



BAI Investor Survey 2021

Rising demand for private debt and ESG

© Bundesverband Alternative Investments e.V. (BAI)

November 2021



Frank Dornseifer
BAI Managing Director
dornseifer@bvai.de



Philipp Bunnberg
BAI Consultant
Alternative Markets
bunnberg@bvai.de



Sven Gralla
BAI Research Associate
Alternative Markets
gralla@bvai.de



Explore further BAI publications



Introduction

Dear readers, investors and BAI members,

the Bundesverband Alternative Investments e.V. (BAI) presents the 2021 BAI investor survey, the 8th and with 104 participating German institutional investors and more than € 1,700 billion AuM the most comprehensive BAI survey to date. This report highlights our annual survey results with a hope of providing you with a deeper understanding of how institutional investors in Germany invest in alternative assets – not just today, but also in the future.

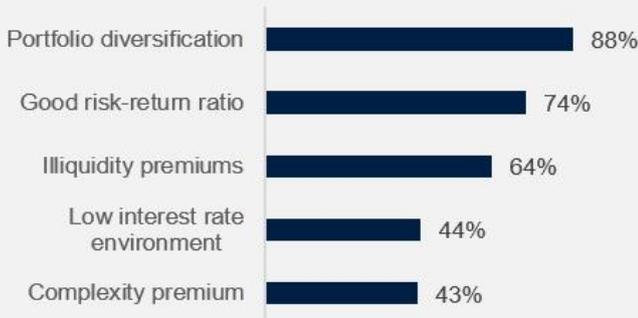
The BAI Investor Survey has been an important component of BAI's research activities since 2013. The range of questions is continuously updated and adjusted to meet the needs of the investors and BAI member companies. The framework for institutional investments in Germany is subject to constant dynamic changes. The realignment of portfolios from an ESG perspective continues. Changes in regulation have also led to new challenges and opportunities, which have been systematically captured in the survey once again. 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.

The objective of our association's 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 more than 250 BAI association's members are based in any field of the professional alternative investments business. The members' directory can be found here.

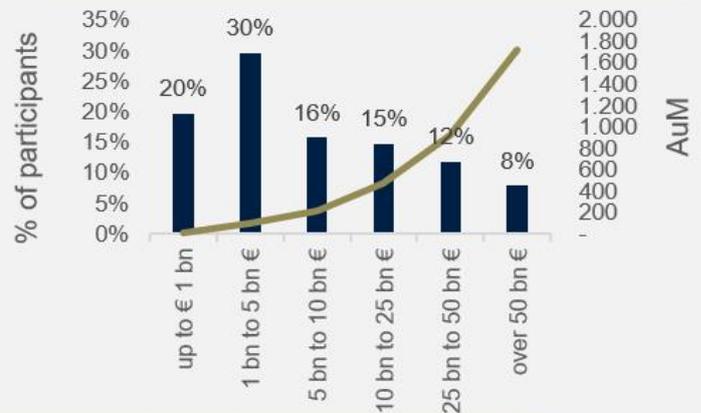
Sincerely,

Bundesverband Alternative Investments e.V. (BAI)

Benefits of AI



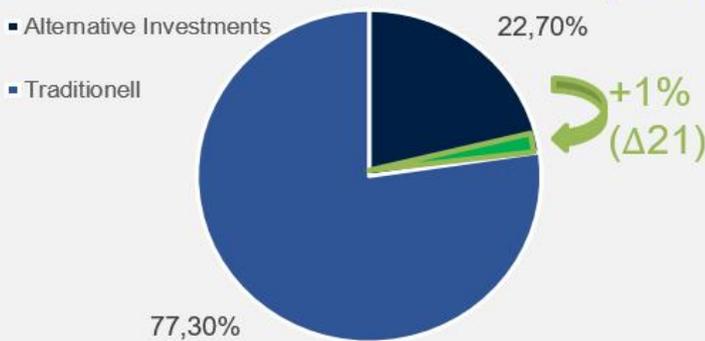
AuM



- Record participation with 104 investors
- AI share in portfolio continues to grow
- Significant growth of the allocation of private debt but also infrastructure equity and corporate private equity
- New investors enter especially the private debt market
- Majority of investors pursue an ESG strategy

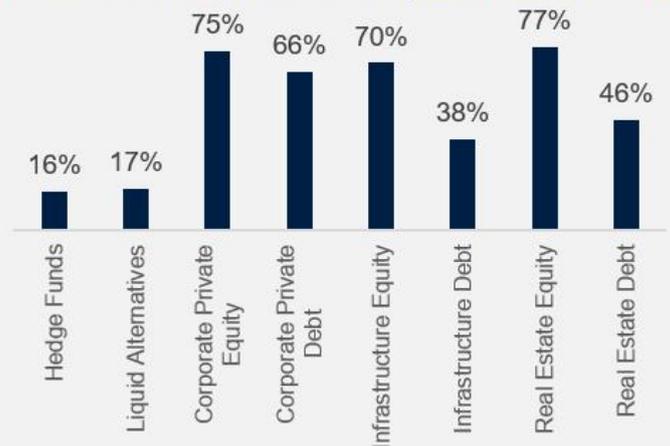
Momentum

Allocation 2021

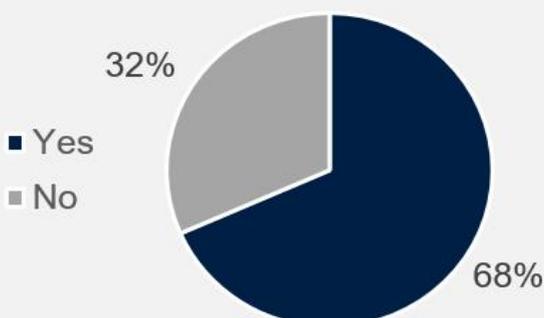


Participation

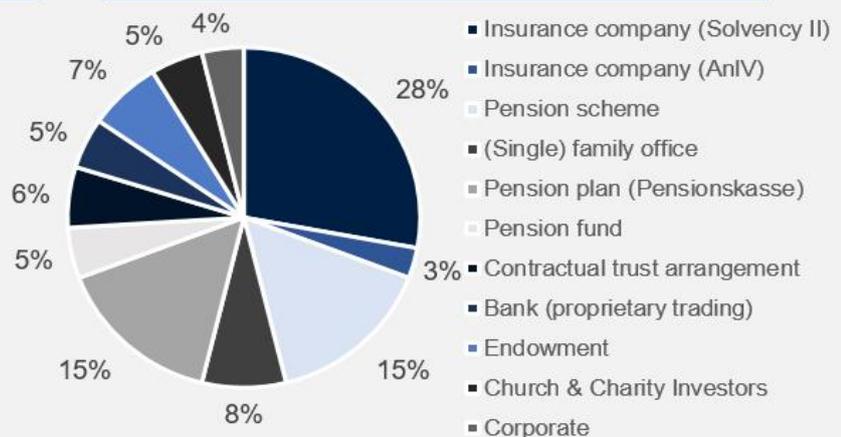
(Share of all investors invested in the respective asset classes)



Investors pursuing an ESG strategy



Investor types



Asset class specific survey results

	Participation	Exits	Entry	Allocation 2020	Allocation 2021	SAA
Hedge Funds	16%	7%	0%	0,53%	0,74%	0,98%
Liquid Alternatives	17%	7%	2%	0,80%	0,65%	0,67%
Corporate Private Equity	75%	0%	6%	3,48%	4,46%	4,81%
Corporate Private Debt	66%	2%	11%	1,70%	2,23%	2,71%
Infrastructure Equity	70%	0%	9%	2,70%	2,79%	3,65%
Infrastructure Debt	38%	0%	15%	1,09%	0,97%	1,24%
Real Estate Equity	77%	2%	3%	9,15%	8,26%	8,13%
Real Estate Debt	46%	1%	11%	1,35%	1,68%	1,95%
Credit Specialties	13%	0%	11%	0,28%	0,40%	0,45%
Other Real Assets	21%	0%	7%	0,54%	0,42%	0,31%
Commodities	9%	9%	0%	0,08%	0,10%	0,10%
Crypto Assets / Tokens	3%	0%	3%	0,00%	0,01%	0,05%



Participants

- Record attendance with >100 investors
 - Insurance companies 31%
 - Pension schemes 15%
 - Pension plans 15%
- Diversified participant structure
- Additional BAI member survey

ESG

- 68% of investors pursue a targeted ESG strategy
- ESG integration takes into account all three aspects almost equally, with environmental aspects in first place
- Investors demand data / reports as a central element of ESG implementation
- Asset managers and investors take greenwashing issue seriously



Participation rates

- Equity continues to be predominant in the investors portfolios
 - Private Equity 75%
 - Real Estate Equity 77%
 - Infrastructure Equity 70%
- Corporate private debt (66%) can catch up significantly

Reasons for AI

- Portfolio diversification 88%
- Good risk-return ratio 74%
- Illiquidity premium 64%



Allocation

- Highest allocation still in Real Estate Equity ~8.2%
- Debt demand boost expected as well as infrastructure equity and private equity (SAA vs. allocation 21)

Other findings

- Dry powder, performance and regulation remain the biggest challenges
- Track record of the team in asset classes is most important for investors
- Single funds and fund of funds are the most popular access routes



Alternative Investment allocation grows by ~4.5% (~1%p) among German investors (21 vs. 20) and is now at 22.7%. We estimate the SAA at 25%. We see particular growth potential for the private debt markets as well as infrastructure equity and corporate private equity.

Content

Introduction.....	1
Highlights	2
Methodology	5
Cross-section of Investors & Assets under Management	6
Alternative Investments Portfolio Allocation.....	9
Alternative Assets in Detail.....	18
Hedge Funds & Liquid Alternatives.....	18
Corporate Private Equity.....	19
Corporate Private Debt.....	20
Infrastructure Equity & Infrastructure Debt.....	24
Real Estate Equity & Real Estate Debt.....	25
Alternative Investor Landscape.....	26
Insurance companies.....	26
Pension schemes (Versorgungswerke).....	27
Pension funds.....	28
ESG – Alternative Investments Perspective.....	30
Access to Alternative Investments	35
Authors	39

Methodology

For this year’s survey, last year’s questionnaire was modified and extended in terms of portfolio allocation. The definition of the asset classes “credit specialties” and “other real assets” was slightly adjusted in order to gain a better insight into the differences of the broad universe of the two asset classes. In addition, current mega topics such as ESG & the EU Sustainable Finance Initiative as well as the rising demand for private debt were included.

Based on the BAI definition of alternative investments, as shown in the BAI “Alternative Investments Navigator” below, we cluster 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 farmland, timberland, aviation, shipping etc.), commodities, and crypto assets. Like in previous years, we have used this definition consistently in order to gain more precise insight.

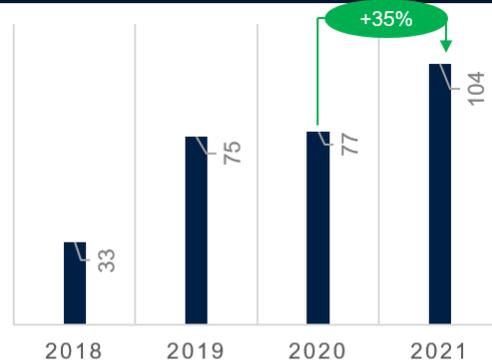
ALTERNATIVE INVESTMENTS NAVIGATOR				DEBT			EQUITY	
Strategy	Liquid	Semi-Illiquid	Illiquid	EXAMPLES	SENIOR	JUNIOR	MEZZANINE	EQUITY
PUBLIC MARKETS {MAINLY LIQUID}	LIQUID ALTERNATIVES (AND OTHER)			- Hedge Fund Strategies within regulated UCITS vehicles - Crypto Assets				
	HEDGE FUNDS			- Equity Strategies - 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.

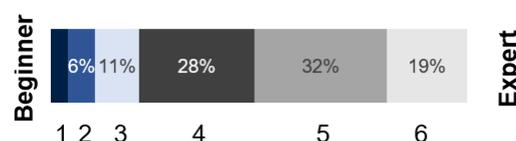
Cross-section of Investors & Assets under Management

104 institutional investors across Germany participated in the 2021 BAI investor survey, including insurance companies, pension funds, pension plans & CTAs, pension schemes, corporates, traditional banks (proprietary trading), family offices, church & charity investors and foundations. The BAI Investor Survey traditionally focuses on the buy-side, not the sell-side, of asset owners, which is why asset manager did not participate. For globally operative asset managers, providers of alternative markets products and members of our association, we have initiated a second survey in parallel. In part, we mirror the results of the limited partners (LP) survey at hand against the results of the general partners (GP) BAI member survey in order to gain further interesting insights. In addition, we will soon publish extra research results, e.g. the asset manager survey results, in a separate paper. To ensure that no investor as well as no GP participates more than once, survey invitations were only sent to one selected contact person from BAI's partners' network.

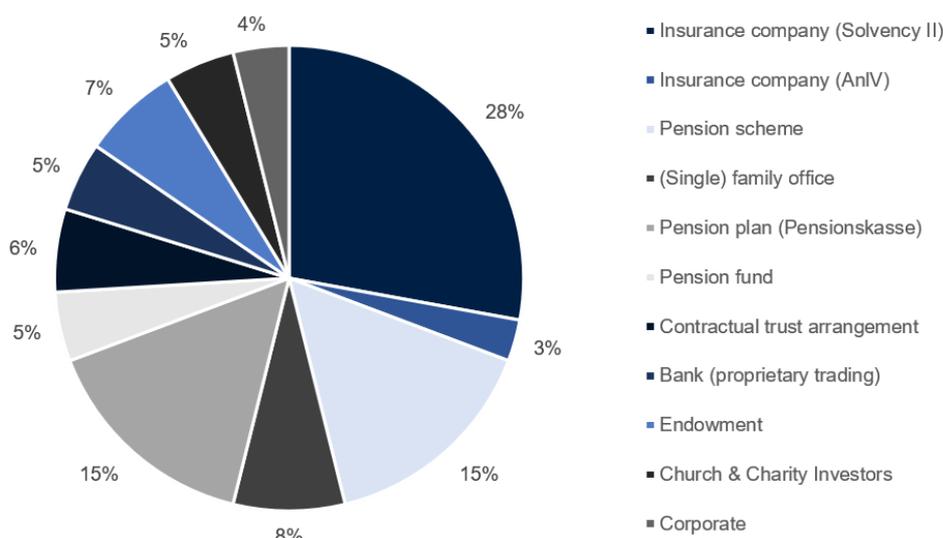
Participants over time



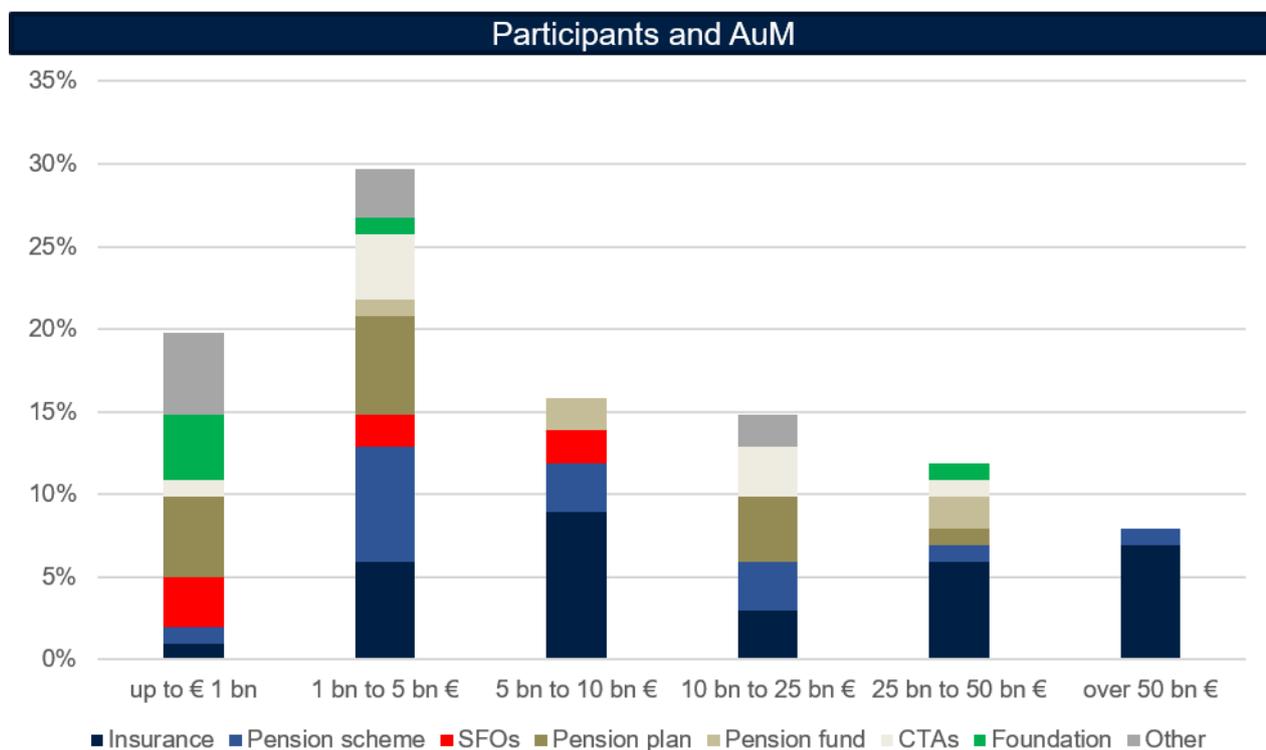
Experience in AI



Participants



The participating investor groups are characterized by their heterogeneity. More than two thirds of the respondents represent insurance companies (31 %), pension plans (15 %), and pension schemes (15 %). The amount of assets under management (AuM) therefore varies significantly among the investors, from less than € 1 billion to well above € 50 billion. Half of participants manage more than €5 billion AuM. 27 % of the participants, mainly insurance companies and pension funds, state that they have AuM between € 10 and € 50 billion. 8 % of the participants, mainly insurance companies, manage more than € 50 billion AuM.



Not only has the number of participants increased continuously over the last three years. We estimate the total AuM of the participant investors at more than € 1,700 billion, which once again 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 AuM such as insurance companies and pension funds.

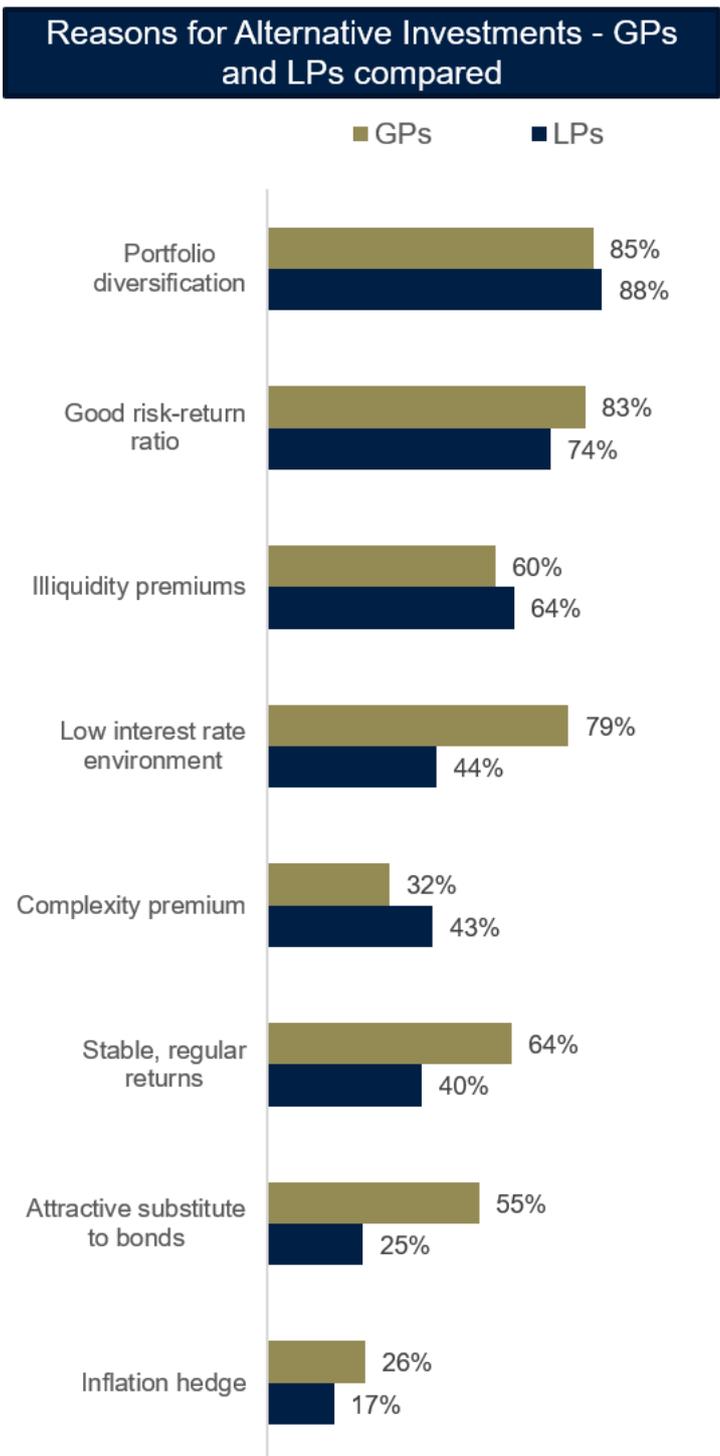
By its very nature, the structure of the participating investors could be a limitation of the study. The results of the BAI investor survey might be positively influenced by a self-selection bias, as investors

from the BAI network are naturally more committed to alternative investments than the overall population of investors. However, with 104 institutions and more than €1,700 billion AuM, we cover a substantial and highly representative part of the investor landscape in Germany. As a consequence, we are convinced that the results of the participating investors are robust and that they very accurately reflect the population and the investment behaviour of the German institutional investor landscape.

Alternative Investments Portfolio Allocation

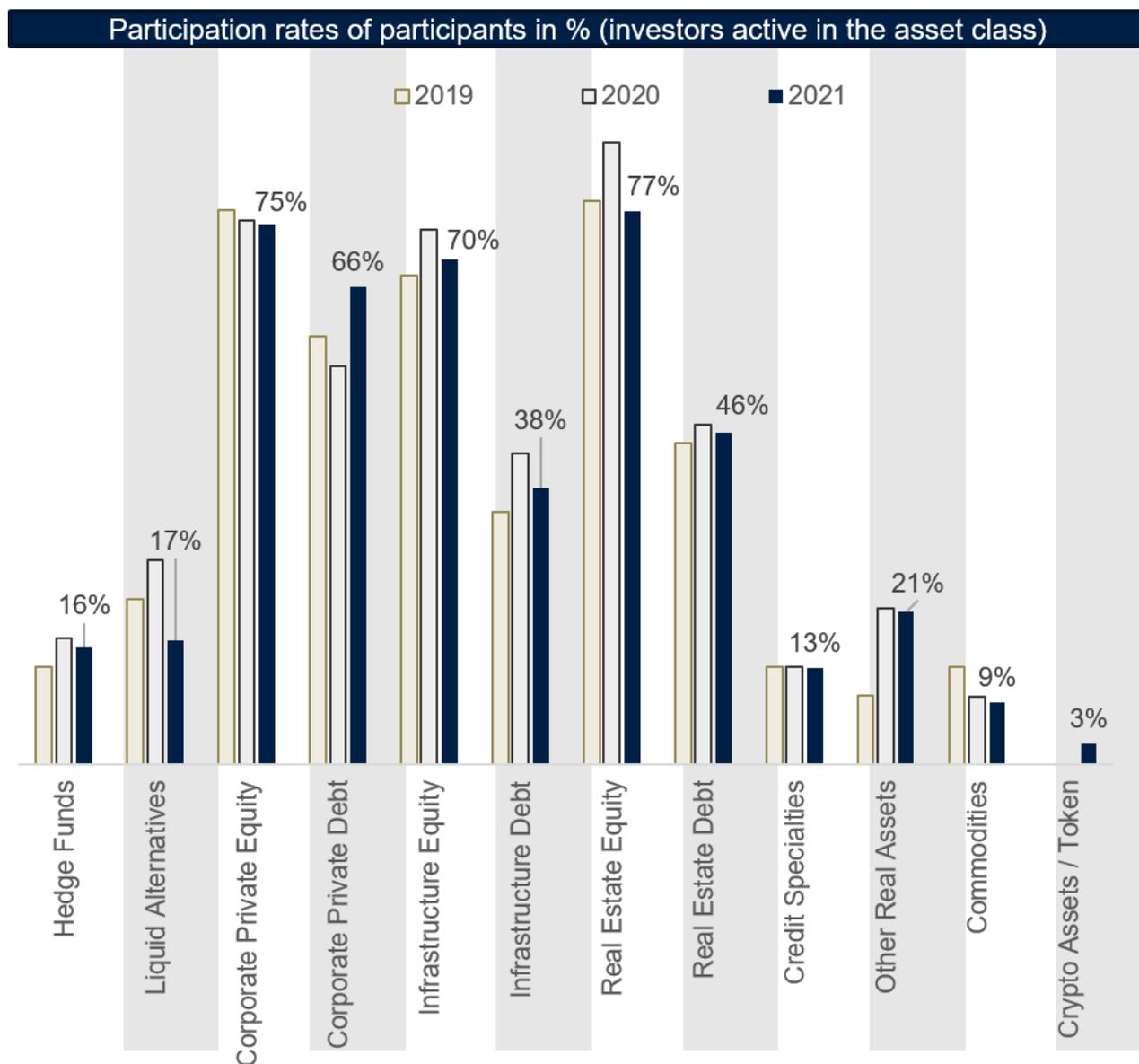
Despite the ongoing Covid-19-pandemic in 2021, the portfolio allocation shift towards alternative assets has not left its impressive growth path. Investors as well as asset managers were asked to name their primary reasons for investments in alternatives. The tremor of Covid-19, creating volatility in liquid markets and leading to a new wave of monetary easing, should only further heighten the appeal of assets with secure, stable, and regular long-term income streams. Or in other words, the replies show that alternative investments have not lost any appeal to German investors during the pandemic.

The narrative that the substitution of traditional with alternative assets is strongly correlated with the persistent low interest rate environment, certainly occupies much of the current discourse on alternative investments. Nevertheless, it is the undoubtedly positive experience of investors in terms of risk-return ratio that explains the significant increase in the allocation to private market investments in recent years. The diversification potential of alternative asset classes, with which LPs unlock illiquidity and complexity premiums, is and



remains the main reason for investments in alternatives.

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 e. g. infrastructure equity and debt gain more and more stakes in the portfolio.



Alternative investments are no longer a niche but an established part of the portfolio for the majority of participants. Private equity investments in corporates (75 %), infrastructure (70 %), and real estate

(77 %) are an integral part of their portfolios. Already 66 % of the investors diversify their portfolios with corporate private debt. This represents a significant increase in investments of new investors in this asset class compared to previous years.

Which is what our last year's investor survey anticipated. What's more real estate debt (46 %) and infrastructure debt (38 %) investments continue to grow significantly. For insurance companies in particular, but also for pension schemes, these two asset classes are of great importance, e. g. due to long maturity periods for their asset liability management.

On the other hand, hedge funds and liquid alternatives continue to have a difficult time in Germany. Many of the investors surveyed completely forgo additional portfolio diversification through alternative strategies. Already in last year's survey, hedge fund investors saw major problems in public perception as well as in the funds' performance. But the rather negative overall picture on the investor side did not appear in a significant exposure withdrawal from hedge fund investments. On the other hand, 9 % of investors have completely withdrawn from commodities. As a result, the number of investors has halved in recent years. Instead, demand for real assets such as timber and farmland is increasing.

„We expand our real assets portfolio, thereby increasing diversification and collecting complexity & illiquidity premiums.“

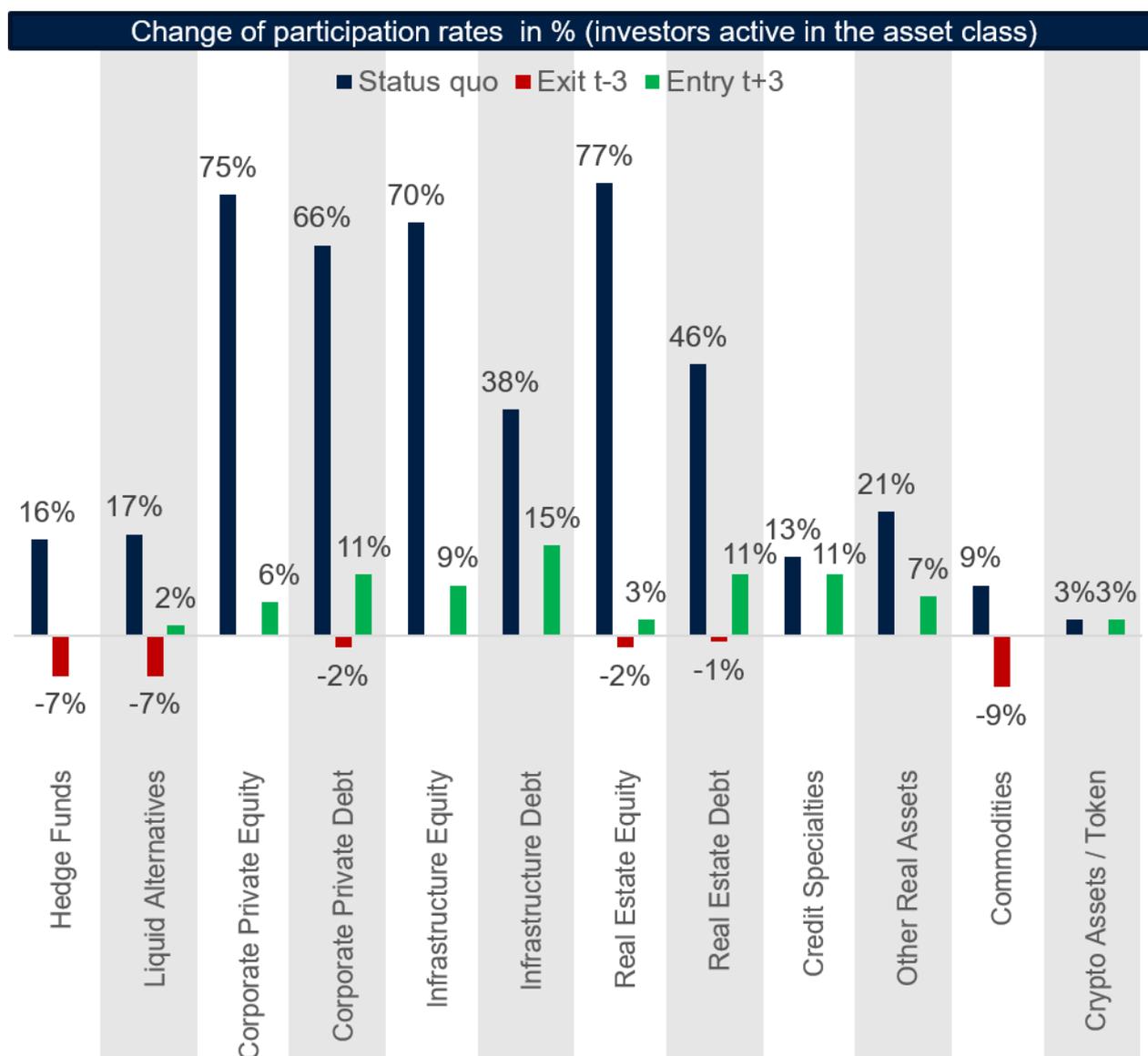
- small pension scheme -

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 and corporate private equity can be found in almost all investors' portfolios nowadays, which is why future first-time investments are limited in size. For infrastructure equity (9 %) and in particular debt (15 %) a significant increase in participation is to be expected.

„We continue to reduce government and corporate bonds due to unattractive risk-return ratios.“

- small insurance company -

Moreover it is striking that, across all asset classes, private market debt investments will continue to catch up to their equity counterparts over the upcoming years. Comparable to last year’s survey it becomes apparent that investors are still willing to increase their investments 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.



Note: The changes do not necessarily have to be associated with the attractiveness of the asset class, but could also relate to the sample size or structure.

What is more, it should not be ignored that, for the first time ever, participants in the BAI investor survey stated that they currently invest in crypto assets such as crypto currencies and crypto token.

The number of crypto investors will double in the next few years as another three percent plan to invest. In Germany, these are primarily HNWIs (not represented by this survey), family offices and foundations. However, the results of the survey clearly show that while interest in digital assets among institutional investors is high, allocation is still low currently. This should not come as a surprise in view of the regulatory framework that is only just developing. The low correlation to traditional investments and guard rails for the market in the form of increasing legal certainty could also make crypto assets an attractive diversifier in institutional portfolios in the future.

In line with the standardised definition of asset classes, investors were asked about their allocation in alternative investments. 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.

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 22.70 % of the portfolio is invested in alternatives.

„Farmland offers value stability and adequate regular returns.“

- large insurance company -

“The realignment of our strategic asset allocation includes the expansion of private market products at the expense of commodities.“

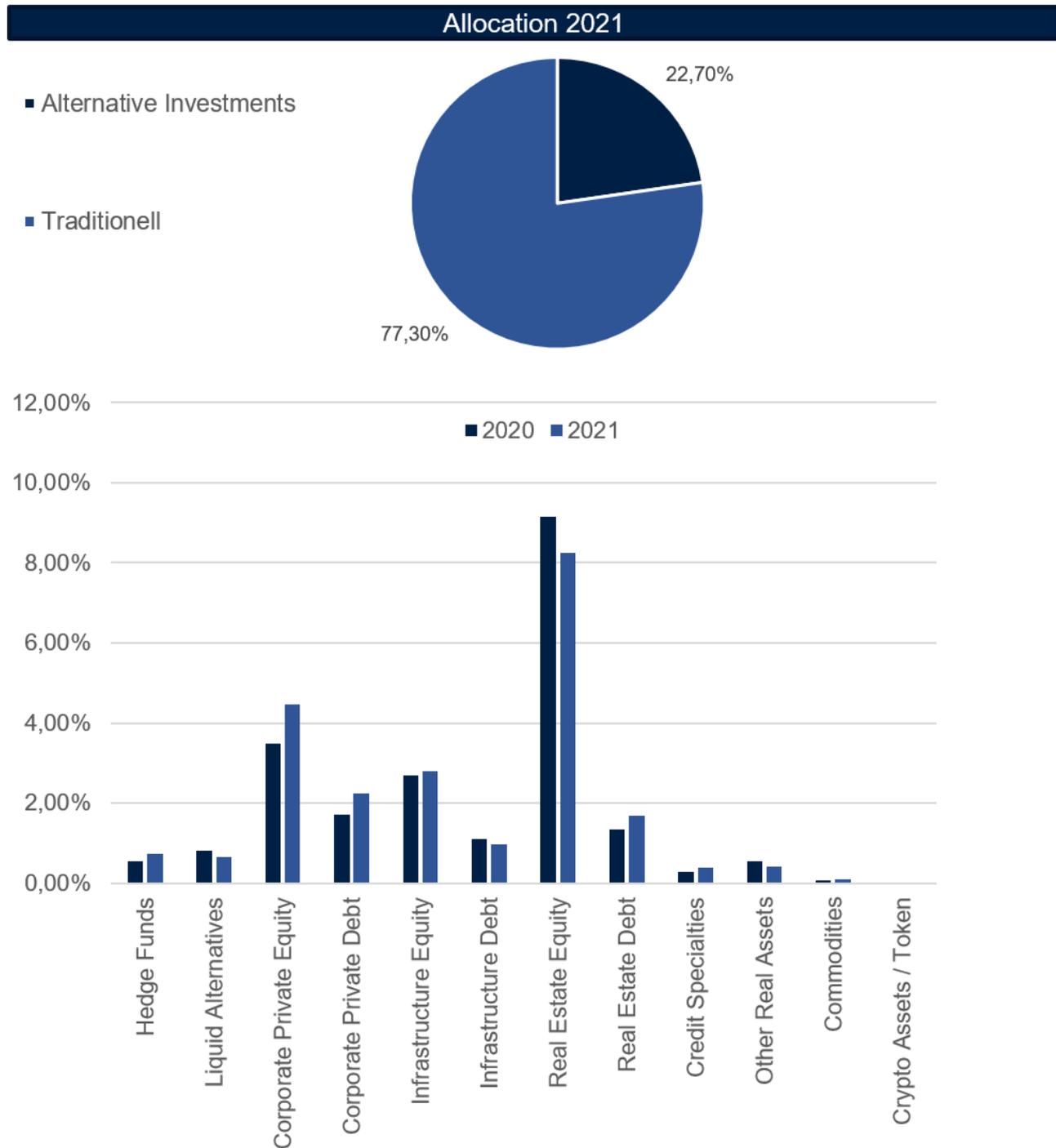
- pension fund -

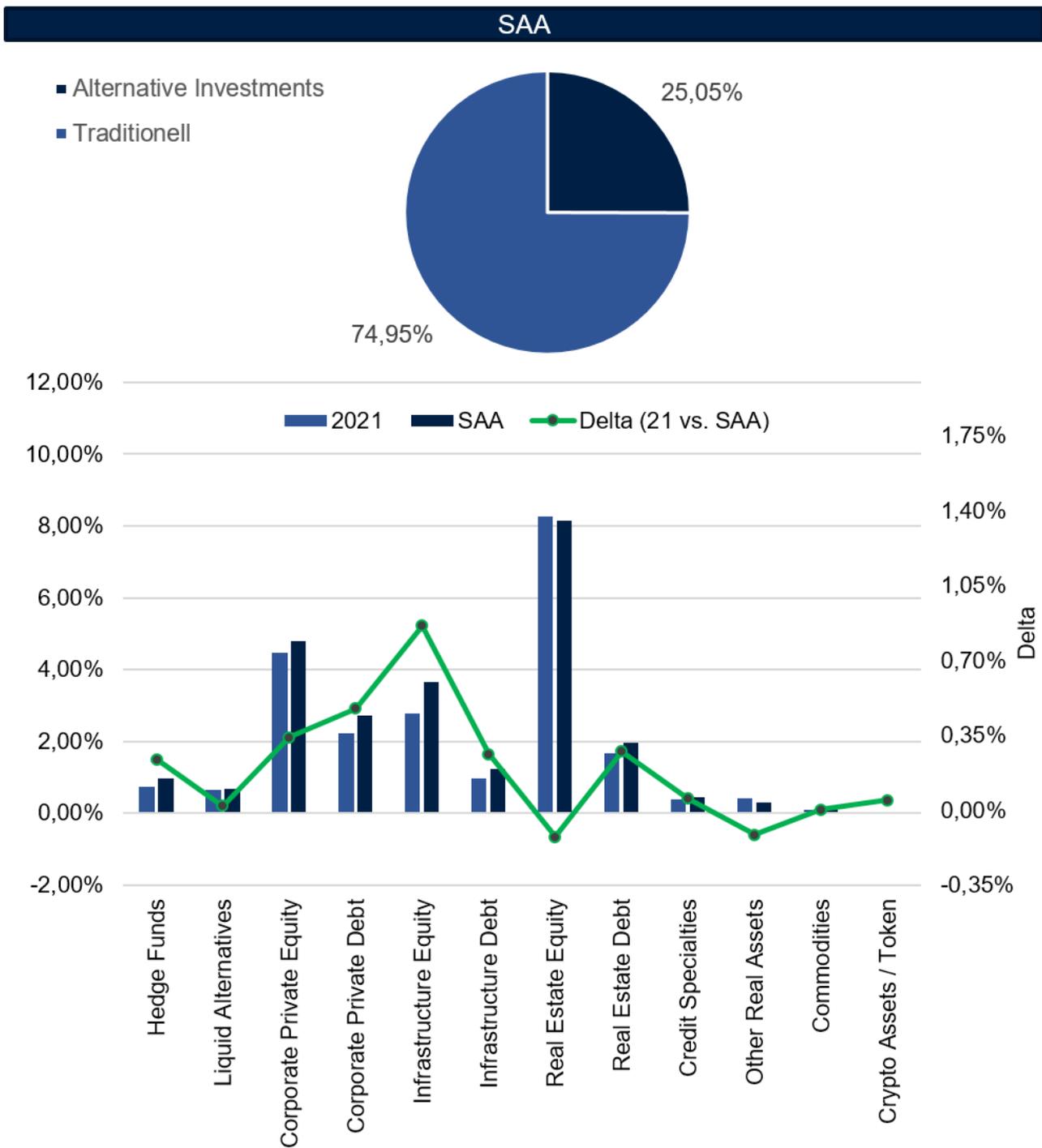
Looking at the distribution of the allocation of those investors who invest in the asset class, it is once again striking, but also not surprising for German institutional investors, that real estate equity has a significantly higher portfolio weight compared to other asset classes.¹ Real estate is followed by corporate

equities.

¹ 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.

private equity and infrastructure equity, two asset classes in which investors have also committed a lot of capital in 2021.





Based on the investors' sentiment, as already stated in last year's survey, the expansion of the alternative investments' portfolio shares will continue next year, as the growth momentum of equity as

well as debt investments in corporates, infrastructure, real estate and other real assets will most likely carry on

We asked investors about their expected strategic alternative asset allocation in order to identify medium term trends in the market.² Our survey results show that the split between traditional and alternative investments continues to become more and more aligned. The triumph of alternative investments has been particularly present in recent years, and the first investors, although only a few, are already reporting that they have reached their alternative investment target allocation.

We expect that the average institutional investor in Germany will expand the alternative invest-

„The ongoing low interest rate environment is pushing for alternative asset classes with stable cash flows and low risk profiles and, where appropriate, an inflation component.“

- small bank -

ments exposure from 22.70 % to over 25 % in the next few years. This corresponds, in line with last year's survey result, to an estimated yearly growth rate of the entire alternative investments industry from 3 % to 6 % in the upcoming years, whilst keeping various exogenous incalculable variables in mind. Our long-term alternative investment allocation growth

rate forecast was confirmed as 2021 is found in the middle (~4.5 %) of the specified 3 % to 6 % range with significant new alternative capital commitments from various investor groups.

By comparing the estimated current and estimated future target allocation, it can be concluded that investors have not yet reached their target allocation in almost all alternative asset classes. One exception to this is real estate equity, which is traditionally very strong in Germany. In this field most investors are already close to their strategic target allocation. Private debt and infrastructure exposure will be increased significantly. On the other hand, other real assets are currently in a more

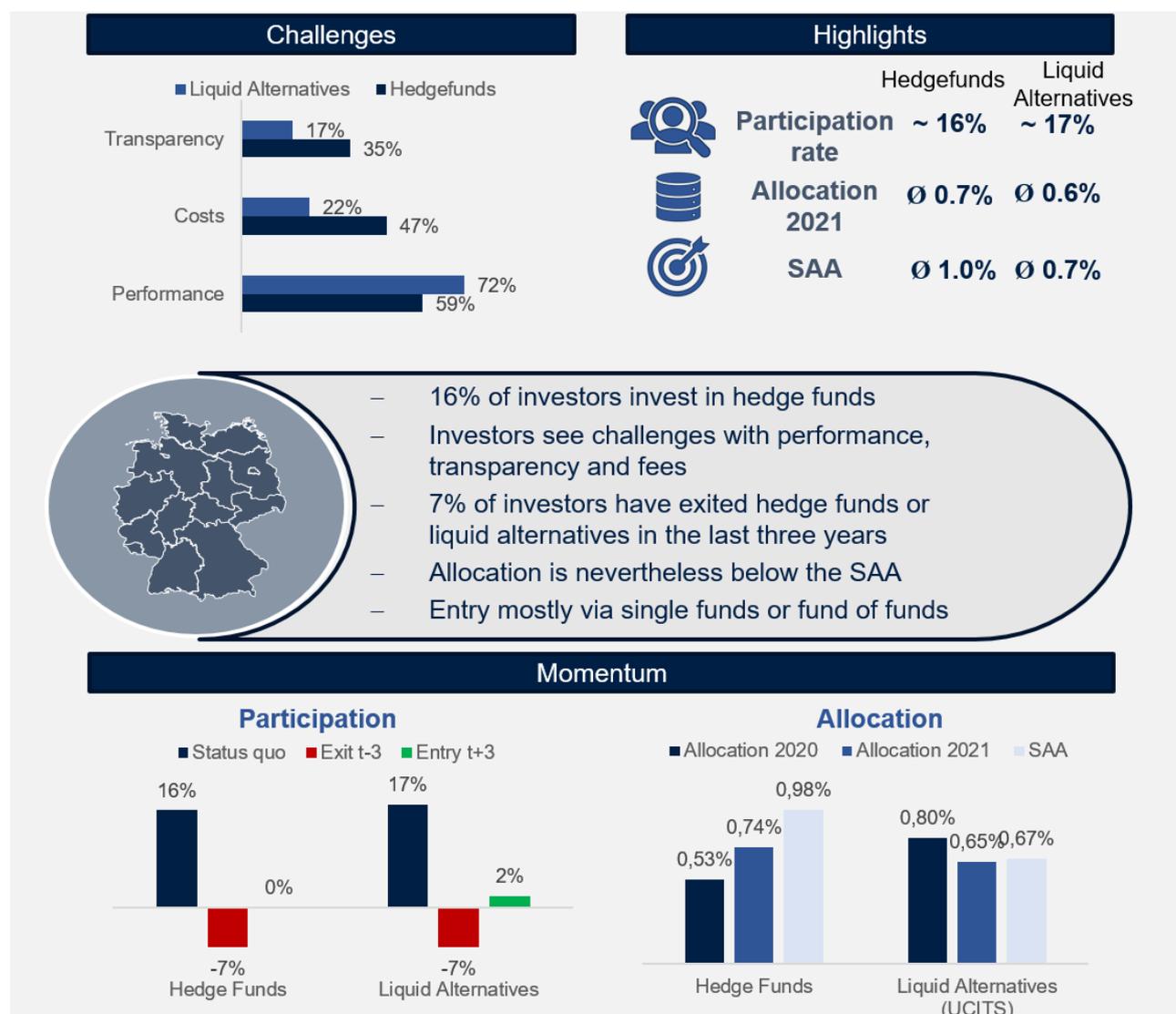
² The calculation was carried out according to the same standards as for the current portfolio allocation shown before.

difficult position, e. g. aircraft and ship financing. This could be related to a realignment of the portfolios from an ESG perspective, but also to the after-effects of the pandemic on travel and interrupted supply chains.

Alternative Assets in Detail

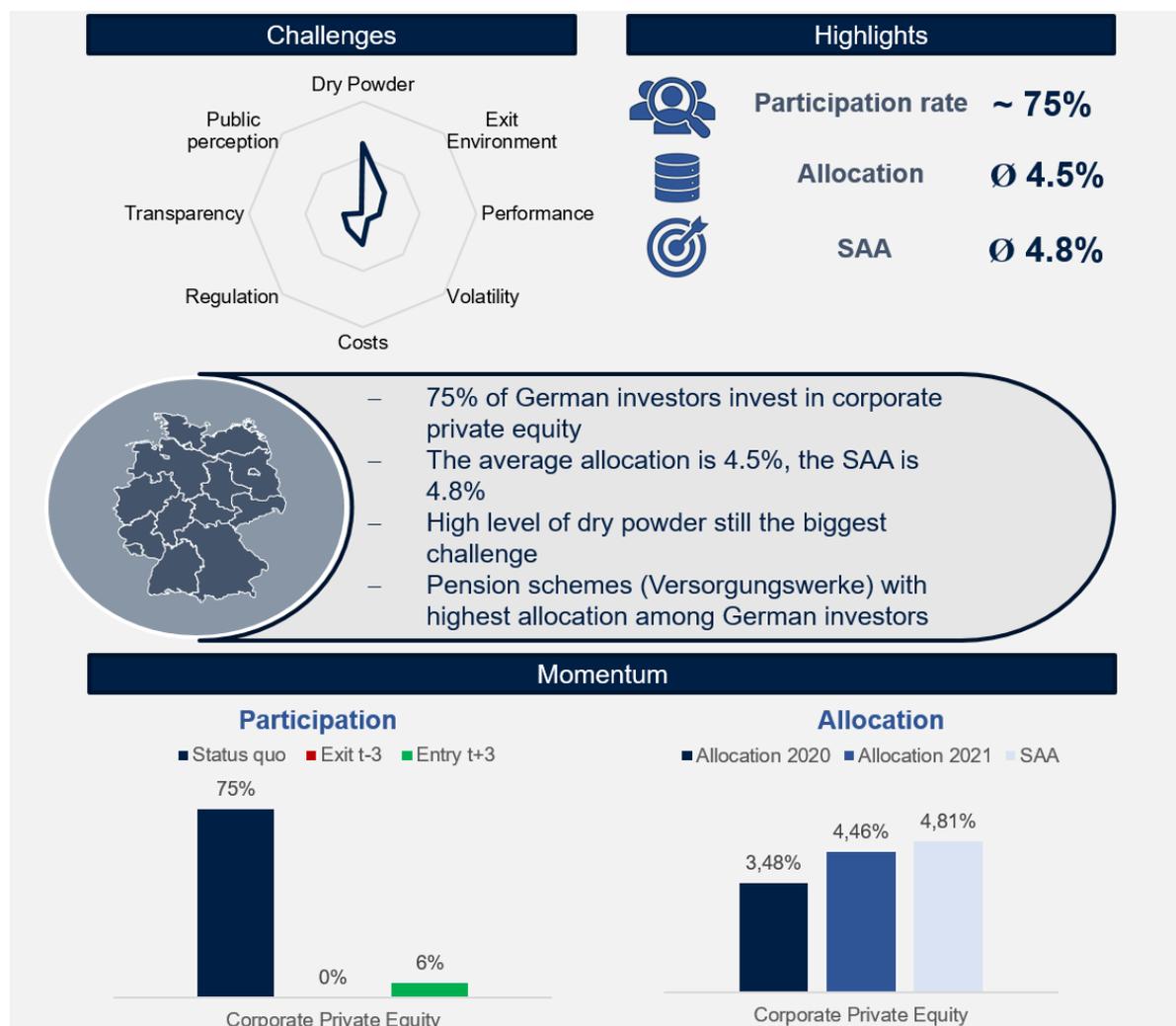
Hedge Funds & Liquid Alternatives

Liquid alternatives (UCITS) and hedge funds still have a difficult time in Germany. Only few investors are willing to enter the universe of alternative strategies. Contrariwise, further reductions of those investments are expected. Product performance remains the biggest challenge, especially for alternative strategies in UCITS vehicles. From the perspective of German investors, management and performance fees are set too high by many hedge fund managers. Nevertheless, one in six investors is still allocated and many of these plan to strategically increase their allocation in the upcoming years.



Corporate Private Equity

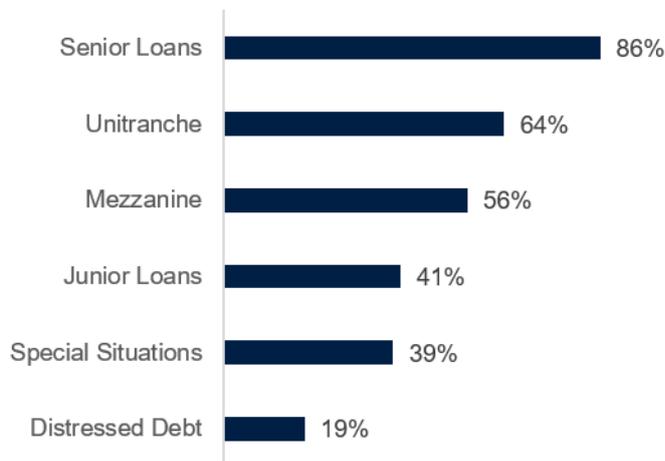
During the Covid-19-pandemic, private equity once again proved its worth as a performance and stability anchor in the institutional portfolio. The high level of dry powder certainly remains a challenge. The fact that not one of the investors surveyed wants to exit the asset class speaks for itself. In the coming years, the allocation is to be steadily expanded so that German institutional investors will soon have on average 5 % of private equity exposure in their portfolios. Pension schemes are pioneers in this regard and are already moving towards an average of 7 % SAA.



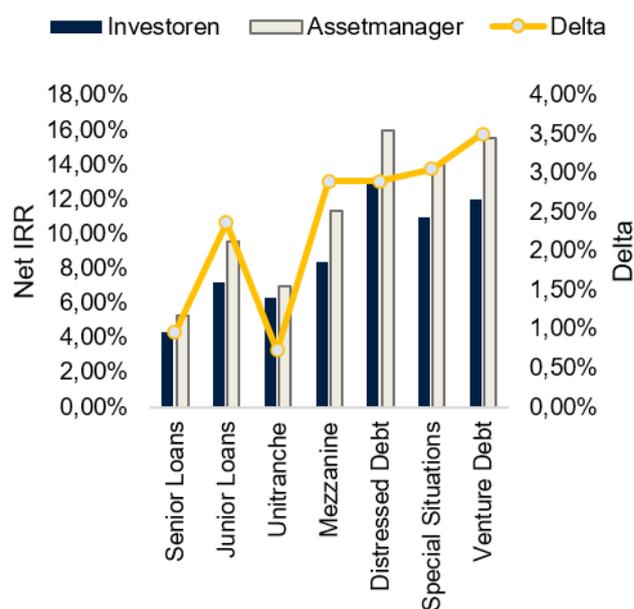
Corporate Private Debt

As mentioned before, debt products in particular will continue to catch up. According to several investors, the market for credit funds should maintain growth momentum. Our survey confirms the increasing demand from institutional investors on the one hand. On the other hand, the financing needs of SMEs are increasing. What is 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. Recent regulatory proposals presented by the EU Commission could therefore provide important impetus, but it will be important that the actual design and implementation is not thwarted in the end, as e. g. in Germany, where a largely unrelated alignment with banking supervision law once again nipped the topic of loan funds in the bud. Consequently, it is not surprising that almost all German investors invest through Luxembourg vehicles. In comparison, German AIFs are only minor components in the portfolios.

Private debt sub-asset classes (of Private Debt Investors in %)



Expected net IRR for private debt



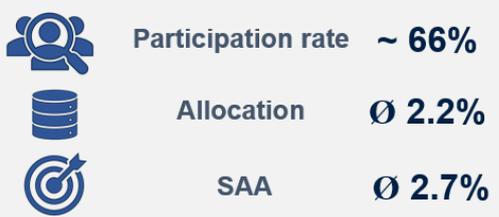
„We will further diversify our private debt program through credit specialties.“

- large pension plan -

Challenges



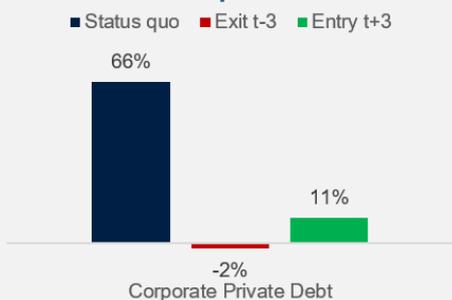
Highlights



- Private debt can catch up significantly with the other asset classes
- 66% of investors are active in PD, and 11% are planning to enter
- In terms of allocation, we expect a significant increase
- Single funds and fund of funds are the most popular entry channels

Momentum

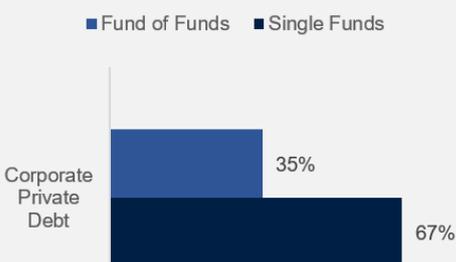
Participation



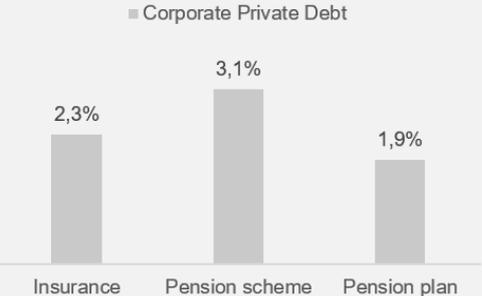
Allocation



Entry



Allocation by Investor Types



In practice, it will be important that possible additional regulatory requirements create a reliable legal framework that will give direct lending funds a 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.

„The attractive risk-return ratio, the low correlation to other liquid corporate asset classes and the low volatility encourage us to further increase our private debt allocation.“
- insurance company -

The demand among investors for corporate private debt, in particular direct loans, as 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

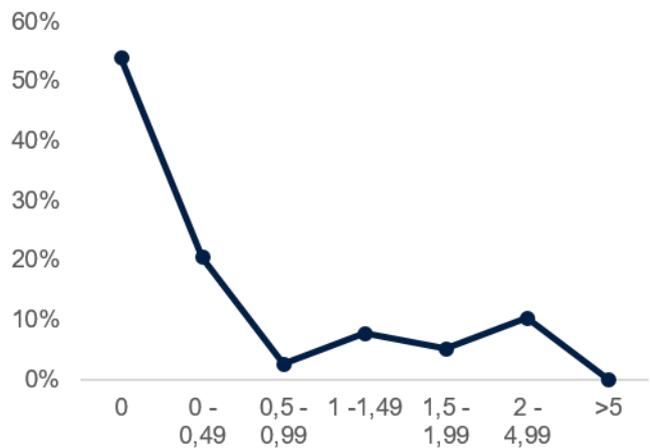
low-rate environment. Senior loans and unitranche are most in demand, with mezzanine and junior on the fast track in the search for attractive returns. Investors have precise return expectations. Nevertheless, return expectations may vary widely within an asset class, e. g. due to different asset vehicles, financing stages, and vintage years. What is striking but not surprising is that the expected returns between LPs and GPs diverge to some extent. This applies to all sub asset classes without exception and makes it all the more important for investors to choose their GPs prudently, as practice shows that IRRs can diverge widely from manager to manager.

All in all, for private debt funds, the Covid-19-pandemic has been a successful test for the integration into the institutional portfolio. An all-encompassing assessment of the private debt market is difficult to rate due to the heterogeneous investment universe. Return patterns diverge (in times of crisis), sometimes strongly, depending on the sub-segment of the asset class under consideration. Nevertheless, in a recent BAI paper we did illustrate that private debt, and corporate direct lending in particular, is an established and systemically important asset class that has been able to generate consistent excess returns at moderate drawdowns even in crisis periods compared to liquid debt instruments. Nevertheless, the pandemic and thus a re-emerging crisis scenario is far from over. In the future, the changing interest rate environment and rising inflation rates will also have to be observed, which may also influence the environment for private debt investments.

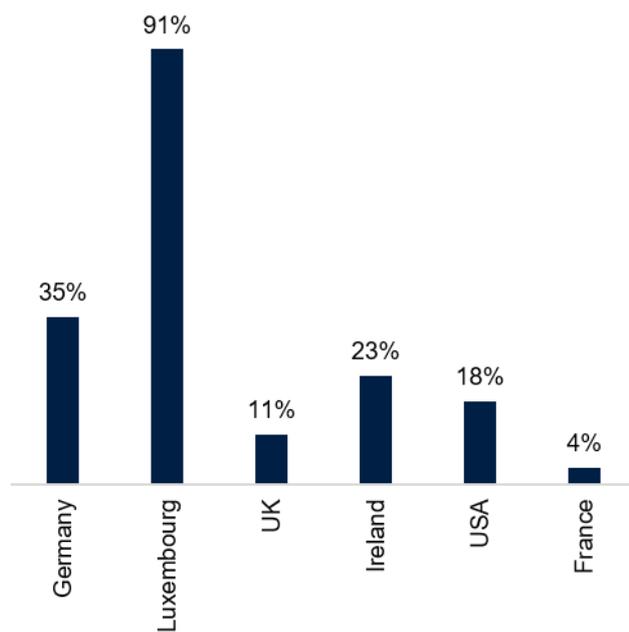
For investors, the prudent choice of reliable partners is decisive. This is crucial e. g. for long-term infrastructure projects. Data on infrastructure investments can be found on the following pages. But we can state for sure that the characteristics of infrastructure equity and debt make them a good diversification tool - even in most tail-risk periods, as the recent BAI study shows.

The same remains to be true for the real estate market. Data about the market will also be presented in the following. Loan funds represent a comparatively new trend in the real estate fund market, which has gained considerable importance in recent years, so that private debt real estate funds have now gained a foothold in the European financing market. The BAI investor survey 2020 already indicated that no other access channel to the real estate market will grow more strongly in the coming years.

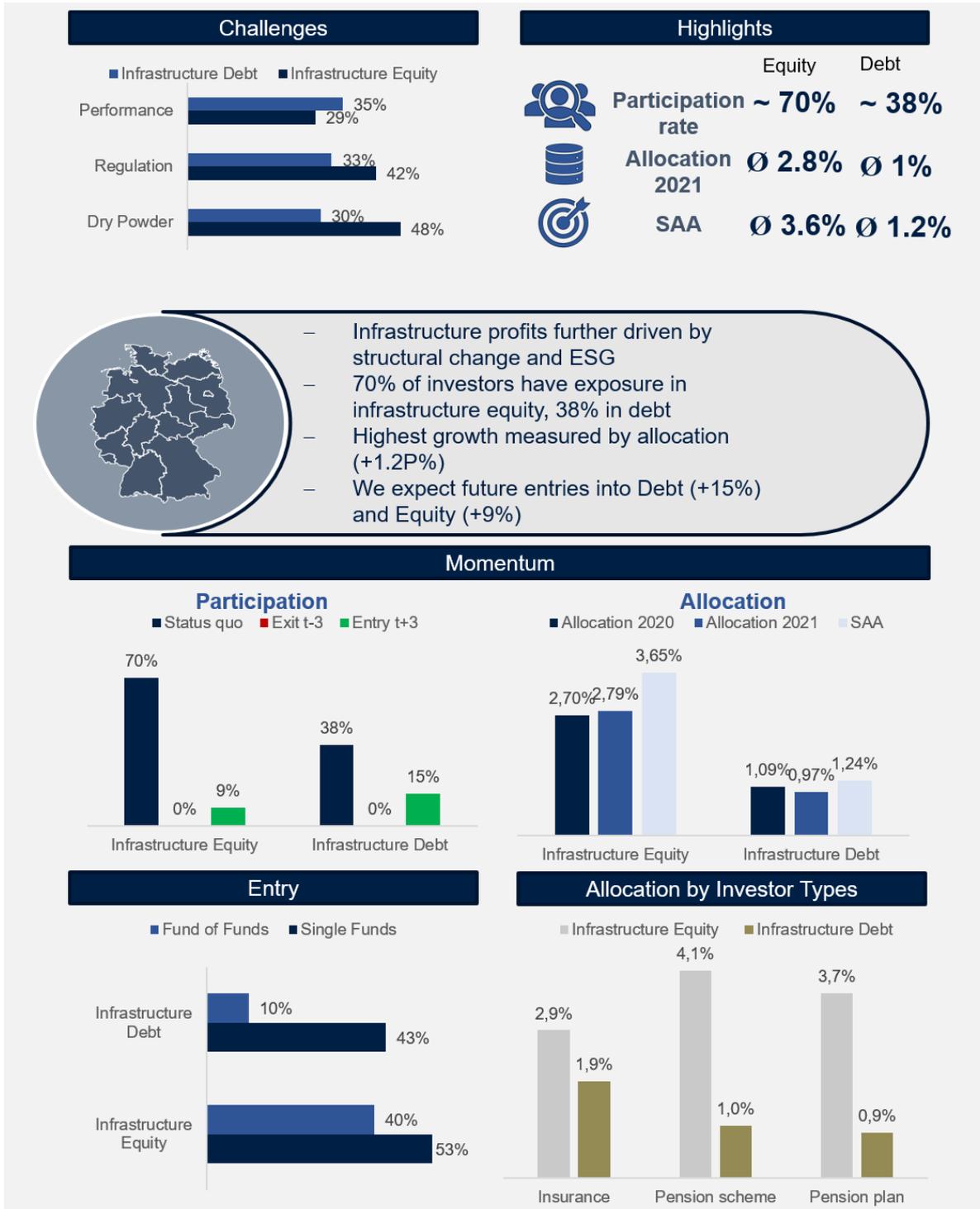
Leverage of private debt funds



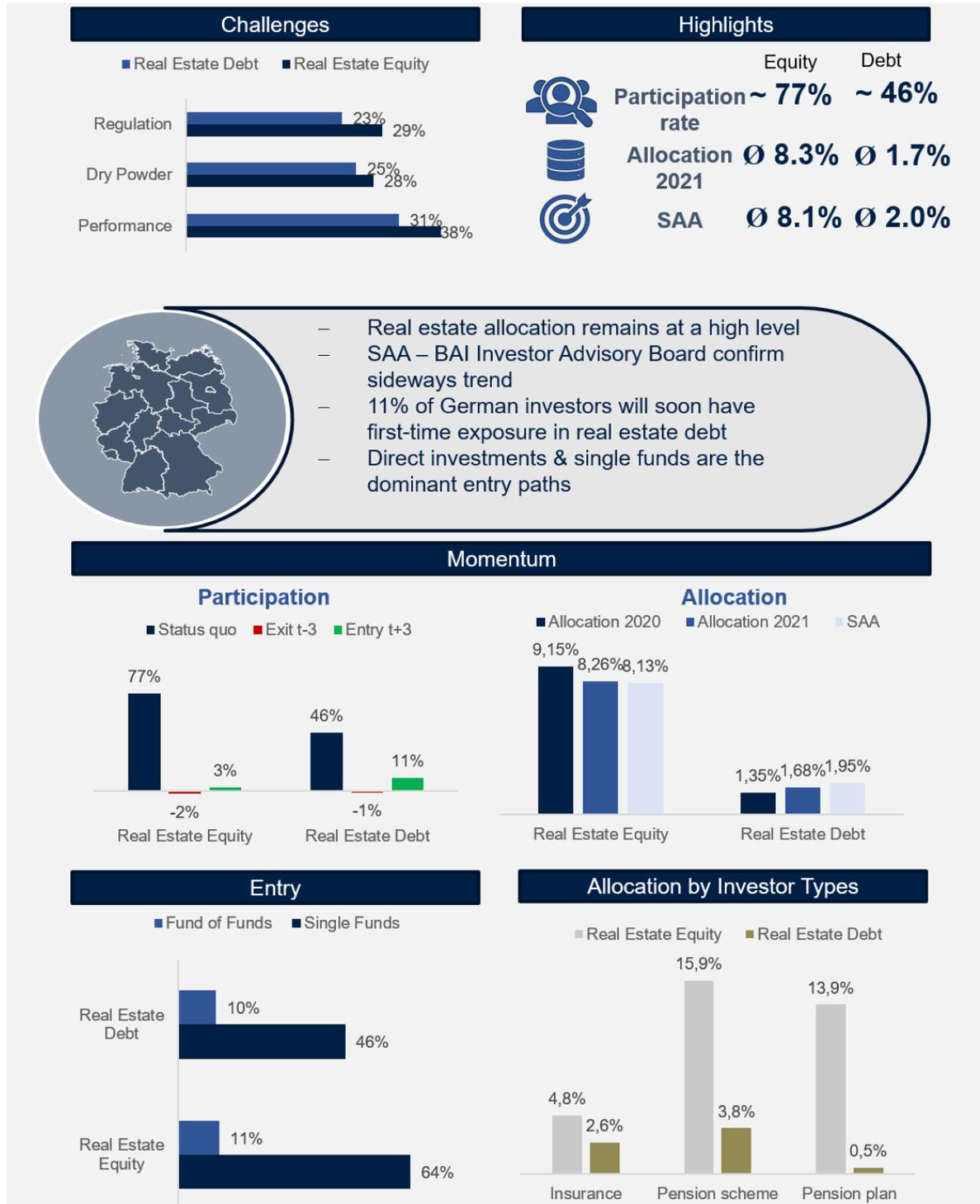
Domicile for Private Debt Single Fund investments



Infrastructure Equity & Infrastructure Debt

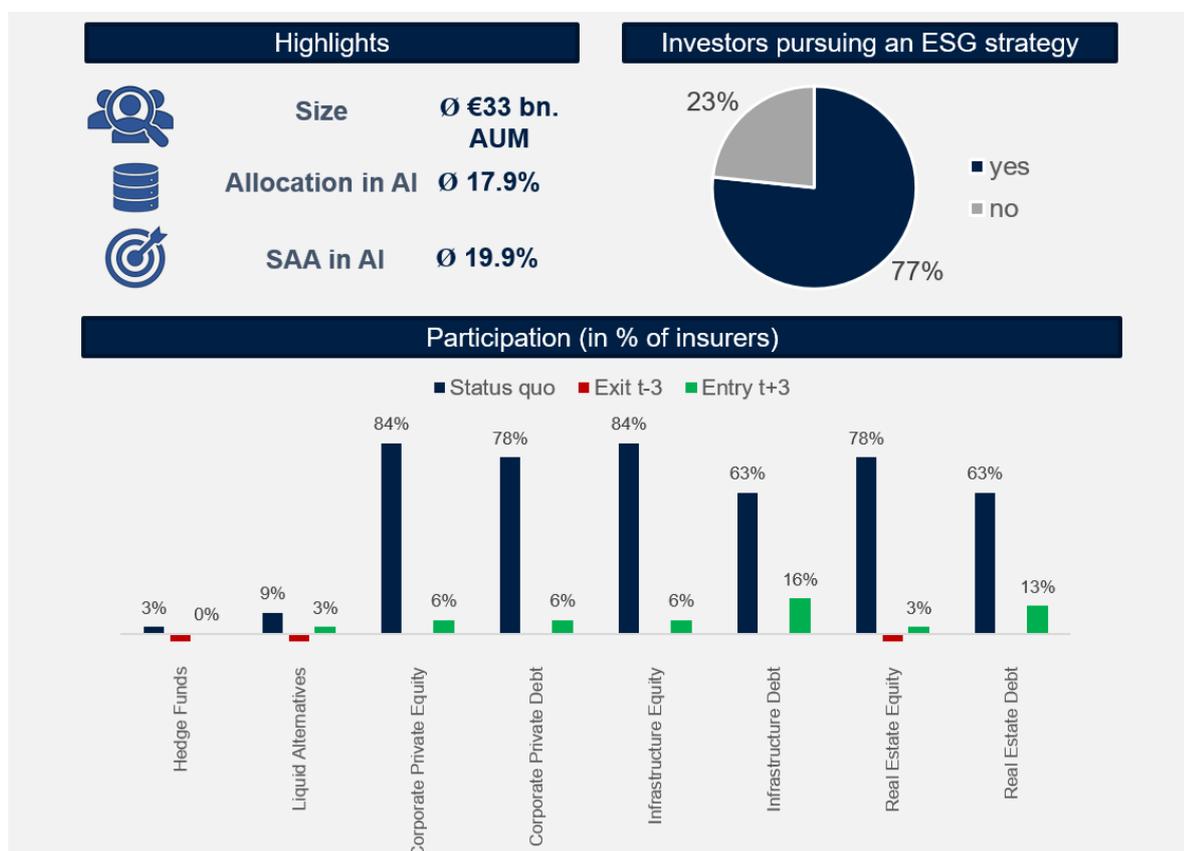


Real Estate Equity & Real Estate Debt



Alternative Investor Landscape

Insurance companies



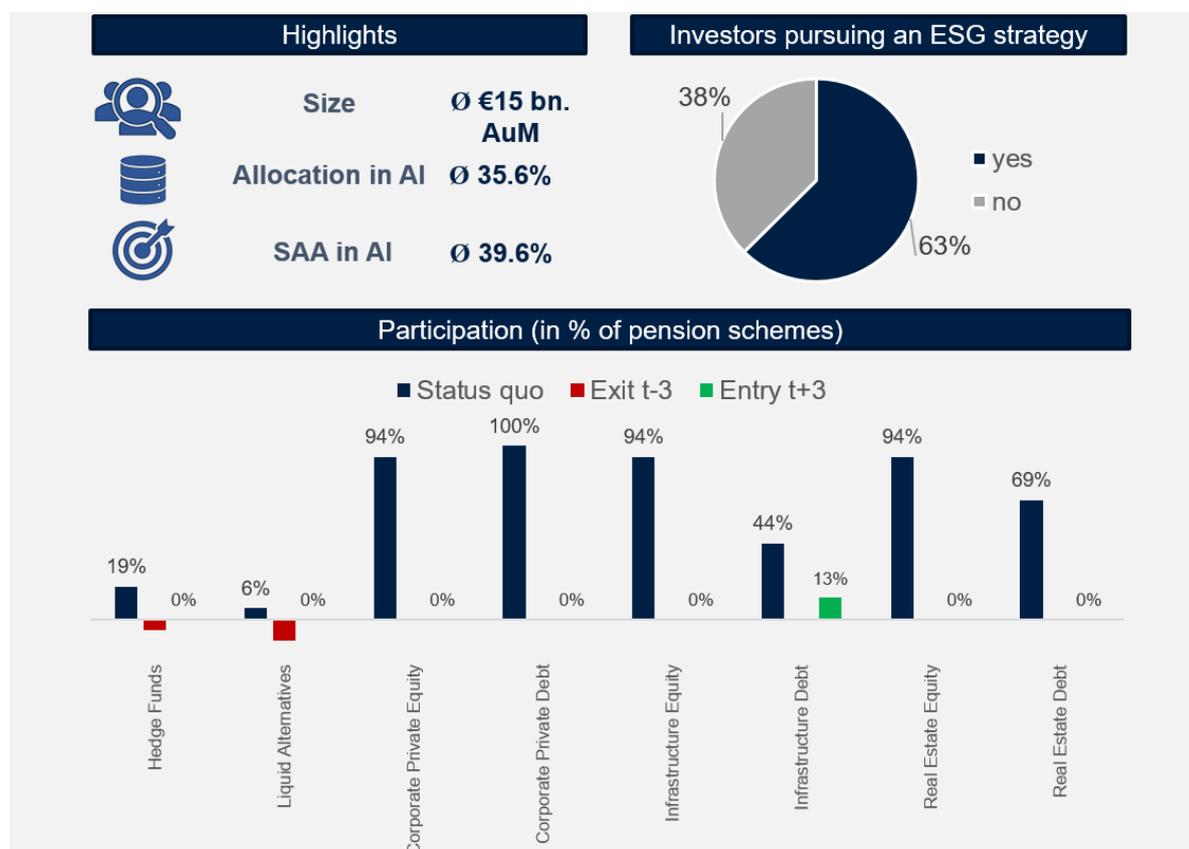
Insurance companies represent the largest group in the BAI investor survey (31 %) with an average of €33 billion AuM. The majority of these are regulated under Solvency II. We cover the majority of the insurance industry in Germany within the investor survey. The German Insurance Association (GDV) states, that the German insurance industry manages a combined amount of €1,800 billion. Our survey covers around 60 % of this.

In contrast to other investors, the participation rate of insurers for private equity and infrastructure equity is even higher than the participation rate for real estate. The gap between equity and debt is also significantly smaller compared to other investors. 15 % of the insurers are planning to enter the infrastructure debt market in the next few years.

The average allocation to alternative investments is around 18 % for insurance companies and is expected to rise to 20 % according to their stated SAA. For corporate private debt in particular, the SAA is 0.5pp above the current allocation, which indicates a substantial growth. Insurers invest in multiple sub-classes of private debt (distribution of private debt investors): senior loans: 64 %; junior loans: 28 %; unitranche: 56 %; mezzanine: 36 %; distressed debt: 16 %; special situations: 28 %. Luxembourg is the most important domicile for private debt funds.

77 % of insurance companies pursue a specific ESG strategy. In particular, they demand data and new reports, but also see inconsistencies in standards and transparency in alternative investments as a core challenge. Due to their size, insurance companies have a high level of experience in alternative investments, which enables them to use diverse access channels such as co-investments.

Pension schemes (Versorgungswerke)



15 % of the investor survey participants are pension schemes. In total, the pension schemes in our survey manage approximately €230 billion. The average pension scheme manages around €8 billion.

Compared to insurers, it is noticeable that participation is predominantly high in real estate equity with 88 %. New entrants are expected in particular in infrastructure debt and corporate private debt. 19 % of the pension funds plan to invest in infrastructure debt, while the entry rate for corporate private debt is 13 %. The interest rate environment and demographic change in particular pose special challenges for pension schemes. Therefore, we expect a continuing shift towards alternative investments.

Overall, pension schemes have the highest allocation to alternative investments with over 35 %. Real estate accounts about 16 %, private equity for more than 6 % and infrastructure equity for 4 %. The SAA for alternative investments even predicts up to 40 %. The growth potential is equally distributed between infrastructure (equity & debt) and corporate private equity and debt.

The access channels differ depending on the asset class. For asset classes with high participation rates and many years of experience, the access channels are much more complex. For relatively young asset classes such as private debt, on the other hand, investors rely on single funds and funds of funds.

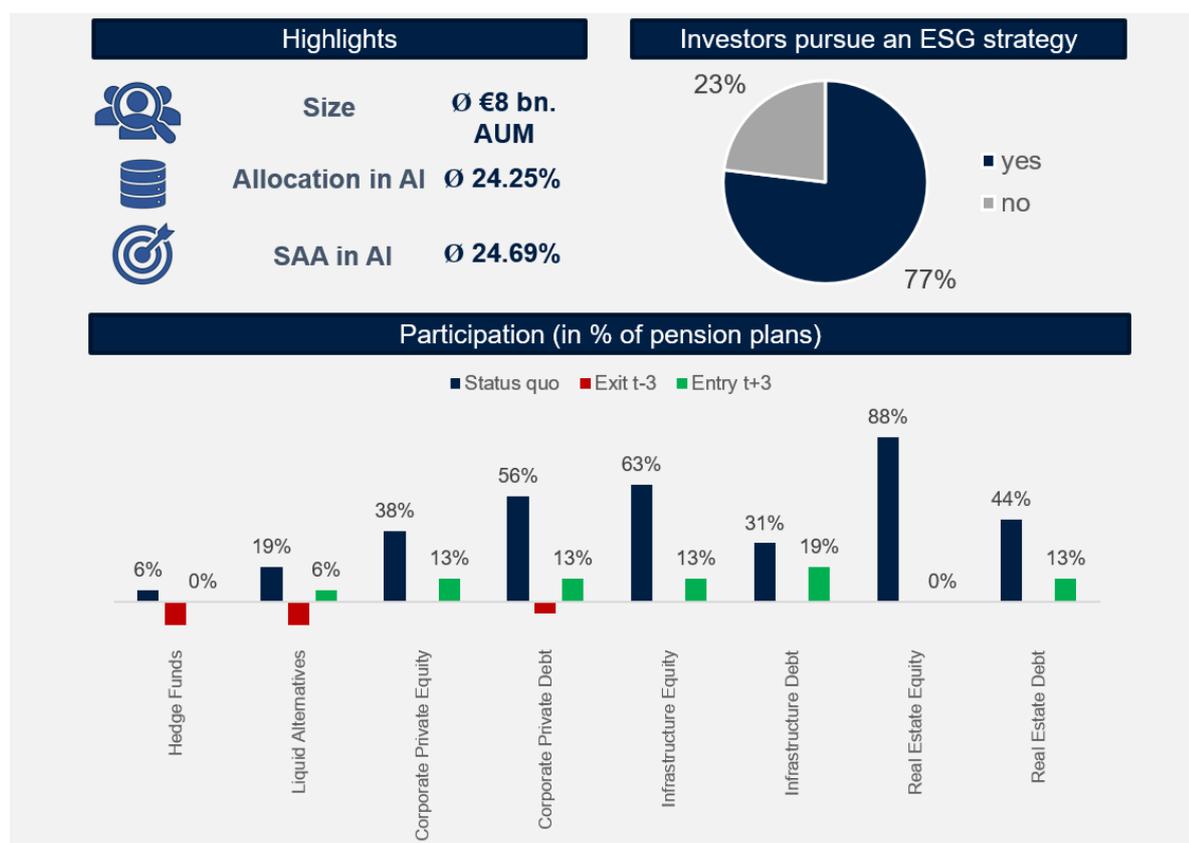
63 % of the pension schemes follow an ESG strategy, 70 % of them even pursue impact strategies. All in all, the ESG strategies are implemented through increased reporting by the GPs and enhanced reporting to their own stakeholders.

Pension funds

The picture for pension plans is similar to pension schemes. According to data from the German Insurance Association, pension plans in Germany manage €186 billion.

88 % of pension plans are active in real estate equity, followed by infrastructure equity with 63 % and private equity with 56 %. However, the participation rates are expected to change, especially for infrastructure (equity and debt) and corporate private equity and debt. Here, 13 % - 19 % of the pension schemes aim to enter the market for the first time. All in all, 77 % of pension plans pursue an ESG strategy. This should significantly prevent reputational risks.

Pension plans invest more than 24 % of their portfolio in alternative investments. Over 50 % of this is allocated to real estate equity. In the future, pension schemes will not significantly increase the share of alternative investments, but rather shift within the alternative investment allocation. Infrastructure equity and debt and corporate private debt will become more important. For real estate equity, the pension plans perceive problems in particular in the exit environment and in the performance of the asset class. For other asset classes, regulation is often identified as a major obstacle.



ESG – Alternative Investments Perspective

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 following figures. Recently almost no other topic is 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 future in the progress of the EU Sustainable Finance Initiative. Concerns about 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.

„ESG ratings are still a problem. There are very few data providers in the alternative investments space. The best coverage is still in the liquid stock market.“

- pension scheme -

The statements made by the investors in the survey provide a clear message. They rely on their own expertise, which they are constantly building up. The investors ESG integration takes into account all three ESG aspects (environmental, social, and governance) almost equally, with environmental aspects coming first, as expected.

“We consider timber and farmland investments, as these can contribute in reducing CO2 emissions and also generate a reasonable return.“

- insurance company -

„We already exited certain investments because sustainability targets were not met.“

- pension plan -

But one legitimate question is driving investors and other market participants: Is greenwashing adequately captured by regulation? There are still many question marks behind this topic. For German institutional investors greenwashing is definitely a concern, but it is not yet adequately covered by regulation.

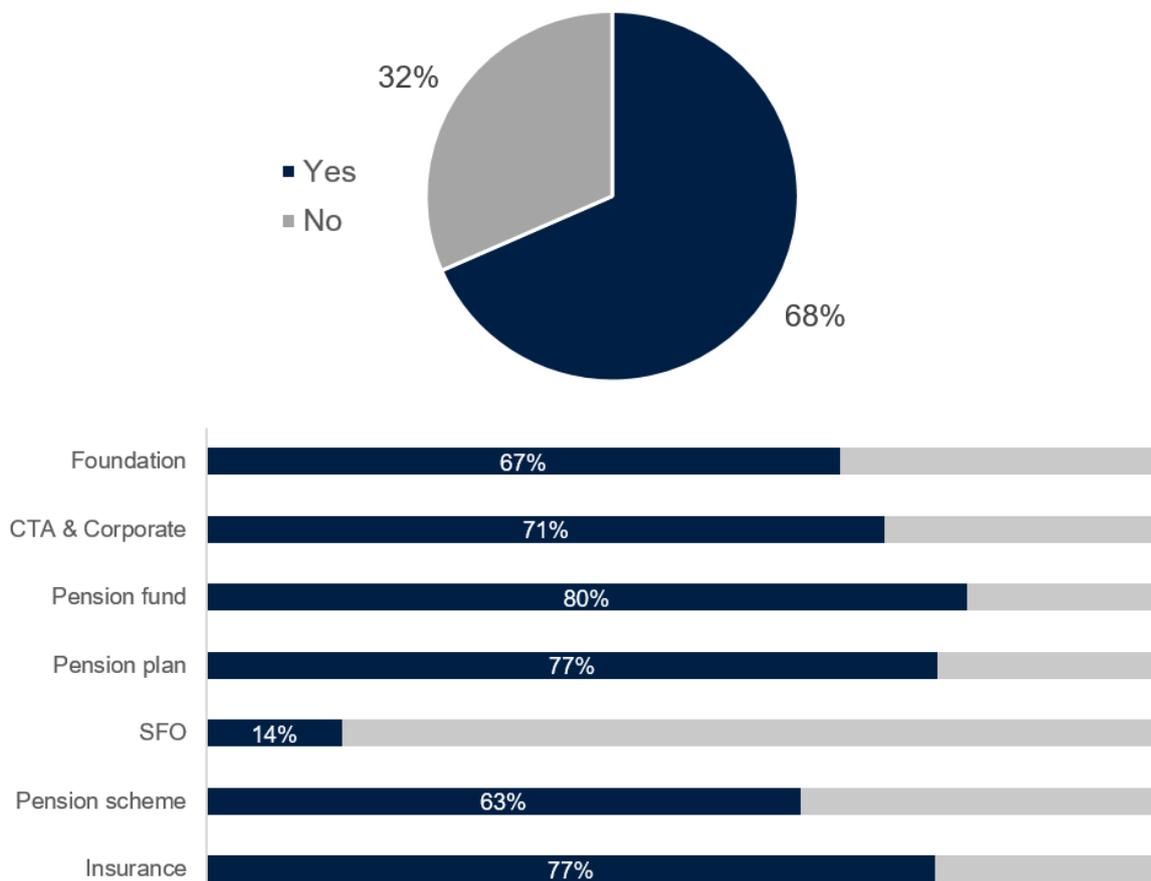
The statements made by the investors in the survey provide a clear message. They rely on their own expertise, which they are constantly building up.

As the sophistication of ESG increases, investors continue to educate themselves about what is most relevant to their portfolios. Looking at last year’s BAI investor survey “timeline” of commitment to ESG principles it became apparent that a far greater number of investors joined the ESG train picking up speed early compared to asset managers.

„Lack of transparency as well as data availability and inconsistent assessment standards hinder us to pursue a specific ESG strategy.“

- pension scheme -

Percentage of Investors pursuing an ESG strategy



Why ESG?



The return on investment is not one of the main reasons for ESG portfolio integration. Instead, primary drivers are the avoidance of reputational risk, which is an intrinsic interest, the expectation of the clients and the ESG implementation into the risk management. The four reasons mentioned have once again significantly increased in importance compared to the previous year's survey. And then only in fifth place come regulatory requirements. The survey results prove that the reasons for ESG integration into the investment process are still extremely heterogeneous. This shows us, as an industry association, how difficult it is to reconcile these sometimes strongly divergent levels of interests of investors as well as of our members and other market participants. For us, but also for the regulators and the providers of

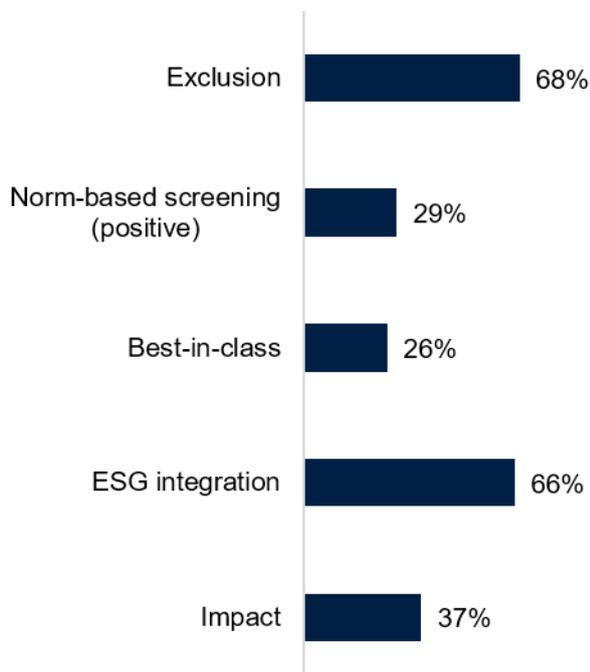
**„Acceptance of our ESG guidelines is not always present with US-GPs“
- large pension fund -**

ESG-compliant investment products, the entire field of sustainable finance will remain a tremendous project in the coming years. In view of the heterogenous understanding of ESG alignment and interests, the exchange and agreement between all market participants and supervisory authorities will have to become more important in order to increase mutual understanding.

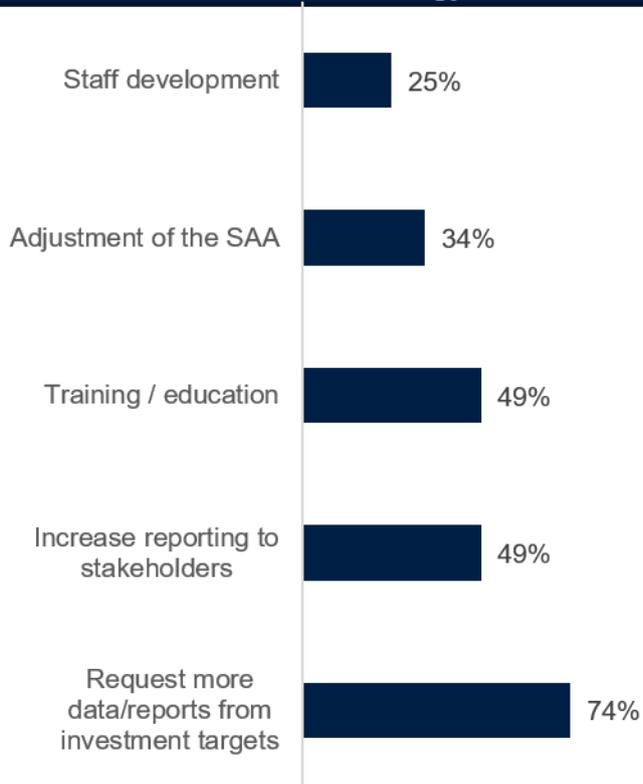
The alternative investment industry has a preeminent role to play in financing the European Green Deal. For this reason alone, it must be ensured that the regulatory framework for AIFs is wisely improved.

„Regulation is currently more of an obstacle to the implementation of our ESG strategy! The requirements for private markets are too high and impractical.“
- insurance company -

Which ESG strategy do Investors pursue?

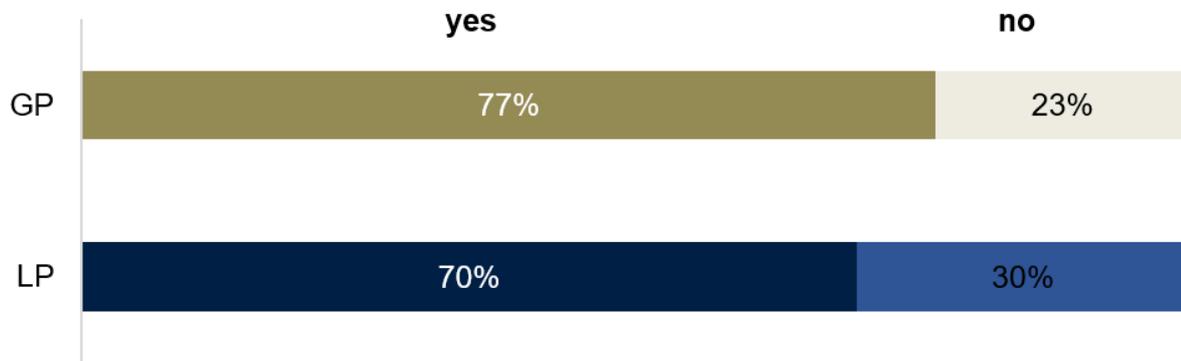


What is the operative implication of the ESG strategy?

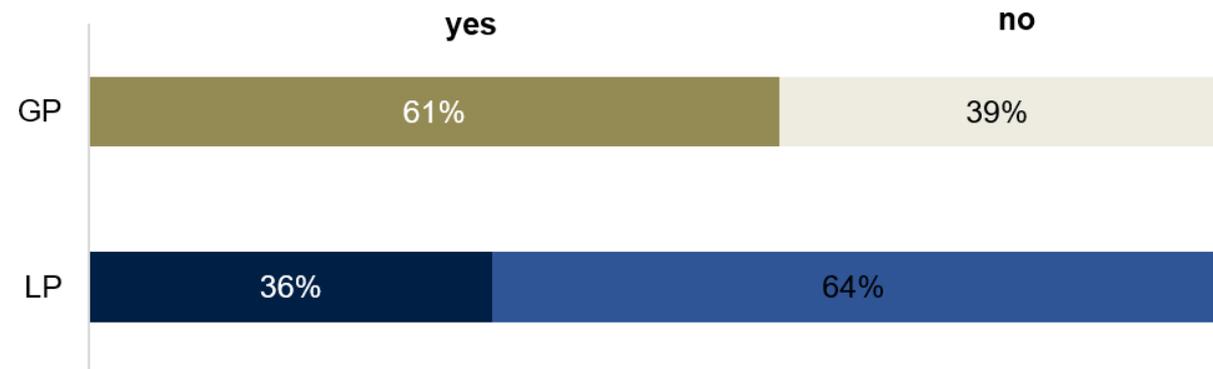


Concerns about greenwashing

Is “greenwashing” a problem for the investment industry?



Does the EU Sustainable Finance Initiative help to prevent "greenwashing"?



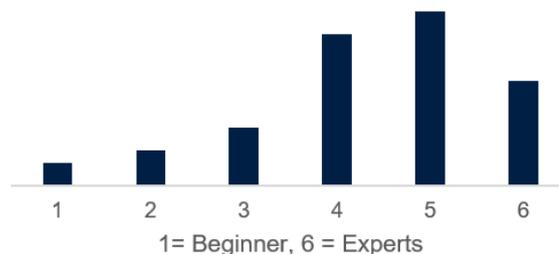
Access to Alternative Investments

This year, we also wanted to gather information from investors on how they assess their own experience in the field of alternative investments. The results show that the experience of the individual investor is extremely heterogeneous with a wide range from rather inexperienced beginners to experts in the field of alternative assets.

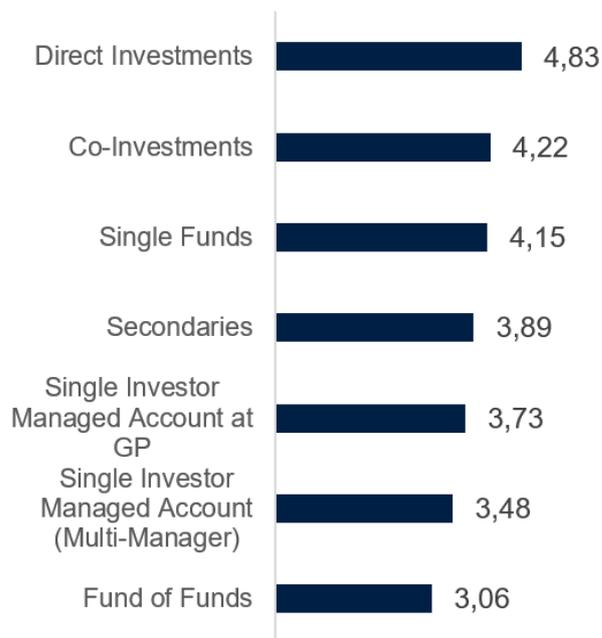
Experience plays a crucial role in access routes into private markets. By their very nature, experienced investors with large in-house investment teams have a more diverse range of access to alternative investments such as direct or co-investments.

In general, we recommend that especially rather inexperienced investors seek external expertise and advice. Our survey among investors shows that experience is necessary even for entry-friendly products such as fund of funds. Managed accounts, which are becoming increasingly important offer an additional, suitable access route.

Experience of German investors



Required level of experience per access route

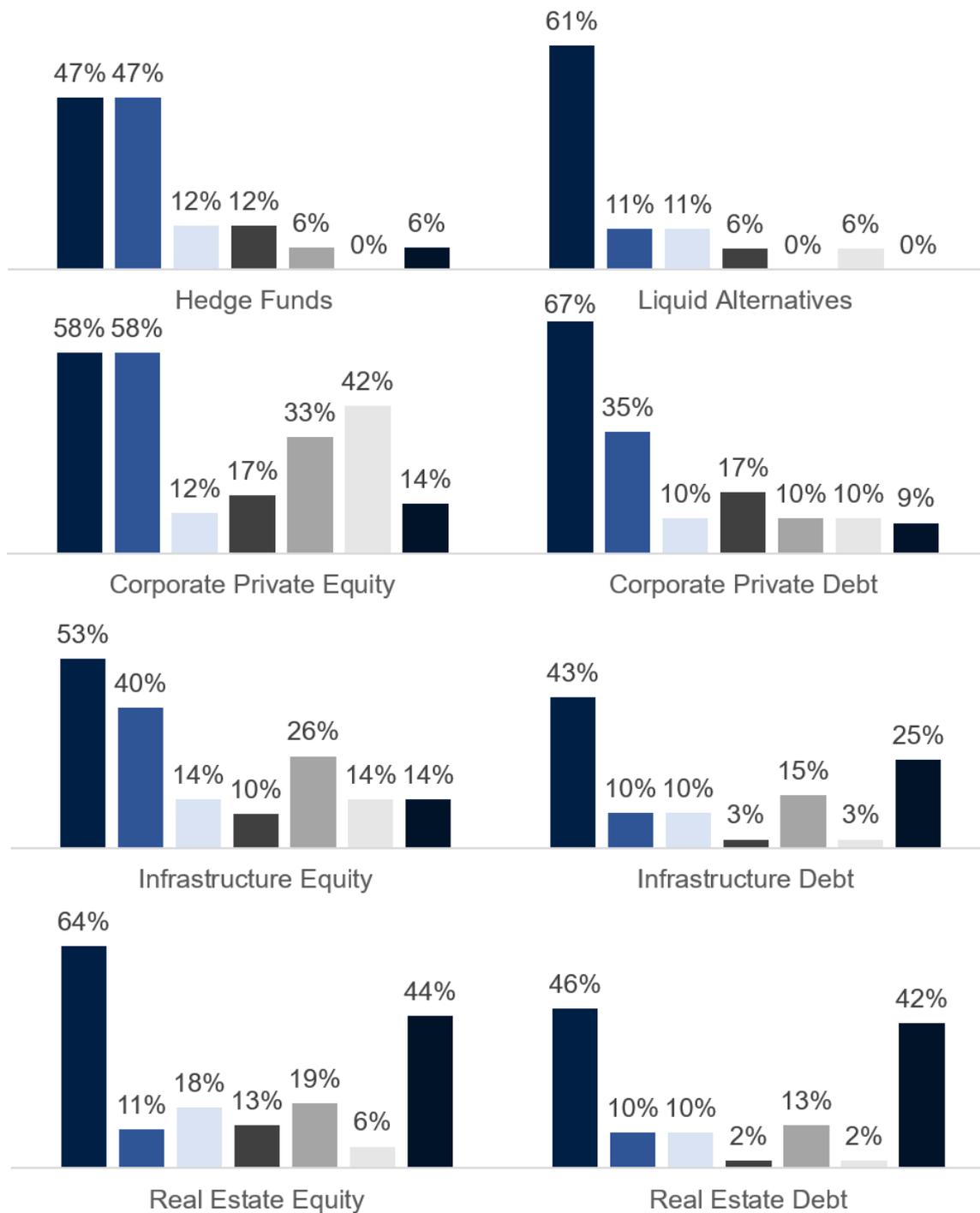


Dealsourcing



Entry paths per asset class

- Single Funds
- Fund of Funds
- Single Investor Managed Account at GP
- Single Investor Managed Account (Multi-Manager)
- Co-Investments
- Secondaries
- Direct Investments



As usual we not only wanted to determine which asset classes are particularly popular among German investors, but also which access routes 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. This applies to all asset classes. In addition, one can invest via fund of funds, managed accounts, and co-investments.³ Co-investments 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. Constant growth is also given for managed accounts and platform solutions. They are becoming increasingly important and are particularly widespread in the established asset classes in the private markets sector such as corporate private equity. This also applies to secondaries, which have recently experienced a genuine boost, especially in private equity.

The next step was to find out which factors are most important to investors when selecting an asset manager. Obviously, compliance with ESG criteria is becoming increasingly important. Also it is not surprising that performance, the track record in the past, is always in the spotlight when choosing the right manager. However, public appearance and recommendations from the investor's own network are also factors that should not be underestimated. 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

³ 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).

Alternative Investments products as well as service providers such as investment advisors, placement agents, legal firms, providers of databases, and consultants. Covid-19 still makes physical meetings difficult, which is certainly a barrier to beneficial exchange. Of course we hope that the BAI Alternative Investor Conference (AIC) and other BAI network events will take place in spring 2022. Nevertheless, in cooperation with our members, we will continue to host BAI Webinars, and online workshops to support education with emphasis in the field of alternative investments.

In short summary, it can be said: Even if the omnipresent pandemic has led to performance losses in some industries, the tenor of German investors is more than clear: The allocation to AI has increased in 2021 and will be further expanded in the coming years. In the search for uncorrelated returns to the liquid capital markets, there is no way around alternative investments.

Authors

Philipp Bunnenberg



BAI, Consultant
Alternative Markets



+49 (0)228-96987-52



bunnenberg@bvai.de

Sven Gralla



BAI, Research Associate
Alternative Markets



+49 (0)228-96987-13



gralla@bvai.de

Imprint:

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