founders (or anchor) classes – which are day-one investors in size – continue to benefit when it comes to fees and capacity. What's new is that many managers are now launching not just with a commingled product, but with a commingled product alongside several separately managed accounts (SMAs). These are less optimal for the manager, as they're owned and controlled by the investors. This means investors can turn off the SMA more quickly than they can withdraw from a commingled fund. The seed market may be emerging from its winter, though seed amounts are smaller, while revenue share percentages have remained flat (or have even increased). Finally, greater regulation means emerging managers need to invest more in their back and middle offices.

What are the effects of rising interest rates and failing banks on funds ability to obtain and extend credit?

Stephanie R. Breslow: Interest rates have risen wildly, far quicker than people are used to. As a result, some banks failed, leaving the unbanked, where successor banks did not take over the banking relationships, and the more expensively banked, who rely on credit in some respect or another. When interest rates go up on a subscription line or a net asset value facility, returns go down.

On the bright side, there are funds making money from this. Loan origination funds make far more sense. In the past, to hit mid-teen returns, you would need to be dealing with distressed borrowers. Now, you can go to somebody for whom bank financing has become unavailable, but who isn't necessarily distressed, and loan them money at a double-digit rate. If you have fixed-rate instruments and the interest rates keep rising, then the value of your instruments goes down. But, if you're buying now, you're getting a better return than you used to. Credit investments are now more competitive with equity returns.

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How is the supervisory regime for third-party AIFMs changing and what impact will this have?

Joseph A. Smith: As you know, private fund managers are regulated in the European Union (EU) under the Alternative Investment Fund Managers Directive. US managers seeking to raise capital in the EU without building out local EU offices have traditionally avoided the need to become regulated in the EU by relying upon reverse solicitation or national private placement regimes, or hiring a third-party alternative investment fund manager (AIFM) to manage parallel EU funds.

The practicality of reverse solicitation has diminished, so non-EU managers without a presence in the EU now find it's important to utilize a third-party AIFM at the inception of their fundraising process. Additionally, the common operational model whereby a third-party AIFM 'delegates' portfolio management back to the non-EU manager has come under increased scrutiny. However, some third-party AIFMs follow a 'discretionary' model in which the third-party AIFM has actual power to approve or reject transactions proposed by the non-EU manager. It's become clear that EU regulators favor the latter approach.

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