ALTERNATIVES

A transaction banking view

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Deutsche Bank specialises in outsourcing for alternative investment funds, providing fund & loan administration, custody, regulatory reporting and middle-office solutions to private equity, real estate, infrastructure and agricultural fund managers, as well as hedge funds and funds of funds. In this article, Dean Kennedy and Jason Sheller of Deutsche Bank provide a snapshot of observations on current trends in the alternatives market and the ways in which, as an institution, Deutsche Bank has adapted to this evolving market.

Current trends

With lending still below the levels seen for deals completed pre-financial crisis, large sophisticated institutional investors who require long-term capital fund structures and fixed income exposure in their portfolios are now a significant segment, as they weigh up the benefits of pursuing illiquid products for a higher yield.

This trend has meant that "alternative funds" continue to become more institutional, as investors are demanding independent fund administration, increased transparency and overall better and more frequent reporting.

> *"Alternative asset fund managers are now managing approximately US$7.5tn globally, up US$500bn from last year"*
>
> **Preqin**

Investors' desire for alternative investments coupled with the shift towards covenant-lite terms, and dependency on credit rating agencies, have unlocked and boosted the market for alternative debt, particularly in Europe where the concept has gained significant momentum.

> *"European direct lending fundraising surpassed North America for the first time in 2015, up 42 per cent from the previous year and up 400 per cent from 2012."*
> **Preqin**

Positively, as highlighted at the recent Annual Loan Market Association (LMA) conference in London, issuance of private debt is up over 50 per cent year on year. Taking these trends into account, alongside legislative changes in Europe allowing alternative credit funds to invest directly in assets, the seemingly positive outlook establishes direct lending as an asset class in its own right.

Direct lending

Access to and availability of sizeable credit through the conventional routes was waning, stunting the growth of small to medium sized enterprises (SMEs) and stifling the mid-market buyout sector. This market, traditionally dominated by lending institutions, has opened to private equity firms and corporate entities as an alternative source of funding.

In response to this trend, Deutsche Bank has evolved its direct lending services by combining the bank's award-winning private equity fund administration service with its expertise in loan administration into a single solution to simplify operations and deliver flexible reporting to originators, investors and borrowers. The solution allows direct lenders to seamlessly monitor loan performance, rate changes, repayments and fee disbursements directly through a customisable online reporting platform.

> *"Recent analysis and surveys reveal the private debt market will continue to grow, particularly over the next 12 months, with the majority of investors satisfied with performance and expecting to increase their allocations to this space in the coming year"*

Private placements

Given reduced investor appetite for public bonds and bank debt, European mid-market companies have looked to the private placement (PP) market for financing, while investors are turning to private debt structures. Investment in these structures has increased by approximately 78 per cent (source: LMA) year on year, including both large and small revenue companies.

The question is: will we now see a more harmonised PP marketplace in Europe? The UK, German and French PP markets are well established. Given the UK government's progress on abolishing withholding tax, and the access to standardised documentation and other guidance being made available to parties, could we see a true pan-European PP market in the near future?

Deutsche Bank has supported the PP market for many years, particularly US and UK PPs and German Schuldschein. We are now seeing the use of new PP templates created by the LMA in practice, not just for mid-market funding, but also in the infrastructure space.

There has been significant institutional investment in European infrastructure over the last 18 months, with many deals being funded by a single institution or a small club of non-traditional investors. This shows the large amount of capital available to this asset class.

> *"Interestingly, 44 per cent of respondents at this year's LMA conference believe such a market will emerge in two to five years' time."*
>
> *LMA*

Infrastructure

The revival of the European project bond market a few years ago has seen a number of the investment arms of the larger insurance companies, and other asset managers, commit to investing directly in infrastructure across Europe. Some of the deals closed in the past 12 months have been arranged by such managers with no bank involvement in the structuring, arranging and distribution of the debt.

The long dated nature of infrastructure debt clearly supports the requirements of these institutions to match their long-term liabilities. What was a space supported heavily by the monoline insurers pre-crisis, is now seeing various capital markets solutions funding infrastructure and energy projects, without the need for bank funding or insurance wraps.

This trend has led Deutsche Bank to focus on this space and enhance its Corporate Trust product offering in project and infrastructure finance by creating a bespoke Project Agency role. Although the role is new for the project bond space, the service itself has been on offer to borrowers and investors in the loan market for some time. With numerous financial structures and instruments now available, roads, bridges, offshore wind and solar assets are being financed by non-traditional investors. These are complex assets which we would normally expect traditional bank lenders to finance, particularly during the riskier construction phase of Greenfield projects.

Regulation

Alternative funds across the board are experiencing much more regulatory pressure than ever before. The introduction of regulations such as Basel III and Solvency II, both requiring deleveraging of assets, improved capital adequacy and a boost in bank balance sheet, has led to significant changes in how funds need to operate. As reported recently by Deloitte Research, over €300bn of loan portfolio sales have been completed since 2013.

With AIFMD and FATCA, our clients have more compliance requirements than previously, so again the "build or outsource?" decision beckons, and some look to outsource to administrators with specialist dedicated teams and the right technology to help them comply.

Investor requirements

In this changing global environment additional investor requirements and queries seems to be going up at an exponential rate. Funds clients continue to require greater transparency based on their particular needs and situations. As the lending fund space continues to attract a lot of attention, this attention comes with added scrutiny. Third party providers and their experience is the key to being able to deliver what investors need. This includes availability of short term liquidity solutions.

As such, Deutsche Bank has expanded its support to the asset/investment management and debt fund community with a new liquidity solution through a committed repo facility.

Deutsche Bank has developed a one-stop shop service for investors looking to incorporate direct lending into their overall fund strategy. In addition, those funds can outsource their accounting, the management of their capital calls and distribution, cash management, the preparation of financial statements, audit coordination, SPV administration and ultimately reporting to their investors to a third party such as us.

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