BAI Newsletter VI/2023 – December 2023

Editorial article from Frank Dornseifer, Managing Director, BAI e.V.

Dear Ladies and Gentlemen, dear members,

The year 2023 - hook on!

The end of the year is always a good time for looking back and looking ahead, and not just in radio and television. Even if our industry is not as glamorous and prominent as Günther Jauch & Co. (or last year's rather hapless Gottschalk/Guttenberg tandem), it is still worthwhile from our association's perspective to briefly summarize 2023 and take a cautious look ahead to 2024.

I don't want to go into the disastrous topic of geopolitics here, where armed conflicts are now almost becoming a terrible habit and where there is no sign of improvement or pacifying. But of course, this also creates considerable risks for the financial and capital markets and institutional investments, and upheavals must be on everyone's radar, which in turn - following the old stock market adage "buy when the guns are blazing" - are then used by investors to make new investments.

In any case, the DAX has started its year-end rally, probably also because investors are already anticipating that interest rates will stop rising or even fall. In any case, equity investors can certainly look forward to 2023, at least if they entered the market at the beginning of the year. The current level is at a record high of over 16,700 points. From a 2-year perspective, the result looks somewhat different again. The DAX is only around 4% above the level at the turn of 2021/2022.

Inconsistent markets / difficult fundraising

It then becomes somewhat more difficult to classify the performance of alternative investments, as there is a lack of meaningful and representative index benchmarks. However, the LPX 50, which, as we know, only applies to listed PE, still shows an increase of almost 30% over the year, while the LPX 50 NAV, which is supposed to reflect the portfolios, has only increased by around 6%. It therefore remains to be hoped that one or two unlisted private equity funds in the portfolios of German investors lie between these values and that the return expectations expressed by investors in this year's BAI Investor Survey have been fulfilled.

At first glance, the infrastructure sector looks significantly worse over the year. Both the S&P Global Infrastructure Index and the Dow Jones Brookfield Global Infrastructure Index - both listed infrastructure indices, mind you - show a - slightly - negative performance for 2023 (YTD). Things are - hopefully - looking much better in the unlisted infrastructure sector. This is certainly not a satisfactory result for a booming asset class on which many hopes are pinned for the future (keyword "sustainable transformation"). At least the EDHEC infra300 and the infraDebt300 index at the end of Q2/23 show an acceptable annualized performance of around 8% and 3% respectively in the year to date, which is in line with the expectations of German institutional investors according to the BAI Investor Survey 2023.

The usual hedge fund indices show average returns in the low to mid single-digit range for the various styles, i.e. they lag noticeably behind the DAX, S&P, etc. But here, too, it is a well-known fact that manager selection is the key success factor that leads to above-average returns. Finally, Bitcoin also appears to be on the winning side this year. The possible approval of Bitcoin ETFs and the upcoming halving seem to have finally put an end to the crypto winter. Let's hope the crypto summer doesn't get too hot.

In short, the results for the year are mixed. However, given the overall scenario of geopolitical risks, gloomy recession clouds, inflation rollercoaster and interest rate capers, this is hardly surprising. The fact that fundraising has also fallen well short of the expectations of the fund industry, which is spoiled for success, also fits the picture. And indeed, there are many investors who are making it clear that interest-bearing investments are once again a real alternative, especially as they bring liquidity into the portfolio, which some investors can make good use of in the short and medium term. This is why they are expressly looking for distributions or exits, as there will be no new investments without sufficient liquid funds. At the same time, investors are also turning to new fund concepts, in particular semi-liquid structures or evergreen funds, which allow more flexibility, unit redemptions and also a greater vintage mix. The fund industry will have to react here.

Challenging regulation, not only in the ESG area

And that brings us to ELTIF, for example, and more broadly to regulation. Here we have - once again - a very challenging year behind us. First, let's look at Brussels: the AIFMD review and, to some extent, the ELTIF review have sent their regards. The new ELTIF regulation will apply from January 10 and intensive discussions are currently ongoing with BaFin and BMF to ensure that the ELTIF also has a chance in Germany. BaFin will shortly be publishing a FAQ on the ELTIF Regulation, which will provide important guidance on approval procedures etc., so that corresponding applications can already be submitted now. We also expect the legislator to adjust, particularly regarding the available organizational forms and their practical design. It is important here that both special funds, but also Investment-AG and Investment-KG are available in both open and closed form, not only for professional investors, but also for private investors. The big challenge here will be how to set up distribution for private investors so that the necessary broad impact can be achieved.

The AIFMD review, including the new Europe-wide regime for debt funds, is a real milestone and was therefore also the focus of our association's work. The final compromise recently reached has already been approved by the ECON Committee and adoption and ratification by the EU Parliament and EU Council in the new year is now just a formality. In this respect, the starting signal for national implementation has been given and fund managers are well advised to evaluate whether further credit funds will now be launched based on the national regimes, for which the grandfathering and grandfathering rules will then apply. We will provide separate information on AIFMD II and ELTIF 2.0 in the new year, including via a webinar and as part of the BAI AIC pre-event on April 22, 2024.

From Brussels to Berlin: the ZuFinG and Growth Opportunities Act have kept us on our toes. The planned expansion of investment opportunities for funds in the areas of renewable energies and infrastructure are an important stimulus, but unfortunately the tax legislation was lacking. After many and quite controversial discussions at federal and state level, it was back to the drawing board and a new attempt is now to be made to launch a coherent overall concept with the Annual Tax Act 2024. We are looking forward to this legislative process and will be following it closely to ensure that it is not just a matter of nice-sounding names, but that the content is also convincing for the fund industry and the investors behind it.

There was also significant activity in the areas of digital finance and sustainable finance at both European and national level. We reported extensively on digital finance in our last newsletter and at the BAI InnovationDay in September. We recently brought you up to date on sustainable finance at the ESG workshop and are doing so with this newsletter, which is dedicated to this key topic. In any case, the central topic of BAI activities in this area is the SFDR review, which - to put it succinctly - calls into question the basic concept of this regulation and thus also raises the possibility of a complete reorientation of sustainability reporting, possibly in combination with the introduction of ESG labels. You (i.e. the EU Commission) first must be that brave. But this self-critical consultation and stocktaking is to be welcomed, even if, from the association's point of view, the entire concept and the tiered transparency and disclosure system should not be called into question. At the same time, guidelines for the designation of sustainable funds are also being discussed and the Disclosure Regulation is being further specified at Level II. It is not easy to keep track of all this. And that is precisely why I would like to take this opportunity to once again draw your attention to our member platform, where we not only provide you with comprehensive information on all regulatory activities and the work of the specialist committees and working groups, but where you can also post briefings and specialist publications yourself, initiate discussions and join in the debate in order to make the best possible use of our unique network. Well over 1,000 representatives from member companies are registered there and can already see for themselves the added value that our member platform provides.

At this point, we would also like to highlight the numerous BAI publications, particularly from the market sector, which we have made available to you this year, starting with the BAI Investor Survey, dedicated fact sheets and information brochures through to the recently published new DDQ on infrastructure. Once again, the association's work this year is impressive.

Not only the supervisory authority needs a sustainable finance roadmap, otherwise there is a risk of ESG fatigue

So much for the review of 2023. As we all know, light and shade are usually very close together. In any case, some people will be happy to simply draw a line under the year and hope that 2024 will bring new and more positive impetus. However, it is already clear that 2024 will once again be a very challenging year. We are prepared for this and hopefully you are too. In any case, there cannot and must not be any standstill in the portfolio, if only in view of the gigantic green transformation, which is only just beginning and will require tens of trillions in investment in the future. In line with the European Securities and Markets Authority (ESMA), which presented its Sustainable Finance Roadmap for the years 2022-2024 at the beginning of 2022 and outlined its priorities, the entire industry and each individual company needs a strategy for dealing with the various resulting challenges. Both the BAI Investor Survey 2023 and the accompanying Member Survey document that the industry and investors are well positioned here and have dedicated ESG strategies in place. So far so good, but the implementation of the diverse but still far from complete regulatory ESG requirements is more than complex and challenging, particularly in view of the still inadequate availability of data and lack of standardization in many areas. And then there are also constantly new or expanded requirements from European and national legislators, from European and national supervisory authorities, as well as from relevant industry-related stakeholder groups such as FinDatEx with the EET. As I emphasized in my welcome speech at the ESG workshop, policymakers and regulators are now more than ever required to ensure that ESG fatigue does not set in among the industry and investors. Surveys of private investors already show that the relevant MiFID exploration obligations quickly lead to a situation in which investments are not made in a sustainable product. Private investors find it difficult to understand the complex regulatory framework and its meaningfulness. The current discussion in the SFDR review about the advantages and disadvantages of an ESG label or a classification system also shows that we are at a critical point and must be careful that the Sustainable Finance Roadmap does not lead to a dead end. This topic depends on acceptance in the industry and among investors. And this is precisely why the Sustainable Finance Initiative requires more pragmatism on the one hand and considered action on the other more than ever. These are precisely the key issues that we repeatedly raise in our positions in the various committees. And of course, we will continue to support and accompany you on this topic. And that is precisely why this newsletter contains many proven specialist articles on the subject.

About the articles in this newsletter

I would like to take this opportunity to thank the many authors and sponsors who have contributed to this newsletter and who have once again contributed very readable articles about ESG and sustainable finance. And I wish you an informative and entertaining read.

And then, finally, on behalf of the BAI Board and the BAI office, I would like to wish you a Merry Christmas and a Happy New Year 2024! Once again, this year, we are foregoing Christmas cards and gifts and supporting the "Bunter Kreis Rheinland e.V." with our donation for the benefit of seriously ill children and their families in our region.

Frank Dornseifer