May 2023

The Alternative Investor

Performance
News
Trends
Regulatory updates

What's going on in the VC markets

In this edition, **Parkwalk Advisors' Moray Wright** writes about the state of play in the university spin-out market, while **Armstrong International's Hugh Barran** looks at the latest trends in VC firms, and **Ioto Iotov,** from **Capricorn Capital Partners,** picks-up private market valuations. Changing tack, we also have **ACC** diving into private credit markets.

A Brodie Consulting publication in conjunction with Capricorn Fund Managers and RQC Group.

#23

HEDGE FUNDS HAVE A SOLID APRIL

While there were fewer economic surprises in April than in previous months, investors largely sat on the sidelines. This was reflected by a muted VIX, which by month-end was at a multi-year low. Click here to see our April review.

In this environment, hedge strategies generally had a reasonable month and by close, the **HFRI Fund Weighted Composite Index** was up +0.4%, and **Asset Weighted Composite** +0.7%.

In equities, the **HFRI Equity Hedge (Total) Index** was up +0.4%, led by the **Healthcare** and **Energy** sub-sectors, +3.9% and +1.5%, respectively. This makes healthcare the best-performing equity sector this year, +4.9%. **Tech** funds, however, had a more difficult month, down -2.8%.

Event-Driven saw marginal gains during the month, with the **(Total) Index** up +0.2%. This was driven by **Special Situations**, up +1.2%, and **Credit Arb**, +0.5%, while the **Activist Index** was down -0.9%.

Macro was the best-performing strategy in April (along with **Fund of Funds**), with the **Macro (Total) Index** up +0.7%. This was led by the large managers, with the **Asset Weighted Macro Index** up +1.1%. Within this, **Systematic** was up +1.6%, while the **Discretionary** focused managers were flat.

Relative Value was marginally up, +0.3%, with **Yield Alternatives** the best performing, +1.4%, and **Fixed Income Sovereign** the underperformer, -1.2%.

Regional performances varied widely across geographies. The best performing region by some margin was **India**, with the Index up +6.0%, followed by **Japan**, up +1.6%. Emerging Markets were, however, more complicated, with the **HFRI Emerging Markets (Total)** down -0.2%, led by **MENA**, down -1.4%.

INDUSTRY EVENTS

16-17 May
Impact Investor Global Summit (London)

23-24 May
Private Fund Compliance Forum 2023

31 May - 1 June
Campden Club | Family Office & Investment Forum (Geneva)

Click here to see all the listings

$200bn

Amount of dry powder available to Blackstone

Source: Blackstone

$23bn

CD&R's largest and latest fund close

Source: CD&R

SEC SEEKS GREATER VISIBILITY

The **SEC** has announced amendments to Form PF, the confidential reporting form for SEC-registered investment advisers to private funds. The move is intended to provide the regulator with greater visibility and fewer surprises, which is a particular area of focus for *Gary Gensler*, SEC Chair.

These amendments force hedge funds with more than $1.5 billion in assets to disclose material losses within 72 hours. The trigger for this includes *'certain extraordinary investment losses, significant margin and default events, terminations or material restrictions of prime broker relationships, operations events, and events associated with withdrawals and redemptions.'*

While this reporting is confidential to the regulator, it has caused concern and is a further admin headache for large funds. As *Jack Inglis*, **AIMA** CEO, commented, *"this will create considerable compliance uncertainty… especially for registered advisers outside of the US."*

Another amendment, targeting private equity funds with more than $2 billion in assets, is to provide additional information on their fund strategies and borrowings in their annual filing.

BIG IS [CURRENTLY] BETTER

A glimpse at **Citco's** first quarter report, which looks at the hedge funds it administers, shows that big funds have been outperforming small ones by some margin. The report shows that funds with over $3 billion in assets have returned a weighted average of 6.4%, compared with 2.7% for funds of between $1 billion and $3 billion. While those with $500 million and $1 billion of assets returned 3.4%.

BILLION-DOLLAR STARTUPS

There may be market uncertainty, but this year has seen the return of the billion-dollar start-ups, with numbers back at pre-pandemic levels, writes Bloomberg. This news follows a few underwhelming years and already we have seen the launch of **SurgoCap Partners**, which raised $1.8 billion earlier this year.

According to the wire's fundraising sources, we are likely to see four further firms launch, raising $6.5 billion. These are decent figures, although if you go back to 2005, again using **Bloomberg** data, there were a dozen funds launching, each with significantly more than $1 billion.

UPDATES (cont.)

MACRO ON BACK FOOT

Those early signs that macro hedge funds were back have yet to be fulfilled. The strategy was up in April, but is still down this year, and has a different feel to last year, with managers finding themselves on the wrong side of central bank actions and currency flows. Having said that, this has yet to impact flows to the space, with **eVestment** reporting net inflows to the strategy in the first quarter.

But perhaps a sign of things to come is a **Bloomberg** story on **Brevan Howard** terminating a $1 billion macro SMA with LA-based **Commonwealth Asset Management**, following losses in short-term interest rates.

MAN GREEN LIGHTS CREDIT

Man Group's intelligence arm, the **Man Institute**, has upgraded its views on credit long/ short from neutral to positive and downgraded macro quant from positive to neutral in its **Q2 Hedge Fund Strategy Outlook.**

The Institute's sees continued volatility in the macro space, which it believes will suit the macro traders but not macro quant; clearly, not a buy signal for Man Group's **AHL** strategies.

The more positive thinking around credit is the dispersion in the space, which the Institute believes is better suited to trading around corporate capital structures. The Institute suggests avoiding more directional credit risk and maintains its negative view on distressed *'for now'*; they are also negative on long-biased equity.

MIXED FLOWS

HFR data points to first-quarter inflows going to larger funds. Funds managing more than $5 billion saw net asset inflows of $7.4 billion. While firms managing between $1 billion and $5 billion saw $1.3 billion and around $330 million went to firms with less than $1 billion. **Citco**-administered funds show a different story, with a 'surge of net outflows' in March, taking the total departing the space to $4.8 billion for the quarter. According to the Citco numbers, investors were however putting their money in Hybrids, with $1.4 billion inflows, while all other strategies saw outflows, led by Equities, with $3.5 billion heading out of the door; Multi-strategy also saw outflows, although to a lesser extent, with $100 million exiting during the quarter.

MAN GROWS

In line with the trend of investors sticking with big brands, **Man Group's** latest trading update shows that the firm has continued to see positive inflows in the first quarter. During this period, Man's assets increased from $143.3 billion to $144.7 billion, with $1.6 billion going to alternative products, while long-only saw outflows of $0.5 billion. Investment performance for the quarter was more mixed, adding only $0.7 billion to assets, mainly from its long-only performances, with **GLG Continental European Growth** up 8.7%, while the **AHL** absolute return strategies were down between 3.6% and 7.0%.

ACTIVE QUARTER

The first quarter was busy for activist investors, with 409 companies subjected to their demands. These figures come from **Insightia** data that shows you need to go back to 2018 to find a busier year when 422 companies were in scope.

Activists have been mainly focusing on large caps (a figure that has been rising year-on-year), with a particular concentration on financial services and industrial sectors.

UPDATES (cont.)

BLUEBELLS WITH A BITE

Since launching in 2014, **Bluebell Capital Partners** has built a reputation for punching above its weight. In the past month, the activist, which manages around $300 million, has taken increasingly public stances against **Glencore** and **Bayer**. It has called for Glencore to 'dump' its highly lucrative coal business and concentrate on copper, given that the future is in renewables. Bluebell argues that such a move will encourage a higher valuation. With Bayer, Bluebell started building its stake at the start of the year and is looking to break up the business and change the supervisory board just before the new CEO *Bill Anderson* takes the helm. Bluebell is not the only activist in Bayer, with *Jeff Ubens'* **Inclusive Capital Partners** also showing keen interest.

HINDENBURG VS ICAHN

Statistics show that it has been busy in the activist space, yet it has felt relatively quiet with only a few big public campaigns.

One activist who has, however, been super busy this year is *Nathan Anderson's* **Hindenburg Research**, which has recently dropped its latest damning research - this time zeroing in on **Icahn Enterprises**.

Hindenburg announced that it was shorting Icahn Enterprises, which it views as being overvalued by as much as 75%, with *"inflated valuations"* for the less liquid assets and performance losses that have yet to be reported.

It is all pretty hart-hitting, with the report describing Icahn's structure as *"Ponzi-like"* and concluding that he has made a *"classic mistake of taking on too much leverage in the face of sustained losses."*

Icahn Enterprises' share price dropped by as much as 36% in the following two days after the report was released. Icahn responded, somewhat softly given his reputation, that this is a *"self-serving short seller report."*

If you can take on (and possibly take down) one of the world's wealthiest individuals, **Gautam Adani**, as Anderson has, then attacking one of the most aggressive corporate raiders is clearly just another day in the office.

CD&R HARD CAPS AT $23BN

Further evidence that big funds continue to attract the assets comes from **Clayton Dubilier & Rice**, which is the latest 'brand' to raise over $20 billion for a flagship fund. This is for its **Fund XII**, which has set a hard cap of $23 billion, a record for CD&R and is a third bigger than the previous **Fund XI**. Fund XII will invest in upper mid-market and value-orientated buyouts across North America and Western Europe. Investors include **General Employees' Retirement Fund** and the **Oklahoma State Regents for Higher Education**.

TPG RAISES $3.4BN FOR TECH

TPG Tech Adjacencies II fund has successfully raised $3.4 billion to invest in tech companies across all stages of growth through a mix of structured and opportunistic minority investments. This fund is TPG's second tech venture and is above the $2.5 billion that was the initial target

UPDATES (cont.)

AG ON THE BLOCK

Alternative firms have been upping their stakes in German software company **Software AG**. This followed news that **Silver Lake** has the backing to buy the firm, with its latest bid standing at EUR 32. According to reports, Elliott has been building its position, given the likelihood of further offers and other potential bidders sitting in the wings. One of which is **Bain Capital**, which has been *'rapidly [building] a stake'*, writes **Bloomberg**, and has offered EUR 36 per share through its portfolio company, **Rocket Software**. Silverlake remains in pole position, with its offer "presenting a high degree of transaction security."

BAIN FAILS TO CONNECT

ConnectWise is up for sale again, valuing the IT firm between $6 billion and $8 billion. Somewhat surprisingly, **Bain Capital**, seen as a front-runner early on, is now out, having low-balled its first offer. Other unnamed 'large' firms are said to be through to the next round.

Thoma Bravo acquired the Florida-based firm in 2019 and today has six of the eight board members.

KKR TAKES STAKE IN FGS

KKR has taken a 29% stake in communications firm FGS Global. Their move values the London and New York business, a subsidiary of **WPP**, at $1.4 billion. As part of the transaction, **Golden Gate Capital**, a shareholder since 2016, has exited. WPP remains the majority shareholder.

CLUB SANDWICH

News that **Subway** was on the market for more than $10 billion broke earlier this year. The most recent suitor - for the 37,000 outlets (many franchised) across 100 countries - is a potential club deal that includes **Advent International, Bain Capital** and **TPG**.

With the leveraged deal market somewhat subdued, Subway's banker, **JPMorgan Chase & Co**, has pulled together a $5 billion finance package to help encourage the sale. Other private equity names in the frame include **Roark Capital, Goldman Sachs Group Inc**. and **TDR Capital**.

PE RAISES $148BN IN Q1

According to **Preqin** data, the first quarter saw private equity raise $147.7 billion, with 168 new vehicles. This is not too far off last year's $150.1 billion for the same period, although it remains some way off the 2021 figure of $189 billion, raised by 399 firms. Unsurprisingly, North America accounted for 71% of this figure and 112 vehicles.

PINCUS BOLSTERS CHINA

While the numbers are relatively small, it is interesting to see **Warburg Pincus** take a 23.3% stake in China's **Zhou Asset Management**. With many firms pulling back from their China expansion, not all asset managers have given up on China's $2 trillion funds market. This development also adds to Pincus' presence in China, which already has a 29% stake in **Hwabao WP Fund Management**, acquired in 2017.

$5BN SECONDARIES SALE

A recent development in the secondaries market is the possible acquisition of one of the largest portfolios in this space. This is part of healthcare provider **Kaiser Permanente's** pension plan, which according to reports, is offloading around $5 billion in private fund positions. Buyers include **Ardian, Blackstone** and **Apollo Global Management.**

STRENGTHENING SECONDARIES

On the subject of secondaries, according to **Preqin**, the secondaries private equity market is expected to strengthen this year. This is the result of public and private valuations becoming more closely aligned. It also comes as the first quarter saw 11 secondaries funds close, raising $32.5 billion, which is more than the whole of the previous year.

UPDATES (cont.)

BLACKSTONE PRIMED

Blackstone's strong first-quarter results revealed almost $200 billion of dry powder. This is a fifth of its assets and is an industry record, with around $85 billion destined for private equity and the remainder for Credit and Insurance investments.

The results also saw the alternative giant announce a big uptick in its AUM to $991.3 billion, up 8% year-on-year, having seen an extraordinary $40.4 billion in inflows during the quarter. The biggest driver behind this increase was Real Estate, with inflows of $17 billion and over $90 billion from the previous year. Just behind was Credit and Insurance, which had inflows of $16.6 billion in the quarter and $69 billion over the 12 months. Private Equity and Hedge Fund Solutions, respectively, saw inflows of $4.6 billion and $2.2 billion in the quarter - $48 billion and $9.2 billion over the previous 12 months.

UNDER THE COSH

Carlyle Group has been given tough ride by multiple parties over the past year. The latest upper cut is from **The Guardian** newspaper, which accuses the firm of being 'particularly dirty.'

From an optics point of view, it does not read well, and is another *'to do'* item to add to *'two month in'* CEO, *Harvey Schwartz's* list, who has also just announced disappointing first quarter results.

According to the article, '*between 2011 and 2021, 90% of the estimated 91 energy companies Carlyle backed were fossil fuel options.'* While only 6% of the total assets were in these firms, according to the same piece, they accounted for *'around half of the firm's overall profits in 2022.'* This was largely the result of Carlyle's majority stake in **NGP Energy Capital Management,** which invests in at *'least a dozen fossil fuel companies'* and has not, according to the report, been included in the firm's emissions disclosures.

Carlyle disputes the findings, responding that its *"latest investments in renewables are outpacing fossil fuels."*

BLACKSTONE BREAKS REAL ESTATE RECORDS

Blackstone has announced the final close of **Blackstone Real Estate Partners X (BREP)**, with $30.4 billion of total capital commitments. This is the largest real estate fund ever raised and is 50% bigger than the previous $20.5 billion **Fund IX** in 2019.

For Blackstone it is a great result and comes at a time when its real estate business has been under pressure, having gated the $70 billion **Real Estate Trust (BREIT)** last year.

While both funds are investing in a similar space of logistics, rental housing and data centres, where they differ is investor-base, with BREP a closed-end, higher-risk offering with an institutional long-term investor base and BREIT an open-ended vehicle with a retail investor base.

EQT MULLS VARIOUS EXITS

With private equity exits proving more problematic in this environment, **EQT** is looking at the various other options available to them. These words came from CEO *Christian Sinding*, who spoke about this on their first-quarter earnings calls, saying that *'partial sales and continuation vehicles'* were being considered.

MUTED VC MARKET

The first quarter was particularly quiet for venture capital funds. There were only 144 VC funds close in the quarter, compared against the five-year average of 460. This comes from **Preqin** data that reports total VC fundraising for the quarter at $27.5 billion, slightly up on the previous quarter, but is down 67% from the first quarter of 2022.

CMCC LAUNCHES $100M DIGI FUND

Hong Kong based VC firm **CMCC Global**, has launched a $100 million Asian-focused blockchain fund. This will invest in blockchain and cryptocurrency infrastructure, fintech and consumer, and claims to be one of the first in Asia. Backing CMCC are the crypto twins, *Cameron and Tyler Winklevoss.*

GUEST PIECES

UNIVERSITY SPINOUTS NEED A CLEAR ROADMAP FOR FUTURE INVESTMENT

MORAY WRIGHT, CEO, PARKWALK ADVISORS

As the Chief Executive of Parkwalk, the UK's largest growth EIS fund manager, I've got to know dozens of founders over the last 14 years and as the UK's largest investor in university spinouts, it's clear to me that the UK has no shortage of talented people looking to commercialise their breakthroughs.

The UK's universities are recognised around the world as producing some of the most cutting-edge ideas. I've seen first-hand how technological innovations like quantum computing, genomics, and projectile fusion are on course to change the world. But this type of deep tech or clean tech could also be game-changing for UK productivity, and go onto employ tens of thousands of people in the jobs of tomorrow.

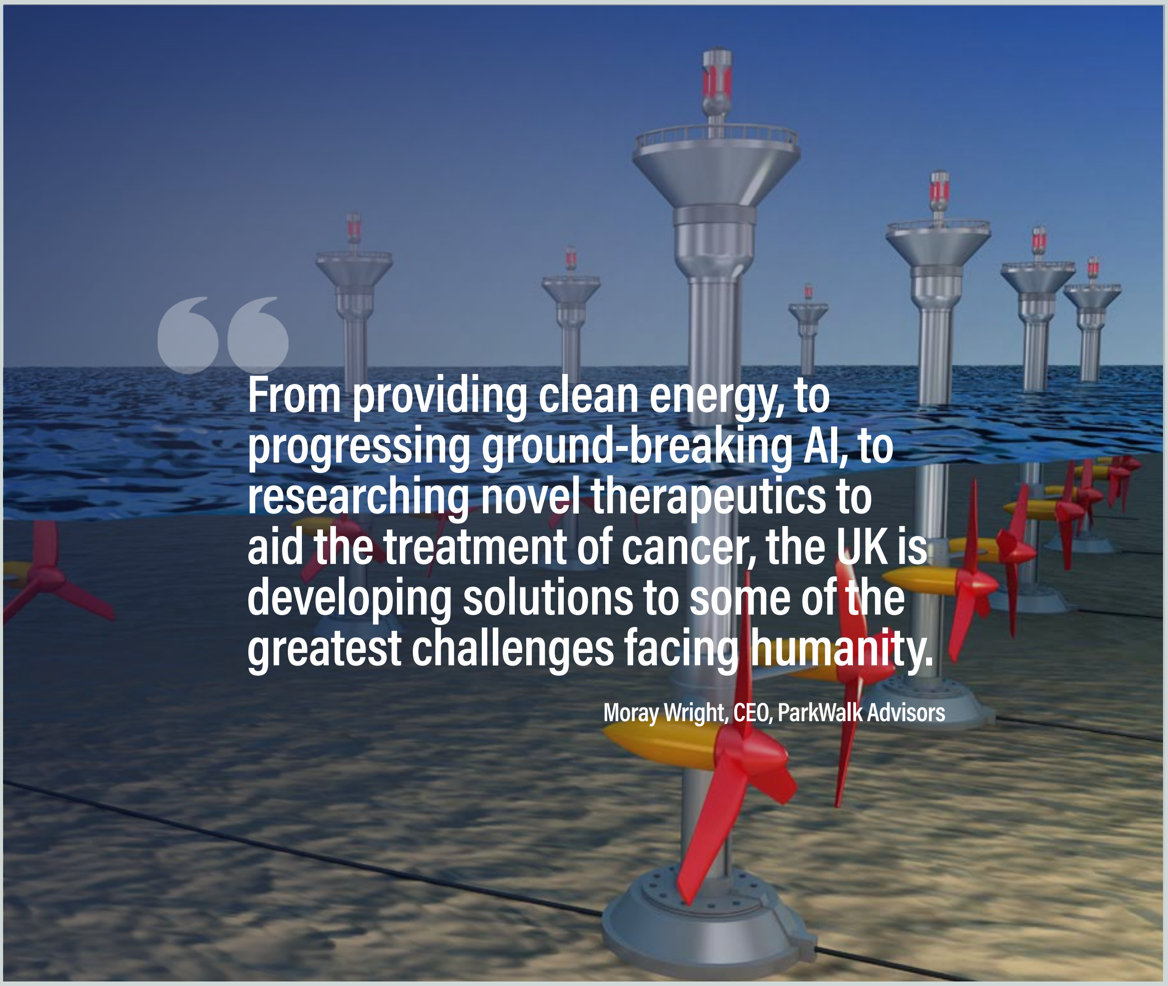
Indeed, UK spinouts secured £2.5bn in equity investment in 2021 - an almost 70% rise from the previous year, and a five-fold increase on investment in 2012. If we can capitalise on this momentum, UK spinouts could be the engine for growth this country needs.

But the conversations with founders I have had recently reveal a common problem. How to secure the long-term investment needed to grow and prosper in the UK?

The recent announcement of an independent review of university spinouts, led by Professor Irene Tracy and Dr Andrew Williamson, could not come at a better moment. The review must look at the kind of investment that early-stage companies need, the potential impact of sector-specific initiatives, the question of retained equity and the importance of having a clear roadmap for investors. The Edinburgh Reforms, and the changes to Solvency II, will help to provide this, but this kind of certainty is vital to encourage investment.

Above all else though, it's vital the Review team and Government create forums for collaboration with the investment industry. Only by working

GUEST ARTICLES (cont.)



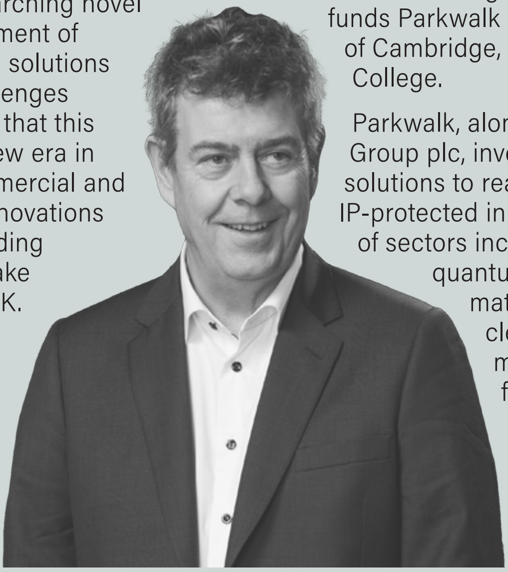
together can we foster an ecosystem which allows new ideas to become new industries – right here in the UK.

From providing clean energy, to progressing ground-breaking AI, to researching novel therapeutics to aid the treatment of cancer, the UK is developing solutions to some of the greatest challenges facing humanity. My hope is that this review signals the start of new era in which we embrace the commercial and economic potential of the innovations coming out of our world-leading academic institutions, and take action to keep them in the UK.

About Parkwalk

Parkwalk is the largest growth EIS fund manager, backing world-changing technologies emerging from the UK's leading universities and research institutions. With £500m of assets under management, it has invested in over 160 companies across its Parkwalk Opportunities and Knowledge Intensive EIS Funds, as well as the award-winning enterprise and innovation funds Parkwalk manages for the Universities of Cambridge, Oxford, Bristol and Imperial College.

Parkwalk, alongside its parent company IP Group plc, invests in businesses creating solutions to real-world challenges, with IP-protected innovations, across a range of sectors including life sciences, AI, quantum computing, advanced materials, genomics, cleantech, future of mobility, medtech and big data. For further information see parkwalkadvisors.com.



Moray Wright, CEO, ParkWalk Advisors

GUEST ARTICLES (cont.)

WHERE VENTURE CAPITAL FIRMS ARE DEVELOPING THEIR TEAMS

HUGH BARRAN, VENTURE CAPITAL, ARMSTRONG INTERNATIONAL

This year has so far been somewhat surprising on the VC hiring front, with many funds still looking to add investors to their team. The background of these funds are robust platforms, pre-seed to seed as their primary investment strategy with a good history of exits. Growth funds have been much quieter but the nature of seed investing is to our minds "market neutral". If only 19% of companies get to Series A in Europe as the statistics suggest, then the low probability of a seed-stage company becoming successful means that regardless of what is happening in the public markets, VCs must continue to invest.

The tougher environment will ensure that only the truly phenomenal founders survive. We should expect to see some of the most exciting companies for the next decade and beyond being created during this time.

After speaking to one Head of Talent at a top-tier multi-billion dollar VC a couple of weeks back, she mentioned that in her four years with the firm they have never stopped hiring associates. Associate hiring will never slow down, for the good ones are too hard to come by. When they do get hired by top-tier funds, they then raise the bar for the next batch to come on board. What we are seeing now is more of a focus at the associate level on the need for a computer science or technology-focused background. Being a superstar consultant or investment banker will hold you in great stead but if you can marry an

GUEST ARTICLES (cont.)

authentic curiosity for technology trends with a passion for business models, there should not be a short supply of funds looking to hire you.

European VCs are continuing to build on the platform side too. LocalGlobe recently hired a Head of Talent from Meta, who also completed stints at Gousto and Neuralink on the West Coast. Atomico has hired a Go-To-Market operating partner in the form of Thibaut Ceyrolle, who was Snowflake's first employee in Europe. It is an interesting time for the industry where funds such as Hoxton, 83North, Point Nine stick to a lean structure, predominantly Partner only, and firms such as Atomico, EQT Ventures and LocalGlobe build out across their platform and positions that directly support their portfolio. It's not an exact science, it's the Benchmark school of thought vs. Andreesen, both have had phenomenal returns but approach the industry in a different way. We imagine founders will want both types of funds on their cap table. It's more a matter of scale than anything. If we see European institutional LPs allocate more than the sub 1% currently to venture capital over the next 10-15 years, we are sure to see more platform and portfolio value creation hiring across the industry.

Armstrong International

Armstrong International is a financial services focused executive search firm. Founded in 1989, the firm built it's reputation hiring for Goldman Sachs and SG Warburg throughout the 90s before broadening into areas such as Hedge Funds, Infrastructure, Real Estate and Private Equity. Hugh leads the VC team focused on hiring investment and platform professionals for VC funds across Europe.

Hugh Barran, Armstrong International

GUEST ARTICLES (cont.)

MULTIPLES: GOING, GOING GONE?

IOTO IOTOV, PARTNER, CAPRICORN CAPITAL PARTNERS

That private market multiples have come off the highs of 2020-2021 is not news. The why, however, is worth exploring. I propose four reasons as to why, with the fifth being higher interest rates, not discussed for fear of stating the obvious.

Mood; greed or fear in public markets: Public markets present a real-time take on pricing sentiment, unlike private markets, which may have gaps of years between price discovery. Using listed Fintech, albeit a sector particularly hard-hit, as a reflection of the public market mood is telling. In Pitchbooks 2023 Fintech & Payments Public Comp Sheet and Valuation Guide, it was shown that multiples have not just cooled off, they have fallen off. The most extreme being for high-growth payment companies, whose EV/NTM revenue multiples careened from c.20x in 2021 to c.5x by Q1 of 2023. The drop off is directionally consistent across other Fintech sub-verticals. This sentiment shift is not lost on private market investors, who question paying comparably elevated multiples for private companies when their typically larger, more mature, and supposedly better managed and stable public comparables are priced lower.

Calculating price; the valuation method employed: Building on the first point but less sentiment and more numerical, the public markets are often seen as an exit route for private market companies investors. Under the Venture Method of pricing a company, the investors work backwards, using a hypothetical IPO price as the exit value. The theoretical IPO price is calculated using the listed comparable multiples. Lower public market multiples will therefore feed back into the pricing of the private market company, leading to a drop in their multiple.

Zeitgeist; the emergence of the bottom line (over the supremacy of the top line): Go back to the heady days of 2020/2021, and few were discussing profitability. Profitability was for boring

GUEST ARTICLES (cont.)

> …these periods of fear, or price rationality (call it what you like), have historically presented excellent buying opportunities, and the vintages have historically proven to be some of the most successful.
>
> Ioto Iotov, Capricorn Capital Partners

people, like accountants (of which I am one) and credit investors. No, what mattered was growth. Growth would solve all! Growth at all costs! This logic was, as would be expected, found to be flawed. Eventually, the company, through a sound business model, needs to generate cash flow from operations (and not just from financing) to sustain itself and pay its investors. Given this new mantra of profitability, or in its absence, the path to it, fewer companies are finding the risk capital that would have previously been available. With investors willingness to pay for growth muted, valuations have similarly retreated.

Closed; back in 18 months: Venture investing activity, both value and volume, has fallen off the peak, albeit from the Everest that was 2021. Dealroom, a data provider, calculates that global VC investment was down 32% in 2022 on 2021. As expected, valuations have fallen as purse strings have tightened. The factors of less money and more sobriety around its deployment have acted like gravity on the prices paid and by extension, the multiples achieved.

The reasons for the decrease in multiples we see in the market are numerous and often intertwined. What is worth noting, however, is that these periods of fear, or price rationality (call it what you like, have historically presented excellent buying opportunities, and the vintages have previously proven to be some of the most successful.

Ioto Iotov, Capricorn Capital Partners

Ioto is a London-based private markets investment professional, who focuses on making investments into leading financial services and enterprise software businesses. Prior to his investing career, he worked at a major international bank, leading financial services firms, as well as at an award-winning fintech. He is a qualified chartered accountant, has an MBA (Columbia Business School, New York), and has earned the CFA and CAIA charter.

GUEST ARTICLES (cont.)

A TALE OF TWO CITIES CREDIT RISK IN PRIVATE MARKETS

NICK SMITH, MANAGING DIRECTOR, ACC, THE PRIVATE CREDIT AFFILIATE OF AIMA

"It was the best of times, it was the worst of times" is the famous opening to Charles Dickens' A Tale of Two Cities. This sentiment comes to mind whenever I'm asked for my views on the private credit market and how current challenges in the economy are shaping the growth of the sector and the opportunities for investors.

Credit risk is paramount for a sector which typically involves holding investments to maturity, and many factors which affect credit risk for investors are now more salient than they have been for some time. Borrowers accustomed to a long period of low interest rates and abundant liquidity now find themselves in a less welcoming environment. Inflationary pressures, supply chain disruptions, reduced customer spending and higher energy costs are all putting pressure on the corporate sector and making it harder for them to be successful enterprises. At the same time, broader challenges in the banking sector mean that many firms, but particularly small and mid-sized businesses, are likely to see their access to credit constrained.

Taken together, these factors add up to a recessionary environment and one in which it will be harder for lenders of all types to price risk and invest prudently. While many of these factors are likely to persist in the medium term, there are still several reasons for optimism about how private credit funds will navigate these headwinds.

The first would be how private credit managers assess and manage their investment opportunities. Our [Financing the Economy] research series has consistently demonstrated that the direct relationships private credit lenders have with their borrowers is a powerful driver of investment discipline and prudent lending. Furthermore, their risk management practices

GUEST ARTICLES (cont.)

mean that stress in their portfolios is likely to be identified and managed more efficiently, improving recoveries.

Secondly, many of the pressures within the credit markets are favourable to private credit firms. With banks and public credit markets either slowing or stalling, borrowers are increasingly turning to private credit solutions. Such borrowers now increasingly include large corporates as well as mid-market businesses, as well as those outside core markets in the US and Europe. In the immediate term, this means that private credit funds continue to see good deal flow while also having more leverage when it comes to loan terms and documentation. Having a bigger footprint outside the traditional mid-market will also provide a long-term boost for the sector's overall development.

Finally, it is important to recall that the asset class is now larger and more diverse than when it first began to find its way into investor portfolios. This means that while there may be challenges within particular lenders or markets, it is now possible for investors to hedge that risk by investing across different managers and strategies.

Dickens also talks about 'the age of wisdom' and 'the age of foolishness' when beginning his story. While there will undoubtedly be examples of both in private credit's future, the attributes of the sector mean that investors have a useful partner to help them navigate the headwinds they face and take advantage of the opportunities that do exist for those ready to capitalise on them.

Nick Smith is the Managing Director, Private Credit for AIMA's private credit affiliate, the Alternative Credit Council (ACC).

REGULATION

Presented by RQC GROUP

FCA BUSINESS PLAN 2023/2024

On 5 April, the FCA published its Business Plan 2023/2024. The Business Plan sets out how the FCA will deliver the second year of its 2022-25 Strategy.

Overall, there are no surprises and the content of the Business Plan builds upon pre-existing regulatory themes and priorities.

The FCA acknowledges current uncertainties in the geopolitical and economic climate:

- Interest rates and inflation;
- Risk of unemployment increasing more than predicted;
- Likely further decrease in household disposable incomes;
- Possible market volatility, resulting from Ukraine war and recent banking crises, notably Silicon Valley Bank UK and Credit Suisse.

It believes that the new Consumer Duty, coming into force on 31 July, will have a key role in protecting customers during the cost-of-living crisis.

The Plan reiterates the Strategy's three main areas of focus, supported by 13 commitments.

1 REDUCING AND PREVENTING SERIOUS HARM

- Dealing with problem firms
- Improving the redress framework
- Reducing harm from firm failure
- Improving oversight of Appointed Representatives (ARs)
- Reducing and preventing financial crime
- Delivering assertive action on market abuse

2 SETTING AND TESTING HIGHER STANDARDS

- Putting consumers' needs first
- Enabling consumers to help themselves
- A strategy for positive change: environmental, social and governance (ESG) priorities
- Minimising the impact of operational disruptions

3 PROMOTING COMPETITION AND POSITIVE CHANGE

- Preparing financial services for the future
- Strengthening the UK's position in global wholesale markets
- Shaping digital markets to achieve good outcomes

The FCA acknowledges that the Business Plan isn't exhaustive. The Regulatory Initiatives Grid, updated twice a year, reveals their planned regulatory programme. Their quarterly Perimeter Report explains the areas they do and don't regulate and addresses issues around the perimeter - identifying certain regulatory gaps, such as "Buy Now Pay Later" schemes, crypto and artificial intelligence. The FCA is also engaged in authorising firms and individuals, supporting consumers and firms, and responding to incidents as they arise.

INNOVATION, AI & THE FUTURE OF FINANCIAL REGULATION

On 17th April, 2023, Jessica Rusu, the FCA's Chief Data, Information and Intelligence Officer, delivered a speech, "Innovation, AI & the future of financial regulation", at the Innovate Finance Global Summit.

Ms Rusu alluded to significant events in the markets: the collapse of FTX, Silicon Valley Bank and Credit Suisse to name but a few; in technology, the release of Chat GPT, the clamp down on TikTok - - then on 29th March, the Department for Science, Innovation & Technology published a new White Paper: A pro-innovation approach to AI regulation.

The use of data and technology continues to transform financial services, and the financial regulator is changing, too. The FCA is seeking to leverage data and innovation to protect consumers, foster growth, and transform their operations.

REGULATION (cont.)

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Questions they were frequently asked:

- How to reduce the burden on firms – making it easier for regulated entities to compete and thrive in the UK market?
- Interoperability – How is the FCA is aligning with other domestic and global regulators?
- Data - How to exploit the mass of data harvested from regulated firms, and from the public domain?

Innovation, artificial intelligence, and digitally enabled regulation, may provide some of the answers.

In the past two years, the team has refreshed its Innovation programme, with more "TechSprints" – events which help develop technology-based ideas, to address specific industry challenges - PolicySprints covering Crypto and Open Finance – and has launched a new Innovation Pathways service. These initiatives draw on collaboration, technical expertise, diverse participants and innovative methods, like synthetic data, to answer complex technical and policy questions.

Last year, they introduced the APP Fraud TechSprint, pioneering the use of synthetic data to detect fraud.

Many new firms have successfully launched with Innovation Pathways, supported by tailored regulatory guidance from the FCA. Firms that pass through graduate onto the FCA's Early and High Growth Oversight function, and many are already delivering positive consumer outcomes.

Other models are tasked with detecting online sludge practices, financial promotion scams, and greenwashing.

Ms Rusu announced the creation of a new Digital Sandbox. This combines a number of features:

- Synthetic transaction and market data, such as that used in the Push Payment Fraud TechSprint;
- Payments & transactions data, investment data, Companies House data, consumer data (and more);
- Crowd-sourcing data, giving access to other FinTech datasets;
- A solutions development, prototyping and test environment;
- Direct access to academics, government bodies, charities and venture capitalists.

It can be used to address complex regulatory challenges like App Fraud, greenwashing and to detect scams.

The team has created a single point of entry through a Digital Front Door, using digital tools and decision trees to triage users to the right Innovation service.

GFIN, the Global Financial Innovation Network, was launched in 2019 by a group of 23 regulators and has since grown to over 80 international organisations. In 2021, it identified three key areas of focus: ESG, Artificial Intelligence, and Crypto.

Scams continue to proliferate, and Innovation has done much to promote its ScamSmart campaign, encouraging consumers to verify a firm or an investment via the Financial Services Register.

In May 2023, Innovation will host a TechSprint focusing on

REGULATION (cont.)

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the FCA Register. They will explore how Register Data can be harnessed by third parties, like comparison websites, for consumers to use before making investment decisions.

While collaborating internationally with other regulators, and supporting firms via TechSprints, Innovation continue to work on Artificial Intelligence, and to understand its regulatory implications, while using AI methods to identify bad actors. The AI White Paper, using a sectoral approach, carries feedback from industry.

Collaborating with the Digital Regulation Co-operation Forum, Innovation are working on an appropriate framework for AI in financial services, considering feedback from the Bank of England's AI Discussion Paper and Machine learning survey, as well as engaging, jointly with the Bank of England, in the AI Public Private Forum.

Opportunities for AI are massive, especially when combined with Quantum computing – but so are the risks, such as Data Bias, Model Risk, with Outcomes-based monitoring implications. Use of synthetic data and Privacy Enhancing Technologies allows for data mining and building of advanced models, while protecting sensitive information. To this end, a Synthetic Data Expert advisory group has been tasked with creating a collaboration framework across industry, regulators, academia and the wider world.

The FCA aims to be a data-led regulator – better exploiting data to detect and prevent harm, and to deliver connected intelligence. Underpinning all this is the FCA's Data strategy. Ms Rusu pointed to a 200% rise in the volume of data processed for investigations, including through encrypted channels like WhatsApp. Enforcement teams sift through millions of legal records; they process regulatory returns for over 53,000 firms each year, with about 600,000 records submitted in 2022; they supplement this with information in the public domain, such as from Companies House, shared by fellow regulators like the Prudential Regulatory Authority or culled from social media; use web scraping techniques to scan c 100,000 websites a day; have data pipelines feeding into the FCA Data Lake to deliver 100,000 record updates each day.

Advances in technology, changes in consumer behaviour, and macro shifts in market stability, all present regulatory challenges. The FCA's Data, Technology and Innovation teams play a vital role in keeping our financial services industry safe, competitive and fit for the future.

REGULATION (cont.) Presented by RQC GROUP

SEC CHARGES NJ-BASED INVESTMENT ADVISER FOR IMPROPER FIXED INCOME SECURITIES TRADING

The SEC charged New Jersey based investment adviser Chatham Asset Management LLC ("Chatham") and its founder with improper trading of fixed income securities. Together with the firm's founder, Chatham agreed to pay over $19.3 million in combined disgorgement, prejudgment interest, and civil penalties.

The SEC's order found that from 2016 through 2018, one Chatham-advised client sold a group of generally illiquid bonds while a different client of the firm purchased the same bonds using various broker-dealers. The trades were executed to address certain portfolio constraints, meet redemption requests and allocate capital inflows. They were executed at prices Chatham and its founder put forward and ultimately resulted in those bonds being priced materially higher than prices of similar securities.

In addition, Chatham priced its portfolio net asset values using pricing data that was based on trading prices of the securities, which inflated the values of the holdings and in turn, resulted in higher fees being charged to the clients.

Without admitting or denying the SEC's findings, Chatham and its founder consented to the SEC's order that they violated Section 206(2) of the Advisers Act, and that they aided and abetted and caused violations of the Investment Company Act of 1944. Chatham and its founder agreed jointly and severally to pay $11 million in disgorgement and approximately $3.4 million in prejudgment interest. They also agreed to pay civil penalties of $4,400,000 and $600,000, respectively.

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