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Corporate deal flows and private funds

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The drive by leading institutional investors (LPs) to deploy large amounts of capital in accordance with their internal allocation needs has presented new opportunities for established fund sponsors and new fund sponsors alike. This article focuses on fund sponsorship by newly formed corporate affiliated managers (CAMs) and related governance, alignments and incentives. CAM transactions serve important strategic and commercial sponsor objectives, and allow new sponsors to participate in opportunities resulting from LP capital deployment needs.

Corporate affiliated managers: key attributes

A CAM sponsor (a corporate, corporate affiliate or parent) is often a mature, prominent enterprise of scale conducting a successful core business with an inherent and sizeable capital investment aspect. The pathways leading to a decision by a corporate to form its own fund manager are myriad. In certain instances, corporates will identify the capital investment aspect of their core business and constitute it as a division first, such as a division that provides forms of seller finance to clients of the core business.

In other cases, corporates prefer to pursue capital by joint venturing. In yet other instances, the potential value and role of a CAM for its corporate parent may have been identified through the corporate's pursuit of balance sheet strategies and corporate finance transactions, including issuance of debt and equity securities.

In the course of following those pathways, a corporate may also recognise that many of its most important commercial objectives may be uniquely served by a private fund capital programme. For example, a private fund initiative can serve to advance a critical corporate strategy by focusing on aspects preferred by the corporate's key capital partners (or larger shareholders), some of which may also be regular investors in the private funds of standalone managers in the corporate's sector. The capital provided by a CAM fund can therefore be complementary to conventional corporate finance and support transitional strategies

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entailing steps with distinct risk-reward profiles.

Affiliations, sectors and trends

The notion that an investment manager with unique, and often proprietary, deal flow would be affiliated with an entity that carries on a core business unrelated to investment management is not new. Many leading investment management firms have, for a portion of their lives, been affiliated with large insurance companies, banks and other concerns.

In addition, many of the attributes of CAMs and their funds are not novel when compared to those of multi-strategy, publicly listed managers. What is novel about CAMs at the present time is their growing role in addressing the capital deployment and deal flow needs of LPs in harder-to-access strategies and capital-intensive strategies, including infrastructure, credit, energy, transportation and real assets in mature markets – the 'sectors of choice'.

In addition to strong LP allocation needs in these sectors, other trends over the last decade have favoured CAM transactions. These include the increasing desire of LPs to pursue direct investing, which has fostered a focus within LP teams on quality, recurring deal flow and the repeat partnering opportunities that CAMs can offer. The critical role of complex services platforms in the generation of recurring cash flows in sectors of choice also favours CAMs in low interest rate environments, which contribute to LP desire for yield.

CAM funds

Private investment funds sponsored by CAMs are in many ways like other private funds, but benefit in many instances from proprietary access to the deal flow opportunities emanating from the corporate's core business. In some cases, such funds also benefit from services (on an arms' length basis) from the corporate platform as part of the value generation proposition of the fund.

The entity that is selected to serve as the CAM is commonly a newly formed, subsidiary entity dedicated to the conduct of regulated investment management activity and providing investment management services to each CAM fund. The corporate may also choose to be a client of the CAM in connection with investing alongside LPs, which may, for tax or other reasons, be accomplished through a vehicle that is parallel to the fund. The CAM, typically acting through its investment committee, is the locus of the regulated, independent investment management decision-making activity conducted for the benefit of each CAM client.

Governance and alignment mechanisms for CAM funds typically rest on best practices and negotiated terms common to many private funds, such as independent investment committee bodies, carefully defined investment guidelines, a role for the fund's LP advisory committee, as well as transaction-specific governance provisions and mechanisms. These mechanisms often reflect the evolving approach to conflicts management taken by large LPs, engendered in part by the preferences of those LPs to limit the number of managers with which they invest.

That preference has fostered complex and broad relationships between LPs and their preferred, very large, publicly listed multi-strategy managers, which are generally not affiliated with banks. Such relationships therefore reflect the refashioned (and sometimes complex) sensitivities to conflict for such managers in the Dodd-Frank era.

Certain advantages of CAM funds for LPs

In addition to offering proprietary access to attractive deal flows, CAM funds can offer LPs enhanced or accelerated exposure to preferred aspects of a corporate's strategy. CAM first time funds can also appeal to LPs' interest in gaining future access to successor funds or even new, subsequent sub-strategies. Mature, large corporates may also be relatively well-positioned to offer significant pre-specified portfolios of closing assets, attractive co-investment opportunities and above-market levels of skin-in-the game capital that support alignment of interest with LPs. Larger LPs are often already invested in a broad range of corporate securities, and can find sponsor relationship history to be helpful in making an investment decision to invest in a CAM fund.

Certain advantages of CAM funds for sponsors

While some corporate treasuries do not impose any meaningful constraints for the corporate's strategic and other objectives, it is often the case that balance sheet factors and capital resources of corporate entities may not at all times accord with optimisation of strategic and commercial objectives by a corporate, particularly taking into account cost of capital. A private investment fund programme can offer a corporate, through a CAM, relatively stable, long-term capital which compares favourably to other capital sources at a strategic and commercial level. CAMs also earn management fees and can over time become a potential profit centre for a corporate. Most CAM funds entail participation by the corporate in a portion

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of any carried interest generated by the CAM fund.

A CAM fund, like any other private fund, may pursue a sub-strategy that differs from the corporate's general profile of risk and reward, geographic exposure or other attributes. This opportunity for strategy segmentation through a CAM fund can represent an important pathway for a corporate to execute carefully (and in a more controlled, private manner) an important part of its overall strategy, while also serving its recruitment and retention goals with respect to highest performing personnel.

The compliance culture of listed or otherwise regulated corporates can also serve as a good foundation for implementation by a CAM of policies and procedures required of registered investment advisers in the US (or under the Alternative Investment Fund Managers Directive (AIFMD) in the EU), which may be a positive for LPs when considering the risks of a first time fund investment.

Alignment, governance and decision making

The role of carried interest or other performance compensation is an important one in all private funds for the establishment of alignment of interests and the establishment of suitable incentives, and CAM funds are no exception. The range of governance structures familiar to LPs often reflects LPs' most complex relationships with managers, including established multi-strategy managers that are not CAMs. Nevertheless, certain shared constants serve as foundations supporting many of these transactions.

The first constant is the importance of the combined effect of economics and autonomous CAM governance for alignment of interests. A seasoned professional at a corporate who chooses to pursue a career as part of a CAM investment team, and who not only knows the corporate, its platform and its sector well but also has his or her non-base compensation exclusively tied to the capital return performance of the fund, has overall incentives that are very similar to a peer at a standalone manager.

A second constant relates to the oversight of entities providing services to the fund portfolio investments. A professional at a CAM may be expected to be armed with information and experience that affords enhanced oversight capabilities, as compared to a person without such specialised knowledge (assuming of course suitable incentives to employ that experience). In this regard, team economic incentives, good governance structures that are conducive to autonomy and experience are likely to be diligenced by investors.

A third constant pertains to the composition of the CAM investment committee. An investment committee composed of independent persons and persons dedicated to the CAM is a common approach to addressing governance and alignment objectives.

Conclusion

CAM structures and governance present certain unique considerations. Transactions in this segment of the private funds world tend to draw on proven features of the relationships LPs have with preferred managers, and on structures that are commonly used in regulated investment management markets while delivering proprietary, attractive deal flow. ■