The rise of onshorization for the Asian market

Luxembourg AIF platforms, a unique reach to growing Asian deployment and distribution

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The Asia Pacific (APAC) region has developed quickly and become a renowned marketplace for worldwide investors. The blend of diversified economies, from mature markets such as Australia, Japan, and South Korea to developing ones likes South East Asia, combined with relatively fewer investment constraints, have tempted major investment firms while allowing local players to expand.

The region's industry has witnessed rapid growth driven by greater performances than those seen in some Western jurisdictions. APAC assets under management (AUM) in particular, experienced a sustainable, double-digit growth between 2018 and 2019, facilitated by a rapidly developing asset management industry in China. So far, the rise in AUM has been advanced predominantly by major players from the fund industries, with pension funds and insurers by far the largest investors holding 65% of total Asian assets. However, from 2017, the fastest, continuous growth has clearly been identified in the alternative and multi-assets strategies.

Certain studies forecast an increase in APAC's private market AUM from US$1.62 trillion in 2019 to almost US$5 trillion in 2025, representing an increase greater than any other region. Many new players have come to the market, quickly building legitimate track records and being boosted by investors in need of diversification. The region has observed an increasing demand for such investment diversification from insurers (in China), pension and retirement plans (in Japan, Taiwan, and Australia), a maturing appetite from family o ces/HNWI (in Hong Kong and South East Asia), and institutional investors across the board. The alternative investment management industry in Asia is on the move and the way platforms will be structured going forward are at a turn, pivoting from a mostly offshore model towards an increasing «onshorization».

The game changer

For decades, the Cayman Islands have been one of the preferred choices for alternative asset managers seeking to set up their cross-border fund platforms. The APAC region does not distinguish itself from this generality—in fact, quite the contrary—yet this position looks set to change. The Cayman Islands' fund industry went through a period of adaptation triggered by the newly introduced Economic Substance Law (ES Law). Passed in 2018, it came into force on 1 January 2019 and brought significant changes to the way alternative investment funds are structured and significantly impacted Asian-based alternative asset managers. In summary, the ES Law is targeting entities, not tax resident in any other jurisdiction other than Cayman, which perform specifically listed activities such as banking, financing, shipping, etc. and which derive income from these activities. Fund management is particularly targeted and a specific focus has been placed on investment funds.

Today, entities in the Cayman Islands face new reporting obligations and, for those falling under the scope of the ES Law, requirements of conducting their core activities in the Cayman Islands will apply. This means local management and control, as well as adequate personnel performing the main activities, must actually be present in the Cayman Islands. As a direct consequence, we have seen the implementation of the most popular Cayman limited partnership fund structures evolving as challenges arose for some players to deploy core activities and people involved in the fund management locally.

Slowly, we have witnessed Asian-based managers begin to make their decisions based on two main trends:
1. Some are relying on a number of unconfirmed positions and still consider the Cayman Islands when setting up new platforms. Indeed, the ES Law actually excludes certain covered entities such as investment funds (including private funds) provided their business consists of pooling investors' money and make investments in view of generating profit. Interpretation has been made by a number of local players that in the case where the General Partner of a Cayman Limited Partnership fund does not perform activities outside the framework of its investment fund, it should be considered as part of the investment fund itself and as such, not subject to ES Law. Although the position has not been formally confirmed and includes risks or uncertainties in terms of applicability especially in the mid- to long-term, many players still rely on a fully Cayman domiciled structure.
2. However, many players are moving partially or fully onshore attracted by newer long-term solutions and the appetite of their investors for more transparency and regulations. In the APAC region, asset managers are now considering at minima plugging an onshore taxable (licensed) manager to a Cayman fund platform or new solutions at their disposal including Hong Kong limited partnership funds (LPF), Singapore variable capital company (VCC) and Luxembourg reserved alternative investment funds (RAIF) or Luxembourg special limited partnership (SCSp).

Last but not least, the cost of operating in the Cayman Islands has surged. On top of the usual ongoing obligations (valuation, cash monitoring, and safekeeping), new reporting requirements and registration fees for private funds have significantly increased the yearly maintenance cost of their solutions.

The emergence of new solutions

Pushed by the recent changes in the offshore funds world and confident from their experience in their respective Asian market, the trend among local asset managers nowadays lies in the expansion of their distribution horizon and in the considerations for more transparent investment solutions. Very recently, Hong Kong (HK) and Singapore have launched their own alternative investment fund platform. In HK, the LPF is a straightforward limited partnership, which under certain conditions (provided by the unified fund exemption regime) would deliver a fully neutral vehicle. Although the exemptions may not be applicable to certain HK investments or investors, the recent concession of the government offering a fully tax exempt carried interest to its HK resident beneficiaries, may eventually be the stimulus it needs to attract China and HK-based asset managers.

Singapore opted for a corporate form vehicle, the VCC. The vehicle, provided it meets the necessary requirements (including qualifying investors minimum fund expenditures, etc.) described in the fund tax exemption schemes as 13R and 13X, will be exempt from corporate taxation. Although uncertainties and lack of certain features remain, both vehicles, currently under the drip of local governments' sponsorship, incentives, and marketing, seem to cautiously seduce a number of APAC asset managers looking at alternative solutions to Cayman structures.

Luxembourg platform, still the most versatile of all

For many years now, the Asian market has seen Western asset managers using Luxembourg platforms for global raising combined with traditional APAC holding or financing entities (often HK/Singapore) as well as structures specifically focused on the investment's jurisdiction (e.g. Japan TK/GK, Australian MIT, Chinese QFLP, etc.) for deploying their funds. Meanwhile, local asset managers were primarily focused on raising funds from Asian or US investors. They had, until five years ago, very low appetite in using what appeared to be in their eyes, relatively complex Luxembourg regulated and supervised solutions (i.e. SIF or SICAR).especially for smaller funds (e.g. below US$100 million) for various reasons like the time to market to launch these vehicles, the higher level of costs (compared to offshore jurisdictions less expensive due to non-regulation and no substance), etc.

The addition of the Luxembourg SCSp regime in 2013 and the RAIF in 2016 in the Luxembourg toolbox has been well welcomed by the local asset managers answering local needs, and significantly reducing time to market. Simultaneously, a growing number of Asia asset managers have emerged with proper strategies boosted by high returns raising interest among European investors. Although this was a positive outcome for APAC managers, the implementation of the AIFMD in Europe in 2012-2013 and the black listing of Cayman by the EU for a limited period, has triggered the need for Asian players to adapt their fund solutions to more demanding European investors requiring EU onshore solutions as opposed to offshore solutions. Consequently, an increasing number of Chinese, Hong Kong, and Singapore managers have decided to 'attach' parallel Luxembourg SCSp/RAIF to their existing Cayman structures or even to implement standalone RAIF solutions.

Luxembourg's alternative platforms are of course not only used for European distribution and an increasing number of Asia-based and global players are launching their platforms primarily for Asian fund raising. As an example, we have seen a number of players interested in implementing Luxembourg RAIF or SCSp combined with a Chinese QDLP feeder, which would definitely represent a flexible solution for raising capital in China. The Japanese particularly appreciate Luxembourg RAIFs under the form of a *fonds commun de placement* (FCP), a contractual fund with no legal personality, as an alternative to the historical Cayman unit trust. Such configuration is clearly oriented towards a local distribution since for some Japanese investors, the FCP units provide for easier accounting valuations in their books and may mitigate controlled foreign corporation (CFC) considerations from a Japanese tax perspective.

An Asian onshore future likely with Luxembourg

Asia is clearly growing, improving, and maturing in the alternative asset management landscape. Going forward, 'Western' alternative managers will not be able to ignore assets or investors in the East. Similarly, Asian managers may not be able to decide to launch without European distribution.

With their new platforms, Singapore and Hong Kong may well play a purely APAC regional role, and Luxembourg remains an undisputed leader in global cross-border fund distribution thanks to the features and compatibility of the vehicles it offers. Asset managers with pan-Asian strategy appreciate Luxembourg for its ability to tag along with local structures while meeting expectations from the perspective of any worldwide investors (including Europe) in terms of marketing. Out of the Luxembourg toolbox, RAIF and SCSp are good solutions fitting all their needs. It is also interesting to note that the EU is becoming the global standard setter for sustainable finance, which is a concept that is gaining interest in Asia. Investors' behaviors have changed, requesting investment managers to manage tax in a responsible and transparent manner with a great degree of tax compliance. The combination of Luxembourg and EU tax, plus the regulatory environment, has reinforced Luxembourg's position as the best fund platform of choice for investors embracing sustainability

With more than US$5 trillion of assets under management, proposed tailor-made solutions (for example a large choice of vehicles for private equity, real estate, infrastructure, and debt funds offering tax neutral and BEPS-compliant products, access to large Double Tax Treaty, etc.) and longstanding experience, Luxembourg is clearly one-step ahead of its Asian counterparts. The Luxembourg platforms' flexibility also allows numerous combinations with other vehicles used in the APAC region depending on the promoter's needs. Luxembourg's fund platforms are still perceived as expensive and lacking of adapted marketing in the APAC region but on a positive note they are clearly becoming a prime choice for fund managers in Asia and we expect such a trend to continue to the benefit of the deployment and distribution growth in the region.

** Preqin special report:The Future of Alternatives 2025*

Le scénario «net zéro» de l'AIE

Par Louise TURRETTINI, Analyste ESG, Quaero Capital

Quelques mois avant la Conférence des Nations Unies sur le changement climatique (COP26), l'Agence internationale de l'énergie (AIE) a publié sa feuille de route mondiale pour limiter le réchauffement de la planète à 1.5°C et atteindre des émissions nettes de dioxyde de carbone nulles d'ici 2050 et les mesures recommandées sont drastiques.

L'AIE a été créée en 1974 dans le cadre de l'OCDE à la suite de la crise pétrolière de 1973 dans le but d'assurer la sécurité et la stabilité énergétiques, c'est-à-dire de disposer de suffisamment de combustibles fossiles pour faire fonctionner l'électricité, les transports et les processus industriels des économies développées. L'AIE n'a commencé à s'intéresser aux énergies renouvelables que beaucoup plus tard, en 2009, et même alors, elle n'a consacré que 2% de son budget aux énergies renouvelables. Ces dernières années cependant, l'agence a fait un virage à 180 degrés et, le 18 mai, elle a publié un rapport contenant une feuille de route qui fixe plus de 400 étapes pour guider le chemin mondial vers des émissions nettes nulles d'ici 2050.

Ces étapes comprennent, à partir d'aujourd'hui, aucun investissement dans de nouveaux projets d'approvisionnement en combustibles fossiles et aucune décision finale d'investissement dans de nouvelles centrales au charbon non exploitées. D'ici 2035, il ne devrait plus y avoir de ventes de nouvelles voitures particulières à moteur à combustion interne et, d'ici 2040, le secteur mondial de l'électricité devrait avoir atteint des émissions nettes nulles.

Dans la vision de l'AIE, l'énergie propre, menée par l'énergie solaire et éolienne, dominerait les systèmes énergétiques mondiaux d'ici 2050. Pour atteindre cet objectif, l'agence préconise un niveau historique de nouveaux investissements, qui devraient atteindre USD 5 000 milliards en 2030. En outre, la quantité de nouvelles capacités électriques solaires et éoliennes ajoutées chaque année, qui a atteint un niveau record en 2020, doit quadrupler. L'agence envisage que 90% de l'électricité provienne de sources renouvelables, l'éolien et le solaire photovoltaïque représentant ensemble près de 70%. La majeure partie du reste proviendrait de l'énergie nucléaire. Les ressources fossiles ne fourniraient qu'un cinquième de l'énergie (contre quatre cinquièmes aujourd'hui) pour des utilisations telles que les plastiques.

L'AIE appelle également à un engagement mondial et à une transition inclusive. Le Dr Fatih Birol, directeur exécutif de l'agence, a déclaré que «malgré le fossé actuel entre la rhétorique et la réalité en matière d'émissions, notre feuille de route montre qu'il existe encore des voies pour atteindre le zéro net d'ici à 2050.» Il a ajouté : «Celle sur laquelle nous nous concentrons est – selon notre analyse – la plus techniquement réalisable, la plus rentable et la plus acceptable socialement. Même ainsi, cette voie reste étroite et extrêmement difficile, ce qui exige que toutes les parties prenantes – gouvernements, entreprises, investisseurs et citoyens – prennent des mesures cette année et chaque année suivante pour que l'objectif ne soit pas hors de portée.»

Ces annonces vont probablement faire beaucoup de bruit et avoir des conséquences réelles, car les rapports de l'AIE sont très influents auprès des groupes énergétiques, qui fondent leur stratégie d'investissement sur les prévisions de l'agence, des gouvernements lorsqu'ils élaborent leurs politiques publiques, et des actionnaires pour anticiper les évolutions du marché. Cette trajectoire comporte encore des défis à résoudre. En particulier, celui des métaux et des terres rares, qui sont essentiels à la transition. Il y a quelques semaines, l'AIE prévoyait que d'ici 2040, la consommation de lithium aura été multipliée par 40 et celle de nickel par 20. Ce sont des besoins énormes pour des matériaux parfois inégalement répartis dans le monde et extraits dans de mauvaises conditions sociales ou environnementales, selon les pays.

Chez QUAERO CAPITAL, nous reconnaissons la responsabilité de l'industrie de la gestion d'actifs dans la lutte contre le changement climatique et nous prenons en compte les questions climatiques comme partie intégrante de notre politique d'investissement responsable. Nous sommes fiers de dire que plus de 40% des actifs gérés sont dédiés à des stratégies durables et nous prévoyons que cette proportion augmentera dans les années à venir. Nous avons récemment adopté une politique climatique, et une partie de cette politique consiste à restreindre, pour l'ensemble de nos fonds, les investissements dans les entreprises ayant l'impact le plus négatif sur l'atténuation du changement climatique, ainsi qu'un engagement à réduire notre propre empreinte opérationnelle.

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