HKVCA 私投募資

Hong Kong Venture Capital and Private Equity Association

香港創業及私募投資協會

The Association for Private Capital in Asia

Opportunities in Global Headwinds

HKVCA **Journal**

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Foreword

Geopolitical issues, regulatory risks and potential recession have been, and continue to be, key concerns for institutional investors in recent years. This tenth issue of the HKVCA Journal is aimed at identifying existing and potential global headwinds that GPs and LPs may encounter this year and likely beyond.

The Association has also leveraged the expertise of our members, helping to identify investment opportunities that exist in private capital amidst uncertainty. Hong Kong is in prime position as the market improves, with a depth of private equity managerial talent and professional advisory services all available in one location with a regional and global outlook.

We want to express our gratitude to all contributors who committed to this tenth issue of the Journal, and to Alain Fontaine, Denis Tse, Joseph Ferrigno and TK Chiang, for their work as editors. We hope that this publication will be a useful platform for the sharing of HKVCA members' stories and ideas, and that they may inspire investors and members of the private capital community worldwide.

Alfred Lam
Research and Policy Director
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Laying the Groundwork

Darren Bowdern, KPMG

Hong Kong has the opportunity to refine its current measures to support the private equity sector to ensure the city remains in prime position as the market improves

After a challenging year for private equity and venture capital in 2023, an improving macro environment and Hong Kong's ongoing efforts to support the asset management sector are providing some grounds for cautious optimism about the outlook for 2024.

But if Hong Kong is to capitalise on the opportunities that will emerge as the landscape improves, it is crucial that the city continues to enhance the environment so it can maintain its role as the private equity hub in Asia.

China and confidence

Private equity globally faced considerable headwinds in 2023, with Hong Kong experiencing some additional regional challenges. Throughout the year, factors including geopolitical tensions, a weaker than expected post-Covid recovery in the Chinese Mainland, and the higher interest rate environment combined to put a brake on asset management activity.

The lack of IPOs in the region also affected private equity in particular, reducing the amount of liquidity in the market and effectively freezing the usual cycle of activity as investments were not able to exit through IPOs.

Looking ahead, the market is expected to remain challenging in the near term, but there have been some signs of improvement in the broader landscape, certainly with regards to China. While geopolitical issues will not disappear, there have been some easing of tensions with a number of high-level meetings between Chinese and US officials taking place in recent months.

The Central Government has also demonstrated its commitment to supporting the domestic economy and boosting confidence through stimulus measures. At the end of January, the People's Bank of China announced a significant cut to the reserve requirement ratio for banks, and there may be further targeted measures to come to support key sectors.

Looking at the longer term, China remains a significantly important market with investment opportunities in sectors including technology, advanced manufacturing, biomedicine and especially ESG. China's ambitious carbon reduction targets will require a huge amount of infrastructure and therefore capital to facilitate the green transition.

Given all these factors, private equity firms are starting to consider deploying capital into China once again. And as Hong Kong plays a crucial role in the flow of investment in the Mainland, it is poised to benefit from the resumption of activity once the environment for private equity improves.

Hong Kong measures

While 2023 was a difficult year in many respects for private equity and venture capital, there were a number of significant developments in Hong Kong that should ultimately benefit the industry.

The Hong Kong Government has stated that it wants to support the asset management sector as a crucial part of the city's role as a global financial services hub. To that end, it has introduced a

variety of regulatory reforms and incentives to enhance the city's attractiveness as an asset management hub.

A key recent development is the Family Office tax incentive, which took effect in May last year and introduced a zero percent tax rate on profits for UNHWIs and their family members on qualifying transactions. There is no pre-approval process or application requirement and only a self-declaration is required.

This tax incentive is one of eight targeted measures to attract family offices, which also include the establishment of the Academy of Wealth Legacy to train professionals for the sector, as well as measures to support Hong Kong's growth as a philanthropy hub and art trading hub.

Two other programmes – the Capital Investment Entrant Scheme announced in December 2023 and the Top Talent Pass Scheme launched a year earlier – have also been successful in attracting interest from high-net-worth individuals. Under these schemes, eligible people and their families can move to Hong Kong so long as they meet the investment or income levels required.

There have also been multiple regulatory developments in the virtual assets space in the past year as Hong Kong continues to strengthen its status as a global hub for the sector. The introduction of a licencing regime for virtual asset trading platforms in 2023 was a major step, and there have also been regulations relating to the underlying technology and updated circulars on a variety of related topics in the past year.

This broad and timely range of regulations and guidance in Hong Kong has successfully put the city on the map as a well-regulated centre for virtual assets.

Hope for further reforms

In fact, the Hong Kong Government has been rolling out measures to support the asset management sector for the past few years. However, some of the reforms have not quite had the intended beneficial impact.

The Tax Concession for Carried Interest, introduced in 2021, is one example. Under this concession, eligible carried interest allocated by the fund will be subject to a 0% tax rate. However, a number of issues have prevented it from being used as widely as expected.

For example, the IRD classifies carried interest as a fee for services, which means that carried interest is liable for tax. The IRD also requires the fund to be certified by the HKMA in Hong Kong, and that the fund should allocate the carried interest through a person in Hong Kong. These requirements essentially run contrary to how the industry actually operates in Hong Kong, which greatly restricts the number of funds that can access it.

In addition, the carried interest concession only applies to gains made on the sale of a private company, which is quite limiting.

For Hong Kong to remain competitive, some revision of the carried interest tax concession would give fund investors more confidence that they will not suffer additional tax on gains repatriated in Hong Kong.

Another measure that has been in place for some time is the unified tax fund exemption (UFE). While this has been fairly successful, it still contains a number of restrictions that limit its appeal. Certain assets classes such as private credit funds and digital asset funds are currently excluded from the UFE. Expanding the exemption to include a wider range of assets would make it more attractive in general.

In addition, the private credit and virtual assets markets in Asia are both growing rapidly. Including these asset classes in the UFE would also send a positive signal about Hong Kong's understanding of the evolving private equity landscape and its support of the sector.

Some other concerns of the industry include the licencing regime, as there is currently no specific licencing type for private equity firms in Hong Kong. Creating a separate licence for private equity and venture capital firms would reduce complexity and uncertainty for firms, and would also benefit the regulators to have more clarity.

Looking ahead

The private equity industry in Hong Kong should not lose focus on continuing to work with the government and regulators to reach the common goal of creating environment that is highly attractive to private equity and venture capital. While the city is the leading private equity location in the region, it also has a number of competitors in the region that have been working hard to attract funds.

Recent measures such as the family office incentive have been successful in attracting more funds to Hong Kong, and also in terms of demonstrating the city's commitment to the continued growth of the asset management sector.

Further reforms to iron out the current hurdles to accessing some of the support measures, such as carried interest and UFE, should strengthen Hong Kong as the regional leader in the private equity space. The city's private equity firms will then be in prime position to take action once the current uncertainty eases and activity in the market resumes.

Darren Bowdern, Head of Alternative Investments, Hong Kong, Head of Asset Management Tax ASPAC, KPMG China

Darren is a partner in KPMG's Hong Kong Tax practice. He has more than 20 years' experience serving institutions in the healthcare, insurance, private equity and financial services sectors in Hong Kong.

Darren has been involved in developing appropriate structures for investing in the Asia Pacific region, conducting tax and financial due diligence reviews in connection with M&A transactions, and advising on cross-border transactions. Many of these projects comprise tax effective regional planning, including the consideration of direct and indirect taxes, capital and stamp duties, withholding taxes, and the effective use of double taxation agreements. He also advises clients in a wide range of industries on establishing direct investment, private equity and other investment funds in Hong Kong.

Healthcare Musings: Generative AI and the Impact on Health Equity

Vanessa Huang, BVCF Management

Generative AI, a type of artificial intelligence (AI) where algorithms are trained on data sets to generate new content, has captured the imagination of many globally. A prime example of generative AI is Large Language Models (LLMs) like GPT-4, which are capable of processing and generating human-like responses. LLMs hold the promise of increasing efficiency, precision, and productivity across virtually all segments of society. One of the most exciting areas for generative AI is healthcare, where its application is rapidly expanding as developers and scientists deepen their understanding of the technology's capabilities and effective utilization. Generative AI applications are revolutionizing healthcare value chain processes from drug development to care delivery models in emerging markets. Moreover, generative AI appears to be a tool that can be deployed to tackle disparities in health access and quality of care, potentially making a significant impact on global health equity.

Potential generative AI applications in healthcare

The book *AI Revolution in Medicine* by Peter Lee, Carey Goldberg, and Isaac Kohane is a stimulating primer on GPT-4's aptitude in healthcare. The authors identified numerous low-hanging fruit applications of generative AI in current healthcare delivery systems (though mostly using the U.S. as an example) and biomedical R&D processes. Examples include: the holistic analysis of a patient's existing medical records; a virtual assistant to doctors that can provide medical references and analyses instantaneously; the automation of administrative tasks in a complicated payment environment; knowledge support for therapeutics and medical devices R&D processes; ready access to medical information in an understandable language for the general public; portable personal health data and chronic disease monitoring for patients; and mental health support for isolated elderly populations and resource-constrained communities.

The general purpose LLMs can be further trained on specific topics in healthcare such as drug target identification, lead optimization, and clinical services, to enhance their effectiveness in tackling specific tasks. NVIDIA Corporation, whose graphics processing units (GPUs) are pivotal to the computing power needed for generative AI applications, presented at the J.P. Morgan Healthcare Conference in January 2024.[1] The company showcased that its GPUs and generative AI solutions are being deployed by various healthcare companies. For example, Amgen, a leading biotech company, employs generative AI to design and predict properties of proteins, whereby accelerating drug discovery process. Similarly, Medtronic, one of the largest medical device companies, is developing AI platforms for medical devices and its real-time AI endoscopy device. NVIDIA reported that their healthcare vertical business has generated over US$ 1 billion in revenue for FY2024. The growing importance

[1] NVIDIA Corporation. "Events and Presentations." NVIDIA Corporation, 2024, https://investor.nvidia.com/events-and-presentations/events-and-presentations/default.aspx. Accessed February 18, 2024.

of generative AI in healthcare sector is further demonstrated by the emergence of the "techbio" subsegment, where healthcare companies are driven as much by technology as they are by biology.

Applying generative AI in the public health ecosystem

Generative AI applications have the potential to transform patient data management, allowing for seamless transfer of medical records across various care settings, thereby advancing a more patient-centric public health ecosystem. A patient-centric approach can increase health awareness and extend health maintenance beyond just managing acute events. For instance, with generative AI applications like predictive analytics, doctors can provide patients with earlier and more accurate diagnoses at community clinics. This care can continue with comprehensive treatment and initial monitoring at hospitals, followed by post-treatment maintenance care at home or community clinics. Health management systems supported by generative AI applications can provide more touchpoints between patients and health professionals, shifting health management from episodic acute responses to a continuous, proactive care process. The continuity of care not only leads to better health outcomes and more efficient resource allocation but also reduces overall healthcare costs.

Furthermore, companies like Alibaba Group Holding are developing healthcare trained LLMs that can cater to local population health needs. For example, the LLMs can be trained using local patient medical records, research papers focused on regional health issues, as well as local languages and cultural nuances. These localized health LLMs can then be the engine for scientists, researchers, and medical professionals to more effectively and accurately identify local disease trends and demographic health needs. Policymakers can apply the insights gleaned from the information to craft public health solutions that are in sync with local resources and wellness practices. Moreover, healthcare information presented in local dialects and languages will empower the general public to actively participate in their own health decisions, thereby fostering a more inclusive healthcare environment.

Challenges of deploying generative AI in public health

The challenges become instantly clear when considering the deployment of generative AI in public health settings. These include disparities in internet access within and across countries, varied levels of computer literacy among different generations and populations, and the nascent state of regulations that can facilitate AI's deployment in high-need areas while safeguarding data privacy, information

integrity, fairness, and accountability. Ironically, the communities that could benefit the most from generative AI – such as elderly populations, rural districts, and countries with underdeveloped healthcare infrastructure – are often the same ones where many of these challenges are discernible.

Social awareness is vital

It is well documented that LLMs can occasionally "hallucinate", generating inaccurate or misleading information. The general public should be educated on the capabilities and limitations of generative AI in healthcare, encouraging informed expectations and responsible usage. Furthermore, it is essential that public health applications are designed with user-friendly interfaces ensuring that vulnerable and elderly populations can access and benefit from these technologies easily. Policymakers need to develop regulations that protect patients' data privacy and health information integrity. However, the regulations should be balanced and not stifle the utilization and mobility of health data, especially for the purposes of global biomedical research of drugs and tools.

Given consumers' rapid adoption of generative AI, the World Health Organization (WHO) in January 2024 released a new guidance on the ethics and governance of large multi-modal models (LMMs).[2] The guidance outlines over 40 recommendations for consideration by governments, technology companies, and healthcare providers to ensure the appropriate use of LMMs to promote and protect the health of populations. For example, the guidance emphasizes that government laws, policies and regulations should ensure that LMMs and applications used in healthcare and medicine, irrespective of the risk or benefit associated with the AI technology, meet ethical obligations and human rights standards that affect, for example, a person's dignity, autonomy, or privacy.

Global collaboration

The accuracy of an LLM typically increases with the volume and diversity of data it is trained on. As countries increasingly digitalize their healthcare systems, the availability of high quality data is expected to surge. Access to comprehensive global health data can yield potential insights that are unattainable from analyzing single population data. This can guide health innovations and interventions to areas with the highest needs. Therefore, global communities should collaborate to develop a regulatory framework that enables countries, organizations, and individuals to share stratified data and anonymized information across borders. The WHO's collection and analysis of daily COVID-19 data from various countries during the pandemic is one example of a central repository of health data.

A potentially positive catalyst

In conclusion, generative AI holds immense potential. It has the ability to enhance R&D success rates, accelerate product development process, and optimize resource allocation across the healthcare value chain. Together with community-based healthcare delivery and public health-focused solutions, generative AI can play a pivotal role in managing healthcare costs and improving health outcomes. With robust policies, effective planning, and cohesive global coordination, generative AI can serve as a positive catalyst for promoting overall population health and advancing global health equity.

Vanessa Huang, General Partner, BVCF Management

Ms. Vanessa Huang is a member of the WHO Council on the Economics of Health For All which aims to reframe health for all as a public policy objective. Ms. Huang is currently a General Partner at BVCF Management. Prior to joining BVCF, she was Head of Emerging Asia Healthcare Investment Banking at J.P. Morgan. Ms. Huang is a member of the HKEX Biotech Advisory Panel and an independent non-executive director of Alibaba Health Information Technology Limited (Stock code: 00241).

[2] World Health Organization. *Ethics and governance of artificial intelligence for health: Guidance on large multi-modal models*. WHO, January 2024, https://www.who.int/publications/i/item/9789240084759. Accessed February 18, 2024.

Investing in Space – Not as Hard as You Think

Eric Ng, Happiness Capital

Despite current economic uncertainty, investing in Space Tech has shown remarkable resilience in the venture capital fund raising market. The Space Tech sector raised an estimated $12.5 billion in 2023, well above $9.3 billion in 2022 but still below the $15.3 billion during the record-high investment volume in 2021.

The global space sector is now worth over $469 billion, with 77% accounted for by the commercial market. In total, over $47 billion of private capital has been invested across the global space sector since 2015, growing on average 21% per year.

M&A activity in the Space Tech sector is also on the rise. In 2023, mainstream news covered historic space industry events like the India's Chandrayaan-3 moon landing, the advancements of SpaceX's Starship, billion-dollar mergers and acquisitions from companies such as Maxar, Viasat and Inmarsat.

In general, Space Tech investments can be categorized into three sub-sectors:

- **Upstream**: Spacecraft manufacturing and launch vehicles
- **Midstream**: Spacecraft operations and in-orbit management
- **Downstream**: Spacecraft-derived data, applications and services, such as earth observation, satellite communications and connectivity, and satellite position, navigation & timing

In recent years, new investors have started exploring opportunities in Space Tech. It is no longer a sector just for specialist investors. Capital from across the investor spectrum has targeted the sector, for example:

- The number of unique investors into space companies grew from 274 to 558 between 2020 and 2022
- At the peak of space investing in 2021, 63% of all space investors were new to the sector
- 64% of corporate investment into the space sector came from non-aerospace and defence companies in 2022 – with increasing interest across technology, telecommunications, media, financial and automotive sectors among others
- 13 of the largest 15 venture capital firms and 8 of the largest 15 private equity firms in the world have invested in space companies. Venture capital (VC) investments in the space sector have grown substantially over the past decade as investors have come to appreciate the long-term commercial potential of the space industry. Much of the capital has flowed to early-stage companies, allowing space start-ups with less mature products or a longer path to profitability to fund R&D of capital-intensive products while working to capture early customer revenue.

The commercial value of space-based services is expected to grow significantly in the next few years. The government sector is also expected to grow rapidly due to increasing global security concerns.

Although the space industry is growing quickly, it faces several challenges:

- **High cost of launching payloads into orbit**: This has limited the growth of the space industry and its ability to bring down the cost of accessing space. As a result, many new companies are focusing on developing reusable spacecraft or alternative launch technologies to reduce the costs of transportation in space, such as electromagnetic propulsion or other methods of non-rocket space launch techniques.

- **Lack of infrastructure in low Earth orbit (LEO)**: LEO is currently used for satellite deployment, research and development, and testing of new spacecraft and technology. However, there needs to be more permanent infrastructure in this area which hampers commercial activity. Developing more reliable and affordable ways to get cargo into LEO would help address this issue.
- **The debris problem in outer space**: A growing amount of debris orbiting Earth could potentially damage satellites or even human habitats in space. Addressing the problem of orbital debris will be critical for ensuring sustainable growth within the space industry.
- **The limited human presence in space**: So far, only a handful of countries have sent people into orbit. Developing the necessary infrastructure and training for sustainable human habitation in space will be a major challenge for the industry in the future.

Space technology continues to attract growing interest from various sectors due to its immense potential for revolutionary breakthroughs. In the past, space was considered the final frontier that is exclusive to governmental agencies. Today, thanks to technological advancements and public-private collaborations, Space Tech offers new opportunities for commercial investment and deployment. The market potential for space technology is estimated to reach $1 trillion by 2040.

Why Space?

The economic contribution of space internationally is predominately driven by thousands of active satellites helping to tackle some of our greatest global challenges - including the transition to a low carbon economy, digitisation of industries, tackling food insecurity and alleviating pressure for future mobility solutions.

Significant Space Tech developments have continued, with new sectors developing space solutions to help tackle some of humanity's greatest problems on Earth. For example, earth observation can be used for a variety of purposes, such as monitoring climate change, tracking natural disasters, and managing resources. Weather forecasting is becoming increasingly important as our reliance on weather-dependent activities (such as aviation) increases. Traffic management and air quality monitoring are both growing sectors that could benefit from the application of Space Tech.

We will focus on several major areas in Space Tech in this article to explain the importance and potential of Space Tech.

Space Sustainability

Recently, BBC reported that a European satellite that pioneered many of the technologies used to monitor the planet and its climate has fallen to Earth. The two-tonne ERS-2 spacecraft burnt up in the atmosphere over the Pacific in early 2024. ERS-2 was one of a pair of missions launched by the European Space Agency in the 1990s to study the atmosphere, the land and the oceans in novel ways. The expectation was that the upper atmosphere would drag the spacecraft down to destruction in about 15 years, which became a reality.

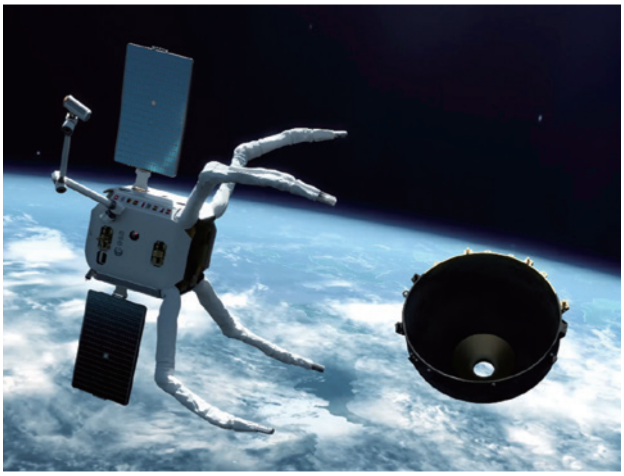
Other example is that a Russian rocket body fell back to Earth near southern Australia in 2023. The crashing rocket generated a "fireball and sonic boom that rattled homes across Victoria, Australia. This space debris had not been up there long. It was the third stage of a Soyuz rocket that had launched a Glonass navigation satellite earlier that same day.

In the 1990s, space debris mitigation guidelines were much more relaxed. Bringing home a redundant spacecraft within 25 years of end of operations was deemed acceptable.

European Space Agency's (ESA) new Zero Debris Charter recommends the disposal grace period now not exceed five years. And its future satellites will be launched with the necessary fuel and capability to propulsively de-orbit themselves in short order. The rationale is obvious: with so many satellites now being launched to orbit, the potential for collisions is increasing. ERS-1 failed suddenly before engineers could lower its altitude. It is still more than 700km above the Earth. At that height it could be 100 years before it naturally falls down.

The Space Sustainability sector is part of a "midstream" sub-sector of Space Tech. ClearSpace and Vyoma are two examples in this sector.

ClearSpace is a pioneer in the Space Sustainability sector in Switzerland. Its mission is to remove debris and reduce the risk of collision and make space a safer place for future generations. It is now building robots in space to chase and handle space debris autonomously. The goal is to capture them, to either remove them from orbit, or to refuel them to extend their life.



ClearSpace's simulation of their robot grabbing a debris (Image from ClearSpace's marketing material)

Vyoma is another pioneer in the Space Sustainability sector in Germany. They are dedicated to creating a sustainable space environment by ensuring collisions are avoided, and the growth of such fragments is mitigated. In simple terms, Vyoma is like a Google Map that charts all the objects in space in real-time. It is fully integrated with satellite operators' manoeuvre systems to help them to avoid collisions with debris. Furthermore, they actively support any efforts in active debris removal such as the services provided by ClearSpace.

Space Monitoring/Observation

Space monitoring/observation applications have existed for a long time. The recent advancements in a variety of technologies enable innovative ways of monitoring/observation from space. A recent example is ICEYE in Finland, which is a typical "downstream" Space Tech company.

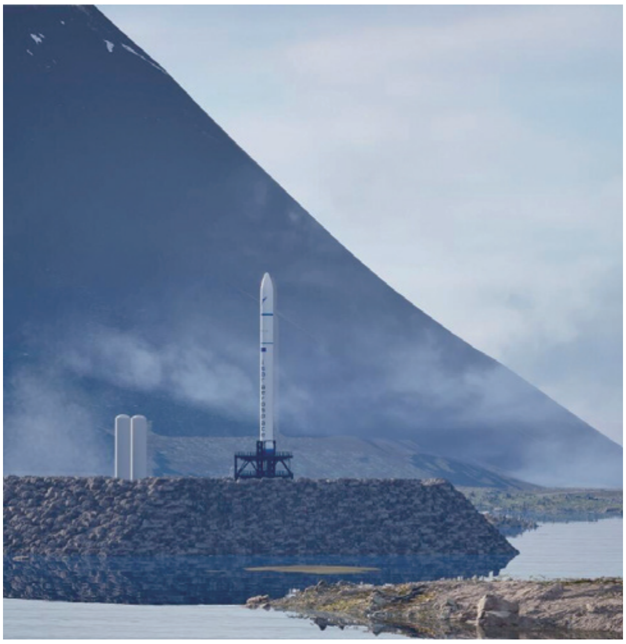
ICEYE delivers unmatched persistent monitoring capabilities for any location on earth. Owning the world's largest Synthetic-Aperture Radar (SAR) constellation, the company enables objective, data-driven decisions for its customers in sectors such as insurance, natural catastrophe response and recovery, security, maritime monitoring and finance. ICEYE's data can be collected day or night, and even through cloud cover. Around 70% of the globe is shrouded in clouds, and at any given time about half of the planet is in the dark. SAR satellites illuminate the ground with microwaves and create images from the energy that is reflected back to the satellite. SAR is superior to traditional electro-optical imaging for monitoring and search applications because it provides a powerful day/night, all-weather imaging capability. This capability is ideally suited for applications such as insurance, natural catastrophe response and recovery, national security, defense and intelligence, humanitarian relief, and climate change monitoring. ICEYE has now deployed 31 satellites since 2018, underscoring the company's position as a world leader in SAR satellite technology. As the owner and operator of the largest SAR satellite fleet, ICEYE can provide customers with faster access to data in emergencies and the highest revisit rates for high-frequency phenomena.

ICEYE's simulation of their SARs (Image from https://www.iceye.com/)

Space Life Sciences and New Materials

Space offers a unique research and manufacturing environment to a broad range of sectors because of its near-vacuum state, microgravity (which confers weightlessness), and higher levels of radiation. These features may enable new processes or reveal new insights. It is a potential gold mine for ground-breaking advancements in life sciences and material sciences. New classes of drugs and novel materials developed in space could have a transformational impact on areas as diverse as pharmaceuticals, telecoms and microelectronics. This represents a whole bunch of new "downstream" opportunities.

Low orbit space is at an altitude of less than 1,000 km from the Earth's surface. Low orbit tech will accelerate advances in bioscience, material science, cyber security, energy and data storage, etc. Bioscience is a particular area of focus because of the unique environmental conditions that space provides to study biology. Scientists have found that microgravity, or very weak gravity present in space, can help mimic how cells grow in the human body. In cancer research, for example, scientists have discovered that cells outside the body maintain their three-dimensional shapes in a microgravity environment. In normal lab settings on Earth, cells grow flat and do not form the shapes they would normally behave in the body.



Future launch site of Isar Aerospace (Image from https://www.isaraerospace.com/)

Space Launchers

Spacecraft manufacturing and launching is the foundation or "upstream" sub-sector of Space Tech. Besides the infamous SpaceX, there are also many innovative companies growing rapidly that offer more affordable access to space. An example is Isar Aerospace in Germany.

Isar Aerospace was founded in 2018 to lower the entry barriers to space. By pushing the boundaries they are opening space as a platform for future technologies and competitiveness. As a launch service provider for small and medium-sized satellites they create easy access to space for global customers by offering the first fully privately funded European solution to meet the growing global demand.

Space Tech has become Global

Space Tech investment have spread out globally and are not just confined in the US. There has been significant increase in private investments in the UK, Europe, Japan. India and Korea are also keen to get a share. This surge is expected to be driven further by strategic initiatives from respective governments, underscoring a global expansion and diversification of venture capital interest and commitment in the space tech sector. Governments realize that now is the time to build up their strength and position in the global space race.

For instance, EU realizes that investments are essential to the growth of space companies. The CASSINI Facility together with the European Investment Fund will deploy a €1 billion investment capacity to boost space companies since 2022. CASSINI will support entrepreneurship in space-related businesses across the EU. The initiative is tailored to meet the needs of companies in different growth stages from seed to mid-caps.

Another example is that **India welcomes more foreign capital to grow its space industry.** New rules have cleared the roads for overseas investment in India's space industry. The new setup will allow up to 49% foreign ownership in launch systems, 74% in satellite products, and as much as 100% external ownership in satellite component manufacturing.

Do You Have the Patience?

The Space Tech sector is evolving rapidly and is creating opportunities for private capital. However, it is more suitable for investors who have patient capital and can face long product development timelines in immature markets. Investors should cautiously consider their investment targets' target market size, the strength of their proprietary tech, the diversity of their customer bases, their business model, and the speed of their go-to-market plans.

Eric Ng, CEO, Happiness Capital

Eric setup Happiness Capital, the global venture capital arm of the Lee Kum Kee Group with the mission to make the world a happier place. Happiness Capital is a Certified B Corp. He is also a member of the Policy Research Committee of the Financial Services Development Council HK. Prior to joining the Lee Kum Kee Group, Eric co-founded AGENDA which was acquired by WPP where he stayed as the Chief Client Officer (Asia Pacific) of WPP Wunderman. Eric's first venture was an AI healthcare startup in the US. He was also Director Consultant of e-Business at Cap Gemini US. Eric was an AI research scientist and university lecturer in the UK in early 90s.

Disclaimer
Happiness Capital is an investor of both ClearSpace and Vyoma

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Evolving Regulation in Fintech

Melissa Guzy, Arbor Ventures

The landscape of global finance is experiencing a profound transformation, fueled by the advent of disruptive technologies that are reshaping the fabric of our daily financial interactions. The emergence of fintech startups has been a catalyst for traditional financial entities, compelling them to embrace digitalization and revolutionize the mechanisms through which we conduct transactions, investments, and overall financial management. This rapid evolution has necessitated a period of adjustment for regulatory frameworks, which have been evolving to address the dynamic and fast-paced nature of the fintech industry.

The realm of payment innovations has witnessed groundbreaking advancements, most notably in real-time account-to-account transfers, marking a significant leap forward in financial technology in recent years. This innovation, alongside the democratization of financial advisory services, has made financial guidance accessible to a broader audience. Moreover, the fluctuating landscape of cryptocurrencies has experienced both growth and contraction, though it is now witnessing a notable resurgence.

The year 2023 was a pivotal moment for global fintech regulation, characterized by a diverse array of developments across the fintech spectrum. These regulatory changes are indicative of the sector's continued maturation and the increasing emphasis on stability, security, and consumer protection amid a whirlwind of technological progress and shifting market dynamics. Notable regulatory focus areas include:

1. **Cryptocurrency and Decentralized Finance (DeFi)**
   Regulatory efforts in the cryptocurrency and DeFi sectors have seen a significant uptick, especially in the United States following initiatives by President Biden in 2022 aimed at enhancing regulatory oversight in the wake of the FTX collapse. The challenge lies in balancing the privacy and autonomy that have fueled the success of these sectors with the implementation of regulations that ensure stability, security, and efficiency. Global institutions like the IMF and the European Central Bank have been vocal advocates for more stringent crypto regulations, while some nations have adopted a more aggressive stance.

   In this turbulent regulatory landscape, 2023 highlighted three cities as burgeoning epicenters for crypto firms in search of regulatory clarity: Paris, Dubai, and Hong Kong. Paris has attracted companies with its implementation of MiCA, while Dubai, home to the world's first crypto-specific regulatory body, VARA, has established a comprehensive regulatory framework. Similarly, Hong Kong has taken the lead in APAC by fostering a regulatory environment conducive to responsible innovation, especially in retail crypto trading services.

   Going forward in 2024, it is anticipated that Paris, Dubai, and Hong Kong will solidify their positions as leading centers for crypto innovation. This trend underscores not a lack of regulation but a commitment to regulatory

clarity, setting high standards for market participants and fostering an ecosystem where innovation thrives within well-defined legal parameters.

2. **Anti-Fraud Regulations in the Banking Sector**
   The fight against fraud remains a critical challenge for global regulators, exacerbated by the proliferation of digital technologies. Nations are increasingly adopting national fraud strategies to curb the rising tide of financial fraud, which poses significant risks to national security and consumer well-being. The goal is to strike a delicate balance between implementing effective anti-fraud and KYC measures and minimizing transactional friction. Enhanced collaboration among financial institutions for monitoring and preventing fraud is a key focus, aiming to bolster consumer protection without impeding the efficiency of digital transactions.

3. **Consumer Protection and Data Privacy**
   The intersection of fintech and regulation is keenly focused on consumer rights and data privacy. With fintech platforms managing vast quantities of sensitive data, regulatory bodies have been proactive in enforcing stringent data protection measures. The GDPR in Europe exemplifies the high standards set for data privacy, compelling fintech entities to adopt rigorous data security practices. Globally, the trend towards comprehensive data protection laws is gaining momentum, with over 120 countries having enacted legislation to safeguard personal data by April 2023.

4. **Open Banking Initiatives**
   Regulatory agencies are increasingly championing open banking, which mandates that financial institutions share customer data with third-party fintech providers. This initiative is aimed at stimulating competition, spurring innovation, and expanding the range of financial services available to consumers. With more than 50 countries either implementing or developing open banking frameworks as of April 2023, the movement is gaining traction worldwide, supported by regulatory environments conducive to such initiatives.

Fintech startups, navigating the complex tapestry of global regulatory landscapes, must embrace regulatory compliance to scale effectively so as to emerge as formidable market contenders. This underscores the importance of a nuanced understanding of international compliance standards, proactive risk management, and strategic planning for cross-border operations.

As the fintech ecosystem continues to evolve, the adaptive nature of regulatory frameworks is crucial in maintaining a delicate balance between encouraging innovation and ensuring consumer protection. The collaborative efforts between industry stakeholders and regulatory bodies are instrumental in shaping a regulatory environment that not only fosters innovation but also ensures financial stability and protects consumer interests.

Melissa Guzy, Co-Founder and Managing Partner, Arbor Ventures

Melissa C. Guzy is a Co-Founder and Managing Partner of Arbor Ventures. Melissa is a member of the Board of Directors of the Hong Kong and the Singapore Venture Capital Associations and a former member of the advisory counsel to the Hong Kong SFC on Innovation. She serves as a member of the Board of Trustees of Jackson Labs. Melissa's expertise in Fintech has earned her recognition as a Top 100 Influencer in Fintech (NxBnk), AlwaysOn Fintech Power Player, as well as One of the Most Influential Women in Tech in Asia. Her current board seats include Paidy, TrueAccord, InCountry, Fundbox, Tabby, EverC and Planck Re.

ESG Regulatory Trend: Visions of a Unitary Regime

Lorna Chen, Anil Motwani, Frank Fu and Evelyn Lin, Shearman & Sterling

Recent years have witnessed a significant rise in market interest and regulatory alignment around environmental, social and governance factors. We project 2024 to be a defining year for ESG, as market players further develop their institutional "ESG" culture and take meaningful decisions on their long-term ESG compliance plans. In this article, we identify what we regard as the latest trend, focusing on consolidation around specific themes in the ESG regulatory space.

'Mandatory Disclosure' for both Public & Private Companies

Mandatory disclosure has largely replaced the prior regime of voluntary disclosure, with the effect that industry players must now identify, measure and describe their ESG profile, even if this profile is not central to their public image or marketing thesis.

In the European Union, the CSRD (Corporate Sustainability Reporting Directive) took effect in January 2023. The CSRD is expected to have an immediate and major impact in pushing mandatory disclosure as the dominant ESG regulatory framework. According to the European Parliament, more than 50,000 companies in the European Union will be subject to the CSRD. Under the CSRD, in-scope companies (generally, 1- listed EU companies, 2- large EU companies and 3- non-EU companies with significant EU operations) must report ESG information tracked to specified standards (the European Sustainability Reporting Standards, or "ESRSs"). Though several disclosures under the ESRSs are mandatory (e.g., regarding governance, strategy, targets and risk management), disclosures on specific sub-topics (e.g., regarding biodiversity/ ecosystems, affected communities, business conduct) are subject to a double-materiality test based on the impact of business operations on the environment or society, and vice versa. The CSRD has helped socialize the concept of a far-reaching, extra-territorial regime for mandatory disclosure, and has meaningfully raised the global reporting standard.

Regulators in Asia lag their counterparts in the European Union. They are nevertheless making strides to expand the scope of mandatory disclosure in ESG regulation. Last year, Hong Kong issued a proposal mandating all listed companies to provide information on climate impact in their public disclosures, replacing an existing framework whereby ESG disclosure was only required for listed companies with an ESG brand or governance system and whereby ESG disclosure could generally be omitted if a valid reason was given (i.e., "comply or explain"). While adoption of the Hong Kong proposal has been postponed to 2025, Singapore last year pushed on. Under Singapore's latest proposal, mandatory climate disclosures will apply to private companies where annual revenue exceeds SGD1 billion (roughly, HKD5.9 billion or USD750 million) – a cutoff that Singapore plans to review in 2027 and potentially tighten to SGD100 million (roughly, HKD587.7 million or USD75 million).

Aligning with the jurisdictions referenced above, the United Kingdom, New Zealand, Switzerland and Australia have all adopted (or at least, proposed) mandatory disclosure for private companies covering climate and sustainability impacts. In the current regulatory environment, private companies are no longer in the clear.

Tracking ESG Impacts within a Supply Chain – Upwards, Downwards, Sideways

Notwithstanding the practical difficulty of tracking impacts within a supply chain, this type of indirect impact has increasingly drawn the focus of regulators. This is likely because, at least in the context of greenhouse gas. or "GHG", emissions, Scope 3 emissions (i.e., from a reporting entity's upstream and downstream supply chains) are regarded as having a larger overall impact than Scope 1 emissions (i.e., from sources controlled or owned by a reporting entity) and Scope 2 emissions (from the electricity and other power/energy purchased by a reporting entity). Global Compact Network UK has estimated that Scope 3 GHG emissions often account for upwards of 70% of a reporting entity's aggregate GHG emissions.

California took the lead in shifting attention to Scope 3 emissions when signing Senate Bill 253 and Senate Bill 261 into effect last year, mandating specified US companies that undertake business in California to track and report GHG emissions. As part of the reporting requirement, disclosure of Scope 3 emissions is mandatory, and moreover subject to forthcoming assurance requirements (to be established by or before 2027). The California bills cover companies both public and private and, on the whole, represent a more rigorous approach towards ESG compliance than that taken by other key jurisdictions and regulators. The European Union and the International Sustainability Standards Board (ISSB), by contrast, have to date exercised restraint and not implemented mandatory reporting of GHG emissions (regardless of type), except for cases satisfying a materiality threshold. Under the above-mentioned SEC proposal, reporting is mandatory for Scope 1 and Scope 2 GHG emissions, whereas reporting for Scope 3 emissions is required only if material or if a registrant has a specific target for Scope 3 GHG reduction. The California bills may be ahead of their time but indicative of future trend. Companies with a global operational footprint, accordingly, should begin considering and collecting data on the carbon footprint of their suppliers, vendors and customers.

Meanwhile in Europe, the Corporate Sustainability Due Diligence Directive (for which the EU Council and the European Parliament reached a provisional consensus on December 14, 2023) will require EU and non-EU companies to conduct environmental and human rights' due diligence across the operations of their business, including their supply chains. This would represent a substantial departure from the existing inquiry and assessment standard. The EU TNFD, or taskforce on nature-related financial disclosures, has been established to shape future regulation and issued recommendations late last year on the need for companies to identify, assess and disclose nature-related impacts, risks and opportunities arising from supply chains. In the not-so-distant future, companies of all sectors and geographies will likely need to confront the ESG impact of supply chain head-on, and develop a tracking infrastructure for ESG compliance.

Incorporating ESG into Financials (and subjecting ESG to Audit & Verification)

In the United States, the SEC has proposed rules requiring climate-related metrics (e.g., regarding the impact of conditional weather events) to be assessed, analyzed and presented in a footnote to a company's financials. These ESG disclosures, which could be expressed in mathematical/scientific terms and/or in narrative/analytical terms, would be tied to specific line items in the body of the financials to permit better contextualization. The integration of ESG analysis in company financials should, in theory, equip investors to better perceive how ESG intersects with a company's financial performance, and thus enable such investors to arrive at better, more informed investment decisions. In addition, this integration of ESG analysis into company financials should have the effect of subjecting climate metrics to oversight by a third-party auditor, thus requiring such metrics and other ESG-related disclosures to be expressed, increasingly over time, in objective and verifiable terms.

In parallel, and with a goal of supporting reliability, the SEC proposal also requires "limited assurance" (i.e., review and confirmation from an independent party) be provided with respect to calculation estimates and analysis of Scope 1 and Scope 2 greenhouse gas emissions. Following a phased-in period for compliance, the proposal would then apply a higher conviction standard of "reasonable assurance" (i.e., verification from an independent party, akin to the audit standard) for the same set of disclosures. This SEC proposal is not new, but rather draws inspiration from earlier draft versions of the CSRD and tracks similar such ambitions from other regulators (e.g., in Australia). Regardless of whether and when this SEC proposal is adopted, we expect ESG service providers to upgrade their servicing capacity in anticipation of formalized assurance requirements, or similar, becoming widespread. In support of this potential development, the International Auditing and Assurance Standards Board (IAASB) has proposed (and seeks to finalize in 2024) an overarching set of standards covering all requests for confirmatory or verificatory assurance.

Globalization in Business and the Interoperability of Reporting Standards

The fragmentation of ESG reporting regimes across the globe presents challenges to market players with global footprints and has strengthened the need for interoperability and alignment among key standards worldwide – namely, the ESRSs in the European Union, the terminology of the SEC proposal, and the overarching standards developed by ISSB, a body within the IFRS Foundation. ISSB's standards have received positive industry feedback, and governments in Hong Kong, Singapore and the European Union have expressed strong support. Notably, the proposed mandatory disclosure regimes of Hong Kong and Singapore, described above, adopt ISSB's standards – an objective for which Hong Kong had originally delayed implementation of its regime.

Differences across reporting standards can be widespread and nuanced, however, covering items such as scope of application, standard of materiality, details on reporting format/substance, assurance requirements and similar. For example, materiality under the SEC proposal is based off a 'reasonable determination' test, with reference to the actions of a prototype investor, construed through past SEC regulatory action and intervening court judgements. The ESRSs adopt a two-pronged, 'inside-out'/'outside-in' approach towards materiality, which is firm. And ISSB's standards on materiality are synchronized with IFRS standards, as applied in the financial accounting context.

Nevertheless, there are concerted efforts to align standards used in ESG governance, strategy, risk management and projections. Similarly, recent action by regulators has shown the value placed on interoperability. Last year, ISSB announced they will continue working jointly with the European Union to promote interoperability between ISSB's standards and the ESRSs, and that they will publish guidance material to assist market participants in navigating differences between the two sets of standards. We expect collaboration amongst regulators and other rule-setting bodies to increase over the coming years, given the shared incentives of promoting compliance.

"Anti-Greenwashing", the Originating Principle for ESG Regulation

"Greenwashing" refers to inaccurate, misleading, and—at times—fraudulent marketing of the sustainability profile of a service or product. As consciousness of ESG factors broadens through society, rigor toward ESG themes has become not just fashionable but necessary for institutional investors. In turn, business operators and capital managers have become increasingly motivated to adopt and promote an ESG brand, including in circumstances where ESG systems are nascent or non-existent.

Regulations against greenwashing typically focus on the accuracy of labeling and classification decisions, with the general principle being that products or services claiming an ESG focus or impact are subject to a higher level of regulatory oversight. The SEC proposal establishes a 3-tier system for categorizing investment funds as: 1- ESG-integrated, 2- ESG-focused or 3- ESG-impact, depending on how extensively the fund proposes to implement ESG factors and seek ESG factor outcomes. The SFDR (Sustainable Finance Disclosure Regulation) in the European Union adopts a similarly tiered approach. Across the European Union, the United States, Hong Kong and Singapore, there are naming rules in place (or at least, proposed) pursuant to which at least 66 2/3% of a fund's net asset value must be invested in synchrony with the ESG focus or strategy suggested by its name.

In Conclusion – Navigating ESG

Market participants are eager for clearer rules and more detailed interpretations, practical guidance and consistent reporting standards. When regulations on ESG have coalesced globally and the transition periods for compliance are over, regulators as well as institutional investors may be more rigorous in expecting all market players to have a robust culture of ESG compliance. Market players should thus keep a close watch on regulatory trend, and build up systems and capacity now in anticipation of a future, more unitary regime.

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Apart from serving as regional leader, Lorna Chen is also a member of the firm's Executive Group. Lorna founded and leads our asset management and investment funds practice in Asia. Lorna has 28 years of experience across the United States, Europe and Asia in the corporate law area, including 24 years in the investment funds and private equity field. She advises clients in the structuring, restructuring, formation and operation of alternative investment products, including private equity funds, venture capital funds, hedge funds, real estate funds, funds of funds, project funds and co-investment structures. Lorna has extensive experience in cross-border transactions representing top global institutional clients such as the world's major sovereign wealth funds, wealth management platforms, commercial and policy banks, insurance companies, as well as family offices and start-up companies. Lorna is a frequent speaker at major regional conferences and is regularly interviewed by the financial media in Asia. She has also been consistently rated a leading lawyer by various independent ranking publications. Lorna is a panel member of the Securities and Futures Appeals Tribunal.

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Private Credit Investing in the Asia Pacific

Jeffrey Lau, Primavera Capital Group

Markets globally are undergoing a dramatic sea change–marked by higher interest rates, a recalibration of traditional banking and increased demand for alternative financing solutions. The Asia Pacific region remains an engine of economic growth. Private credit in Asia has grown at a CAGR of 26% since 2017 to reach a total AUM of US$76.1 billion as of 2022 but remains underpenetrated, offering white space for expansion as the banking sector retrenches.[1] For credit investors, Asia is a compelling opportunity providing superior all-weather returns, exposure to a burgeoning middle-class and downside protection though robust covenants, structuring, and collateral.

Rising Demand for Flexible Capital

Following the 2008 global financial crisis, central banks around the world embraced low interest rates and asset purchases to stimulate economic recovery, creating a prolonged, and unprecedented, period of easy money. However, as inflationary pressures mounted following the COVID-19 pandemic, central banks abandoned their accommodative policies. From March 2022 to July 2023, the Fed raised interest rates 11 times, lifting rates from near zero to over 5 percent in just 18 months, the fastest pace of tightening since the 1980s. Inflation now appears under control, but we expect non-zero rates will remain, forcing businesses and markets to adjust valuations and operations.

In the United States and Europe, the rise of private credit resulted from banking regulations implemented in the aftermath of the 2008 financial crisis. Increased capital requirements and regulatory constraints led to a tightening of lending standards, reducing the loan portfolios of banks and creating a gap in financing that was filled by alternative sources, including hedge funds, private credit funds and other nonbanks lenders that are not subjected to capital requirements. The "Basel III endgame" unveiled in mid-2023 will be fully implemented in 2025. The biggest banks are expected to face a 19% increase in capital constraints.[2] At the same time, demand for financing from companies has not slowed. The total AUM of private credit globally has nearly doubled since 2020 to $1.6 trillion and is expected to reach $2.3 trillion by 2027.[3]

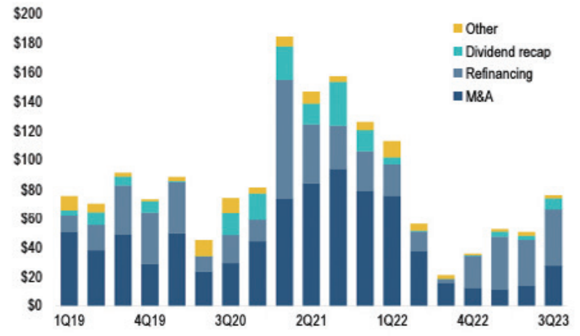
In Asia, banks were generally less impacted by the tightened regulatory regime post-2008, and private credit is still in its infancy with only US$90 billion in assets under management.[4] Nonetheless, the development of Asia Pacific alternatives market followed the path of the US and Europe only on an accelerated timeframe. Asian banks' capitalization held up during the pandemic, but rising global risks are leading regulators to tighten macro-prudential regulations, notably in markets like Australia and South Korea.[5]

Since the Fed rate hiking cycle began in early 2022, both high-yield bond and leverage loan

1 Ares, Private Credit Opportunities in Asia Pacific, October 2023, p. 8. Data is from Preqin as of Sept 2022
2 Bloomberg, New Capital Rules Bring Marvel-Like Drama to Banking, 2023.7.29
3 Alliance Bernstein, Private Credit Outlook: Evolution and Opportunity, 2024.1.04
4 Bloomberg, Private Credit has more reasons to thrive in Asia, 2023.1.08
5 Cleary Gottlieb, Asia Pacific Private Debt: An Industry Poised for Growth

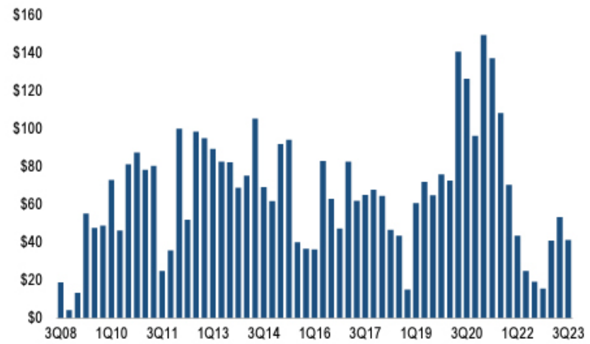
issuance declined swiftly as rising interest rates and concerns about inflation prompted investors to reassess risk. Despite a recovery being seen since Q3 2023, activity in the public debt markets remained dampened from the peak of 2021 (see **charts 1** and **2**).[6] The "loan maturity wall" is now higher than ever, with over $120 billion maturing by 2025, half of which is riskier debt rated B-minus or lower (see **chart 3**). More and more businesses are turning towards alternative financing solutions.

Chart 1: US institutional loan volume (US$ billion)[7]



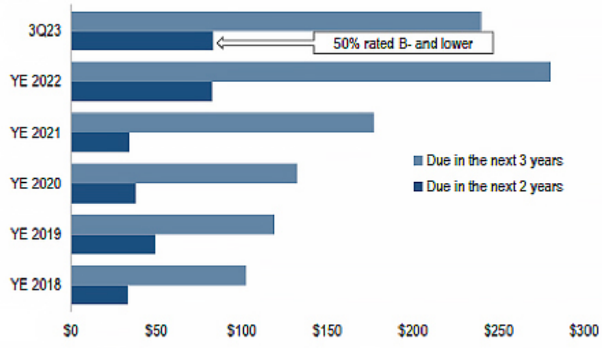
Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 2: US high-yield bond volume, US$ billion, quarterly[8]



Source: PitchBook | LCD • Data through Sept. 30, 2023

Chart 3: US leveraged loan maturity wall, US$ billion[9]

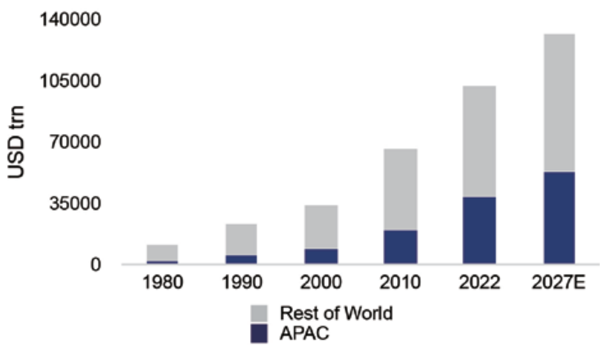


Source: PitchBook | LCD • Data through Nov. 22, 2023

The Asia Pacific region is not exempt from external shocks and geopolitical uncertainty. Businesses recognize the importance of financial resilience and adaptability. Private credit is more flexible, providing certainty of execution and customized financing solutions.

Despite Global Headwinds, Asia's Rise Continues

Chart 4: Asia Share of World GDP, IMF forecast



In spite of a challenging environment, economic growth in the Asia Pacific region is expected to continue. Comparatively, Asia Pacific's growth trajectory will outpace that of the United States and Europe. Growth in consumption and investment is expected to stimulate demand for business financing. By IMF's forecasts, the Asia Pacific region already contributes about two-thirds of global GDP growth,[10] while McKinsey

[6] Pitchbook LCD, US 3Q23 Credit Markets Quarterly Wrap. In 3Q23, US leveraged loan issuance was $76 billion and high-yield bond issuance was $41 billion

[7] Pitchbook LCD US 3Q23 quarterly, p.3

[8] Pitchbook LCD US 3Q23 quarterly, p.16

[9] Pitchbook LCD, Back to the maturity wall, 2023.12.2

[10] IMF October 2023 forecast: Asia Pacific is on track to contributing two-third of global growth in 2023

projects Asia to account for almost half of the world's total GDP by 2040 and contribute 40% of total consumption.[11]

With a burgeoning middle class, the region is expected to attract a substantial share of global capital expenditure and investment. According to the Brookings Institution, Asia is currently home to half of the world's 4 billion people in the middle and upper-income consumer class. By 2024, the majority of Asians will be either "middle class" or "rich".[12] At the same time, Asian consumers are spending more on products made within the region, shown by the growing share of intra-regional trade flows within APAC.[13] This heightened economic activity will necessitate substantial financing for businesses to expand operations, invest in innovation and capitalize on emerging opportunities.

Chart 5: Asia's consumer tipping point will occur in 2024

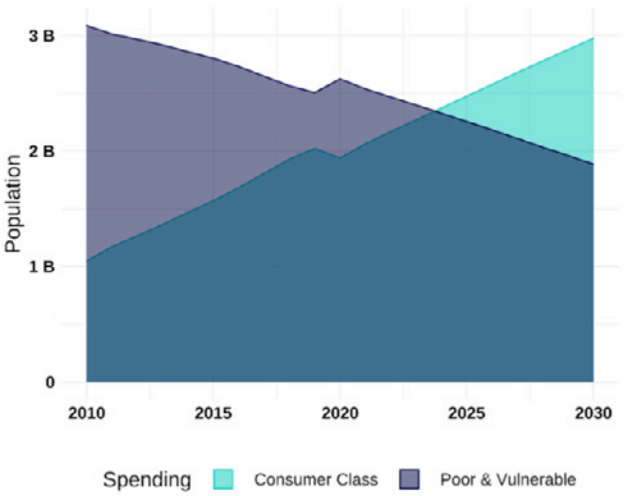
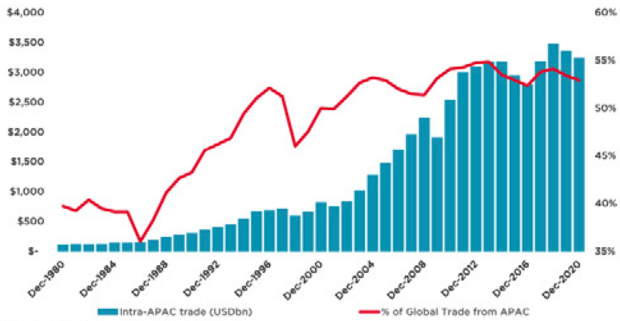


Chart 6: Growth of Intra-regional trade flows in Asia Pacific



Source: IMF; Moody's; Cushman & Wakefield

White Space for Private Credit in Asia

Compared to Europe and the United States, firms in the Asia Pacific region face more difficulties in accessing capital. Asia is still reliant on traditional banking channels, which account for almost 80% of funding, compared to roughly half in Western markets.[14] Additionally, the banking sector in the region takes a more conservative approach, with rigid lending criteria and a bias toward larger enterprises and government-supported sectors. By offering tailored solutions, private credit empowers innovative and growth-oriented enterprises.

Private credit as an asset class remains underpenetrated in the region. As of H2 2022, while private capital AUM in Asia is of similar scale to Europe, private credit represents less than 4% of total private capital in the region, compared to 16% in Europe and 13% in North America. The bulk of private capital in Asia is still equity, representing 85% of private capital AUM, compared to 52% in Europe and 63% in North America.[15] The relatively underdeveloped and vastly diverse regulatory regimes in the Asia Pacific require localized legal knowledge and operational know-how. Private credit can also offer a tailored way to help business owners meet funding needs without needing to dilute equity capital.

[11] McKinsey, Asia's future is now, 2019.07.14

[12] Brookings, Asia's tipping point in the consumer class, 2022.6.2. "Middle class" is defined as those spending $12-120 in 2017 PPP dollars per day, "rich" is defined as spending over $120 per day. The "consumer class" includes those spending above $12 2017 PPP dollars a day

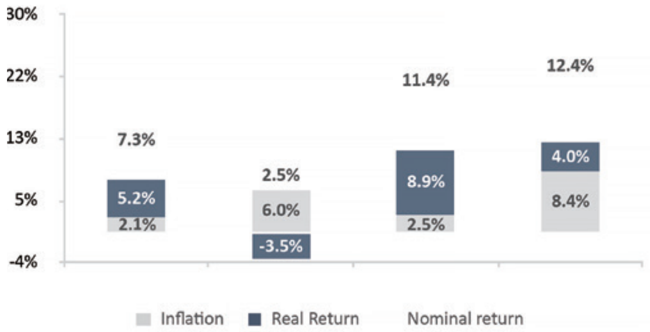
[13] Cushman & Wakefield, The role of Asia Pacific in global supply chains, March 2022, p.11

[14] KKR, Private Credit in Asia Pacific: A Region on the Rise, p. 10, data from BIS as of March 31, 2023. Bank credit represents 79%/54%/33% of lending in Asia Pacific, Europe and the US respectively

[15] McKinsey Global Private Markets Review 2023. "Equity investments" include both PE and VC AUM. Total private capital AUM was $2.5 trillion in Asia, compared to $2.3 trillion in Europe and $6.3 trillion in North America

For Investors, private credit provides attractive all-weather returns in diverse economic environments and a degree of protection against inflation (see chart 7). Asian private credit will appeal to investors seeking diversification, and exposure to the region's continuing growth.

Chart 7: Bond vs. Private Credit Returns,
1928-Present



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VC Evergreen Fund: Empowering Investments and Overcoming Challenges

Michael Sidler and Rafael Hubatschek, Redalpine

The Opportunity

The European venture ecosystem has both matured and become more professional, leading to greater innovation and cutting-edge research across such areas as energy transition, mobility, artificial intelligence, quantum computing, new food, synthetic biology, and health-technology.

Yet, while SMEs have always been the backbone of Europe's prosperity, today these companies face challenges when it comes to raising funding for their continued growth. Despite the extraordinary companies, founders, and technologies that Europe produces, the vast majority of sizable financing rounds in Europe (those of more than $100 million) are led by investors in the US or Asia. This is just one data point of many that highlights the meaningful funding gap for European growth companies. However, a VC evergreen fund that is specifically tailored to bridge this funding gap may provide a unique approach to venture capital via its semi-liquid format and multi-stage investment strategy, allowing it to leverage innovation across the continent.

Europe is home to some of the world's most innovative countries. According to the Global Innovation Index 2023, published by the the World Intellectual Property Organization, seven of the ten most innovative countries are in Europe. This is bolstered by Europe's impressive science and engineering talent, hosting more than half of the world's top science clusters (according to data provider Dealroom). Moreover, according to VC firm Sequoia, Europe has the highest concentration of AI talent and, according to data analytics firm Clarivate, the highest share of highly-cited research publications.

Europe's position has not gone unnoticed. In fact, over the last three years, it was the only region globally to experience a growth in venture capital investment (+18% in invested capital, according to the Atomico State of European Tech 2023). Europe also outperformed the US in terms of returns in the last three, five, and ten years (as per Cambridge Associates and McKinsey & Company).

Venture capital reimagined

A VC evergreen fund presents a complete venture capital solution within a single strategy. It offers an innovative, open-ended approach that provides access to the entire value chain of venture capital, broadly diversified and in a semi-liquid format. By combining investments in early stage-focused fund manager's existing funds with its growth strategies, the evergreen fund offers diversified venture capital exposure from day one.It serves as a conduit to private asset opportunities, underpinned by an institutional manager and anchored by a fund manager's existing track record.

Concretely, with the evergreen vehicle, investors participate in the success of early-stage funds, emerging superstars from former funds' portfolio companies, and investments in other sector leaders, where the fund manager has exclusive access to its long-standing early-stage activities and international network.

Hence, the fund allows for multifaceted diversification. Firstly, it provides diversification across various economic cycles by automatically

Evergreen Venture Fund

allocating to every new closed-end early-stage fund launched by a fund manager every two to three years. Secondly, it provides diversification across all investment stages - from pre-seed to pre-IPO. Thirdly, investors profit from a diversified set of strategies (primaries, secondaries), enabling the fund to capitalize on opportunities and dislocations in the market. And finally, the fund provides exposure to a sizable portfolio featuring a broad range of companies and business models, with a focus on both software and science-based companies.

The Importance of fund structure

Matching the stage of investment with the right approach and corresponding structure enhances efficiency, maximizes returns, and provides for an optimized risk-return profile. Investments in early-stage companies are likley best pursued via traditional closed-end fund structures, allowing the manager to stay true to its proven portfolio construction technique.

The latest research suggests that smaller venture capital funds outperform large ones. Only 17 percent of venture funds that are over $750 million have returned their investors more than 2.5 times the total value to paid-in capital, after fees and expenses. Meanwhile, 25 percent of funds that are smaller than $350 million achieve a 2.5 times return rate, according to an analysis of PitchBook data by Santé of more than 1,300 funds dating back to 1978. To put it simply - a smaller fund is roughly 50 percent more likely to return more than 2.5-times TVPI than a larger fund. The performance gap between small and large funds is even wider when considering the cumulative internal rate of return. Larger funds have an average IRR of 9.7 percent, compared to the average 17.4 percent IRR of smaller funds, according to the Santé report.

In the growth stages, direct investments offer the perfect addition, providing for the combination of fund investments with diversification across ventures and direct investments in later stage companies with proven business models. Thus, a VC evergreen fund can seek growth investment opportunities within fund manager's portfolio. Consciously crafting moderate-sized funds aligns fully to and are a function of this strategy and the deliberate portfolio construction technique.

It is also worth noting the enhanced flexibility for investors and the GP alike that open-ended structures provide. Such a format provides the opportunity to capitalize on market opportunities as they arise; lower reinvestment risk compared to funds with a finite lifetime; a compounding effect due to continuous investment; a higher invested to committed capital ratio; better control of an investor's desired target allocation to the asset class; and lastly, a high degree of transparency based on a reliable and uninterrupted track record. Furthermore, new investors gain the ability to easily build and maintain target allocations. Little to no J-curve effect applies as capital is invested from the start. Investors face less blind-pool risk, as they can see what assets are part of the portfolio before investing. Again, they face lower reinvestment risks and reinvestment decisions as the capital is not distributed.

Accessing venture capital with a perpetual fund

For investors who are looking to build a private investment program, perpetual funds could effectively reduce the impact of cash drag and J-curve effects during the initial years. An additional benefit perpetual funds offer is reduced operational complexity. Based on analyses performed by UBS and Burgis, investors who want to build a private investment program from scratch could mitigate cash drag and J-curve effects in the first five to six years of building a program by using perpetual capital funds, while gradually shifting into closed-ended funds to maximize return multiples. For investors who may not have the capital or operational support, starting with perpetual funds is likely to provide beneficial access to a diversified allocation of multiple vintage years and strategies that can capture a potentially significant illiquidity premium above public market investments.

Evergreen structures are not a complete patent recipe. After all, the success of open-ended funds ultimately relies on the investment acumen and flow of a manager. Having said that, open-ended evergreen funds should be a tool in every investor’s toolkit, helping them overcome the structural and cyclical challenges of private markets.

Dr Michael Sidler, Founding Partner, Redalpine

Michael Sidler is the co-founder and partner at Redalpine. Michael holds a Ph.D. in molecular biology, and was part of The Boston Consulting Group. In 2003 he joined Prionics, one of the early Swiss role-model startups. Following his passion, he eventually changed the sides of the table to focus entirely on venture capital. He sees venture capital as an indispensable driver of the future economy. Michael has two daughters and enjoys sports.

Rafael Hubatschek, Head of Investor Relations, Redalpine

Rafael Hubatschek is the Head of Investor Relations at Redalpine. Rafael has over 7 years of experience working in the financial sector with companies such as Credit Suisse, Deutsche Bank, and UniCredit Bank Austria AG. Rafael has also worked as a Venture Fellow with the Newton Venture Program, a highly competitive and selective investor training program.

Rafael Hubatschek has a postgraduate master's degree in finance and wealth management from the University of Luxembourg. Rafael also has a master's degree in international business administration with a focus on entrepreneurship, innovation, and strategy from the University of Vienna. In addition, they have attended summer school at the London School of Economics and Political Science and completed an exchange semester at Copenhagen Business School. Rafael holds a bachelor's degree in business administration with a focus on finance from the University of Vienna.

Redalpine

Founded in 2006, Redalpine brings together financial investment, operational expertise, and a vast international network to help ambitious entrepreneurs transform their vision into a reality. To date, the manager has raised seven funds, showing consistent top-quartile performance across all vintages uniquely combining technology and (life)science-based investments with commercial mastery. With over €1bn in assets under management and a disciplined, sector-agnostic investment strategy, the firm has backed some of Europe’s most disruptive companies, including N26, Taxfix, Inkitt, 9fin, Carvolution, Zenjob, vivenu, and Umiami. Redalpine has over 95 companies in its portfolio and invests Europe-wide, with a team of 35 people (nine natural science PhDs with dual profiles and deep investment expertise), from its offices in Zurich and Berlin. Find out more at www.redalpine.com.

In the Year of the Dragon, Flaring Tensions in the U.S./China Economic Relationship Remain a Significant Risk for Private Fund Managers and Investors[1]

Chris Hayes and Jason Mulvihill, Capitol Asset Strategies

As we enter 2024, the year of the dragon, the U.S./China relationship remains rocky, and there are significant conversations happening behind the scenes in Washington that pose risks to private fund managers and institutional investors deploying capital in the People's Republic of China (PRC).[2] These risks include: (1) expanded restrictions on investment in companies in China beyond the "critical technologies" currently contemplated; (2) growing scrutiny, data collection, and potential tax increases on U.S. private fund managers and investors invested in the PRC; and, (3) the increased limitations on IPOs and access to U.S. public markets for exits. Each of these risks continues to grow, despite recent efforts to stabilize the relationship between the U.S. and PRC political leadership.

Current State of Play:

Last August, the U.S. Treasury Department and the Biden Administration issued an Executive Order and a related Advance Notice of Proposed Rulemaking (ANPRM) to establish new controls on outbound U.S. investment into certain foreign countries and entities, including private funds. The ANPRM restricted investments with "covered foreign persons" engaged in operating businesses in a "covered national security technology or product." This included semiconductor technology, quantum information technologies, and artificial intelligence (AI) systems. The comment period on the ANPRM has closed and Proposed Rules (crafted incorporating feedback on the ANPRM) are expected sometime in early 2024. Final Rules implementing the policy will potentially follow later this year, but could be delayed into 2025, during a second term for either President Biden or President Trump, depending on the outcome of the 2024 elections. Under either U.S. Administration, we expect some version of these rules to be brought into force.

While the Biden Administration's Executive Order and related ANPRM established the President's initial position on the topic, Republicans and Democrats in the United States Congress (Congress) have also continued to advance bipartisan legislative efforts to impose new outbound investment restrictions on the PRC. These legislative proposals in many cases would go further than the Executive Order and ANPRM, expanding the scope of sectors targeted by investment restrictions, requiring new or increased reporting on investments in PRC from private funds and institutional investors, and imposing tax increases on investments in the PRC.

[1] This article provides summary information only and is not intended as legal advice. Readers should seek specific legal advice before taking any action with respect to matters discussed herein. Please contact info@capitolassetstrategies.com if you would like to discuss any of the issues in this article.

[2] For the purposes of this article, we refer to the PRC as also inclusive of the Hong Kong Special Administrative Region (SAR) and the Macau SAR.

Risk No. 1: Further Expansion of Proposed Scope of Outbound Investment Limitations

The most significant risk facing private fund managers and investors in the PRC is the potential for scope expansion of the existing Biden Executive Order (Biden EO) and ANPRM in the proposed and final rules, or through bipartisan legislation in Congress. While the Proposed Rules will come out early this year, various legislative efforts are already in motion.

The legislation with the highest potential to be enacted is the newly proposed bipartisan *Preventing Adversaries from Developing Critical Capabilities Act (H.R. 3649)*, which would essentially enact into law much of the proposed regulatory framework from the Biden EO and ANPRM, while also imposing an expanded scope of covered technologies. If the Congress were to pass such legislation and the President were to sign it, the obligations would become statutory, making it harder for a future President to remove such requirements absent new legislation from the Congress authorizing he or she to do so. This bill recently passed out of the House Foreign Affairs Committee in Congress with bipartisan support at the end of November.

There remains an ongoing debate in Congress on the Republican side of the aisle, highlighted in a January 2024 House Financial Services Committee congressional hearing, about whether imposing new sector related restrictions (as is contemplated in the Biden EO and ANPRM) is the appropriate method to address PRC investment concerns, or whether expanding the existing approach of blacklisting specific companies through the U.S. Treasury's Office of Foreign Assets Control (OFAC) list would be more effective and efficient. This debate highlights differences in approach between Republicans focused on national security concerns, who prefer more restrictive approaches, versus Republicans who are concerned with the economic impacts of the policy in addition to national security issues, who prefer a sanctions/OFAC list approach. Democrats appear to be generally favoring the Biden Administration's sector related approach advanced in the Biden EO and ANPRM, some form of which appears the most likely to move forward at this point.

Bipartisan support, between Democrats and Republican national security hawks, provide the potential ability for this legislative effort to advance. If any legislation passes both houses of congress, it would be politically difficult for President Biden to veto it, particularly if the legislation is attached to other important legislation, such as the annual National Defense Authorization Act.

Risk No. 2: Increased Scrutiny, Data Collection and Potential Tax Increases on U.S.-Managed Fund Investors and Other Institutional Investors Deploying Capital in the PRC

Beyond the potential expansion of the Biden EO and ANPRM sector restrictions, U.S. based private fund managers and institutional investors are also facing a variety of other types of political scrutiny, proposed data collection and reporting efforts, and even potential tax increases on their investments in the PRC.

In December, the House Select Committee on the Strategic Competition between the United States and the Chinese Communist Party (hereinafter the "Select Committee") released a bipartisan report[3] that called for greater restrictions on private fund managers and institutional investors deploying capital in the PRC. The report suggested the Biden EO and related ANPRM did not go far enough, claiming in part that the restricted technologies are currently too narrowly scoped, in line with Risk no. 1. The report also explicitly called for adopting the following legislative measures to restrict investment in the PRC:

> *Congress should [also] enact legislation that requires private equity firms, as well as employee retirement plans governed by the Employee Retirement Income Security Act (ERISA), to disclose their continuing investments in companies based in or controlled by foreign adversaries. Congress should consider and discuss proposals to end purchases of any further interests in those entities, such as the Protecting Americans Retirement Savings Act (H.R. 4008).*

The report also encouraged legislation to support greater divestment from PRC by proposing increased taxes on capital gains income and dividends made by U.S. based private fund managers and institutional investors from investing in the PRC while also providing economic incentives for relocating investments outside of the PRC. Specifically, the report states, Congress should:

> *Enact legislation to ensure capital gains and dividends made from investing in the PRC are not taxed at a lower rate than American workers' salaries. Congress should give investors a one-year period to divest from PRC entities then tax investment in the PRC at the same rate as ordinary income. At the same time, it should defer capital gains taxes for investments shifted to strategic sectors and small businesses in the United States.*

Although it is unclear whether this proposal would apply to non-taxable entities, such as U.S. pension plans, the message such a legislative proposal would send is clear: *decrease investing in China or face a targeted tax increase on continued investments.*

Political scrutiny is also increasing on U.S. based institutional investors. A Future Union report[4] released on December 27, 2023, examined closely the continued significant investment by some of America's largest public pensions (e.g., NYSCRF, CalPERs, CalSTRS and others) and university endowments (led by public endowments like University of Michigan and UTIMCO) into PRC-based companies. Future Union, a group focused on linking democracy and corporate governance, has indicated it will continue to produce research on this topic and continue to share it with the Select Committee. This data sharing could fuel greater efforts to restrict investment in the PRC by U.S. institutional investors, whether through private funds or otherwise, through both public pressure and direct policy action.

Legislative efforts in Congress have also been introduced to require enhanced reporting by fund managers and institutional investors of their investments in the PRC. The DETERRENT Act passed out of the House in December. This legislation would impose a new reporting requirement on private institutions with endowments above $6 billion or "investments of concern" in designated countries above $250 million. The new reporting requirement would apply to investments made through pooled investment vehicles. Private educational institutions subject to this new obligation would have to report this information to the U.S. Department of Education. While this legislation is unlikely to become law, it will likely increase political pressure on university endowments and administrators to reconsider their investment allocations to the region.

Similarly, Congress has introduced bipartisan legislation focused on adding aggregate reporting requirements for investments in China by U.S. Securities & Exchange Commission (SEC) registered private fund managers on SEC Form PF and Form ADV. While Form PF was already recently updated with new geographic reporting requirements in 2023, it is not a publicly available form, whereas Form ADV would be both available to the public and would cover smaller private fund advisers and exempt reporting advisers. This enhanced public reporting could then be used as further political leverage for greater outbound restrictions, like the data collection on institutional investor allocations to investments in the PRC.

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3 The Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party, Reset, Prevent, Build: A Strategy to Win America's Economic Competition with the Chinese Communist Party, December 12, 2012, available at: https://selectcommitteeontheccp.house.gov/sites/evo-subsites/selectcommitteeontheccp.house.gov/files/evo-media-document/reset-prevent-build-scc-report.pdf

4 Kia Kokalitcheva, Mapped: U.S. public pensions have a lot of investments in China, Axios, December 27, 2023, available at: https://www.axios.com/2023/12/27/us-public-pensions-investing-china-map; https://futureunion.co/pensions/

Finally, at the state level in the U.S., some elected officials have advanced proposals to push local and state public pensions to divest from assets in the PRC. Notably, in December, the Missouri State Employee's Retirement System, MOSERS, voted to divest[5] most of its investments in PRC based companies, totaling over $200 million in value. We may see additional efforts over the next few years to push more U.S. public pensions in specific states to divest from the PRC, either from board public pressure, or from legislative action at the state level. Such efforts would supplement any U.S. restrictions imposed at the federal level.

U.S. institutional investors and U.S. based private fund managers across the country who invest in the PRC will continue to face pressure to reduce or divest from their investments, posing fundraising challenges for funds in the region, and potentially limiting access to U.S. capital for companies in the PRC.

Risk No. 3: Political Headwinds in Advance of Resumption of Chinese IPOs in the U.S.

After much uncertainty, IPOs of companies based in the PRC on U.S. stock exchanges have recently resumed, restoring an exit option for many private funds in the region. This IPO development occurred after an agreement between the Chinese government and the U.S. Public Company Accounting Oversight Board (PCAOB) to provide audit access for U.S.-listed companies based in the PRC. Chinese regulators also provided more clarity for technology firms to conduct overseas IPOs. Before this intergovernmental agreement, the Holding Foreign Companies Accountable Act of 2020 created continued risk that PRC-based companies listed on U.S. exchanges would be forced to de-list if they were not able to be audited by the PCAOB. The resurgence of PRC company IPOs in late 2023 has generated some concern from groups advocating for a tougher stance on the PRC[6] in the policy space. For example, recent testimony by the Foundation for Defense of Democracies advocated that, *"The SEC in the United States should require Chinese-domiciled entities to provide detailed accounting for their ties to the Chinese State and to the Chinese military and surveillance apparatus as a part of fundraising efforts in the United States."* These efforts seek to limit the ability for select companies in the PRC to access the U.S. capital markets and may gain traction in 2024, particularly if geopolitical tensions ratchet up again.

What's Next – Will the Year of the Dragon Become Even More Rampant for China Focused Investment Funds?

The overall U.S./China investment climate will continue to be tethered to the larger geopolitical dynamics between the two countries. The release of the Proposed Rules and later any Final Rules on PRC investment restrictions by the Biden Administration will provide another flash point in the ongoing political debate over how far to go. In addition, with 2024 being an election year, it is likely that presidential candidates and congressional candidates from both major political parties will push for more restrictions on investments in the PRC.

Private fund managers and institutional investors investing in the PRC can take some steps to mitigate the challenges presented by the political environment. First, they can continue to monitor the proposed and final rules presented by the Biden Administration later this year and stay updated on what may result after the U.S. 2024 elections. Second, they can be very clear about their investment strategy and in their marketing materials and private placement memorandum (PPM), assuring U.S. based institutional investors that their investments will be outside the scope of sector-based limitations that are contemplated in the Biden EO, the ANPRM, and other sensitive sectors. Third, for funds with a broader Asia-Pacific (APAC) strategy, they can bifurcate China, Hong Kong, and Macau investments into a separate fund vehicle for non-U.S. LPs, allowing non-China APAC strategies to continue to fundraise in the clear from U.S. based institutional investors. Even with these protective measures, however, investors in the PRC, including private fund managers and institutional investors, will likely continue to face significant new challenges in the year of the dragon.

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5 Rudi Keller, State board votes to divest Missouri employee pension fund from China, Missouri Independent, December 12, 2023, available at: https://missouriindependent.com/2023/12/12/state-board-votes-to-divest-missouri-pension-fund-from-china/

6 Nathan Picarsic & Emily De La Bruyere, Commanding Heights: Ensuring U.S. Leadership in the Critical and Emerging Technologies of the 21st Century, Statement for the Record: Foundation for Defense of Democracies, July 26, 2023, available at: https://www.fdd.org/analysis/testimonies/2023/07/26/commanding-heights-ensuring-u-s-leadership-in-the-critical-and-emerging-technologies-of-the-21st-century/.

Chris Hayes, Managing Partner, Capitol Asset Strategies

Chris Hayes is a Managing Partner at Capitol Asset Strategies.

Before joining Capitol Asset Strategies, Hayes held several policy roles in the web3/blockchain industry, as well as in the traditional financial services space. Most recently, he led global government relations for the Celo Layer-1 blockchain, as well as US government relations for Sorare SAS, an NFT company backed by Softbank.

Prior to entering the blockchain industry, Chris built and led the global advocacy program for over 600 institutional investors in private funds at the Institutional Limited Partners Association (ILPA) for five years. He also led its legal best practices initiatives, as well as ILPA's engagement with in-house legal teams at LPs.

Jason Mulvihill, Founder & President, Capitol Asset Strategies

Jason Mulvihill is the Founder & President of Capitol Asset Strategies.

Prior to starting the firm, Mulvihill served as the Chief Operating Officer and General Counsel at the American Investment Council for over 12 years. In that role, Mulvihill spearheaded advocacy efforts for many of the leading private equity, growth capital, and private credit firms in the world. He oversaw the AIC's Regulatory Committee, General Counsels Committee, Tax Committee, the Private Credit Working Group, and the Chief Compliance Officers Working Group.

Capitol Asset Strategies

Capitol Asset Strategies ("CAS") provides strategic advice, guidance, and risk management on complex policy and regulatory issues in the financial services and crypto/web3 industries. We offer clients custom-tailored representation to ensure long-term success. Our team includes bipartisan professionals with over 25+ combined years of experience working on financial regulatory issues, with a specialization in cross-border firms, private funds and blockchain/crypto/web3. We can help you understand and influence the regulatory and policy issues that impact your business.

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