African BUSINESS

South African Fund Managers: Trends in Fund Domiciliation and Capital Raising

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Acknowledgments

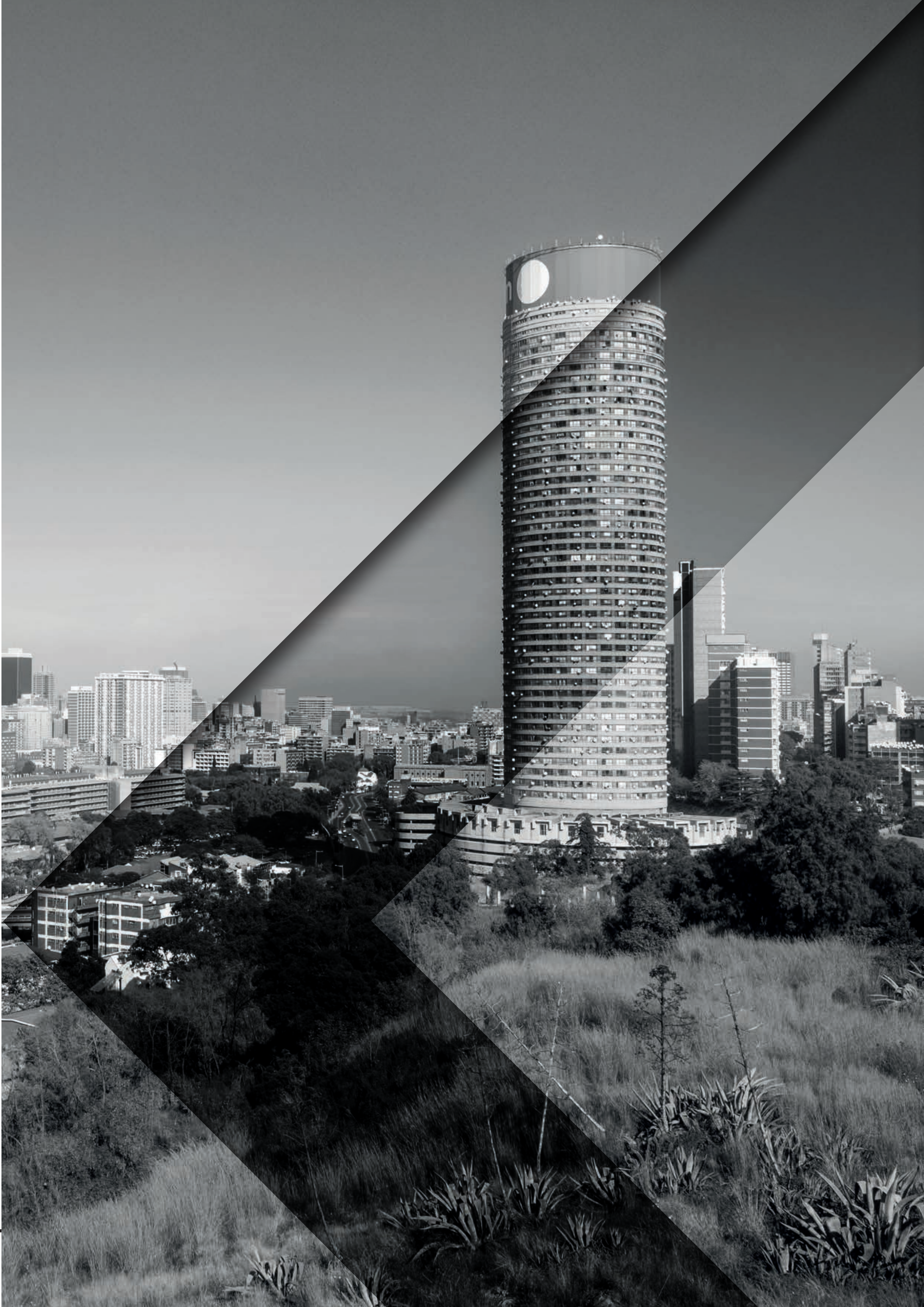
We hope you find reading this report as engaging as I found conducting the research. I had the privilege of speaking to expert international teams from Johannesburg to Jersey, and across Africa, the UK, EU, US and several offshore jurisdictions. We hope the report stimulates debate and is practically useful. Many thanks to Jason Venkatasamy for the design, and to the team at Jersey Finance, in particular Allan Wood, Elliot Refson, Claire Lyons, Joshua Bisson, Jasmine Hamilton and Alicia Mathieson. Thank you also to the companies and individuals listed below* who participated in and facilitated this research – these ground-breaking internationally relevant findings would not be possible without you.

With kind regards,
Dr Desné, Masie,
Chief Strategist, IC Intelligence and Editorial Director, African Business Magazine (Report Author), November 2020

** This is not an exhaustive list due to constraints of data privacy laws*

Selected List of Respondents

- *Africa 2 America Consulting (A2A) LLC*
- *Africa Finance Corporation*
- *Africa Infrastructure Investment Managers*
- *Alexander Forbes Research Institute*
- *Alitheia Identity Managers*
- *Apex Partners*
- *Barak Fund*
- *Benguela Capital*
- *Cannon Asset Managers*
- *CDC Group*
- *Convergence Partners*
- *Crown Agents*
- *Emerging Africa Infrastructure Fund*
- *Ethos*
- *FBN Quest*
- *GRESB*
- *Investec Private Equity*
- *Kawisafi Ventures*
- *Lugano Group*
- *Medu Capital*
- *Millennium Challenge Corporation*
- *Momentum Investments*
- *Moshe Capital*
- *Motswedi Emerging Mangers*
- *Ms Muitheri Wahome*
- *Novare Investments*
- *Old Mutual Alternative Investments*
- *Pembani Remgro*
- *Phatisa*
- *The Private Infrastructure Development Group*
- *Rockwood Private Equity*
- *Rootstock Private Equity*
- *Sanlam Alternative Investment Managers*
- *SAVCA*
- *Simmons & Simmons*
- *Structured Credit International Corp*
- *Symbion Energy*
- *United Nations Development Programme*
- *Valuation Research*
- *Werksmans Attorneys*
- *Woods Capital*
- *Zebu Investments*



Executive Summary and Methodology

The African Opportunity

In our rapidly-evolving global market, the choice of fund domiciliation has become an increasingly salient issue for both investors and fund managers looking for efficiency, stability and transparency. Jersey Finance has therefore commissioned an independent research report from *African Business* magazine surveying more than 60 LPs and GPs operating in jurisdictions worldwide and with a connection to South African managers to find out the emerging trends for fund domiciliation and capital raising, particularly as a route for private equity impact investing into the wider African continent.

This research is a development on from Jersey Finance's 2015 report "Jersey's Value to Africa" where the opportunities to facilitate capital flows to the continent were explored at a macro level and the 2019 report commissioned from IFI Global on Fund Domiciliation. In this report we aim to go more granular and unearth pragmatic market findings for funds and investors to make these aspirations a reality.

Africa's population is set to double by 2050. By 2100, 1 in 3 people in the world will be African - the majority of them Ethiopian and Nigerian. With its young population, growing middle class and rapidly deepening capital markets, this presents exponential opportunity with expanding labour and consumer markets.

Even though starting from a low base, the opportunities for capital raising in Africa are substantial. The past two years have seen unprecedented capital commitments to Africa in foreign direct investment as the region becomes more economically and politically strategic. South African funds are facilitating flows into the wider African continent, and they are raising these funds across international capital markets, from America to Asia.

In September 2018, both China and the EU committed substantial sums to the continent. China pledged US$60bn to African partnerships at the Forum for China-Africa Cooperation, while the European Union (EU) pledged US$45bn to the continent to help deepen economic relations, boost investment and create jobs. Also in September of 2018, then prime minister, Theresa May, announced an ambition for the UK to become Africa's biggest G7 investor by 2022 alongside US$5bn in foreign direct investment (FDI) commitments as part of its Global Britain strategy. With the western moral panic over China's role in Africa, Japan's not insubstantial influence is often overlooked: *African Business* magazine reports that Japanese Overseas Development Assistance to Sub-Saharan Africa in 2018 comprised 15% of Japan's total global spend with commercial FDI at around US$9bn in 2018. Not to be left behind is Russia, which announced ahead of last year's inaugural Russia Africa Summit in Sochi that its commitments to the continent had quadrupled to US$20.4bn since 2015.

"Even though starting from a low base, the opportunities for capital raising in Africa are substantial. The past two years have seen unprecedented capital commitments to Africa in foreign direct investment as the region becomes more economically and politically strategic. South African funds are facilitating flows into the wider African continent, and they are raising these funds across international capital markets, from America to Asia."

There is a role for International Financial Centres (IFCs) to play in extending their financial expertise into these investments alongside private and institutional investors in a cost and tax-efficient setting with support from Development Finance Institutions (DFIs). This is the driving rationale for this research. We wanted to get a sense of how this capital can be deployed alongside current trends in capital raising and fund domiciliation.

The shifting geopolitics introduced by Brexit, Trumpism and now also Covid-19 are reconfiguring Africa's place in the world and driving its rapid ascendency. One important consequence is that Brexit and Trumpism have brought home some inconvenient truths that political risk is not idiosyncratic to Africa and so-called "emerging markets" but rather, that they are features of markets everywhere. With increasingly stable African political economies, and a world of low to negative interest rates across the EU, suddenly Africa's high-yielding opportunities don't look so risky anymore from a western perspective in the hunt for diversification.

South African fund managers are ahead of the curve with these opportunities and the past two decades have seen South African private equity expertise facilitate investment into retail, consumer, real estate and infrastructure investments across the wider African continent, typically partnering with DFIs from the UK and Northern Europe to drive economic development with often spectacular returns. These days, it is more risky to be outside the African opportunity than to be inside it, actively participating in its economic acceleration.

Research Design

Methodology: Using semi-structured interviews, we compiled a snapshot in both qualitative and quantitative dimensions to find out how and where South African fund managers are raising capital and structuring their funds.

Sample: Our sample comprises more than 60 C-suite or partner-level executives. For the fund manager side, we looked at companies that had a base or substantial connection to South Africa, irrespective of where their funds were domiciled. The majority of the fund managers were private equity firms with a connection to South Africa, but we also spoke to some traditional asset managers running alternative private market strategies or international vanilla equity portfolios for geographical diversification. On the investor side, our sample is taken from all over the world, as SA managers are raising capital globally. Given the impact nature of the investments, the majority of funds were raising from DFIs and family offices in Europe and the UK, a smaller component were raising in the US, and an even fewer amount were raising in Asia. For this reason, our investor sample is taken from the EU, UK and US, comprising mainly DFIs.

Overview of Findings

Our survey looked at the drivers of domiciliation and capital raising from many dimensions.

First, we find that the choice of jurisdiction ultimately rests with LPs. Among LPs, and the DFIs in particular – situated in the US, UK and EU, 100% of capital is invested internationally, and given the substantial war chest of such investors, their portfolios are not limited to Africa. They have no particular preference to using a particular jurisdiction, provided the level of governance and regulation is sound with no major red flags. That being said, there remains some resistance amongst EU investors against IFCs, particularly with the push for sustainable finance. Well-governed IFCs should communicate those credentials actively to such investors.

However, for the typical SA private equity fund investing into Africa, many LPs use Mauritius for that geographical context and this has been the status quo for many years. This will, however, be complicated by Mauritius still being on the EU blacklist at the time of writing. Among GPs, our sample had around 60% of their capital committed internationally, with the managers all having a connection to South Africa, but their funds or special purpose vehicles domiciled across onshore and offshore jurisdictions – the majority in Mauritius, but also around 30%-40% in Caymans and Sub-Saharan Africa, and a smaller subset of around 10-15% of funds domiciled in the EU (mainly the UK, Dublin, Luxembourg and Jersey).

"We find that, top of mind for LPs is the quality of the legal and regulatory framework, given the industry trend focused on transparency through anti-money laundering (AML), know-your-customer (KYC) and substance provisions resulting in increased regulatory reporting and costs only further exponentialised by the recent push for environmental, social and governance factors (ESG) to be incorporated into investment decision making."

Ultimate factors leading to the choice of jurisdiction are hence also LP-led and this is determined by some key factors as set out on pages 10-11 looking at drivers of domiciliation: familiarity, cost, tax neutrality, regulation and governance, and the quality of local service providers and non-executive fund directors. We find that, of these, top of mind for LPs is the quality of the legal and regulatory framework, given the industry trend focused on transparency through anti-money laundering (AML), know-your-customer (KYC) and substance provisions resulting in increased regulatory reporting and costs only further exponentialised by the recent push for environmental, social and governance factors (ESG) to be incorporated into investment decision-making. Political and fiscal stability is also an increasing factor, given the aforementioned geopolitical tumult.

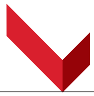
Managers overall expect to use offshore and EU jurisdictions more given the increased interest in impact investing driven by ESG-led investing, and crucially, a better understanding of the risks and opportunities of doing business in Africa.

For those South African managers who are already raising capital in the EU the majority are using private placement, as the full EU Alternative Investment Fund Managers Directive (AIFMD) provisions are, in their opinion, inconsistently applied and incoherent for non-EU fund managers.

Those who have tried and are raising would really like to see AIFMD II become less draconian and smoother for non-EU managers, or some alternative solutions. In addition to these worries, low and negative interest rates across the EU are also a major frustration, given the offset of high yields in Africa.

As regards Brexit and Covid-19, these twin peaks of market volatility are also concerns. Brexit is a concern for those with exposure to the UK, while the pandemic is becoming a hindrance for capital raising and fund exits.

Apart from these frictions, managers and investors remain wildly optimistic about the African opportunity.



Findings:
Jurisdictional Spread

Ultimately the choice of jurisdiction was determined by the investor's preference, and this is normally driven by issues such as governance and tax requirements, quality of local service providers and NEDs as well as business relationships. This is discussed in more detail in the drivers of domiciliation section on pages 10-11.

For our sample, fund managers (GPs) with a base in South Africa and raising capital globally, we found that the vast majority, currently around 75%-80%, have a preference for and presence in Mauritius, given the exposure to Africa. Many SA-managed funds are used to facilitate impact investing and large infrastructure investment into the wider continent with capital raised from predominantly UK and EU DFIs.

Hence Mauritius's proximity to Africa, the tax treaties in place and the mutual recognition of its arbitration seat make sense in these cases and is a known route for private equity investment on the continent.

This status quo, which has a track record of several years, is being upended due to Mauritius being placed on the EU blacklist in 2020, particularly given the strict governance requirements of the Northern European DFIs.

Some managers were thinking of relocating, some already have. This obviously represents an opportunity for other IFCs pitching to this universe of funds.

Next most popular jurisdictions (25%-30%) were Caymans for those raising capital in the US; UK, Ireland (Dublin) and Luxembourg for those funds raising in the UK and EU; and Jersey (although some of this may be reconfigured by Brexit).

There was also a smattering of more exotic locations (from the South African manager perspective) like Malta and Cyprus, but these were undoubtedly the outliers.

While we found that from the South African GP perspective Mauritius was the most dominant jurisdiction, with the LPs, who have diverse international portfolios, the spread was wider. Mauritius was most prevalent in the sample, given the exposure to Africa, and Caymans given the preference for US investors.

While the majority of SA funds used Mauritius, and many LPs see it as the default choice "for Africa" and had a perfectly good experience, the choice of using Mauritius seemed to be more a function of aggressive marketing and institutional status quo for using Mauritius than any joined-up thinking. And of course there is the issue that it has ended up on the blacklist, which cannot be ignored. One lawyer surveyed said they actively advise their clients not to use Mauritius given the problems with the quality of some service providers and the regulator. The regulator, for example, has often made mistakes where funds are thrown out because of shoddy paperwork. The result of some of these issues has been Mauritius ending up on the blacklist. One further issue is of the marketing onslaught is that the tax treaties that Mauritius has in place with African countries are not comprehensive. Our respondent pointed out that Mauritius does not have a treaty in place with Nigeria, Africa's largest economy – which seems a significant oversight. One should not discount the importance of politics in the background to some of these issues. The attitude to IFCs is still antagonistic in many quarters and apparently half of the government in Mauritius does not support the vision of it becoming a financialised state. If not everyone in the government is pulling together in the same direction the lack of political will to continue making it the leading IFC for Africa hangs in the balance.

Within this context, we asked LPs and GPs whether they were likely to use EU and offshore jurisdictions more, less or about the same in future and to state why.

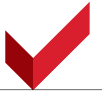
What LPs said:

- *"Using the EU more would depend on the politics around the blacklist."*
- *"Using offshore more would depend on standards of governance, regulation and OECD transparency."*

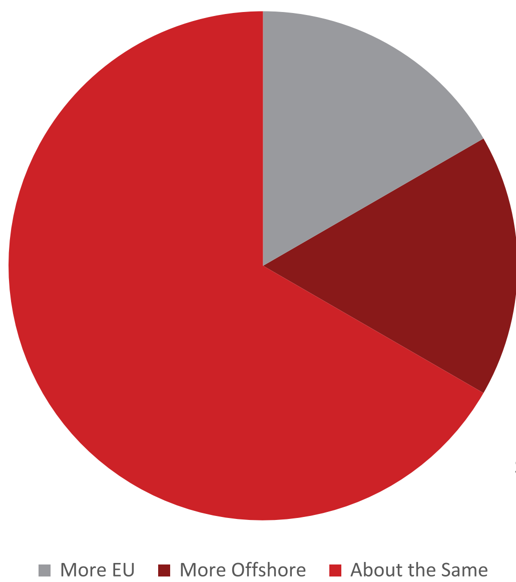
What GPs said:

- *"We expect to use offshore and EU onshore more because we had a successful first raise in the UK, and now we are aiming to target DFIs in the EU, such as Norfund and FMO."*

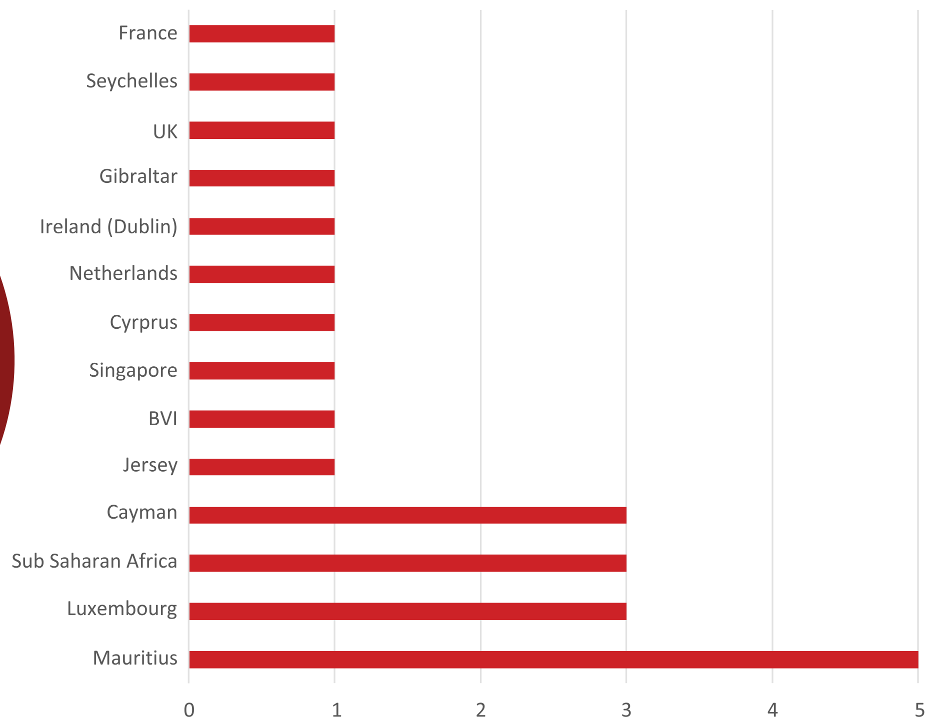
"While the majority of SA funds used Mauritius, and many LPs see it as the default choice 'for Africa' and had a perfectly good experience, the choice of using Mauritius seemed to be more a function of aggressive marketing and institutional status quo for using Mauritius than any joined-up thinking. And of course there is the issue that it has ended up on the blacklist, which cannot be ignored."



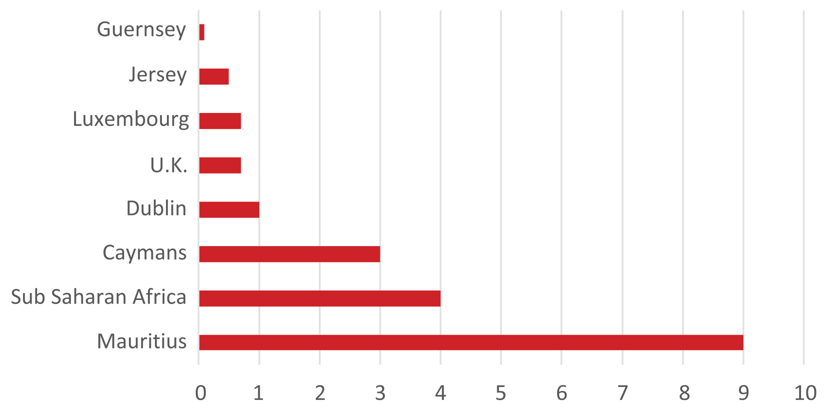
Future Usage of EU and Offshore



LPs - Jurisdictional Spread and Preferences



GPs - Jurisdictional Spread and Preferences



Findings: Drivers of Domiciliation

As mentioned previously, the ultimate choice of jurisdiction rests with the LP, and for this reason their preferences are very important in understanding the drivers of domiciliation.

We asked our respondents to rank a list of drivers of jurisdictional choice out of 10, with 10 being the highest, and to add any other factors we did not mention. As you can see below, Regulatory Standards and Established Legal Framework was the most important driver for LPs.

This finding also corresponds with the overarching issue arising out of the finding of the leading industry trends for LPs – that the amount of regulation and governance is increasing and this is affecting the reporting requirements of jurisdictions, and hence their competitiveness. This again signals a challenge for jurisdictions known to be more cost effective as reporting costs increase across the board. The findings for the predominant industry trends are to be found on pages 12-13, where more qualitative depth and richness can be found supporting these quantitative findings. In the leading industry trends we also see that managers and investors are all very aware of the growing interest in investing with environmental, social and governance (ESG) factors. It is likely that this growth in ESG investing will only increase governance standards and, hence, reporting requirements. This is already on the horizon with the new EU ESG disclosure regulations being released in March 2021.

For many LPs, particularly in the US, another very important issue was tax incentives and in particular whether treaties were in place or jurisdictions offered tax neutrality. Political stability is also an increasing consideration in a turbulent world marked by the US-China trade war, Brexit, Trumpism and populism due to growing inequality. Jurisdictions with a reputation for certainty and stability stand to benefit as hedges from the volatility on the horizon.

Mental Model of Jurisdictional Value

One respondent said with the increasing costs associated with reporting for transparency, it would become harder and harder for jurisdictions roughly in the middle, such as Jersey, with its high transparency and regulatory standards and competitive pricing, and Mauritius, with its geographical and historical advantage, to sell their offering. Some funds and their investors would mainly go to the "gold standard" option of Luxembourg and Dublin, which also represent an increased level of regulatory complexity and cost, while a small majority would be open to light-touch regulation on the other end of the continuum. He suggested a rough mental model of the situation (see chart below).

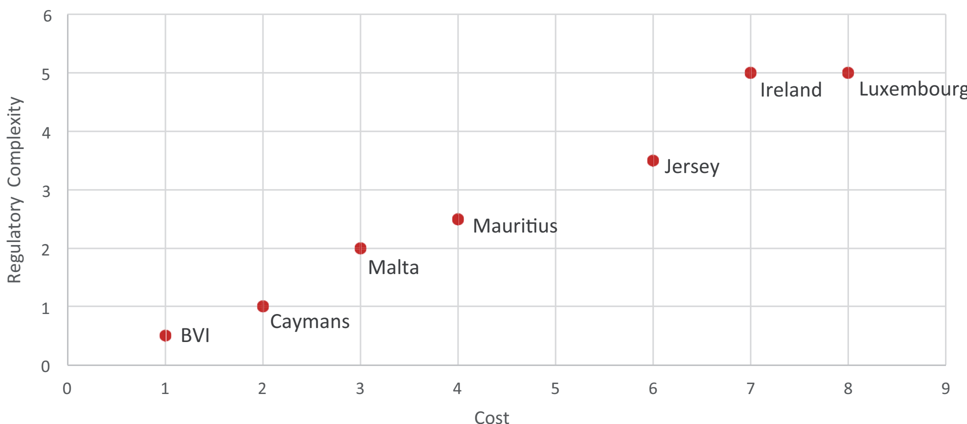
Besides cost, incoherence within application of AIFMD, as discussed on page 17, and language and cultural barriers made Luxembourg almost impossible for the average non-EU emerging manager from one perspective.

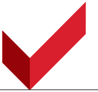
SURVEY QUESTION: *Please rate out of 10 (with 10 as the highest value) the reasons why you would prefer the fund to be domiciled in the offshore jurisdiction(s) that they are in.*

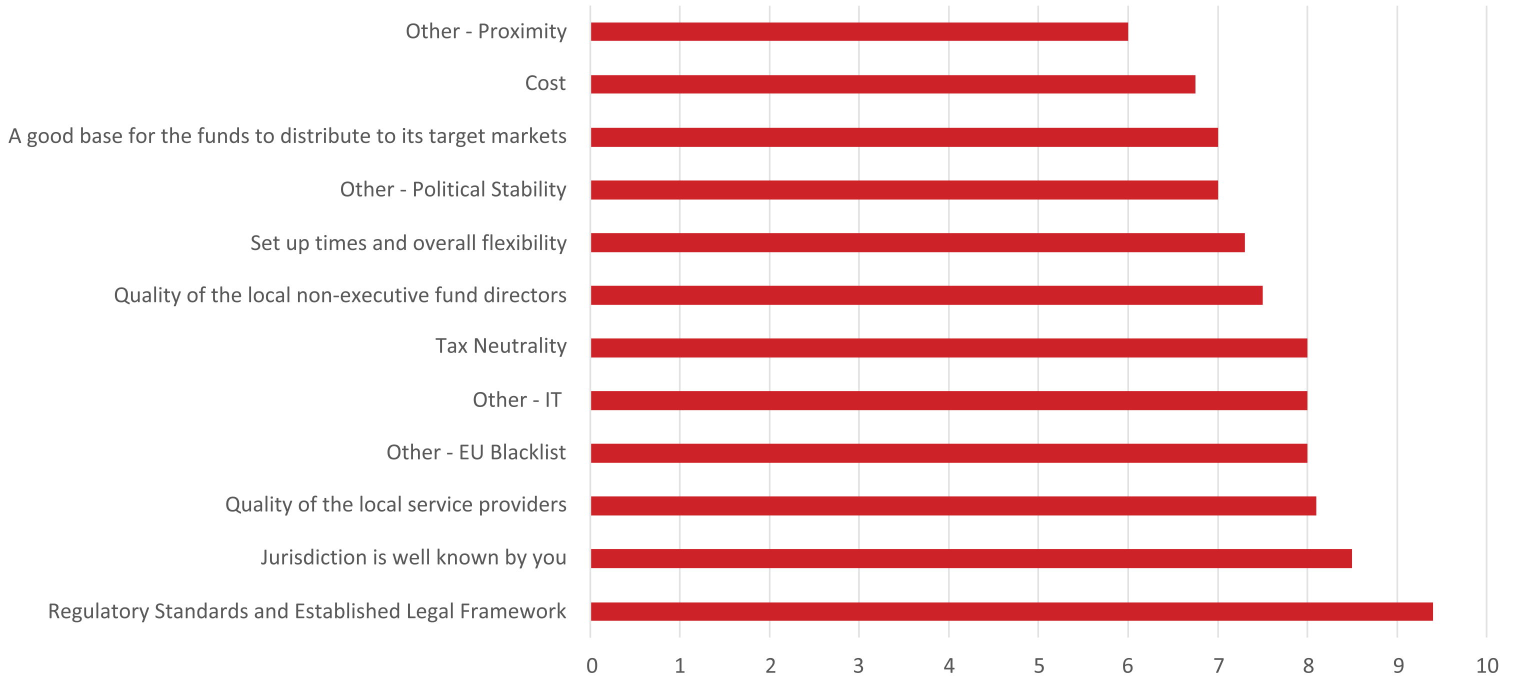
ANALYSIS: *What do the resulting graphs tell us about the drivers contributing to the ultimate choice of domicile?*

As we can see from these charts, LP preferences drive the choice of domiciliation, and within this, regulatory standards and established frameworks are most important for LPs, while for GPs the quality of local service providers are particularly important. The importance of networks and business relationships should also never be underestimated. Political stability is also a growing concern for investors, while geographical proximity is becoming less important, both these trends will only be further entrenched by Covid-19. These quantitative findings are supported by the qualitative comments on the most important industry trends set out on pages 12-13.

Mental Model of Jurisdictional Value






LPs - Drivers of Domiciliation
Other - Proximity
Cost
A good base for the funds to distribute to its target markets
Other - Political Stability
Set up times and overall flexibility
Quality of the local non-executive fund directors
Tax Neutrality
Other - IT
Other - EU Blacklist
Quality of the local service providers
Jurisdiction is well known by you
Regulatory Standards and Established Legal Framework
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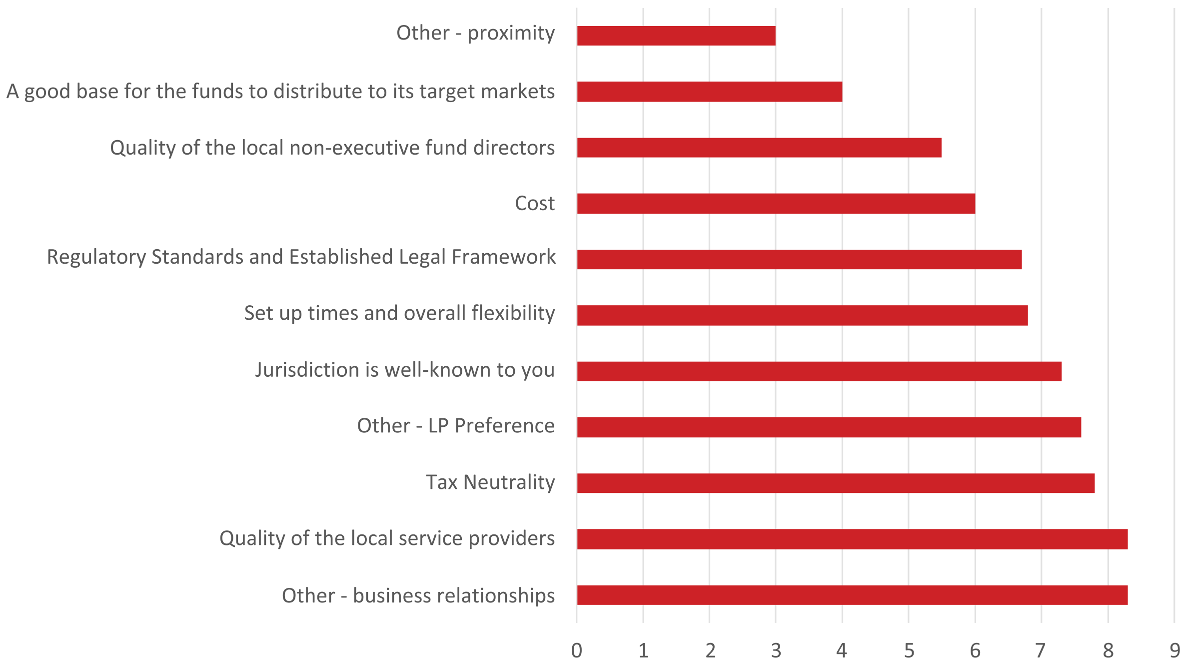
GPs - Drivers of Domiciliation
Other - proximity
A good base for the funds to distribute to its target markets
Quality of the local non-executive fund directors
Cost
Regulatory Standards and Established Legal Framework
Set up times and overall flexibility
Jurisdiction is well-known to you
Other - LP Preference
Tax Neutrality
Quality of the local service providers
Other - business relationships
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Findings: Trends in EU and Offshore Funds Industry

The main industry trends we unearthed are listed in bullets below and discussed in more detail further below.

- The dominant trend was increased complexity and cost of regulation and reporting
- The rise of ESG being pushed actively by DFIs in Northern Europe
- ESG and impact investing push resulting in more awareness of the African opportunity
- Political stability a concern amidst Brexit, Trump and Covid-19
- Caymans remains dominant for US and Mauritius for Africa due to aggressive marketing
- Low and negative interest rates increasing costs of deals and not offsetting high African yields

Regulatory and Reporting Burden Driving Up Costs and Complexity

One of the major trends – also supported by the findings in drivers of domiciliation on pages 10-11 is that the regulatory burden is increasing alongside increased oversight of anti-money laundering (AML) and Know Your Customer (KYC) requirements. Many respondents highlighted that the due diligence for AML and KYC has not only driven up costs, but also affected the competitiveness of jurisdictions.

"Regulation and governance is becoming more strict. This means better transparency but it also means more reporting that was formerly very light. And that makes Mauritius less attractive. Because of the expense involved with regulation and governance, you may as well be in the EU."

LP1, EU/UK

"After the global financial crisis everything is much more heavily regulated and extremely prescriptive. Commercial investments feel like a bit of a sausage machine as a result."

LP2, EU/UK

The obvious consequence of this is that jurisdictions that are already known to be relatively expensive will become less competitive as a result. One professional services partner surveyed told us:

"Luxembourg has now become very hard and expensive in the increased push for transparency."

Adviser, UK/SA

While these reporting issues are becoming a headache, overall, as long as there are robust legal and regulatory controls and AML capacity in place in a jurisdiction – and as long as there are not any other major red flags – investors "don't have much of a preference one way or the other" one UK-based LP told us.

ESG Push and EU Sustainability

The increased interest by investors in incorporating environmental, social and governance (ESG) factors into their portfolios will only see the reporting burden increase, particularly as the EU regulation on Sustainability-Related Disclosures (Disclosure Regulation) legislation comes into force in March 2021. The Disclosure Regulation aims to enhance transparency regarding integration of ESG matters into investment decisions and recommendations. The regulation will apply to fund managers, financial advisers and many other regulated firms in the EU, as well as to non-EU fund managers who want to market into the EU. The regulations will require clarity on how sustainability risks (ESG issues) are incorporated into the investment thesis and whether their investment decisions have any adverse impact. The fact that these developments are being lobbied for by EU DFIs will be of significance to SA fund managers given how many raise capital from this investor segment.

Exposure (risk in relation) to climate-related disclosures is also accompanying investor thinking on ESG.

Political Stability

People are looking for a hedge against uncertainty with Brexit, Trump and Covid-19. In relation to offshore, now investors want jurisdictions that are credible and transparent, with robust regulation. Many fund managers are going to Luxembourg and Dublin already because of Brexit in an attempt to guarantee continued access to the EU.

Political Economy of the EU Blacklist

For all IFCs, particularly the better-regulated and transparent Channel Island jurisdictions, it will be important to communicate to such LPs that tax neutrality has advantages for cost efficiency of funds and the ultimate investment returns to beneficiaries. This cannot be overstated. One LP told us that for some EU investors, tax is a moral issue and falls within their governance mandate within ESG as they see it, so there is some work to do here on the communication front. "For European investors, the issue that really overrides investor thinking besides ESG is OECD transparency and AML issues."

The politics around the EU black and grey lists has made 2020 a tricky year for Mauritius and Caymans in particular. On 7 May 2020, the European Commission identified Mauritius as a high-risk third country for the purposes of its anti-money laundering. Subject to approval by the European Parliament and EU

Council, the change came into force on 1 October 2020. At the time of writing, Caymans had managed to get off the grey list and avoid the blacklist, while Mauritius was still having trouble getting off the blacklist, even though it has made commitments to address the deficiencies. This has already caused some funds to redomicile to jurisdictions such as Jersey and Dublin. Even though Mauritius is a well-trodden path for SA fund managers, these issues together are forcing a rethink given, as one respondent said “EU DFIs have been the main funders in Africa." For example, one adviser told us after years of convincing the EIB to approve the domiciliation of funds in Mauritius, after finally succeeding, this might now be all for nought, they said: “EIB might now prefer structures based in the EU." There is obviously a lengthy window of opportunity for competing jurisdictions to capitalise on the current situation and signal themselves as a useful alternative for SA fund managers aiming to access global capital.

Aggressive Marketing Maintains Status Quo Such as Caymans for US and Mauritius for Africa

Almost without exception, managers and investors with exposure to the US capital market were using Caymans as a domicile. One LP told us that “Caymans market very aggressively in New York and have been doing so for over a decade." The Mauritius route for investing into Africa is also very much entrenched and another respondent remarked that he gets daily emails from service providers soliciting for Mauritius.

Low and Negative Interest Rates Increasing Cost of Capital and Offsetting Higher Yields in EM

One LP complained: “Low interest rates mean we have to work a lot harder to achieve a meaningful financial return." What everyone wants is to de-risk the financial return eroding the opportunity to hedge with higher yields in EM negative interest rates (particularly in Germany for euro) – a risk when raising capital in euros the risk premium is significant on your cash.

Increased Opportunities for Funds and Providers with Wider Interest in Africa Alongside Impact Investing

Last but not least, our respondents attested to wider interest in Africa and impact investing. Even though starting from a low base, the opportunities for capital raising in Africa are substantial. The past two years have seen unprecedented capital commitments to Africa in foreign direct investment as the region becomes more economically and politically strategic. South African funds are facilitating flows into the wider African continent, and they are raising these funds across international capital markets, from America to Asia.

Two GPs we spoke to supported this trend and said:

“In our experience, there has been a lot of positive sentiment towards emerging markets, particularly Africa. You do, though, hear some rhetoric that people are holding back on emerging markets, but as a fund, we have not had any such resistance. Many of the DFIs we have dealt with are actually allocating extra budget. So I guess you have two competing narratives, or that people are looking to the east, but in our experience, investors who have been in Africa know the opportunity and its rewards, and remain committed to supporting that growth.”

GP 1 (SA/Mauritius)

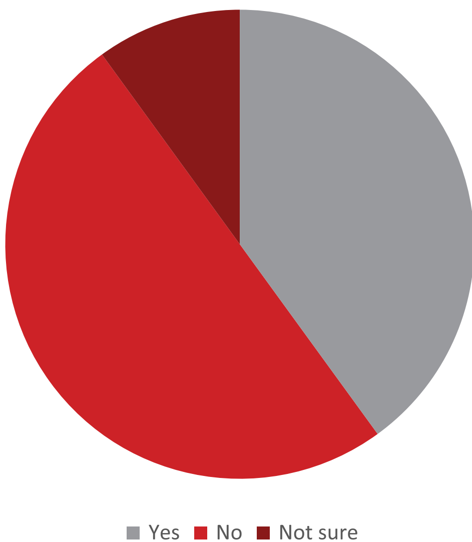
“As an African fund, a major industry trend that we have noticed over the past few years is increased appetite for the supporting managers and enterprises from the DFIs in particular, that seems to have balanced out the reversal of purely commercial monies that used to flow into the continent. It would seem the DFIs have stepped into the breach left by commercial investors.”

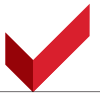
GP 2 (SA/Mauritius)

Macro Findings: Covid-19

Around half of our respondents thought that Covid-19 would have an effect on capital raising and domiciliation, others thought it was less significant. What is interesting is that we interviewed the GPs at the start of lockdown, where the majority of respondents didn't think it would have a significant effect. By the time we began interviewing the LPs in August and September, that view was very different as the enormity of the crisis was becoming clear. "It won't affect much. In Q1 and Q2 we saw LPs in a holding pattern and a lot of dry powder, but now there is more re-engagement and trade finance is starting up again."

Will Covid-19 affect capital raising and fund domiciliation





Those who thought Covid-19 was a significant factor offered the following insights:

GPs *(Interviewed 1 May – 30 June 2020)*

"The Covid crisis will set things back considerably. We were hoping to finally exit our fund next year but I think it will now be more like in the next couple of years. Who knows?"

"Covid is affecting everything. It remains to be seen how long the industry can function remotely and how the long-term macro effects will play out."

"It will affect fund raising for new funds."

"Yes there will now be more attention to regional situations, capital markets now have very different policy priorities."

"I think that with increased risk aversion, fund structures will for the most part maintain a status quo with domiciliation. I don't think now is the time to try anything new or funky."

LPs *(Interviewed 1 August – 30 September 2020)*

"Green market and digital be the biggest trend coming out of the pandemic."

"Yes, there is an unresolved question in what type of displacement of capital in US stock markets will take place. The US stock market has, in tech in particular, been a beneficiary of Covid-19. There is also intense fiscal stimulus, which will at some point wane."

"Yes, USAID is cutting its DFI scheme and capital raising."

"Yes, it will affect domiciliation though not directly – although many investment issues can be adapted such as electronic signatures, it will affect due diligence that can be done on prospective investments when travel is limited."

"It might affect domiciliation as travel restrictions continue."

"We are seeing reduced appetite – it takes investors into defensive mode, which in our case (private debt markets) means they are less likely to want to add more debt to the portfolio."

"Yes, it will affect capital raising; we don't have the full picture yet, but it will likely make people more risk averse."

"Yes, people will be more cautious in assessing long-tail risks including epidemics in making assessments."

Macro Findings: Brexit

For US and African investors, Brexit is ostensibly not that much of an issue, but most respondents concede it will likely affect anyone with an exposure to the EU and UK, or if trying to distribute into either jurisdiction.

There is a clear competitive advantage here for jurisdictions that have a third-country equivalence arrangement with the EU and good arrangements with the UK, while being neither in the UK or EU, such as Jersey – a fact about which there was not much awareness from US and SA respondents in particular.

Third country equivalence arrangements also contribute to a fair degree of political stability and fiscal certainty, which is probably the most compelling hedge provided by jurisdictions with such political and economic protections.

Wider macro observations from this segment highlight that the UK was always big in Africa from a DFI standpoint and that will only increase. So a Global Britain push into the continent could be an opportunity for Africa and anyone trying to raise capital or structure funds to service the region.

Some respondents were concerned about the extent that the UK becomes less stable if it had less support from the EU.

Whatever the thoughts of non-EU managers and their international investors on the wider effects of Brexit on the industry, everyone is watching it closely.

"There is a clear competitive advantage here for jurisdictions that have a third-country equivalence arrangement with the EU and good arrangements with the UK, while being neither in the UK or EU, such as Jersey."

Here is what some LPs had to say about Brexit:

"Yes, at the very least it creates capital market uncertainty."

"For Jersey it will be important to communicate to investors if it is off-limits or not."

"Not from our perspective, but certainly for the UK investment industry, already so many portfolio managers are leaving London to go to the EU."

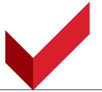
"It will affect capital raising mainly for funds based in the UK."

"Whatever happens, we are watching closely. It might affect funds exposed to the UK to some extent, but I don't think much will change practically."

Here is what some GPs had to say:

"It is not immediately clear to me how for a non-EU fund or manager how it will affect me, but hopefully Brexit can't possibly make entry into the EU less coherent than it already is from our perspective."

"We are not entirely clear on how Brexit will affect our passporting arrangements. We have registered for AIFMD, but I don't know if we need to do anything else to prepare given we are raising in both the UK and EU."



Marketing into Europe and Beyond for SA Managers

Being outside of the EU means South African managers are not subject to EU directives when targeting investors from the rest of the world, but there have been problems when marketing into Europe even with a structure in the EU. One major issue for funds marketing into Europe, besides choosing a jurisdiction not on the blacklist, as mentioned in on pages 12-13, is the choice between private placement and the EU Alternative Investment Fund Managers Directive (AIFMD). While the majority of funds use private placement, some have used full AIFMD passport for selling into the EU. An issue in this regard that keeps coming up for the GPs on AIFMD, however, is the lack of coherence and overly draconian provisions in terms of selling. The application of AIFMD for non-EU funds has been an issue in the market for several years. Shown below are some of the GPs' continuing concerns.

"We would like to see some level of sense and proportionality for AIFMD. We are not allowed to fly to Paris or Zurich or wherever, to talk to anyone about raising funds, or we will be breaking EU law. Power balance is totally skewed against (smaller) SA funds who just want to have a speculative, fact-finding discussion."

"We have marketed into Europe but it has not been easy. AIFMD is very disjointed and the European Supervisory Authorities do not seem to apply the rules consistently, even within the same jurisdiction. For example, we did a raise in Denmark and were asked to provide a letter from the SA regulator. The regulator told us it was the first time they had to provide such a letter, and were not sure what the ESA really wanted them to say in it. It's so odd. Yet I am sure we couldn't have been the first SA fund to do a raise in Denmark."

As mentioned before, in the event of Brexit, there is clearly an opportunity to facilitate non-EU capital raising from the UK and EU for Jersey, given their good relationships with the UK and passport arrangements to sell into the EU given their track record as third countries, outside both the UK and the EU, and more so if they can innovate and rationalise through private placement regimes. This side of the Brexit equation is especially true in relation to the Channel Islands – which literally sit between the UK and EU, and have guaranteed Private Placements Agreements with the UK even in the event of a no-deal Brexit. This means they bridge the gap between the EU and the UK in both a pre- and post-Brexit environment and takes off the table the uncertainty of what will happen in the UK after the end of the transition period on 31 December 2020, while the financial sector agreements between the UK still hang in the balance. This provides a great degree of political and fiscal stability for investors and funds exposed to both the EU and UK.

"We would like to see some level of sense and proportionality for AIFMD."

Research by Jersey Finance shows that by the EU's own statistics, only 3% of all Alternative Investment Fund Managers are registered to market in more than three European jurisdictions. This means that 97% of all managers do not market in more than three EU countries. If you are a part of the 3% who market on a pan-European basis or to the retail market then you will most likely need to access EU markets via another jurisdiction under full scope of AIFMD or UCITS. But if you are one of the 97% who do not market so widely within the EU, and this is particularly the case for non-EU managers, more cost-effective, faster and more efficient solutions outside the full scope of AIFMD, such as those offered in Jersey, become useful.

At the time of writing, a full review of AIFMD had been launched by the European Commission on 22 October, which opened a consultation with the industry to explore a range of issues including a potentially complicated delegation of fund managers' activities.

US and Asia Sophisticated Investor Framework and Asia Region Funds Passport Becoming Competitive to EU

Fund managers in the survey also tell us that the US and Asia's sophisticated investor framework also make capital raising easier for South African managers in some aspects, particularly emerging managers looking to raise capital via a hub in the Caribbean for the US, such as Caymans and BVI, and Singapore or Hong Kong for Asia. The accelerating pace of the Asia Regions Funds Passport to facilitate selling between markets in Asia including Australia; Japan; New Zealand; the Republic of Korea; and Thailand, are also fast offering similar standards to the EU's UCITS and AIFMD frameworks, which will further smooth the path for African funds looking to raise in Asia. However, one GP said: "we have never had a problem accessing US or Asian capital through our Jersey partnership."

Findings: Substance

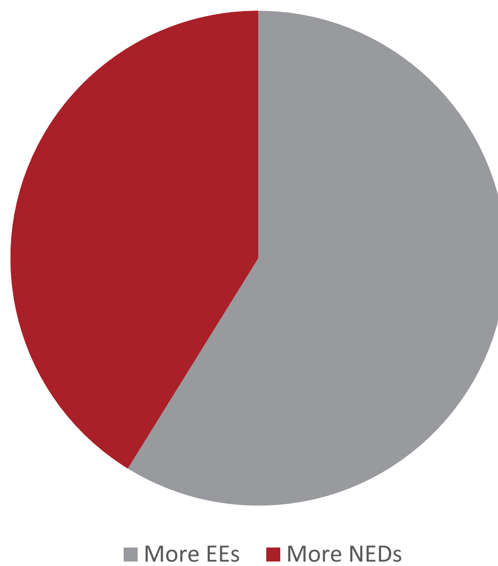
Substance Laws to comply with the EU codes of conduct for substance requirements became effective in BVI, Cayman Islands, Jersey and Guernsey from January 2019, clarifying tax residence and entity classification, contractual and outsourcing arrangements, corporate governance, employment and premises arrangements, and other business information for tax reporting. Sanctions for non-compliance can include fines, striking off of company registers and, even imprisonment.

We did not ask LPs about substance requirements given this was less relevant for them operationally. Most of the GPs were aware of developing substance requirements for funds, and would add substance by increasing local employees, more so than adding local directors. Some GPs questioned whether this issue was really relevant for the SA manager context, and a small number were not aware of these provisions at all.

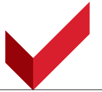
But all were in agreement that for these purposes “the days of hopping on a plane for board meetings are over, and that was the case pre-Covid”.

One GP noted that “if the substance requirements became more onerous and a hindrance due to having to open offices internationally, they might have to review offshore domiciles.” He also noted that:

“I think Covid will put more pressure on IFCs and the popular backlash will deepen. As the covid crisis becomes an increasingly economic one, countries will be looking for someone to blame for the revenue shortfall, and the transparency requirements for IFCs will only increase and increase, making it difficult for any of them to stay off the grey and blacklists.”



“The days of hopping on a plane for board meetings are over, and that was the case pre-Covid.”



Are Investors Missing Out on Non-EU Opportunities?

We asked our respondents if investors are missing out on non-EU opportunities and hence, how flows into Africa could be supported.

Our sample obviously has some exposure to non-EU opportunities on the investor side into Asia and Africa. So as individuals they did not personally feel they were missing out, but they did not believe this to be true for the universe of investors.

“Yes, they have missed out – Africa is the last investment frontier demographically, with the huge labour and consumer markets and rising middle class, there are enormous opportunities for those who are attuned.”

“The US economy is in freefall so hopefully over time this will change as investors see more opportunities to diversify."

“Yes, they are missing out on diversification opportunities due to lack of knowledge and bias to status quo.”

“Yes, they are missing out on diversification opportunities, due to a lack of knowledge of the risks and a bias to the status quo. The long time it takes to complete international deals is also a deterrent.”

"Yes, they have missed out – Africa is the last investment frontier demographically, with the huge labour and consumer markets and rising middle class, there are enormous opportunities for those who are attuned."

“Lack of data means investors are missing out on high yield opportunities in Africa. But on the flipside, the forex risk is significant in Africa – forex markets can be illiquid and volatile."

“Lack of access and understanding sees investors missing out. But the information deficit is because it can be hard for SA fund managers to get into networks of LPs.”

“Yes, they are missing out, in the EU hardly anyone wants to invest outside of the EU because of regulatory hurdles and tax non-EU perception of risk profile. This perception of risk is led by Moody's, and isn't really fair or reflective of what is happening in emerging markets, particularly in Africa.”

Clearly a deficit in understanding the opportunity and a comfort with the status quo has been one of the major hurdles for facilitating investment flows into Africa. Thought leadership and business and cultural diplomacy are the main tools with which to address this, supported by robust empirical evidence in reports such as these.

Conclusions

While there are enormous opportunities for driving capital in Africa, particularly given the low base, a few respondents wished to highlight that even though South Africa has deep and liquid capital markets with a highly sophisticated financial services workforce, it was still a developing country and this brings with it unique challenges. This means that there are political factors to consider with black economic empowerment given its apartheid history, and this included not just empowered funds and boards, but also targeted investments aimed to address inequality. Nonetheless, capital, particularly in PPP frameworks facilitated by DFIs, has seen the interest and commitments climb up. The perception of emerging market risk has also been moderated by tumult in the wider geopolitical economy, as we set out in the introduction.

For agile professionals and investors, there are many opportunities for those who can offer a credible value proposition balancing regulation, governance, cost and innovation. For IFCs, those who can facilitate capital flows, while meeting all these requirements, there is an opportunity to do really well while doing an abundance of good.

The next year will be particularly interesting for this ecosystem, as Mauritius looks to figure its way out of the blacklisting and its government figures out whether it is going to support the aspirations to be an IFC. There is an opportunity as fund managers and investors re-evaluate their domiciliation and structuring arrangements.

As the world settles into the reconfigured working patterns in the wake of the Covid-19 global pandemic, there may be a deep economic crisis even if capital again begins to flow to stimulate recovery. If the crisis remains protracted beyond 2021, there could be a backlash against IFCs as other jurisdictions lash out at their tax-neutral strategies amidst revenue shortfalls and civil unrest.

It's really important for IFCs to now show that increased investment returns arising from low to no tax structuring means more infrastructure and more savings and investments to contribute to global prosperity.

The increased interest in ESG also demands that IFCs actively get involved in governance conversations and demonstrate, if they can, their commitment to transparency and social and environmental impact. All these factors together will likely see an increase in reporting requirements across the board.

The choice of domiciliation can make or break a fund's success. Amidst the sea-change in attitudes and practical conditions in the business environment, there are big rewards in this ecosystem for first-movers who can see the opportunity and facilitate the optimal conditions for capital to arrive and thrive in the African Continent.

"For agile professionals and investors, there are many opportunities for those who can offer a credible value proposition balancing regulation, governance, cost and innovation. For IFCs, those who can facilitate capital flows while meeting all these requirements, there is an opportunity to do really well while doing an abundance of good."