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Audience Q&A's - Spotlight Private Wealth Co-Investment Trends

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Moderator: Tim Houghton, Global Head of Private Wealth & Family Offices, TMF Group

Panellists:

- Charlotte Thorne, Partner, Capital Generation Partners
- David Fletcher, Partner, Farrer & Co
- Josephine Howe, Partner, Ogier
- Karen O'Hanlon, Senior Director – Private Client Services, JTC

Has the pandemic accelerated your client's interest in/appetite for co-investing?

Charlotte Thorne: I think their appetite for coinvesting has been growing for some time anyway. Those who are already involved in co-investments have probably seen some extra complexities arise as a result of the pandemic with supply chain management being an important topic which is coming to the fore as a result of the pandemic.

So, I think many investors are fully engaged with managing their existing co-investments through the crisis but they may feel that having successfully navigated this challenge they will be able to approach future co-investments with more confidence.

Josephine Howe: There has been an exponential growth in private wealth around the world and also a noticeable growth in the overall number of family offices that are established; those families are of course looking for good investment opportunities.

During the last year, despite the turmoil caused by the coronavirus pandemic, almost 100 new Jersey Private Funds (JPFs) were registered, bringing the total number of JPFs in Jersey to over 400, the vast majority of which are Jersey domiciled structures.

Karen O'Hanlon: Yes, very much so, diluting their risk, ensuring governance is being applied and excess cash available for investment with interest rates low and finance cheap!

Aside from crypto, are you seeing a marked interest in ESG-related deals?

Charlotte Thorne: Yes, we have seen an increase in ESG related deals but the better quality deals tend to be fairly technical and sector-specific so it can be challenging to build expertise in this space as the various technologies are so different. Many of them also rely on emerging network effects which makes the exit difficult to predict. For instance, investments in battery technology for electric vehicles or replacements for domestic gas boilers require significant public take-up to become profitable and although we believe that the change is underway, we have clearly not reached the tipping point, where these technologies become completely mainstream, just yet.

So, the ESG deals may be a longer hold than other deals - but family investors are well placed to be sources of long term capital so this need not be a barrier as long as everyone understands the position ahead making the investment.

Karen O'Hanlon: Definitely a lot of interest however due diligence and governance play a large part therefore lots of research going on in the background.

Josephine Howe: Impact investing and ESG has become a powerful mechanism for family offices looking to balance their desire to preserve wealth through the generations with income needs and investment sentiment of the current generation. It is an area that we are increasingly being asked to advise on in the context of trustee duties. In this respect, sustainable investments are not necessarily incompatible with trustees' duties and can still be an investment with the aim of an income or capital return.

What part does risk play in setting these structures up?

Karen O'Hanlon: Risk is at the top of the list, invariably the investment nature will be deemed high risk by Trustees and Directors, both of whom have a fiduciary duty to ensure the investment objectives are being followed and whether the reporting is adequate meet the fiduciary requirements and what will the impact be if the investment fails. A lot of considerations before the investment is even made.

Charlotte Thorne: From our perspective structuring is aimed at mitigating the risks associated with co-investments by setting out very clearly the rights and responsibilities of the shareholders ahead of time. Co-investments which rely on good will to resolve conflicts are more likely to fail.

Josephine Howe: Given a trustee's fiduciary duties, a trustee might have a different risk appetite to its co-investors. Where trustees are co-investing the adoption of the appropriate corporate governance and organisational structure to implement and monitor the investment management process, including access to resources with appropriate skills and experience and putting in place appropriate reporting lines is key to mitigating risk and demonstrating that it is acting in accordance with its duties.

How do you manage the expectations of clients when a co-investment deal goes wrong?

Josephine Howe: In order to mitigate disputes and misunderstandings between co-investors it is important to consider the expectations of each investor at the outset, with particular focus on the allocation of roles and responsibilities, implementing an appropriate corporate governance and organisational structure, the investment horizon and potential exit strategies.

Charlotte Thorne: Our job as adviser in these cases is to make sure that clients understand the risk associated with their investment going in. Typically, clients tend to have a good understanding of their co-investments as risk-on money and to appreciate the risk associated with that.

However, it is worth saying that for our clients, their co-investments sit alongside a managed portfolio of financial assets which is designed to produce steady returns with managed volatility, and this liberates clients to take more risk in their co-investments. Co-investments should be put in the context of an overall portfolio of assets, some of which are lower risk and are designed to produce lower but more reliable returns and some of which are more volatile but potentially able to produce outsized returns.

Karen O'Hanlon: Most clients will be involved at the outset rather than operating at arm's length. Incredibly important to have the 'legals' such as shareholders agreements well drafted with exit agreed upon and discussions at the outset regarding failure.

How important is the client's reputation in accessing the best deals?

Karen O'Hanlon: Clients' reputations may well give more accessibility to clients however on the flipside this can also go against.

Josephine Howe: Reputation should be an important factor for a client in determining the person they want to partner with in any co-investment; reputation should equally be considered in respect of the jurisdiction in which the co -investment structure is established, as well as the advisors and service providers that are brought in to advise on and support the governance of the structure.

Charlotte Thorne: The client's reputation is crucial – they will find themselves working with numerous different providers, all of whom will have to take the investor on as a client, and this will mean rigorous KYC checks. But in addition, founders are not going to want to work with external shareholders who have a poor reputation or who have shown themselves unable to complete on previous deals.

This is why it is important for clients to work with highly respected providers who can help them complete on a deal. Deals which fail for lack of professionalism or lack of specialist knowledge on the part of the providers tarnish the reputation of everyone involved including the founder who will then find it harder to engage successfully with other potential investors because the opportunity will then be viewed, potentially unfairly, as somewhat second rate.