BAI

diversification matters.

BAI Investor Survey 2020

Spotlight on the Portfolio Allocation of Alternative Investments: Access and Obstacles for Institutional Investors in Germany

December 2020

Frank Dornseifer
BAI Managing Director
dornseifer@bvai.de

Philipp Bunnenberg
BAI Consultant
Alternative Markets
bunnenberg@bvai.de

Sven Gralla
BAI Working Student
Alternative Markets
gralla@bvai.de

Explore further BAI publications

Dear Readers, Investors and BAI Members

The Bundesverband Alternative Investments e.V. (BAI), the asset class- and product-spanning representation of interest for Alternative Investments in Germany, presents the 2020 BAI Investor Survey, the 7th and most comprehensive BAI Survey to date. This report highlights the survey results with a hope of gaining a deeper understanding of how institutional investors in Germany invest in alternative assets – not just today, but also in the future.

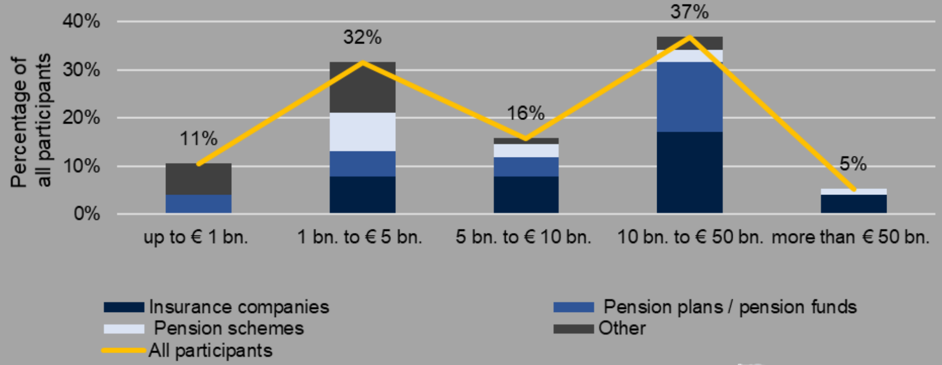
The BAI Investor Survey has been an important component of BAI's research activities since 2013. The range of questions is continuously updated and adjusted to meet the needs of the investors and BAI member companies. The framework for institutional investments in Germany has changed fundamentally since last year, due, inter alia, to the COVID-19 pandemic and continuing low interest rates. The realignment of portfolios from an ESG perspective and changes in regulation have also led to new challenges and opportunities, which have been systematically captured in the survey. The results will hopefully serve as a valuable source of information for you but are also highly relevant to our association work as they give substantial weight to our arguments in exchange with regulators. Therefore we would like to thank you again, dear investors, for your participation in the survey.

The objective of our associations work is to improve the level of public awareness, create internationally competitive and attractive conditions for Alternative Investments, and represent the interests of the industry to politics and regulators. The BAI's annual Investor Survey helps to increase transparency in the Alternative Investments Market. Founded 1997 in Bonn, the BAI association's members are resident in any field of the professional Alternative Investments Business. More than 240 national and international companies are members of the BAI. The members' directory can be found here. To work with BAI on studies and reports, events and webinars or other fields of Alternative Investments, please contact us at info@bvai.de.

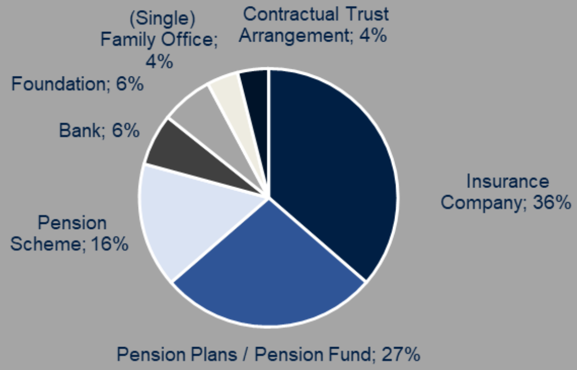
Sincerely, Bundesverband Alternative Investments e.V. (BAI)

Highlights BAI Investor Survey 2020

77 Participants with EUR 1300 bn AuM



Distribution of participants



Alternative Investments

I. Portfolio diversification (96%)
II. Good risk/return ratio (85%)
III. Low interest rate environment (75%)

I. Achieving returns / medium term (57%)
II. Dry powder/ medium term (54%)
III. COVID-19 / short term (52%)

Implications of COVID-19

I. Performance losses (79%)
II. Extension of investment periods due to delayed exits etc. (48%)
III. Evaluation problems (31%)
IV. Delays in mandating new managers (27%)

Key Insights

- 77 institutional investors participated, representing a broad cross-section of investor types and sizes.
- As a group, their combined assets under management are well over 1300 billion Euro.
- Alternative investments are no longer a niche but an established part of the portfolio for most participants.
- By 2025 the portfolio allocation to infrastructure investments (debt & equity) will be almost doubled compared to today.
- Corporate private debt: No other asset class will attract more first-time investors in the up-coming three years.
- But not everything is rosy: 79 % of participants are suffering adverse effects of the corona crisis in the form of performance losses.
- Among all participants a substantial shift out of hedge funds, liquid alternatives and commodities can be observed.

"We expect the average Alternative Investment exposure of German institutional investors to increase from **22% to 26%** over the next 3 to 5 years, corresponding to a CAGR of 3-6% of the Alternative Investment industry."

Asset class specific survey results

	Participations rates	Exit (last 3 years)	Entry (next 3 years)	Estimated portfolio allocation	Estimated expected portfolio allocation (3-5y)	Expected rate of return
Hedge Funds	18%	12%	0%	0.5%	0.5%	5%
Liquid Alternatives	28%	8%	1%	0.8%	0.8%	3%
Corporate Private Equity	76%	0%	7%	3.5%	4.5%	9%
Corporate Private Debt	55%	0%	18%	1.7%	2.7%	6%
Infrastructure Equity	74%	1%	9%	2.7%	4.1%	6%
Infrastructure Debt	43%	3%	16%	1.1%	1.5%	3%
Real Estate Equity	86%	0%	1%	9.2%	9.6%	5%
Real Estate Debt	47%	1%	8%	1.3%	1.4%	3%
Credit Specialties	14%	3%	7%	0.3%	0.4%	4%
Other Real Assets	22%	1%	4%	0.5%	0.5%	5%
Commodities	9%	11%	1%	0.1%	0.1%	4%

Content

Methodology

For this year's survey, last year's questionnaire was significantly modified and extended in terms of portfolio allocation. The definition of asset classes was also adjusted in order to gain a better insight into the differences between equity and debt investments in private markets. In addition, current topics such as co-investments, crypto assets, and COVID-19 were included.

Based on the BAI definition of Alternative Investments, as shown in the BAI Alternative Investments Navigator below, we cluster the alternative asset classes into hedge funds, liquid alternatives (mainly UCITS), private equity (in detail: corporate private equity, infrastructure equity, and real estate equity), private debt (in detail: corporate private debt, infrastructure debt, and real estate debt), credit specialties (such as ILS and trade finance), other real assets (such as aviation, shipping etc.), commodities, and crypto assets. In contrast to previous years, we have used this definition consistently in order to gain more precise insight.[1]

ALTERNATIVE INVESTMENTS NAVIGATOR			DEBT			EQUITY
Strategy: Liquid / Semi-liquid / Illiquid		EXAMPLES	SENIOR	JUNIOR	MEZZANINE	EQUITY
PUBLIC MARKETS {MAINLY LIQUID}	LIQUID ALTERNATIVES (AND OTHER)	- Hedge Fund Strategies within regulated UCITS vehicles - Crypto Assets				
	HEDGE FUNDS	- Equity Strategies - Macro Strategies - Event Driven Strategies				
	COMMODITIES	- Energy - Metals - Agricultural				
PRIVATE MARKETS {MAINLY ILLIQUID}	CORPORATE	- Private Debt incl. Direct Lending - Private Equity - Venture Capital				
	REAL ESTATE	- Residential Real Estate - Commercial Real Estate - Social Real Estate				
	INFRASTRUCTURE	- Transportation - Communication - Energy / Renewables				
	OTHER REAL ASSETS	- Aviation - Shipping - Raw Materials incl.Timber				
	SPECIALTIES	- Insurance Linked Securities - Trade Finance - Regulatory Financing				

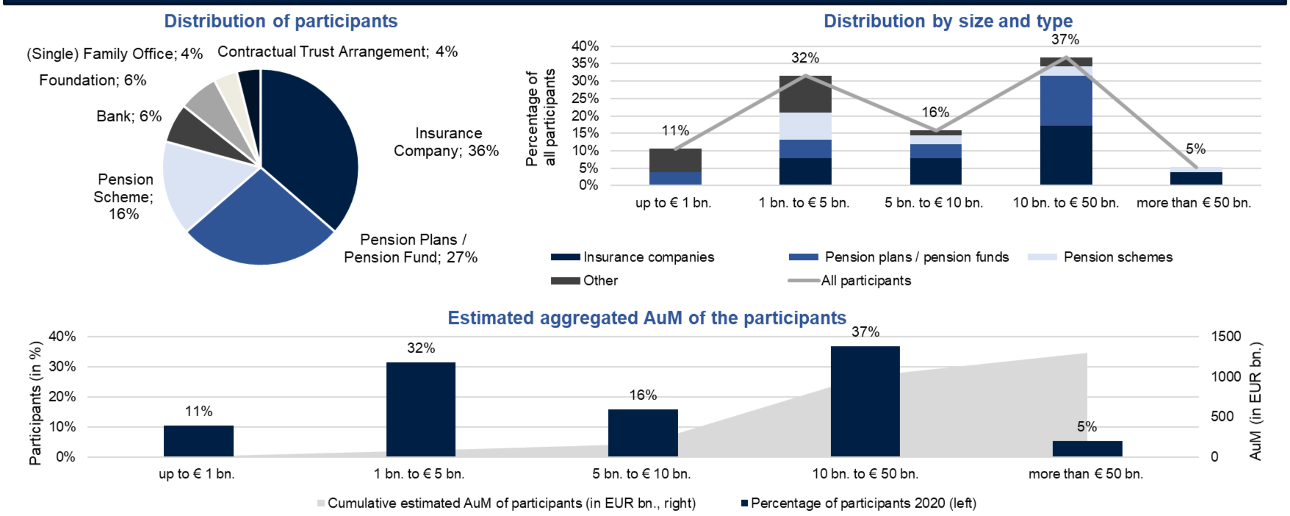
Further existing: Listed Private Equity Funds, Listed Private Debt Funds, Listed Infrastructure Funds, Listed Real Estate Investment Trusts etc.

[1] Note: The results of the BAI Investor Survey might be positively influenced by a self-selection bias, as investors from the BAI network are naturally more committed to alternative investments than the overall population of investors. However, with 77 institutions and more than €1.300 billion assets under management, we cover a substantial and highly representative part of the investor landscape in Germany.

Cross-section of Investors & Assets under Management

77 institutional investors across Germany participated in the survey, including insurance companies, pension funds, pension plans & CTAs, pension schemes, traditional banks, family offices, and foundations. The BAI Investor Survey traditionally focuses on the buy-side, not the sell-side, of asset allocators, which is why asset & fund managers did not participate. To ensure that no investor participates more than once, survey invitations were only sent to one selected contact person from BAI's partners' network. More than three quarters of the respondents represent insurance companies (36 %), pension plans / funds (27 %), and pension schemes (16 %).

Investor types and assets under management of the participants

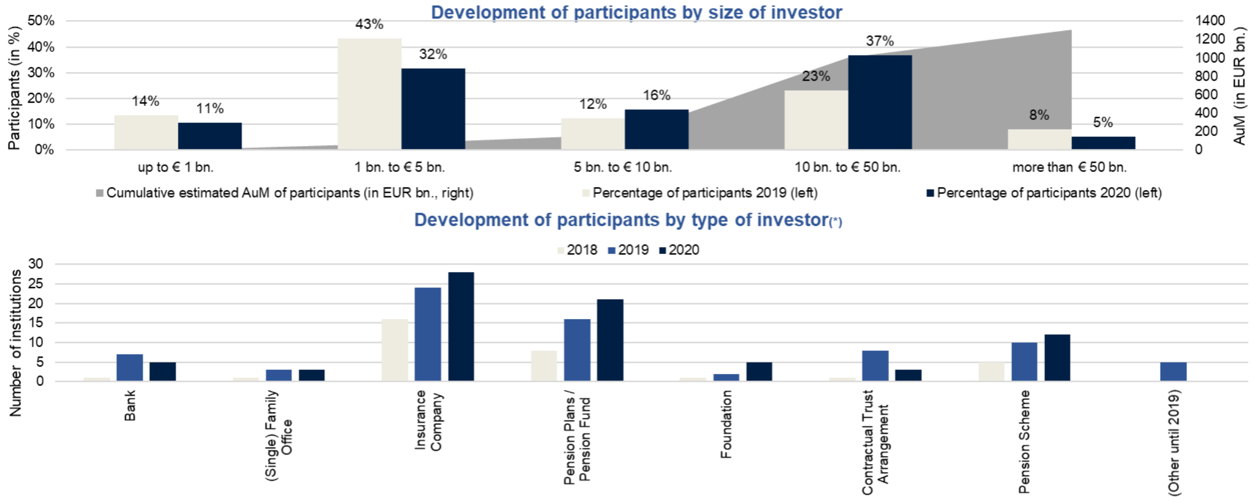


Structure of Participant Investors

The participating investor groups are characterized by their heterogeneity. The amount of assets under management (AuM) therefore varies significantly, from less than €1 billion to well above €50 billion. 37 % of the participants, mainly insurance companies and pension funds, state that they have assets under management between €10 and €50 billion.

The number of participants has increased continuously over the last three years. We estimate the total AuM of the participant investors at more than €1300 billion, which is a significant increase compared to previous years. This is due both to the development of the investor network as well as to an increase in participants with high volumes of assets under management such as insurance companies and pension funds.

Comparison of the number and structure of participants

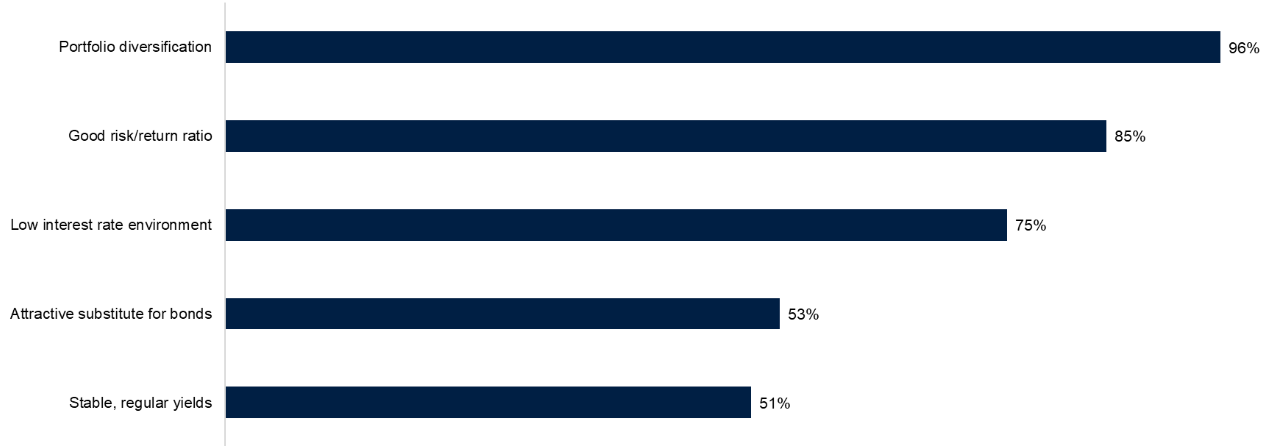


Alternative Investments Portfolio Allocation

The continuing low interest rate environment and the excellent risk-return-ratio of Alternative Investments are the main drivers for the growth of the entire Alternative Investment Industry. Additionally, investors intend to further increase their portfolio diversification with Alternatives.

Investors were asked to name their primary reasons for investments in Alternatives. The replies show that Alternative Investments have not lost any appeal to German investors during the pandemic. The tremor of COVID-19, creating volatility in equity markets and leading to a new wave of monetary easing that has suppressed bond yields, should only further heighten the appeal of assets with secure, stable, and regular long-term income streams such as real assets.

Main reasons for participating in Alternative Investments



In short, the main reasons for considering Alternative Investments as a diversifier have not changed. They act as a hedge against possible inflation and generate consistent cash flows, which is why infrastructure equity and debt gain more and more popularity (as shown later on in this report). The questioned investors gave additional explanations of their motives. Here the reasons mentioned above were confirmed once again, which essentially relate to diversification effects and the returns generated by illiquidity premiums.

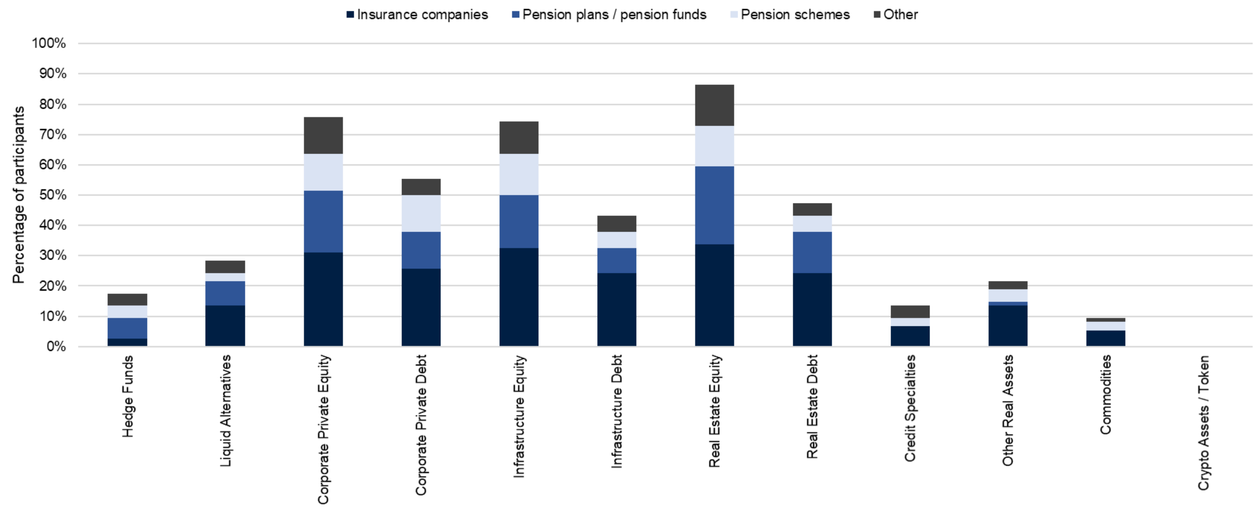
> *“We are specifically focusing on the illiquidity premium of alternatives.”*

> *“Alternatives diversify our equity exposure.”*

Alternative Investments Exposure

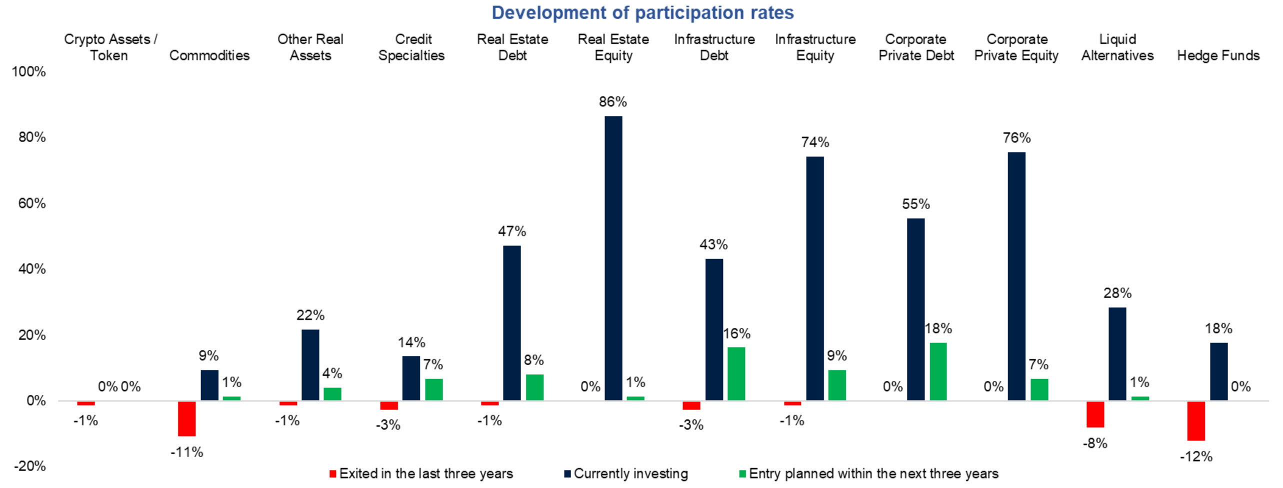
Alternative investments are no longer a niche but an established part of the portfolio for the majority of participants. For more than three-quarters of the surveyed investors, private equity investments in corporates, infrastructure, and real estate are an integral part of their portfolios. About half of the investors diversify their portfolios with corporate private debt, real estate debt, and infrastructure debt investments. Hedge funds and liquid alternatives, on the other hand, can be found in less than a third of participants' portfolios.

Participation rates in the asset classes for investor types(*)



In order to be able to determine general trends for German investors, the participants were first asked about their development of commitment in Alternative Investments. This includes, besides the status quo of their investments, exits in the last three years as well as planned entries in the next three. At first glance, one can see that real estate equity can be found in almost all investors' portfolios nowadays, which is why future first-time investments are limited in size. For infrastructure equity and debt a significant increase in participation is to be expected. More than that, it is striking that, across all asset classes, private market debt investments will continue to catch up to their equity counterparts over the next three years. Compared to last year's survey it becomes even more apparent that investors are increasingly willing to invest in private debt vehicles. The entire range of debt asset classes, corporate private debt, infrastructure debt, real estate debt, but also credit specialities such as ILS, will grow further in the upcoming years.

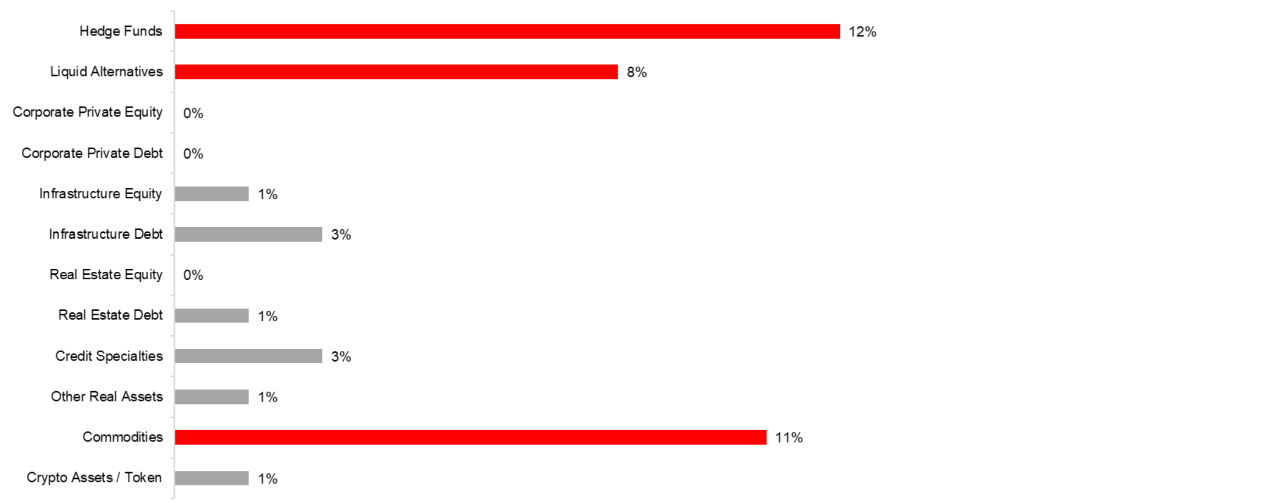
Status quo, exits (last 3 years) and entries (next 3 years)



What's more, it should not be ignored that, without exception, all participants in the BAI Investor Survey stated that they currently are not invested in crypto assets such as Bitcoin and – surprisingly almost unanimously - do not plan to invest in the upcoming years. We will deal with barriers to market entry later on.

In last year's survey, investors in hedge funds saw major problems in public perception as well as performance. The rather negative overall picture on the investor side now appears in a significant exposure withdrawal from hedge fund investments. 12 % of all Investors withdrew completely from Hedge funds (8 % from liquid alternatives) in the last three years. This number is even more significant considering that overall only 18% of participants are still invested in hedge funds (28 % in liquid alternatives).

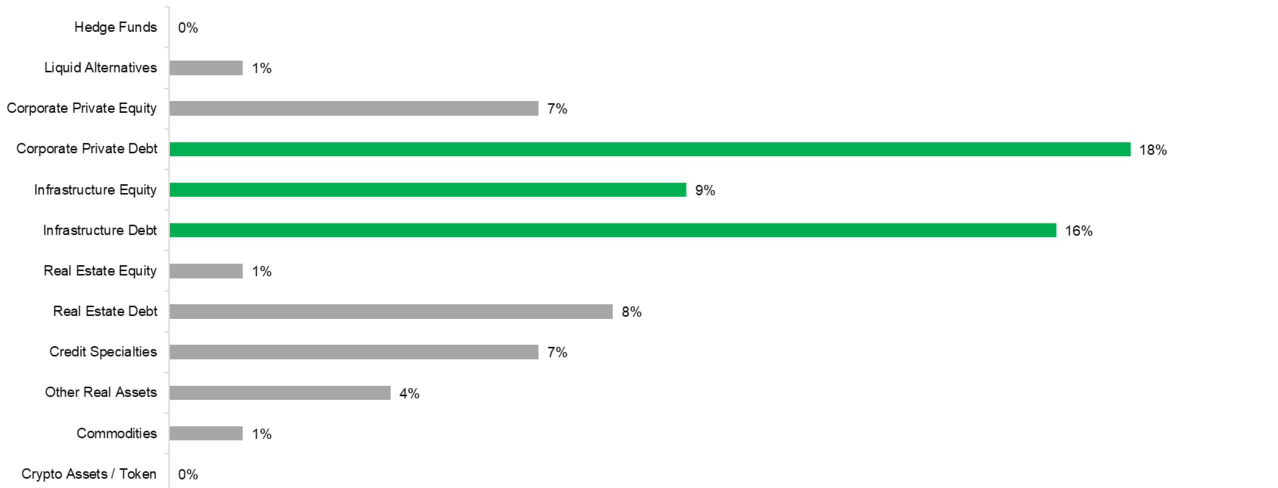
Exits from asset classes in the last three years



Besides the withdrawals from hedge funds, the rather weak performance of many commodity investments also leaves investors disappointed, so that some have completely turned their backs on commodities in recent years.

All in all, there are noticeable signs that investors are shifting from liquid Alternative Investments, such as hedge funds and commodities, to illiquid private market investments.

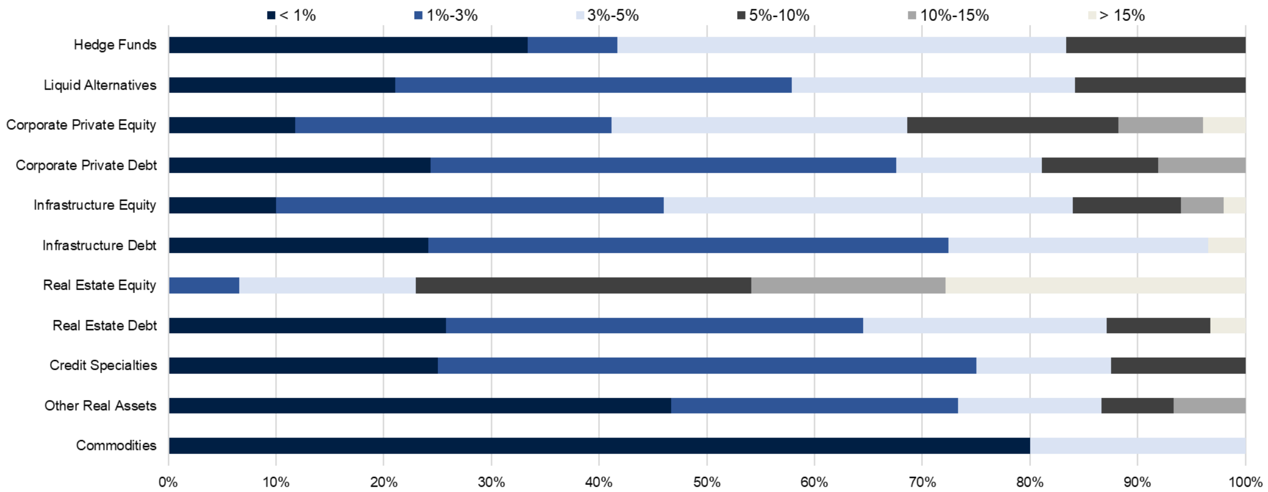
Entry into asset classes over the next three years



Thereby, as mentioned before, debt products in particular will continue to catch up. According to several of the investors in the survey indicating that they are looking for access to corporate private debt, the market for credit funds should maintain growth momentum. In practice, it will be important that possible additional supervisory requirements create a reliable legal framework that will continue to give direct lending funds sufficient scope to provide the financing they need in the market. It is to be hoped that supervisory and tax authorities will remove current hurdles in such a way that access to private debt is not unnecessarily difficult for German institutional investors in particular under the Anlageverordnung (AnlV). What's more, many investors state that they are willing to invest in infrastructure and real estate debt as well as credit specialties such as ILS for the first time in the upcoming years. Thus, infrastructure overall will continue to gain importance in the next few years.

In line with the standardised definition of asset classes, investors were asked about their allocation in Alternative Investments. The technique of questioning has been optimised so that only the investors who are currently invested could provide information on the allocation.[2]

Distribution of the current portfolio allocation within the asset classes for those who invest



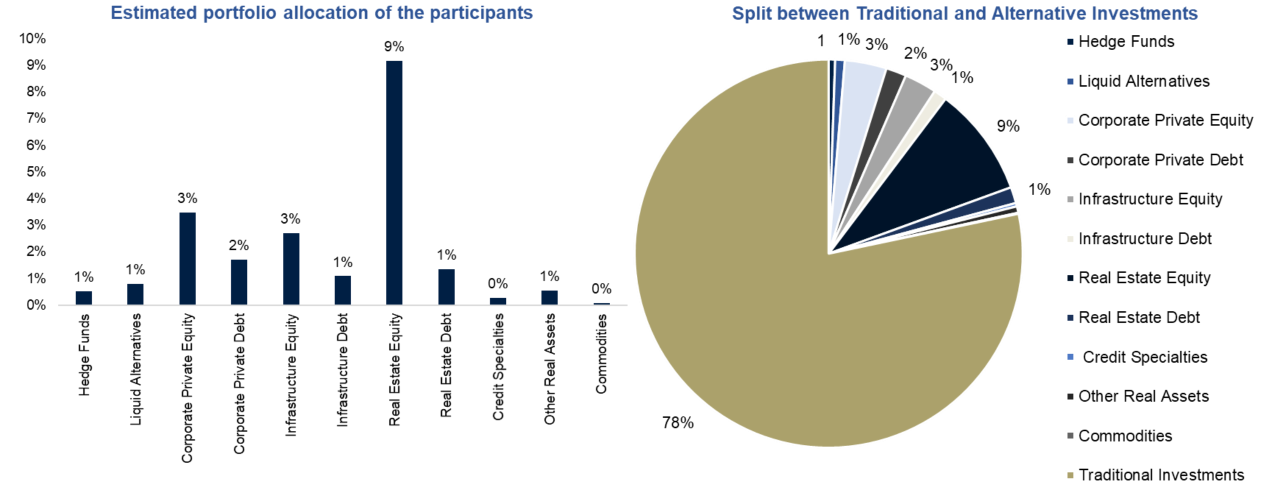
Looking at the distribution of the allocation of those investors who invest in the asset class, it is once again striking that real estate equity combines significantly higher portfolio weights compared to the other asset classes. Real estate is followed by corporate private equity and infrastructure equity at a considerable distance.

To gain a deeper understanding of the demand for Alternative Investments, we estimated in detail the current and future portfolio allocation for the average institutional investors in Germany in Alternative Investments. We consider non-Alternative Investments as Traditional Investments, such as listed equities, corporate and sovereign bonds, and cash, but do not further discuss or quantify them.[3]

[2] Note: In the following diagram the answer "no answer" was excluded, so the results may be biased. In addition, it should be noted that the number of answers vary significantly among the asset classes, as shown above in the participation rates of the various asset classes.

[3] Background: The calculation of the current allocation requires strong assumptions. Here, the mean interval limits of the allocation were multiplied with the distribution of the participation rates among all participants in order to obtain an estimate

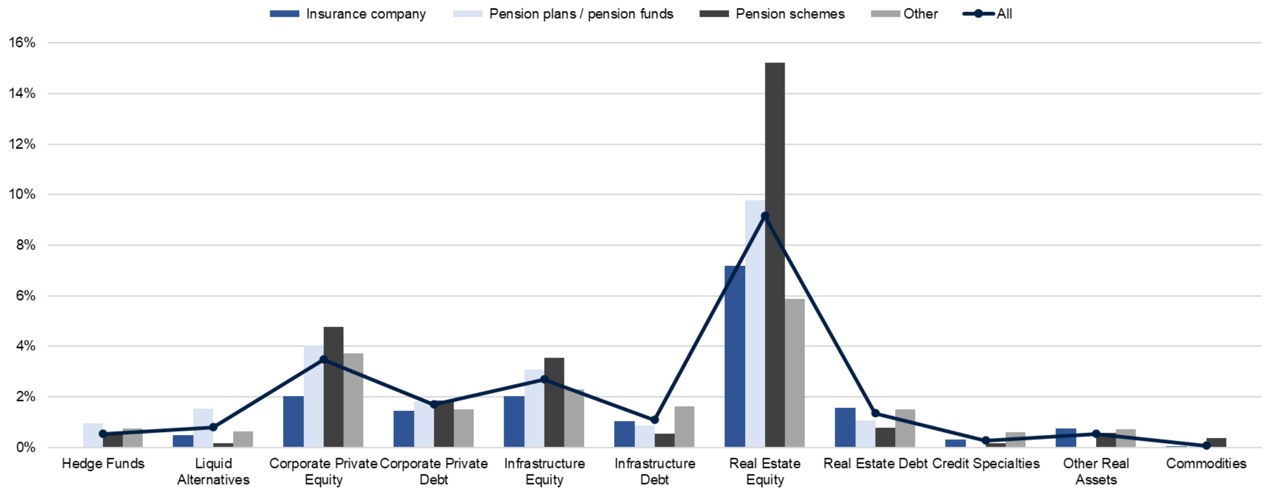
Estimated portfolio allocation of the participants regarding Alternative Investments (*)



The growth of the Alternative Investments market is reflected by our estimated Alternative Investments portfolio allocation, based on the information provided by the respondents. On average, about 22 % of assets are invested in alternatives. Unsurprisingly, real estate equity takes the highest share in the investors' portfolios amongst Alternative Investments for all types of investors, followed by corporate private equity and infrastructure equity. Pension schemes in particular take up a significant share of the portfolio in real estate equity investments. Private market investments in corporates and infrastructure also cover a significant part of the portfolios nowadays.

of the average allocation. Due to the bias described above, the results should be slightly shifted to the upper end. Nevertheless, it is interesting to look at the relationships between asset classes and the expected shift to the target allocation in the next 3-5 years.

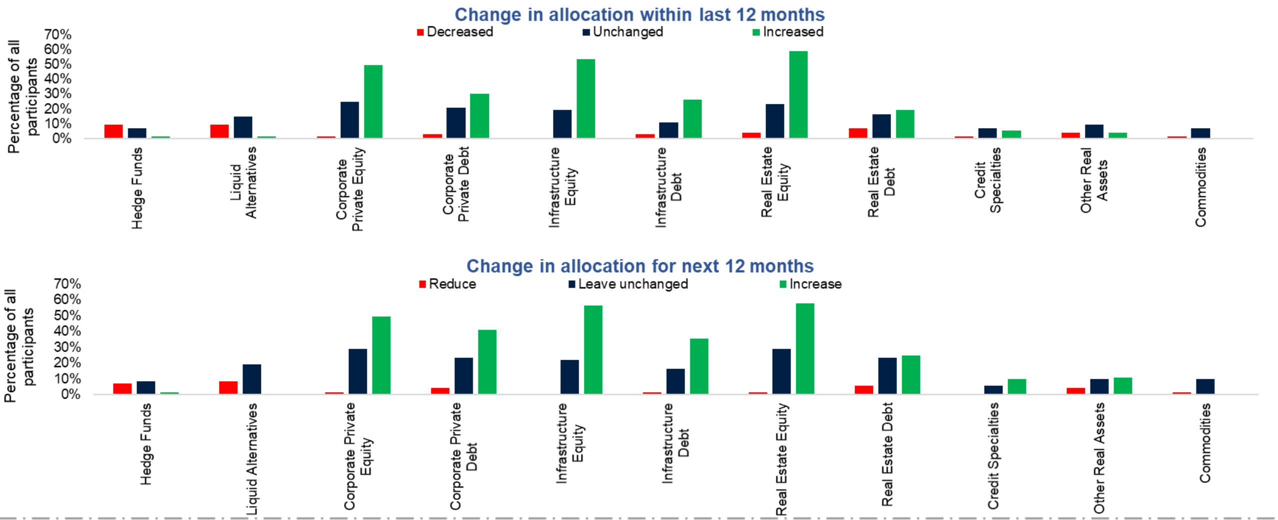
Estimated portfolio allocation of for different investor types (*)



Expected Future Demand

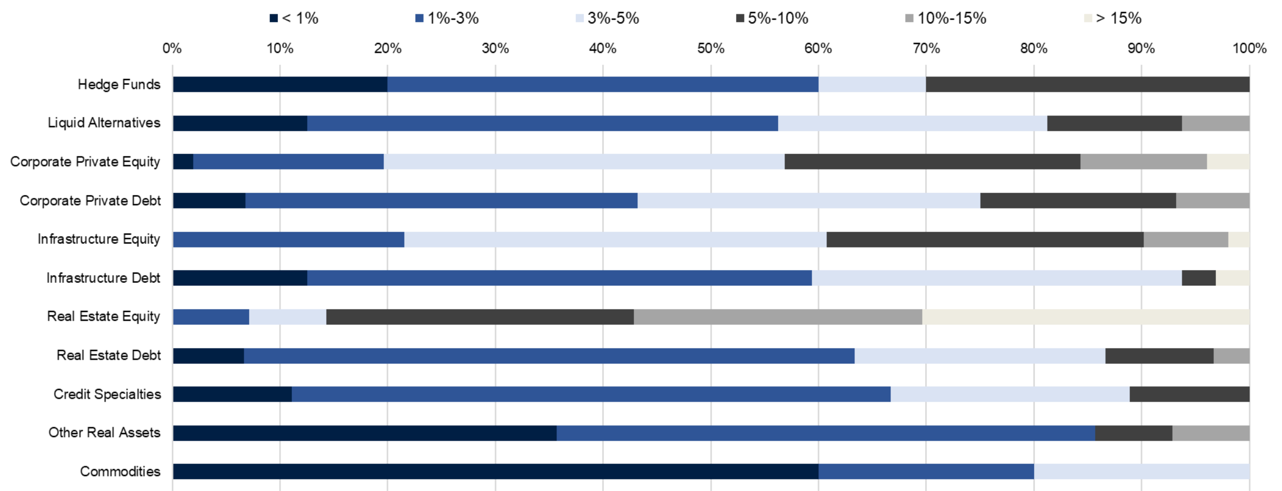
The expansion of the Alternative Investments' portfolio share will continue in the next year, as the growth momentum of equity as well as debt investments in corporates, infrastructure, and real estate will most likely carry on based on the investors' sentiment. Private equity has historically performed well during periods of uncertainty, with buyout funds raised during past economic crises delivering strong returns. With that in mind, investors are willing to increase their portfolio share of private equity investments.

Change in portfolio allocation



On the other hand, mainly liquid and/or publicly traded products such as liquid alternatives (UCITS), hedge funds, and commodities will probably face extra difficulties in the upcoming months. Only few investors are willing to increase the allocation in those asset classes. Contrariwise, it is expected that further reductions of those investments will result.

Distribution of the target portfolio allocation (3-5 years) within the asset classes

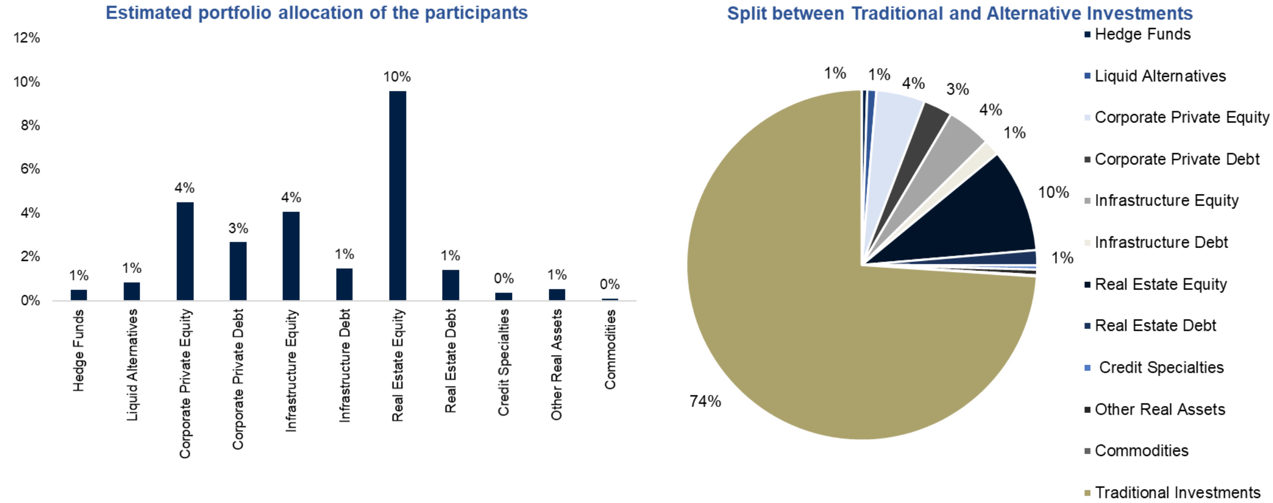


We asked investors about their expected allocation in 3 to 5 years in order to identify medium term trends in the market.[4] Basically, the distributions between the Alternative Investments asset classes are similar to the current allocation. Real estate equity has the highest target exposure, followed by corporate private equity and infrastructure equity.

Our survey among those institutional investors in Germany who have exposure to Alternative Investments shows that the split between Traditional and Alternative Investments is becoming more and more aligned. The decline in Traditional Investments is certainly related to the ongoing interest rate environment. However, learning effects that explain an expansion of private markets products may also be relevant here, as German institutional investors are catching up to their international peers.

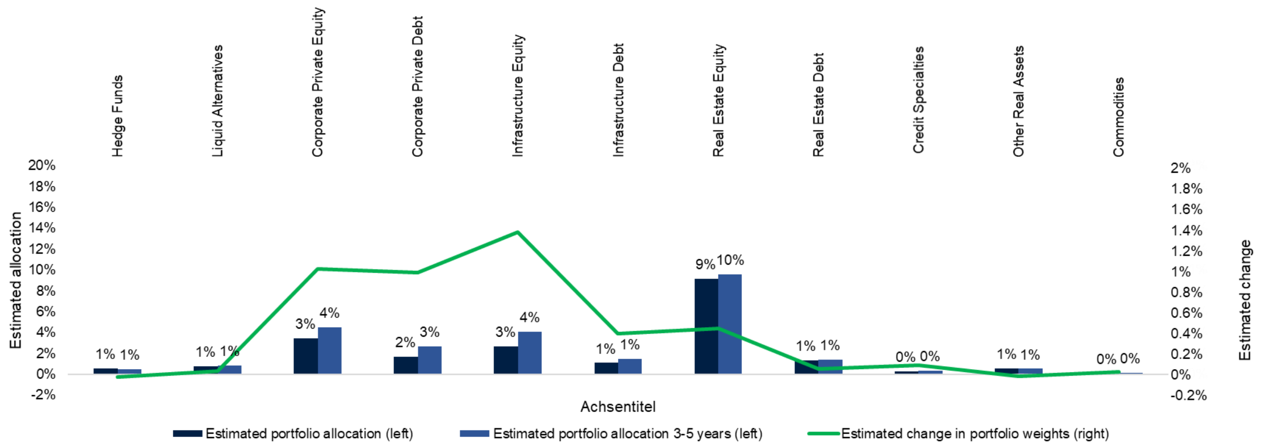
[4] The calculation was carried out according to the same standards as for the current portfolio allocation shown before.

Estimated target portfolio allocation for the next 3-5 years (*)



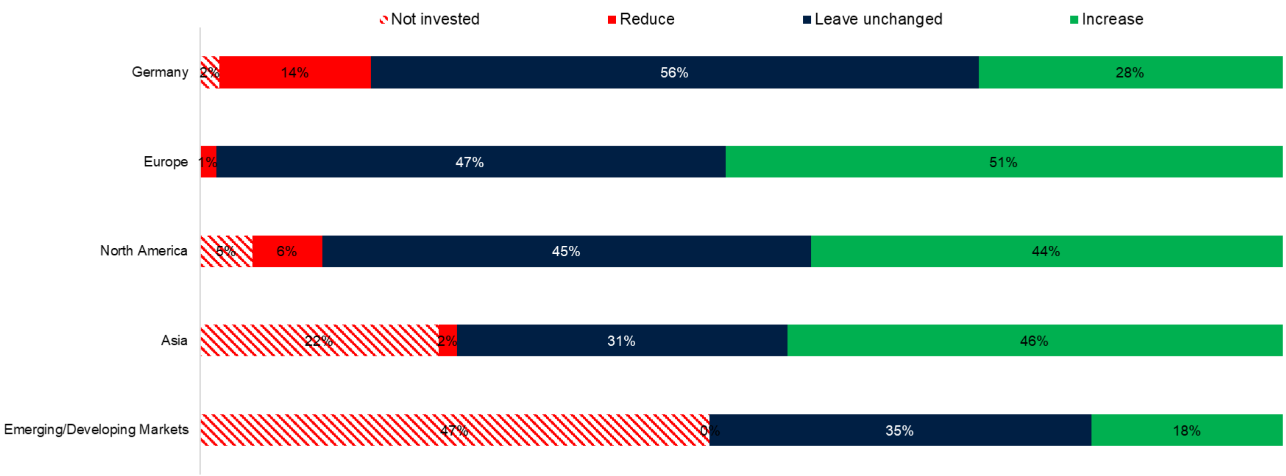
By comparing the estimated current and estimated future target allocation, it can be concluded that infrastructure equity will become more important for investors in Germany. In addition, a significant increase in corporate private debt and corporate private equity is to be expected. Overall, we expect that the average institutional investor in Germany will expand the Alternative Investments exposure from 22 % to 26 % in the next three to five years. This corresponds to an estimated yearly growth rate of the entire Alternative Investments industry from 3 % to 6 % in the respective period, various exogenous incalculable variables in mind.

Comparison of current allocation and target allocation in 3 to 5 years (*)



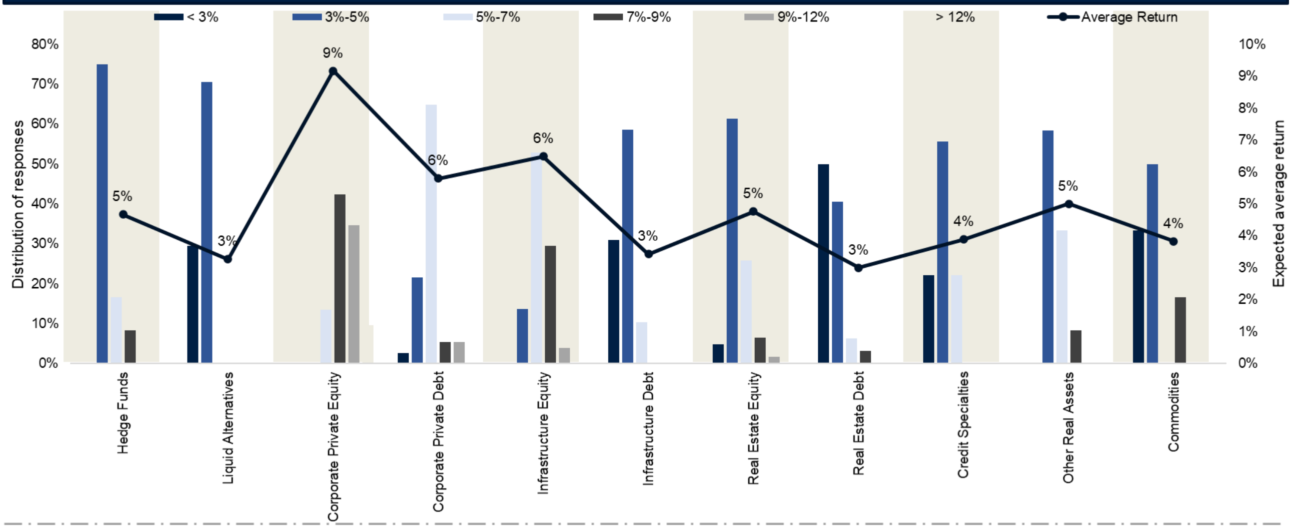
In a next step, investors were asked to indicate their planned changes in their geographical investment exposure over the next 12 months. Our survey found that investors try to reduce their home bias further by shifting target investments away from Germany to other European countries as well as North America and Asia. Additionally, it became clear in dialogues with placement agents that target exposure in Asia is increasing significantly and that if COVID-19 and Trumpism had not been the dominant topics this year, many more deals would have been closed in 2020.

Change in geographical exposure over the next 12 months (by target investments)



Return on Investment & Fee Structure

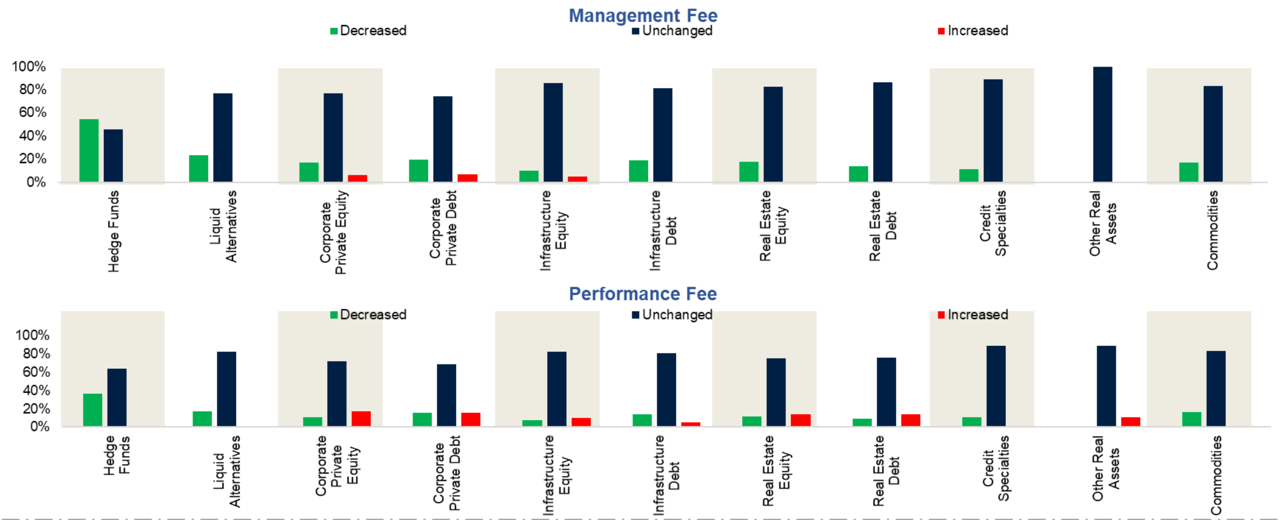
Return distribution and expected return in the asset classes(*)



Investors have precise return expectations. Our results draw a stable overall picture. Nevertheless, return expectations may vary widely within an asset class, e. g. due to different asset vehicles, financing stages, and vintage years. A comparison of the asset classes shows, however, that corporate private equity has the highest expected net returns, on average 9 %.

The demand among investors for corporate private debt, in particular direct loans, the most common type of private debt strategies, has been exceptionally high in recent years. Private debt's high cash yields are especially attractive to investors in the persistent low-rate environment.

Distribution of perception of cost developments within last two years



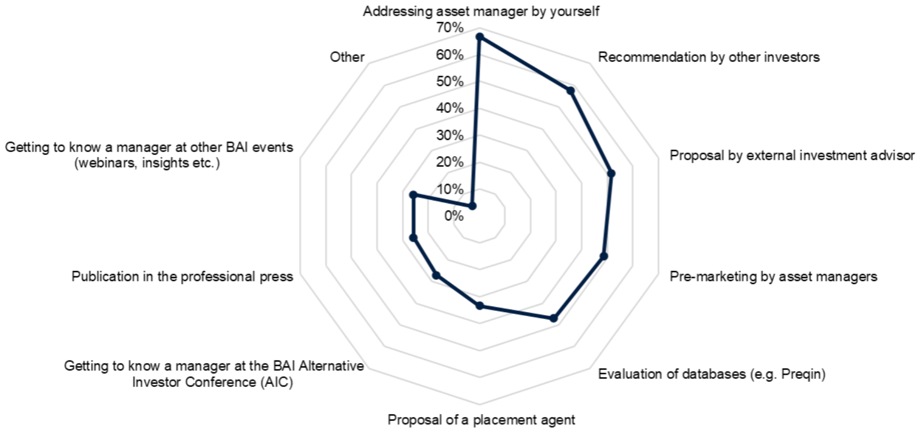
The overall picture of our survey draws a clear trend regarding the development of raised fees. While fixed management fees have been significantly reduced over the past two years, there have been increases in variable performance remunerations, mainly to be observed in illiquid private market products. In the meantime managers of hedge funds and liquid alternatives tried to prevent a further withdrawal from their products by lowering management and performance fees significantly. As a result, the traditional, popular "2 and 20" fee structure is less frequently to be observed.

Opinions about raised management and performance fees go hand in hand with expected returns as several statements of investors indicate. For example, a manager of a small insurance company invested in alternative equity investments claimed: "Against the background of lower return expectations and the very sufficient income of the fund and sales managers, the management fees should generally be reduced further."

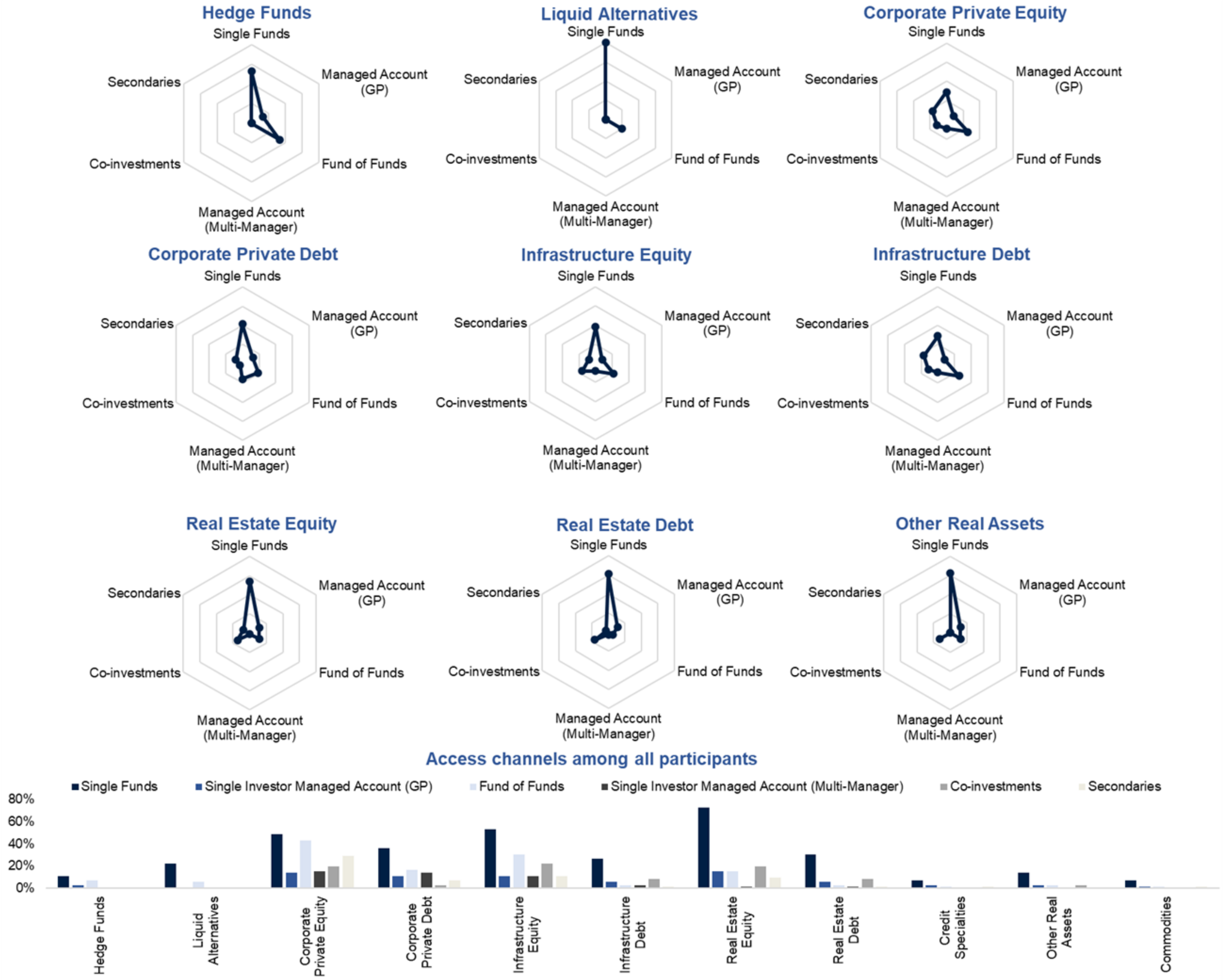
Access to Alternative Investments

This year, we also wanted to gather information from investors on how to approach potential asset managers. Most of the participants – two thirds – stated that they would contact well-known asset managers directly. The second most common response was to follow the recommendations of other investors. Therefore we, as the German industry association for Alternative Investments, will further intensify our work as a catalyst in developing a wide-spread network between professional German investors, recognized worldwide providers of Alternative Investments products as well as service providers such as investment advisors, placement agents, legal firms, providers of databases, and consultants. Despite COVID-19 the BAI Alternative Investor Conference (AIC) will take place in spring (virtually) and in cooperation with our members, we will continue to host BAI Webinars, BAI Insights, and BAI Workshops several times a year to support education with emphasis in the field of Alternative Investments.

Development of the longlist of the Alternative Investments



Access routes to Alternative Investments

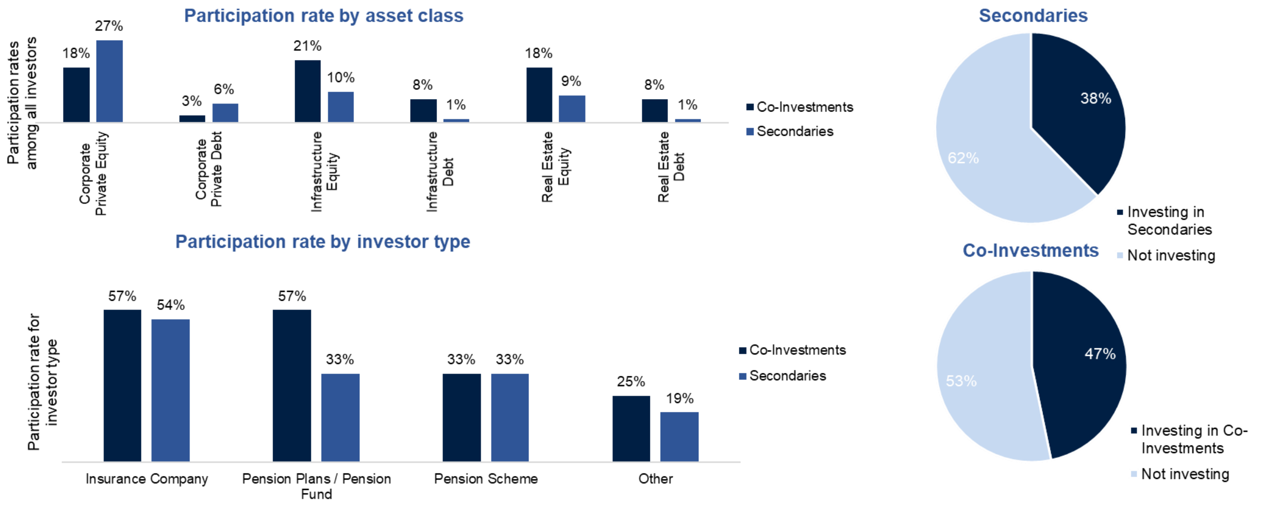


We not only wanted to determine which asset classes are particularly popular among German investors, but also which access path and vehicles they use to invest in. Basically, there are various ways to invest in an asset class. The most popular path among the participants is the acquisition of single funds. In addition, one can invest via fund of funds, managed accounts, and co-investments (as funds, direct or alongside a flagship fund which we call sidecar). This access path is becoming increasingly important and is particularly widespread in the established asset classes in the private markets sector such as corporate private equity. A fast exit from an investment is not or only a limited possibility for investors of mainly private alternative investment funds. A way out of this dilemma can be offered by the secondary market, which provides investors with liquidity in often basically illiquid asset classes. Investors also have the option of selling closed-end funds with limited redemption volumes or temporary redemption windows and low cash liquidity ahead of time.

Co-Investments & Secondaries

Co-investing, whereby limited partners (LPs) in a fund invest directly into deals alongside the fund, has gained in attractiveness in recent years. Investors show an increased appetite for co-investments which goes together with our previous findings: Recently, BAI intensified its research and activities on co-investments with a survey and a paper as well as webinars on the topic, in order to derive the requirements for investors, pitfalls and trends. Together with investments in secondaries, we have therefore analysed this more closely in this year's Investor Survey.

Distribution of co-investments and secondaries in general among German investors

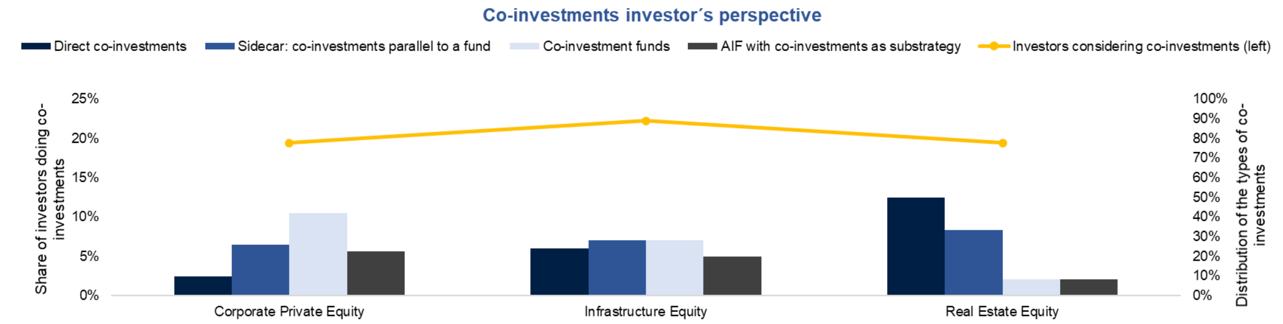


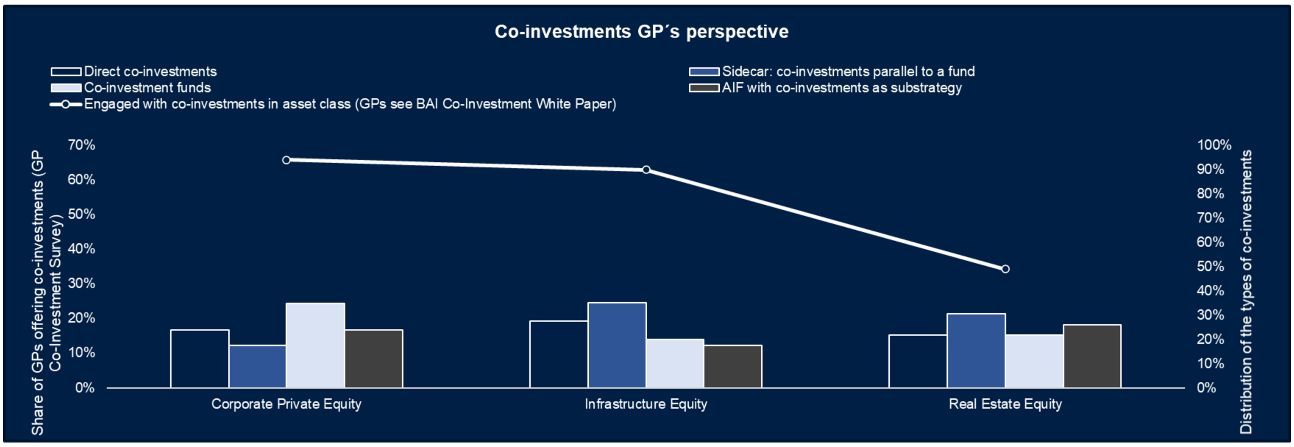
Altogether, 38 % of the participants invest in secondaries. Concerning co-investments, the figure is significantly higher at 47 %. Co-investments are most common in infrastructure equity with 21 % of all participants, followed by corporate private equity and real estate with 18 % each. Looking at the participation in terms of investor type, it is striking that mainly insurance companies invest in co-investments and secondaries, representing more than 50 % of the investor landscape. The participation within other investor groups is significantly lower.

The term co-investments can be subdivided into co-investment funds (funds that invest exclusively in co-investments), direct co-investments (LPs do not invest in the flagship fund at the same time), and sidecars (usually particularly large LPs of the fund are offered the opportunity to invest additionally in single transactions). In order to gain an impression of the market size, general partners (GPs) among BAI members were questioned in a dedicated survey and investors were interviewed individually. From the point of view of asset managers, the demand for co-investments by investors has increased significantly and is most widespread in private equity. The investors have confirmed that co-investments are particularly attractive due to cost advantages. However, they require many years of experience in the asset class as well as fast decision-making processes. You will find the results of the co-investment survey as well as detailed research and information about co-investment here (in German).

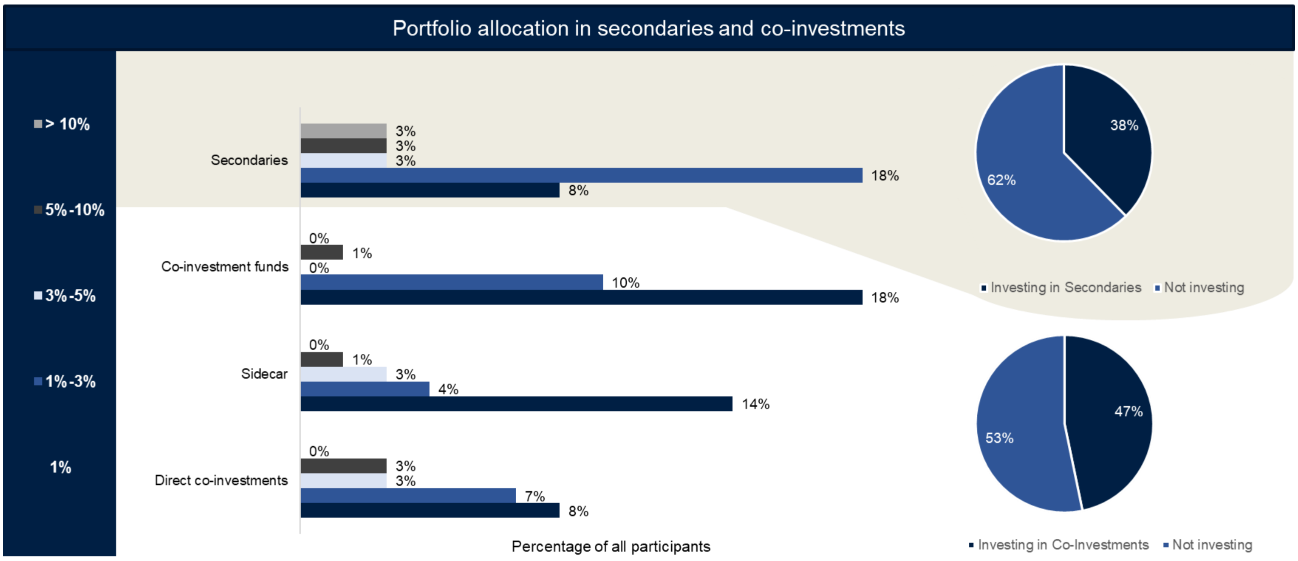
We also asked more questions on these topics in this year’s BAI Investor Survey to verify the previous results of the above mentioned BAI research. Most investors are involved in co-investments in the areas of corporate private equity and infrastructure equity. This result is consistent with the statements of the GPs in the BAI Co-Investment Survey. It is particularly striking that in the area of corporate private equity, co-investment funds seem to be particularly popular for German investors. Co-investment funds have the advantage over sidecars and direct co-investments that the decision-making processes can be outsourced to the manager.

Characteristics of the individual co-investment forms and general participation rates



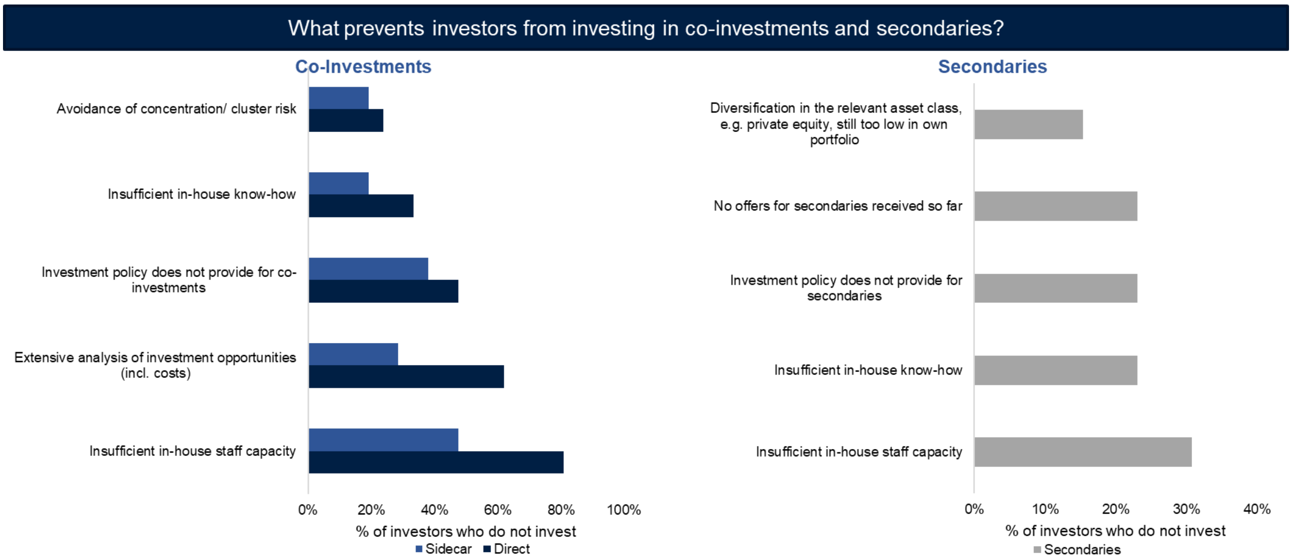


The secondary market for alternative investments serves investors primarily for their active portfolio management (adjustment or realignment of asset allocation). Thus, buyers of secondaries enter the market for strategic reasons. For instance, positions can be built up much faster through secondary market purchases. It is also advantageous that secondary investors invest in an existing portfolio. Let's take the example of a real estate secondary fund: Investors participate immediately both in the rental yield and the increase in value of the properties after the conclusion of the secondary market transaction.



Co-investments and secondaries are more time-consuming in comparison to single fund investments. The associated personnel requirements and the knowledge of what needs to be built up internally seems to be a central obstacle for some investors.

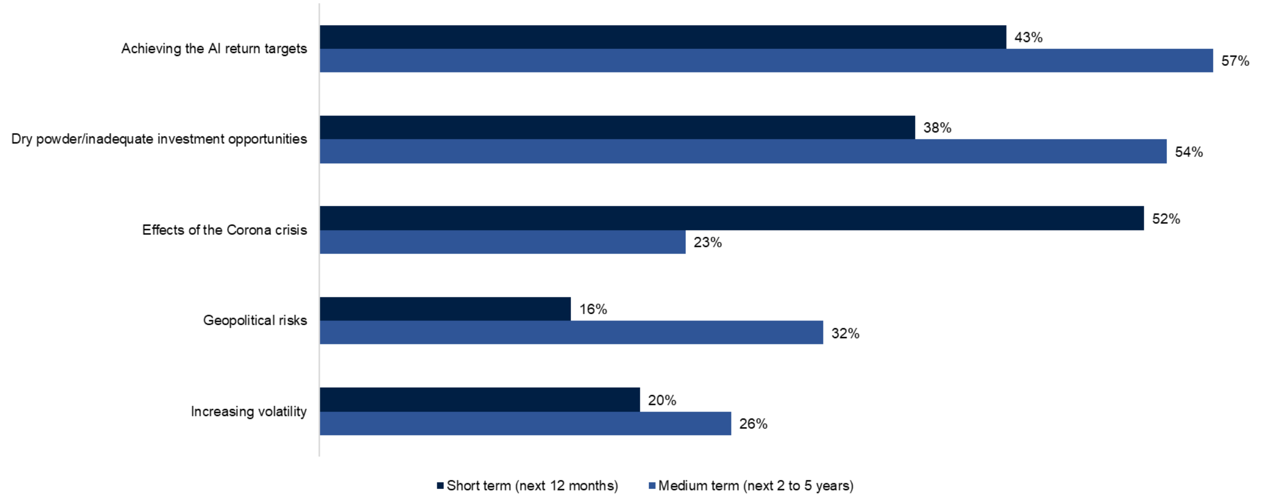
The interviewed investors emphasised that the path to co-investment is a product of many years of experience in the asset class and necessary long-time exposure. Expert knowledge minimises concentration risks and at the same time speeds up decision-making processes. Given the expected overall shift of the portfolios towards private markets, it can be assumed that co-investments will continue to grow in importance in the long term.



Despite the surveyed obstacles, the COVID-19 pandemic is likely to become the biggest driver for secondaries in recent years, at least for some asset classes such as real estate, based on the premise that bad times for the specific sectors of the real estate market are good times for entering the secondary market. This should become apparent especially with regard to hotels, offices, and commercial buildings. The secondary market could offer investors more favourable entry prices compared to subscribing to a newly launched fund.

Selected Topics and Key Challenges

Challenges over the next 12 months and the next 2 to 5 years



As in last year's survey, investors see the greatest challenge in achieving their return targets in the next two to five years. Like in recent years, another key challenge is the huge amount of dry powder, which also has an impact on expected returns. Geopolitical risks such as the trade conflict between the USA and China still are expected to have a major impact on the deal environment in the upcoming years.

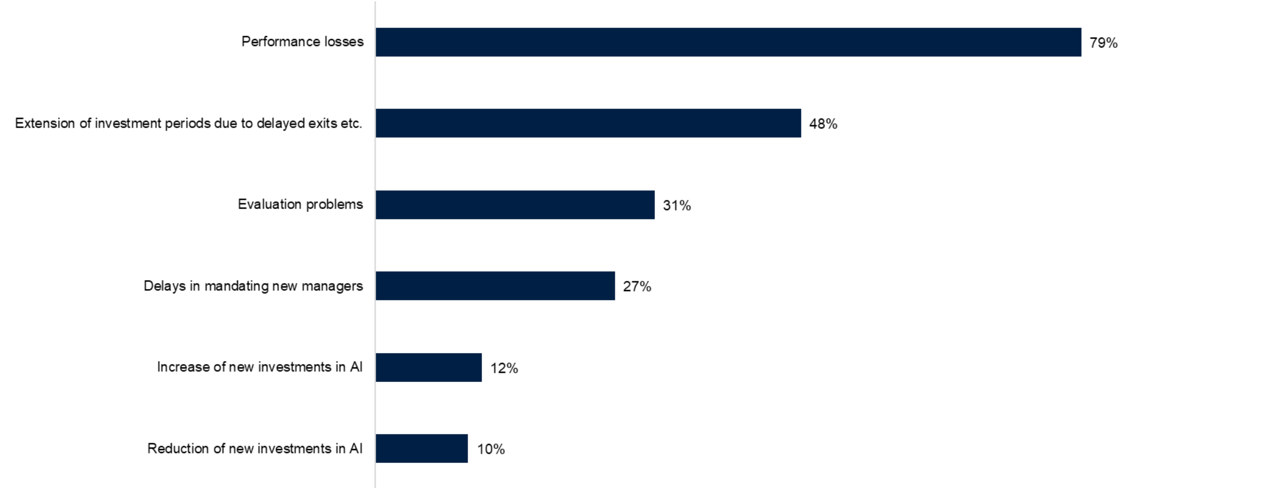
It is obviously impossible to conduct a survey in 2020 and not refer to the COVID-19 pandemic. As things currently stand, it looks as if the year 2021 will continue where the year 2020 is going to leave off. The surveyed investors still see the COVID-19 crisis as the greatest challenge in 2021. But with a vaccine in mind, COVID-19 should not have that much of an impact on invertor’s actions in the medium term.

In the long term, as stated before, especially private equity stands to benefit from the sustained low-yield environment, as it has in the years following the global financial crisis. The private equity industry has been shown more than once to outperform public markets in a downturn and this time, taking into account the high numbers of dry powder, should prove no different.

COVID-19 Impact

It should be noted that at the time of the poll the effects of a possible “2nd wave” during autumn and winter in Germany as well as in the rest of the world could not yet be conclusively determined. Nevertheless, we asked investors to what extent the COVID-19 crisis is already having a noticeable impact on their portfolio. Unsurprisingly, 79 % said that they mainly had to deal with performance losses during the first half of 2020. In addition, due to delayed exits etc., investment periods tend to be prolonged. Obstacles such as necessary travel restrictions and remote working could also lead to continued delays in mandating new managers (27 %). Some also monitor unprecedented evaluation problems.

Implications of COVID-19 for the investors



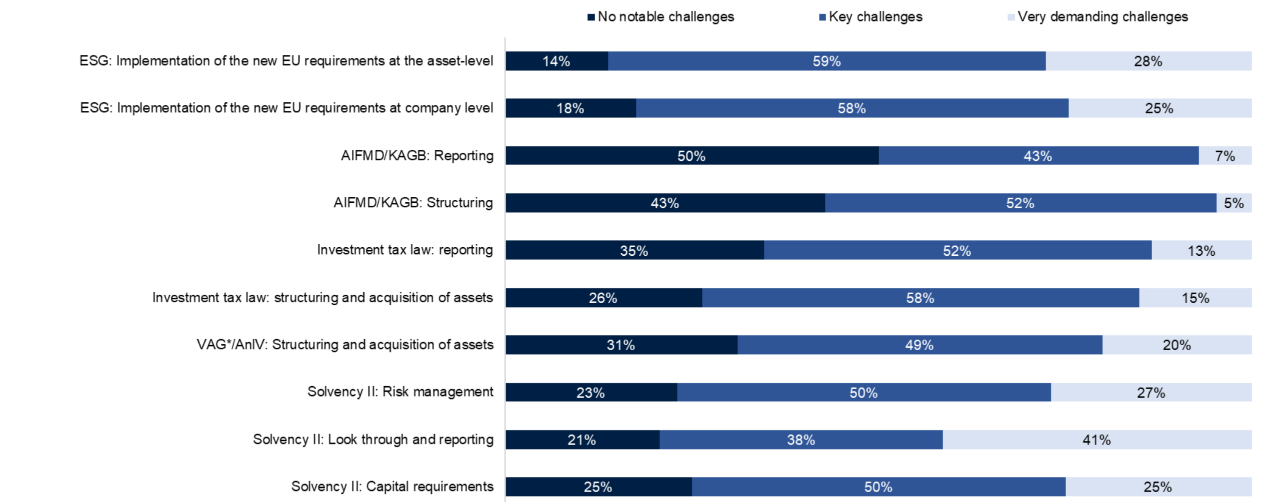
In addition, one of the surveyed investors further explained that the entire investment process becomes more difficult due to of COVID-19. This is especially the case for new managers with whom no experience has been gathered so far. Consequently, managers with a short track record should find it difficult to raise capital during the pandemic. Stable, long-term business relationships between asset managers and investors are becoming even more valuable.

> *“Virtual fundraising makes our due diligence more difficult.”*

Regulatory Requirements

As in previous years, we wanted to know with which regulatory requirements investors still have difficulties implementing. As the EU Commission's ESG initiative in particular will be subject to a number of regulatory changes in the coming years, investors see this as a considerable challenge. We will closely monitor this process to ensure the practicability of regulatory approaches for the asset management industry. For insurers regulated under Solvency II, the issue of look-through is still a major challenge.

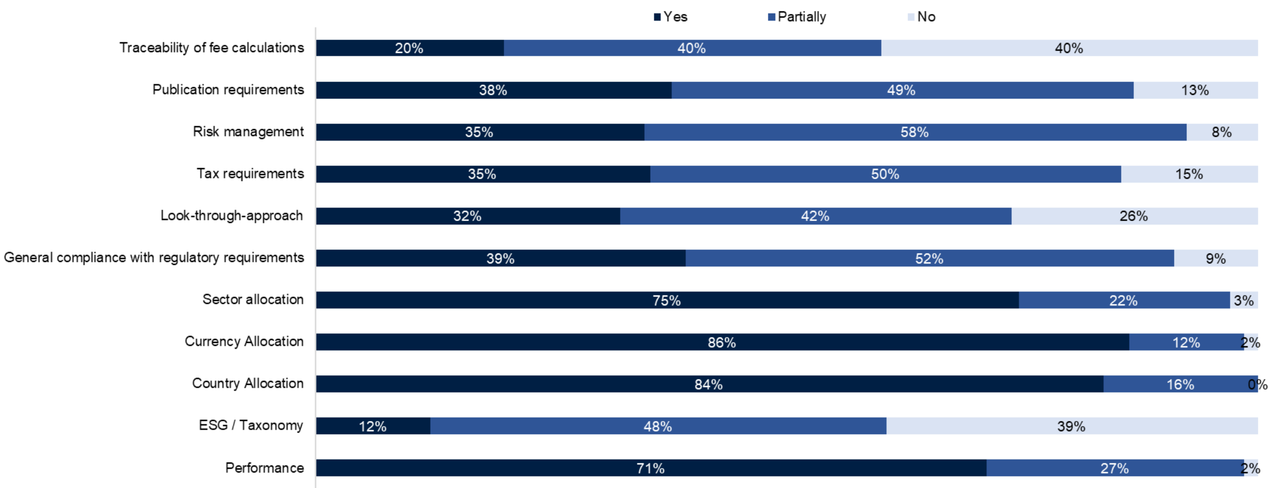
Investor perception of regulatory requirements (*)



Insufficient Information

We also asked the investors about the transparency of information contained in central reports by service providers such as asset managers, AIFM, custodian banks, etc. Here, it is noticeable that there is still a lot of catching up to do in terms of ESG reporting. This will be a key issue for the asset management industry in the next year. The calculating the fees of asset managers is also perceived by 40 % of investors as too non-transparent.

Transparency of information by the asset managers



The Key Drivers of ESG Integration

Integrating environmental, social, and governance (ESG) principles in the investment process is increasingly vital for the Alternative Investments industry. Asset managers are responding to growing demand from institutional investors pursuing to allocate to ESG-committed funds. The need for transparency across the industry is vibrant as shown in the figure above. No other topic is currently of greater importance to the entire industry, and there is no doubt that ESG will become an even bigger part of the industry in the next months and years. Concerns such greenwashing are common and the need to draw lines are pursued by regulators in various manners in the context of the EU sustainable finance initiative.

Public equities have several rating systems such as those offered by private data providers, but fewer options exist for the private markets. What role do the investors we surveyed play? The pressure will need to come from the outside. As the sophistication of ESG increases, investors must and will educate themselves about what is most relevant to their portfolios. Looking at a “timeline” of commitment to ESG principles shows that a far greater number of investors joined the ESG train picking up speed early on compared to asset managers. But what are the reasons for their ESG investments?

While in last year's BAI survey only 10 % of investors stated that the return on investment is one of the main factors for ESG integration in their investment process, today, one year later, this number has more than doubled to 23 %. Nevertheless, return on investment is still not one of the main reasons. Instead, primary drivers are in-house management directives to increase ESG-compliant investments (48 %), regulatory requirements (47 %), intrinsic interests (40 %), as well as the expectations of the shareholders (39 %). The survey results prove that the reasons for ESG integration into the investment process are extremely heterogeneous. This shows us, as an industry association, how difficult it is to reconcile these sometimes strongly divergent interests of investors as well as of our members and other market participants. For us, but also for the regulator and the providers of ESG-compliant investment products, the entire field of sustainable finance will remain a tremendous project in the coming years. In view of the diverging interests, the exchange and agreement between all market participants and supervisory authorities will have to gain in importance in order to increase mutual understanding.

> "*ESG investments increase our portfolio diversification.*"

> "*Our members expect ESG eligible Investments from us.*"

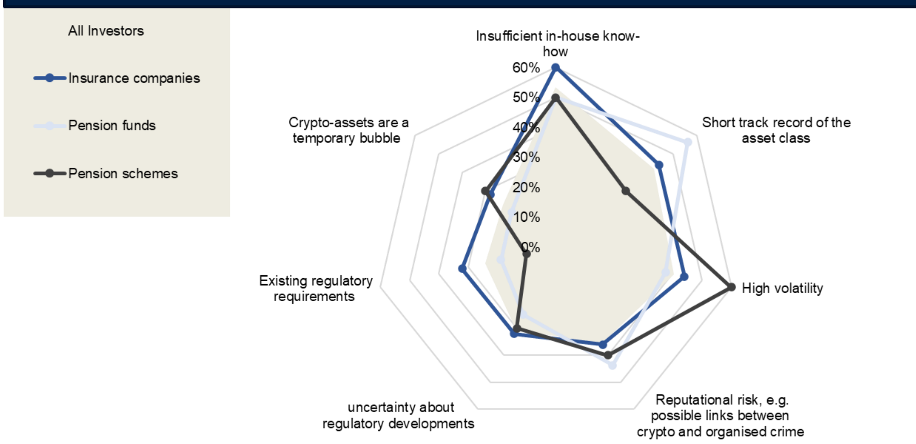
In addition, investors commented that ESG investments are required by the commitment to members themselves. Another investor also said that ESG investments offer additional diversification effects.

Crypto Assets Obstacles

As mentioned before, all participants in the survey stated that they are not invested in crypto assets and do not plan to invest in the upcoming years. The investors were therefore asked to identify their investment barriers. The results show that crypto assets have not yet been able to completely shake off their sometimes negative image. Instead, they still are associated with organised crime, money laundering, and terrorist financing, with the consequence that investors still see potential reputational risks in crypto assets.

Regulatory requirements (Investorenaufsichtsrecht for the respective investors) and uncertainty about future regulatory developments are aggravating factors, with the result that many access channels are unavailable for numerous investor groups, e.g. through management requirements. In addition to the short track record of many crypto assets, one market risk is at the forefront: volatility. Many investors continue to associate Bitcoin etc. with very high volatility - sometimes wrongly, as numerous research studies in the field have shown.

What prevents investors from investing in Crypto Assets?



Investor comments:

"Retention of value, but no investment."

"Are crypto assets really an asset class?"

"Restrictions by the management."

"Crypto Assets are pure speculation."

"No eligible asset class."

The subject of crypto assets is clearly still in its infancy in Germany – apart from a constantly growing crypto asset network of experts, companies and start-ups. At this point, however, investors are also called upon to pay more attention to topics relating to blockchain technologies and crypto assets. At least the BAI Investor Survey results show a pronounced self-reflection among the investors surveyed: Insufficient in-house know-how about crypto assets continues to be the main obstacle for first-time investments. In the future, there will be a significant need for more information. The transfer of knowledge must be given even greater priority. BAI, together with its members and partners, will continue to meet this challenge in the future through events, webinars and publications.

Authors

Philipp Bunnenberg

BAI Consultant

Alternative Markets

+49 (0)228-96987-52

bunnenberg@bvai.de

Sven Gralla

BAI Working Student

Alternative Markets

+49 (0)228-96987-13

gralla@bvai.de

<u>Imprint:</u>

Responsible:

Bundesverband Alternative Investments e.V. (BAI)
Poppelsdorfer Allee 106
D-53115 Bonn
Telefon: +49(0)228-96987-0
Fax: +49(0)228-96987-90