March 2024

The Alternative Investor

Performance
News
Trends
Regulatory updates

A look at how ESG is playing out in the Alts space

In this edition, we get brilliant insight on ESG programs and practices of the ten largest private equity firms from **Dhruti Patel, Jelmer Laks and Sabrina Katz** at **Blue Dot Capital**. **Ocorian's Paul Spendiff** writes about the importance of ESG credentials and strategy behind fund managers' investment decisions. **AIMA's Thomas Sharpe** looks at EU ESG developments, with the review of SFDR and ESG Ratings Regulation. **Simmons & Simmons' Lucian Firth** and **Tristram Lawton** follow a similar line, writing about rising UK-US ESG tensions as approaches increasingly diverge. In **Letter from America, Prosek's Mark Kollar** looks at GP stake sales, which are an increasingly popular way of raising capital and broadening fund brands.

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

Equity managers catch the tailwind

The wind was definitely behind equity markets in February, particularly in the US, which had another strong month, as many of the biggest tech stocks reported bumper results (to read more, click here). In this environment, all the main hedge fund strategies, particularly Equities and Macro, had a very good month. By close, the HFRI Fund Weighted Composite Index was up +2.5% and Asset Weighted Composite +1.4%.

At the head was the HFRI Equity Hedge Index, +3.2%, with several exceptional underlying strategy performances and no numbers in the red. The best performing was Technology, +6.0%, followed by Fundamental Growth, +4.5% and Healthcare, +4.0%. The worst performing was Energy/ Basic Materials, which was still up +1.6% for the month.

Event Driven was more nuanced, as it was in January, with the Index up +1.7%. Activists were the standout performers, +4.3%, after a more difficult January, which saw the strategy down -2.2%. The one underlying strategy in the red was Merger Arbitrage, -0.2%.

The Macro Index had a much stronger month than January, up +3.0%. This was led by the Systematic managers, as they caught the macro tailwinds, with the Systematic Diversified Index up +4.8%. Discretionary managers were only marginally in positive territory, +0.1%, while Currency managers were down -2.3%.

Relative Value was up +0.8%, with all underlying strategies in positive territory. The spread was relatively tight, with the best-performing Fixed Income Convertible Arbitrage Index up +1.4 % and the worst, Volatility, up +0.1%.

On a regional level, Asia (excluding Japan) emerged as the front-runner in February, with a strong performance of +3.4 %. Japan was hot on its heels, posting a gain of +3.3%. North America also had a commendable month, up +2.6%, while China kept pace with a solid +2.5%. However, despite a promising start in January, India fell behind in February, down -1.7%.

Upcoming Events

17 March 2024
ESG & Impact Investing Forum

18 March 2024
ALTSLA

18 March 2024
Digital Asset Summit London

19 March 2024
Dallas Family Office & High Net Worth Conference

21 March 2024
Economist: 4th Annual Business Innovation Summit

Click here to see all the listings

$40tn

Global ESG assets by 2030

Source: Bloomberg Intelligence

$22bn

EQT's latest fundraise

Source: EQT

EQT hard closes at €22bn for flagship

The big fund-raise in the past month was EQT hard closing EQT X at €22 billion total commitments. This is the Stockholm firm's largest-ever fund, which is 40% larger than the previous vehicle, EQT IX. The Fund has already made several investments, including Envirotainer, Zeus, Billtrust and Dechra Pharmaceuticals. EQT X follows other EQT mandates with a broad focus on Healthcare, Technology, Tech-enabled Services and IT, in Europe and North America. EQT has also just closed its fund raising for EQT Future fund at €3.3 billion. According to the firm, since being established, the firm has a realised gross multiple on invested capital of 2.7x.

CVC raises $6.8 billion for Asia fund

CVC Capital Partners continues to pull in investors, having attracted $6.8 billion in total commitments for its sixth Asia fund, CVC Capital Partners Asia VI. This figure is more than the $6 billion target, with VI looking for control, co-control and partnership investments in high-quality businesses across core consumer and services sectors in Asia. CVC has been active in Asia since 1999 and, to date, has made more than 80 acquisitions in the region.

General Atlantic cosies up to Partners Capital

Growth equity pioneer General Atlantic is acquiring a minority stake in Partners Capital from external shareholders and various founding partners. These are two giants, with General Atlantic running over $80 billion and around 500 employees, and Partners Capital $50 billion with 350 employees. Once regulators and clients give the green light to the deal, the new relationship will link Partners Capital with General Atlantic's 'extensive global network,' helping to extend Partners' investment capabilities.

Growth of SWF co-invests

Goldman Sachs and Mubadala have agreed to a $1 billion private credit deal for investing in Asia. This is a Bloomberg story that reports the focus will largely be India. Asia is increasingly of interest as an under-invested new frontier for private credit deals, with both the US and Europe seen as saturated. These deals are becoming increasingly commonplace, with Mubadala already investing alongside Ares Management and Blue Owl.

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UPDATES (cont.)

Dell's family office backs 5C

Michael Dell's family office, DFO Management, has become the first external investor to back 5C Investment Partners, the newly launched credit-focused alternative investment firm. According to the Financial Times, DFO is taking a passive stake.

Founded by former Goldman Sachs duo, Tom Connolly and Mike Koester in September last year, who were described by the Financial Times as "heavy-weights," 5C will initially focus on the US and then expand to Europe. Connolly commented that the "long-term outlook for credit-orientated investments is attractive and… now is the ideal entry point."

Carlyle turns to private wealth channels

In line with its peers, Carlyle has launched a European open-ended, semi-liquid private credit fund, Carlyle European Tactical Private Credit Fund (ETAC), for wealthy individuals.

This fund is an entry point for European investors to access Carlyle's credit strategies and follows on from the success of the North American-focused Carlyle Tactical Private Credit Fund. The firm's head of Wealth Strategy, Shane Clifford, commented that this "represents a milestone in Carlyle's drive to provide individuals access to private markets, particularly in Europe."

This move is in line with other private equity firms as they seek to broaden their investor pool, with Preqin writing that a quarter of Blackstone's assets are from this channel.

Blackstone sticks to London

While London may no longer be the financial powerhouse it once was, a feather in its cap was Blackstone's decision to stick to London for its new European headquarters. The building, which this month started construction, sits on the footprint of its previous office space at Lansdowne House.

Emphasising Blackstone's 'green credentials', it is using recycled steel from the original building, ground source heat pumps, solar panels, and will harness renewable energy. Furthermore, the building will be two-thirds larger than the previous office, which will allow the firm to double its London-based headcount to more than 600.

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UPDATES (cont.)

Blackstone restructures GP business

Blackstone is restructuring its GP business, with the loss of its head, Mustafa Siddiqui, who has decided to leave the group. The unit, which takes stakes in other private equity firm, is being folded into the Strategic Partners unit. Clearly, GP stakes and secondaries have synergies, so the move does make sense. Strategic Partners, run by Verdun Perry, has also been on a roll recently, having raised sizeable assets, and today manages around $70 billion in secondaries.

Loeb adds private credit

Dan Loeb's Third Point is branching out beyond its more natural event-driven market as it looks to build a private credit business arm this year. In doing so, Loeb joins multiple other funds across private equity and hedge looking to this space. Heading the business is Christopher Taylor, previously CEO of Madison Capital Funding (now called Apogem Capital). Reuters picked up this story from an investor letter. Loeb is not straying too far from his expertise as he intends to focus on providing "opportunistic credit" to act as a liquidity provider during times of stress.

Eisler's aggressive moves

Eisler has recently announced aggressive expansion plans, with the Financial Times writing that the London-based manager is planning to raise between $1 billion and $1.5 billion and add 25 portfolio managers. Such a move would take its total managers to around 120 and appears increasingly par for the course in multimanager territory, with Millennium and Citadel likewise aggressively hiring. This development comes shortly after Eisler's announcement that it was opening an office in Dubai and recent hire of Jeff Russel as Head of Discretionary Long-Short Equity from Balyasny Asset Management.

Elliott expands into commodities

Elliott Investment Management is moving into the commodities space, a development that has nothing to do with losing its case against the London Metal Exchange over cancelled nickel trades. The activist manager currently manages an impressive $71 billion and is launching a new business called Hyperion that is looking to invest at least $1 billion in undervalued mining businesses. Hyperion will have a broad mandate to invest across base and precious metals and commodity metals related to the production of electric vehicle production. Heading the new company is Sandeep Biswas, former CEO of Newcrest Mining.

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UPDATES (cont.)

Manning up

After a glowing profile in The Times ('being different is my superpower'), Robyn Grew, Man Group's very impressive new CEO, is not having it all her own way.

In Grew's first full-year results, Man Group reported what the it described as a "solid set of results", yet profits were down 56%.

Assets, however, continued to grow and now stand at $167.5 billion, a big up-tick on last year's $143.3 billion, although a large chunk of this came from the acquisition of Varagon Capital Partners.

The most notable number was the core performance figure, down 77% at $180 million, while management fees rose 4% to $963 million. AHL Diversified and GLG Global Emerging Market Debt were largely responsible for the disappointing performance fees, with the funds down 3.8% and 7.7% for the year.

Tiger finds its mojo

Tiger Global is increasingly getting its mojo back and is preparing to return to front-foot technology investing. This is according to the Financial Times and comes after its well-reported pull-back following poor performance.

Last year was described as a "solid recovery" year, up 29%, as tech investments once more took off, although the firm only took part in 27 deals, writes Crunchbase, totaling less than $2 billion.

The new investments will be in the crossover fund, where the firm said it will "swing hard."

Coffey set to acquire EMSO

We see a various examples of small[ish] hedge funds being acquired by larger players. The latest is Greg Coffey's Kirkoswald potentially buying EMSO Asset Management, the emerging market fixed-income manager.

A combination of Kirkoswald's $8 billion of assets and EMSO's $5 billion creates a new $13 billion player with significant macro and emerging market business. If agreed, Kirkoswald's president, Joe Mauro, will become president of the combined group.

Weiss calls it a day

It is always sad to see long-standing hedge funds close. The latest is Weiss Multi-Strategy Advisers, which is closing its doors after 46 years.

This was not a small fund and had not suffered huge losses, with the New York based fund managing over $3 billion as of the middle of last year and was up 6% for the year, writes Bloomberg.

George Weiss, the fund's founder, wrote to clients and partners saying that he has decided to "conclude the journey" and the "vast majority" of client portfolios have been wound down.

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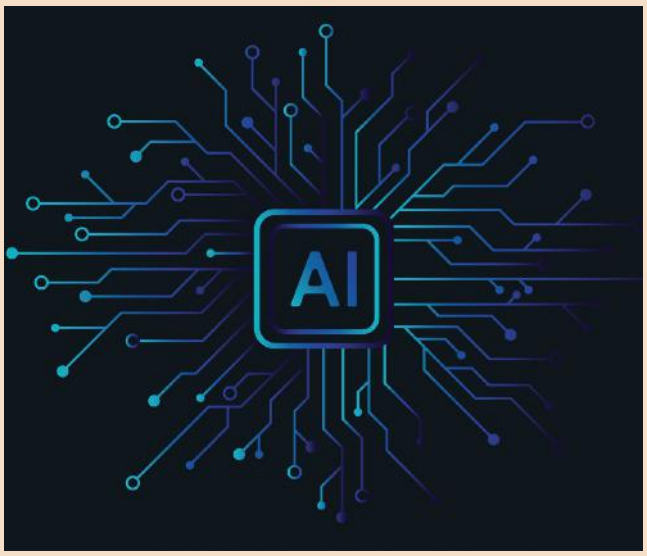
UPDATES (cont.)

AI shines bright in VC

Venture capital fundraising has been a particularly hairy environment over the last year. Figures from Private Equity News show that the total size of deals fell to $243.8 billion in 2023, which is the lowest level since 2017.

There was, though, one shining light, artificial intelligence, which accounted for $50 billion of this investment.

Bain & Company reported a similar picture, with global VC funding down 15% quarter on quarter in the second half of 2023, while the average size of early and late-stage deals fell 9% and 16% over the same period. Bain also saw an upswing in GenAI start-ups that "shows no signs of stopping."



Crypto on a tear

With Bitcoin hitting new highs as it breaks $69,000 (then promptly falling 8%), crypto funds are again making big returns.

According to Bloomberg, the recent market surge saw many managers struggling to keep up, as they traded through the night (remember, these are 24-hour markets).

Interest has also surged in the recently launched bitcoin ETFs, which continue to see new volume records, led by BlackRock's ETF, which now has almost $11 billion in assets (only a few days earlier, this figure stood at $8.5 billion).

Source: Yahoo Finance

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Private equity is lifting the kimono as GP stakes sales gain momentum

Always an industry known for protecting its competitive advantages, a consolidation of sorts is taking place in private markets. In the last quarter of 2023, according to PitchBook, some 27 GP stakes deals took place, either as minority or majority transactions -- in an investment strategy that makes LPs out of GPs and PE peer groups even tighter,

GPs making investments into other PE firms in a strategy referred to as GP stakes is not new, with the first transactions taking place more than two decades ago. But interest has been on the rise especially with middle-market firms , as illustrated by higher deal counts but lower values per deal, across the industry.

> ...a consolidation of sorts is taking place in private markets. In the last quarter of 2023, according to PitchBook, some 27 GP stakes deals took place, either as minority or majority transactions...

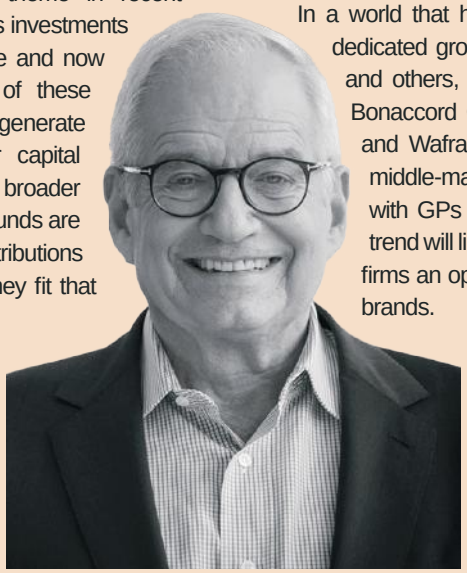
The story got more interesting with the recent announcement that the credit giant and alts manager Blue Owl, based in New York, has launched a joint venture with Lunate, an asset manager with focus on alts out of Abu Dhabi. Together, these two firms will reportedly provide growth capital in leading private middle-market firms that have under $10 billion in assets under management.

The trend underscores an ongoing theme in recent strategies within private markets such as investments in infrastructure, secondaries, insurance and now even wealth management. In most of these cases, investors are looking for ways to generate strong income with the potential for capital appreciation and reduced correlation to broader equity markets. Given most GP stakes funds are perpetual vehicles that make regular distributions mainly derived from managers' FRE, they fit that need very well.

For the GPs themselves, selling a stake provides the necessary liquidity needed in today's environment as firms grow and need to fund higher GP commitments into their own funds, expand into new asset classes and geographies, attract and retain the best talent and facilitate succession, among many other purposes. Additionally, and especially in the growing middle-market GP stakes space, the GP stakes investors can offer the firms the strategic, operational, fundraising and managerial guidance and resources they would not otherwise have access to on their own.

One element of GP stakes transactions that differ from many traditional PE investments is that these sales are minority stakes to perpetual vehicles, where the buyer and seller will ideally be partners for decades to come. Accordingly, GP stakes firms must be especially conscious of their reputation as a reliable, value-added partner to the target, meaning price is not the only factor at play. The more GP stakes firms can emphasize their differentiated ability to collaborate with firms they invest in to grow and improve, the better they will be able to attract top-tier firms. Similarly, GPs looking to sell a stake must not only demonstrate a track record of fundraising and investment success, but also a strong reputation and a strategy to continue building on and accelerating that strong trajectory.

In a world that has been dominated by Dyal, the first dedicated group to pursue the strategy, to Blue Owl and others, we see firms such as AXA IM Prime, Bonaccord Capital Partners, Hunter Point Capital, and Wafra among others making inroads in the middle-market. As LPs become more comfortable with GPs as one of "them" in a transaction, the trend will likely continue to provide high-performing firms an opportunity to raise capital and build their brands.



Mark Kollar
Partner, Prosek Partners

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...pre-Brexit, I think there was a very decent chance for London to become as important to the global financial markets as New York is. Post-Brexit, it's of course quite difficult and people had to move jobs, to Ireland, to the continent, for a variety of regulatory reasons, when for most of my career, London was the perfect place to work. That's a cost. That's a net cost to a country.

Emmanuel Roman, CEO, PIMCO

www.moneymazepodcast.com

GUEST ARTICLES

Snapshot | ESG Programs and Practices of the Ten Largest PE Firms

Dhruti Patel, Director, Jelmer Laks, Director, & Sabrina Katz, Senior Associate, Blue Dot Capital

In September 2023, Blue Dot Capital (Blue Dot) published our inaugural snapshot of the environmental, social, and governance (ESG) programs and practices of the world's ten largest private equity (PE) firms (per Private Equity International's 2023 PEI 300 ranking):

1. Blackstone
2. KKR
3. EQT
4. Thoma Bravo
5. The Carlyle Group
6. TPG
7. Advent International
8. Hg
9. General Atlantic
10. Warburg Pincus

Sabrina Katz, Blue Dot Capital

The combined assets of the ten largest PE firms span nearly all investable geographies and industries, and we believe a snapshot of the ESG practices of these firms is representative of how ESG practices of the broader private markets ecosystem have evolved in recent years and of the areas of focus for the future.

We reviewed publicly available ESG policies, annual ESG and sustainability-aligned reports, and other information (such as firm websites, regulatory filings, press releases, etc.) of the ten PE firms, distilling insights on their ESG policies, processes, and initiatives. All materials referenced are the latest versions available as of June 30, 2023.

Our analysis shows variation in how the ten largest

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GUEST ARTICLES (cont.)

PE firms are structuring, resourcing, integrating, and reporting on ESG across their organizations and investment strategies, echoing the range of approaches in the space. However, a few commonalities did emerge: six firms have disclosed setting emissions reduction targets for at least some funds and/or strategies, seven firms publish Task Force on Climate-related Financial Disclosures (TCFD)-aligned reporting for at least one of their investment vehicles, and all ten firms are signatories of the Principles for Responsible Investment (PRI).

Since the end of Q2 2023:

- Multiple firms have launched or closed landmark climate-focused funds: Blackstone closed what is reportedly the largest ever energy transition credit fund at its hard cap of $7.1 billion. Meanwhile, KKR launched its first global climate fund targeting $7 billion, and Carlyle launched its second renewable energy fund with a $1.6 billion target and $2 billion hard cap.
- Firms have pursued alternative strategies and structures to capitalize on climate-related opportunities: TPG joined BlackRock and Brookfield Asset Management as the inaugural launch partners for ALTÉRRA, a climate finance fund launched by the UAE during COP28. ALTÉRRA committed an aggregate $1.5 billion for the next generation of TPG Rise Climate private equity funds, including the new Global South initiative. General Atlantic announced the acquisition of global sustainable infrastructure investor Actis, citing a global paradigm shift towards sustainability.
- Several firms have released updated ESG reporting, highlighting new portfolio engagement initiatives: Thoma Bravo launched a responsible AI learning cohort in 2023 to help its portfolio companies address this rapidly evolving landscape, provide education, and share best practices. 75% of Thoma Bravo portfolio companies participated in the launch. Warburg Pincus piloted scenario analysis for a subset of its portfolio to evaluate potential exposure and impacts from physical climate risks. Blackstone held the inaugural Blackstone Career Pathways Summit, convening portfolio company leaders, ecosystem partners focused

Dhruti Patel, Blue Dot Capital

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GUEST ARTICLES (cont.)

on workforce development and skill building, as well as other industry leaders and thought partners to share experiences and discuss ways to accelerate their efforts.

As strategic consultants to private markets investors, Blue Dot continues to keep a close eye on how ESG integration and impact investing approaches in private markets are evolving. Materiality, scalability of processes, and operational value creation are recurring themes in our conversations with executive, investment, and ESG teams of private markets firms. We believe that over the next few years, private markets ESG integration will be marked by the need for efficient, streamlined processes and quantifiable value creation and risk management outcomes. Buoyed by technological advancement, policy stimulus, and accelerated learning curves, climate-focused fund formation will continue.

Read our 2023 Snapshot here.

Our 2024 Snapshot of the sustainable investing practices and programs of top global PE firms will be published later this year.

Dhruti Patel, Director, Jelmer Laks, Director, Sabrina Katz, Senior Associate

About Blue Dot Capital

Blue Dot Capital is a sustainable finance consultancy. Blue Dot partners with investment management firms – principally private market firms - on the end-to-end development and execution of ESG and impact investing programs, capabilities, and products.

Since H2 2020, Blue Dot has advised investment management clients with $1.7 trillion in collective AUM.

www.bluedotcapital.co

Jelmer Laks, Blue Dot Capital

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GUEST ARTICLES (cont.)

ESG drives alternative fund managers' investment decisions

Paul Spendiff, Head of Business Development, Funds Services at Ocorian

ESG credentials and strategy are the biggest influencers when it comes to making fund investment decisions, according to research* among alternative fund managers across the UK, US and Europe carried out by Ocorian, specialist provider of alternative fund services and global leader in entity administration, fiduciary and compliance solutions.

It will be harder to launch new funds without a strong ESG focus

Its study found almost all (98%) alternative asset managers agree that it will become harder to launch new funds unless they have a strong ESG focus. Of these, almost two in five (39%) strongly agree with this view.

As well as being central to fund investment decisions, alternative fund managers believe ESG will have the second biggest impact on innovation in the alternative asset management sector.

The biggest impact, they believe, will come from growing pressure from investors for new solutions and advances in technology. Data analytics will have the third biggest impact, the research found.

The study from Ocorian, which manages over 15,000 structures on behalf of 6,000+ clients globally, shows the UK is ranked as the jurisdiction which will most increase in popularity for alternative fund managers targeting European investors over the next 18 months. This is followed by Jersey, Mauritius and Guernsey.

*Ocorian commissioned independent research company PureProfile to interview 100 alternative fund managers across real estate, private debt, private equity and infrastructure, residing across the UK, US, France, Germany, Netherlands, Sweden, Switzerland, Finland and Norway during April 2023.

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GUEST ARTICLES (cont.)

Paul Spendiff, Head of Business Development, Funds Services at Ocorian, said: "Even when faced with tough economic conditions, our research shows that ESG credentials and strategy are now of the utmost importance to alternative fund managers, taking its place alongside more traditional investment decision-making criteria such as the investment manager and capital growth. For an increasing number of fund managers, a strong ESG strategy and credentials ultimately drives strong, long-term performance as well as having a huge impact on innovation in the sector."

ESG considerations continue to become ever more embedded in all aspects of private markets, with a backdrop of an increasingly complex regulatory landscape, according to commentary from the firm.

The implementation of the EU's sustainable finance disclosure regulation (SFDR) is a transformative and permanent game changer for investors designed to facilitate the contribution of private capital towards funding an EU wide transition to a net zero economy.

Industry players such as Ocorian are realising partnerships to respond to growing demand for ESG reporting as a result – such as the one the firm recently announced with Treety, a leading ESG SaaS solution.

Paul Spendiff, Head of Business Development, Funds Services at Ocorian

How Ocorian Fund Services can help with your fund administration

Ocorian's fund services team delivers operational excellence across fund administration, AIFM, depositary and accounting services to the world's largest financial institutions along with dynamic start-up fund managers and boutique houses. Its team of over 300 funds specialists work across all major asset classes of alternative investment funds such as private equity, real estate, infrastructure, debt and venture capital, whilst its specialist Islamic Finance team is a leading provider of Sharia-compliant investment structures.

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GUEST ARTICLES (cont.)

Navigating the new terrain of EU ESG standards

Thomas Sharpe, Associate Director, Markets, Governance and Innovation, AIMA

Developments in sustainable finance regulation have come thick and fast under the current European Commission – the most seminal of which has been the introduction of the Sustainable Finance Disclosure Regulation (SFDR) in 2021. The SFDR requires asset managers to disclose the sustainability of their financial products in one of three main categories: Article 6 for funds which have no sustainable objectives; Article 8 for funds which promote environmental or social characteristics; and Article 9 for funds which have sustainability objectives.

Although the EU achieved a world first in requiring sustainability disclosures, AIMA members have borne the brunt of new regulatory and administrative burdens. Compliance with the regime has required a significant investment of time and financial resources. When news came in September 2023 that the European Commission was reviewing SFDR and considering a rewrite of the rules, AIMA members were understandably frustrated. The regime had only been in operation for two and a half years.

The European Commission's review of SFDR is based on the premise that the current regime is not operating as intended. In a public consultation on the issue, the Commission stated that managers were using sustainability disclosures as de facto product labels – effectively a marketing tool to promote funds' ESG credentials. This was never the EU's intention and the Commission is concerned that continuing with such an approach could lead to greenwashing risks.

The European Commission's public consultation – the first step in the review of SFDR – proposes two possible changes to the current SFDR regime: the first is to introduce minimum standards to disclosures as a means of strengthening the regulation. The second is to supplement disclosures with a new set of product labels, to reassert the boundary between disclosures and labels.

To inform our response to the consultation, we listened to the views of AIMA members who argued a review should create a simpler regime and ease the regulatory burden on managers.

For this reason, we want to see SFDR continue as a principally disclosure-based regime and we do not agree with minimum standards in disclosures. Minimum standards would increase complexity and make SFDR more rigid. Alternative investment managers pursue a variety of investment strategies and the introduction of

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GUEST ARTICLES (cont.)

minimum standards could limit investment in sustainable funds, particularly those with transition assets.

At the same time, AIMA supports the creation of product labels as a separate regime aimed principally at retail investors. We also recommended that entity-level and website disclosure be removed from the SFDR regime entirely, given that the reporting costs they impose on managers relative to the information they provide to investors is disproportionate.

The SFDR consultation closed in December and we now wait for the European Commission to determine next steps.

Of more immediate effect, is the ESG Ratings Regulation. This is likely to be finalised at EU-level in the coming months and take effect in late 2025 or early 2026. The ESG Ratings Regulation imposes new governance and transparency requirements on ESG rating providers and seeks to avoid conflicts of interest in the services that providers offer to clients. This will be of benefit to alternative managers, with greater transparency over the methodologies used by ESG ratings providers and the costs involved.

The regulation also captures ratings produced 'in-house' by asset managers and disclosed to third parties in marketing material. Managers affected will be required to publicly disclose a range of information on the methodology used to produce their ratings. This includes information on whether the methodologies used are forward or backward looking, information on ratings' objectives and whether the rating is expressed in relative or absolute terms among a long list of other disclosures. The regulation does not apply to private ESG ratings which are not made public or used exclusively for internal purposes.

While we do not anticipate new regulation to come as thick and fast at EU level in 2024, AIMA will continue to monitor developments and always advocate for new sustainability regulations that take into account the sophisticated investment strategies of alternative fund managers.

Thomas Sharpe, Associate Director, Markets, Governance and Innovation, AIMA

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GUEST ARTICLES (cont.)

UK ESG regulation steps up as UK-US ESG tensions rise

Tristram Lawton and Lucian Firth, Simmons & Simmons

Fund managers are continuing to see divergence of approach to ESG on each side of the Atlantic putting strain on their ability to satisfy their international clientbase.

In the US, Republican states have openly challenged managers over the integration of ESG into investment decisions and voting at corporate AGMs, leading many to downplay their consideration of such factors or at least exercise extreme caution as to how they talk about it.

Meanwhile many UK-based managers will be preparing to produce mandatory climate-related financial reports by 30 June, where they will disclose their approach to climate-related risks and opportunities in line with the Taskforce on Climate-related Financial Disclosures ("TCFD") recommended disclosures. New FCA rules require TCFD disclosures for any firm with AUM of at least GBP 5 billion so will capture a sizeable portion of the UK hedge fund market. Importantly, these rules apply regardless of the manager's stance on ESG and regardless of whether it has any ESG oriented funds. These reports need to be published on the manager's website – and for many it will be the first time they have publicly disclosed in relation to ESG issues. Firms will be looking to tread carefully – noting that they have a wide audience with potentially diverse views on climate-related financial risks.

Tristram Lawton, Simmons & Simmons

In more recent UK ESG developments, the FCA's new Sustainability Disclosure Requirements and investment labels rules were published in November 2023 and will come into force over the next 3 years. Currently these predominantly apply to UK fund managers of UK funds, and so will have little or no impact on the traditional hedge fund manager. However, one element that will impact all UK managers (regardless of the domicile of their funds) is the anti-greenwashing rule which comes into force 31 May 2024. This new rule (which builds on the existing "fair,

> ... the [FCA's] anti-greenwashing rule which comes into force 31 May 2024... requires all sustainability-related claims relating to a product or service in client communications and financial promotions to be consistent with the sustainability characteristics of the relevant product/service...
>
> Tristram Lawton & Lucian Firth, Simmons & Simmons

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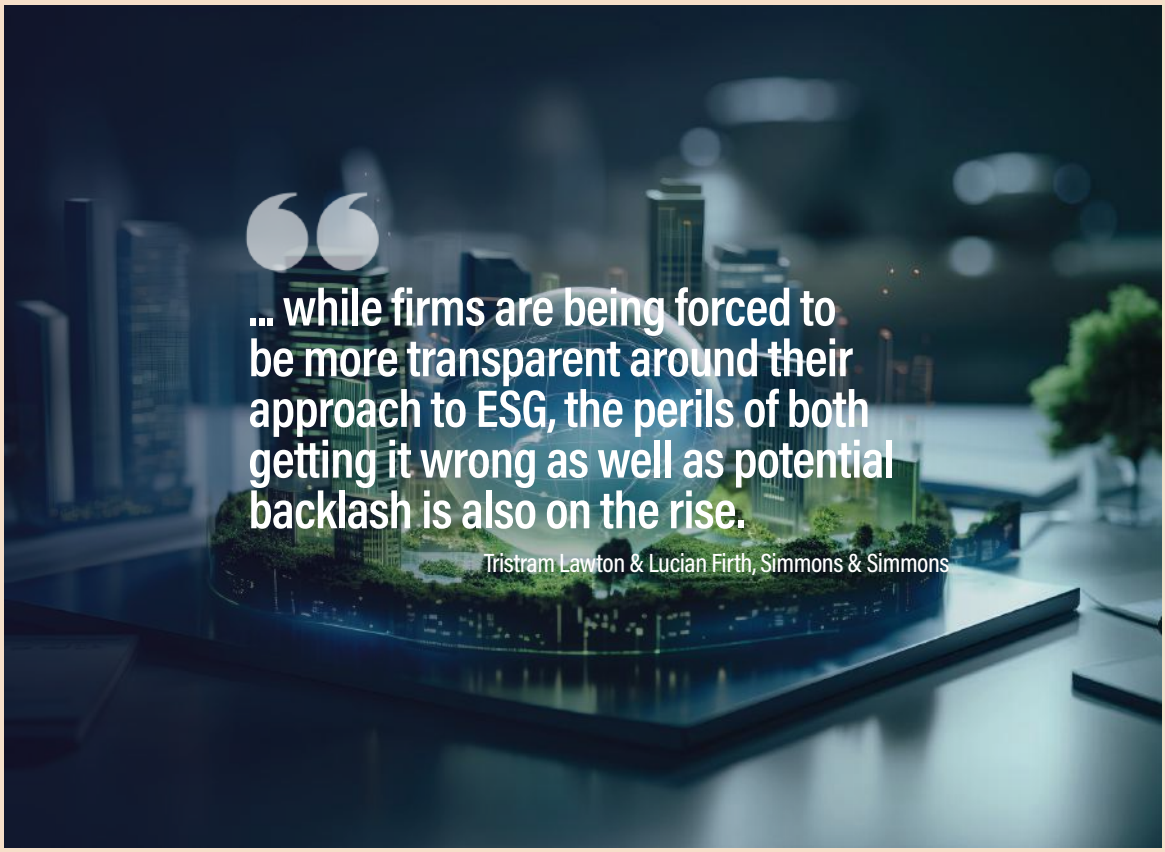
GUEST ARTICLES (cont.)



clear and not misleading") requires all sustainability-related claims relating to a product or service in client communications and financial promotions to be consistent with the sustainability characteristics of the relevant product/service, as well as being fair, clear and not misleading.

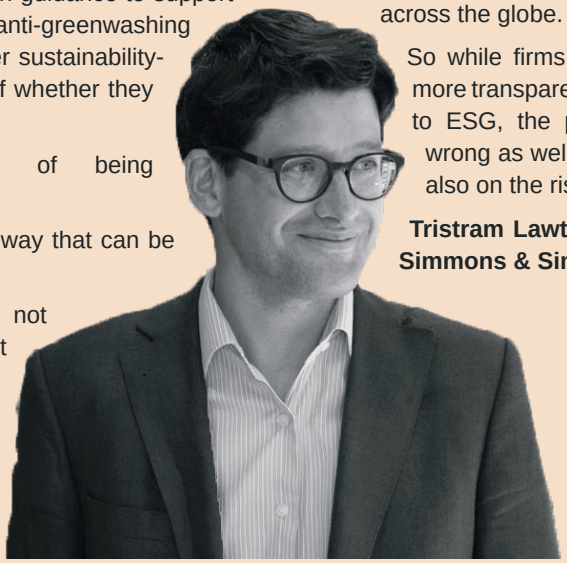
The FCA has also consulted on guidance to support firms in applying the new anti-greenwashing rule, requiring firms to consider sustainability-related claims in the context of whether they are:

- Correct and capable of being substantiated
- Clear and presented in a way that can be understood
- Complete – they should not omit or hide important information and should consider the full lifecycle of the product or service
- Fair and meaningful in relation to any comparisons to other products or services.

While the rule only applies to UK firms communicating with UK clients and prospects, the EU's approach to greenwashing will soon be supplemented by the European Supervisory Authorities' final reports on greenwashing in May 2024 and various global enforcement cases have highlighted the risks of greenwashing in the financial services industry across the globe.

So while firms are being forced to be more transparent around their approach to ESG, the perils of both getting it wrong as well as potential backlash is also on the rise.

Tristram Lawton and Lucian Firth of Simmons & Simmons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REGULATION

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FinCEN's new rule on Beneficial Ownership Information reporting

January 1, 2024 was the effective date of a new rule issued under the Corporate Transparency Act which requires domestic and foreign corporations, limited liability companies and other similar entities (each a "Reporting Company") registered to do business in the United States to report beneficial ownership information ("BOI") to the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN").

The BOI report includes certain information about a Reporting Company's beneficial owners. A "beneficial owner" is any natural person who directly or indirectly:

- Exercises substantial control over a Reporting Company; or
- Owns or controls 25% or more of the ownership interests of a Reporting Company.

Entities formed on or after January 1, 2024 are also required to include information about "company applicants", defined as any individual who is primarily responsible for the filing of the document that creates or registers the entity.

Exemptions

The Corporate Transparency Act includes 23 exemptions to the definition of Reporting Company that exclude a substantial number of entities from the definition and therefore reporting requirements of the Act. Each exemption has specific requirements that an entity must satisfy to qualify for the exemption.

Certain of the available 23 exemptions apply specifically to asset managers, e.g. SEC registered investment advisers and commodity pool operators and commodity trading advisors registered with the CFTC.

While these entities are expressly exempt from the definition of a Reporting Company, other asset managers, including exempt reporting advisers ("ERAs"), are not and may be in scope unless one or more of the other exemptions apply. Similarly, the general partner or managing member of a private fund advised by a registered investment adviser may be considered a Reporting Company. This will require evaluation on a case-by-case basis.

In determining whether exemptions apply, investment advisers should consider all specific facts and circumstances and ownership structures applicable to their own organization.

Effective dates

The date by which BOI reports are required to be filed varies depending on when a Reporting Company is registered:

Date of registration	Initial BOI report deadline
Prior to January 1, 2024	January 1, 2025
On or after January 1, 2024 but before January 1, 2025	Within 90 calendar days after registration has become effective
After January 1, 2025	Within 30 calendar days after registration has become effective

If there is any change to the information included in a BOI report, the Reporting Company must file an updated BOI report no later than 30 calendar days after the date of the change.

Conclusion

The Corporate Transparency Act is complex and open questions relating to its implementation remain. Investment advisers should carefully review their own entity structures versus the requirements of the Act in making a determination of whether a BOI report is required to be filed with FinCEN. We will continue to monitor all additional information and guidance issued by FinCEN as it becomes available.

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REGULATION (cont.) Presented by RQC GROUP

NFA releases regulatory obligations related to common deficiencies for CPO and CTA Members

Demonstrating its commitment to providing its Members with the resources they need to meet their regulatory obligations, the National Futures Association ("NFA") released a list of regulatory obligations that tend to be common deficiencies during the examinations of Commodity Pool Operator ("CPO") and Commodity Trading Advisor ("CTA") Members.

These include:

- Self-Examination Questionnaire
- Digital assets
- Third party service providers
- Cybersecurity
- 4.7 Exemption
- Eligibility for Membership
- Notice Filing Requirements
- Changes in Fiscal Year End
- Changes in Certified Public Accountant ("CPA")
- Extension Requests
- Cessation of Trading
- Calculation of Financial Ratios
- Financial Reporting
- Pool Relationships
- Pool Account Statements.

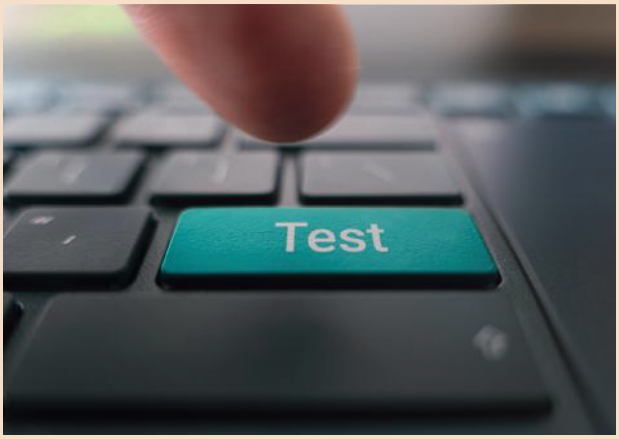
SEC expands the definition of Dealer

The SEC has adopted new rules expanding the definition of "dealer" and "government securities dealer" in the Exchange Act, which will require many unregistered persons to register with the SEC and Financial Industry Regulatory Authority ("FINRA").

In the Exchange Act, "dealer" is defined as "any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise". The Exchange Act later excludes from that definition those persons who, for their own account or in a fiduciary capacity, buy or sell securities but "not as a part of regular business."

The SEC adopted two qualitative tests, each of which would make the participant a "dealer":

- Expressing Trading Interest Test; and
- Primary Revenue Test.



SEC and CFTC adopt amendments to enhance Private Fund reporting

The SEC and Commodity Futures Trading Commission ("CFTC") have combined to adopt amendments to Form PF, the confidential reporting form for certain SEC-registered investment advisers to private funds. At the same time, the two regulators have agreed to a memorandum of understanding related to the sharing of Form PF data.

SEC Chair Gary Gensler noted that "Since Form PF first was adopted, the SEC, CFTC, and Financial Stability Oversight Council have identified gaps in the information we receive from private fund advisers." The adopted amendments serve to provide better insight into the operations and strategies of these private funds and their advisers and improve data quality and comparability.

The amendments will enhance reporting in the following areas:

1. Large hedge fund advisers on qualifying hedge funds
2. Basic information about advisers and the private funds they advise
3. How advisers report complex structures
4. Remove aggregate reporting for large hedge fund advisers.

The amendments will become effective one year after publication in the Federal Register, with the compliance date the same as the effective date.

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FinCEN proposes rule to require Investment Advisers to comply with AML and CFT standards

The Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Treasury, proposed a rule that would broaden the definition of "financial institution" under the Bank Secrecy Act ("BSA") to include certain investment advisers. The rule would require those advisers to establish Anti-Money Laundering ("AML") and Countering the Financing of Terrorism ("CFT") programs, report suspicious activities, and other related changes. FinCEN's proposed rule aims to address gaps in the current regulatory framework to combat the misuse of money and financing of terrorists or other actors with illicit aims.

Currently, no Federal or State regulations require investment advisers to maintain AML/CFT programs. FinCEN argues that tens of trillions of dollars are invested in the U.S. economy without the appropriate oversight to combat nefarious use. The proposed rule would extend the applicability of the BSA to SEC-Registered Investment Advisers ("RIAs") and Exempt Reporting Advisers ("ERAs").

U.S. Enforcement Round-up

SEC fines 16 firms, totalling over $81 million, for failing to maintain and preserve electronic communications

The SEC announced settled charges against 16 financial firms, including broker-dealers and investment advisers, for failing to maintain and preserve electronic communications over an extended period. The SEC's actions highlight ongoing efforts to enforce recordkeeping requirements crucial for monitoring compliance with federal securities laws.

The investigation found widespread use of unapproved off-channel communications, including personal text messages, affecting record preservation and potentially hindering SEC investigations. The recordkeeping failures involved employees at all levels of authority, including supervisors and senior managers. The firms were charged with violating recordkeeping provisions and failing to supervise to prevent such violations.

SEC charges husband of energy company manager with insider trading

The SEC charged a Houston man with insider trading for using material nonpublic information gained from eavesdropping on his wife, a mergers and acquisitions manager.

The SEC alleges that the defendant listened in on his wife's work calls and gleaned information that oil and gas company BP plc had agreed to purchase TravelCenters of America ("TA"), a publicly traded truck stop and travel center company. In December 2022, the defendant began accumulating shares in TA, selling existing positions he held in individual brokerage accounts and a ROTH IRA account. By February 2023 the defendant had purchased 46,450 shares of TA's stock, which he sold immediately after the merger was announced (with TA's stock price up over 70%) for a profit of more than $1.76 million.

NFA permanently bars Florida-based commodity pool operator from membership

The National Futures Association ("NFA") has permanently barred an NFA Member and commodity pool operator ("CPO") located in Doral, Florida, from NFA membership and from acting or being listed as a principal of an NFA Member.

The default decision came after Bit5ive Mining Fund Advisor, LLC ("Bit5ive"):

- Submitted materially false or misleading information to the NFA about the operations of the firm and its commodity pool;
- Failed to comply with CPO reporting requirements; and
- Failed to cooperate promptly with the NFA during an examination.

Previously, in September 2023, the NFA had issued an emergency enforcement action against Bit5ive, which suspended the firm from NFA membership and imposed restrictions on the firm's operations (e.g. prohibited the firm from soliciting or accepting any funds). This action was initially taken "to protect customers, the derivatives industry and other NFA Members" after Bit5ive's failure to cooperate with the NFA during an examination.

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FCA's new approach to enforcement

The FCA is proposing to change its approach to enforcement by announcing enforcement action at an earlier stage of proceedings.

The regulator recognises the importance of deterrence, and of educating market participants on regulatory expectations, and where others have fallen short.

However, the deterrent effect of enforcement action is greater the closer it is to misconduct occurring. Due to the time taken to conclude enforcement action, there is often a significant gap between the incident and the public announcement.

The FCA aspires to speed up investigations, including – where appropriate – informing the public about an enforcement action prior to the conclusion (or near conclusion) of the action.

The regulator intends to start publishing earlier information about the enforcement investigations it has opened, using a flexible public interest framework.

Where appropriate, the FCA will publish the identity of the subject of the investigation, if it assesses that this is in the public interest and there are no compelling legal or other reasons not to.

This is more likely to be the case for entities as opposed to individuals, mainly for data protection reasons.

Market Abuse: Market Watch 77
Trading by organised crime groups; criminal enforcement activity

The FCA's Market Watch 77 publication addresses trading by organised crime group ("OCGs"), and how firms can mitigate the risks.

Such groups, apparently, account for a substantial component of the overall suspicious trading to be found in UK and internationally listed equities.

The FCA considers the following to be characteristic of OCG activity in equity spread bets and contracts for difference ("CFDs"):

- A pattern of trading before M&A announcements, even before press speculation;
- Pro-active recruitment of inside information sources;
- Use of umbrella accounts at overseas brokers, who lack UK equivalent safeguards, to mask account holders' identities;
- Using facilitators, including authorised firm employees, to open accounts at such overseas firms;
- Feeding stories about M&A, both true and false, to financial media outlets, to benefit from price movements; and
- Links with other types of serious crime.

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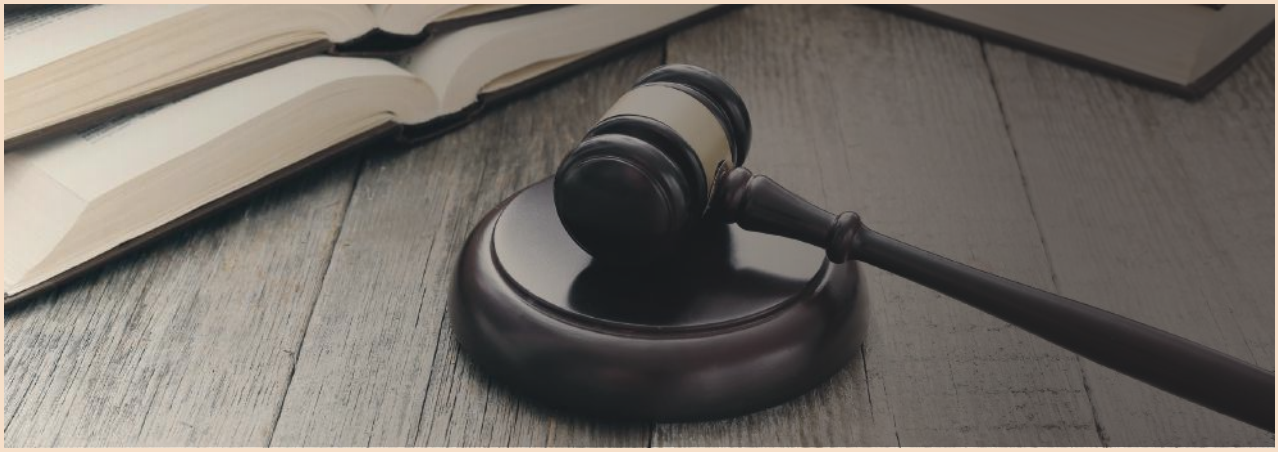
Executing firms should be alert to the risk of OCGs using them to facilitate insider dealing.

Some causes for suspicion – Clients who are:

- Regularly producing Suspicious Transaction and Order Reports ("STORs");
- Often trading before M&A activity is announced;
- Opening positions shortly before, and closing after, media speculation about M&A, without waiting for issuer comment;
- Several clients trading in the same security for the first time; and
- In connection with other clients about whom the firm has concerns, or whose trade has generated STORs, or trading in similar ways.

Advisory firms should be aware that staff members with access to insider information may be approached by members of OCGs to disclose it.



FCA Authorisations operating service metrics 2023/24 Q3

On 13 February, the FCA reported its quarterly authorisations metrics for the period October to December 2023, noting that 9 metrics are green, 6 are amber and - (improving on the previous 4 quarters) - none are red.

These metrics are for solo-regulated firms only; those for dual-regulated firms appear on the Prudential Regulation Authority's website.

The FCA publishes the lower quartile, median and upper quartile of the range of calendar days taken for each category of application. It maintains that 97.8% of applications across all metric areas were determined within the statutory deadline, and many, especially complete and comprehensive applications, significantly in advance of it.

EU

European Parliament approves final "AIFMD II" text

On 7 February 2024, the European Parliament approved the text of "AIFMD II" which revises certain parts of the original Alternative Investment Funds Managers Directive ("AIFMD").

AIFMD II will enter into force 20 days following its publication in the Official Journal of the EU, which is expected March or April 2024.

Member States will then have 24 months to transpose the requirements to national rules; implementation is therefore expected in March or April 2026.

AIFMD II is not a substantive overhaul of the regime, but it does update certain elements and introduces some new concepts. Among other things, AIFMD II tackles the following:

- Delegation (among other things, EU AIFMs will continue to benefit from the ability to delegate portfolio management or risk management to third parties outside of the EEA. However, such EU AIFMs will be subject to enhanced regulatory reporting requirements);
- Conflicts of interest;
- Liquidity risk management;

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REGULATION (cont.)

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- New rules for Loan Origination Funds;
- Costs and charges, and
- Senior management.

By way of next steps, the 'devil of the detail' will be fleshed out, for example, 'Level 2' measures such as Regulatory Technical Standards published by ESMA, and the transposition of the new rules by each member state.

This does not directly impact the UK's equivalent AIFMD regime, albeit some changes to the UK regime might occur in the coming years as part of the FCA's wider review of the asset management framework. However, some UK firms will be affected by this, for example where they have been delegated portfolio management by an EU AIFM or where they are marketing alternative investment funds into the EU.

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Alastair Crabbe
Director
Brodie Consulting Group
+44 (0) 778 526 8282
acrabbe@brodiecg.com
www.brodiecg.com
www.alternativeinvestorportal.com

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Jonty Campion
Director
Capricorn Fund Managers
+44 (0) 207 958 9127
jcampion@capricornfundmanagers.com
www.capricornfundmanagers.com

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United Kingdom:
+44 (0) 207 958 9127
contact-uk@rqcgroup.com
United States:
+1 (646) 751 8726
contact-us@rqcgroup.com
www.rqcgroup.com

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Editorial Board

Alastair Crabbe
acrabbe@brodiecg.com

Darryl Noik
dnoik@capricornfundmanagers.com

Jonty Campion
jcampion@capricornfundmanagers.com

Lynda Stoelker
lstoelker@capricornfundmanagers.com

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