KEYNOTE INTERVIEW

Tailwinds swell PE's wealth push





Managers benefit from a favourable regulatory environment and evolving fund structures, say Fried Frank's Jeremy Berry and Robert MacVicar

Q Where do you see private wealth investors focusing their commitments to private markets?

Jeremy Berry: In the US, when it comes to attracting private wealth, alternatives managers have long had better success in the real estate and private credit markets, making use of real estate investment trusts and business development companies. Lately, though, private equity has been catching up, using innovative semi-liquid products and long-term investment funds. We also see a push by funds of funds, and by secondaries, co-investment and infrastructure sponsors, who are successfully raising significant retail capital.

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These asset classes are gathering momentum thanks to the rise of new structures that have withstood regulatory scrutiny and been widely accepted by the market. When you combine that momentum with a widespread recognition in private wealth channels of the benefits of investing with alternatives managers, you can see a real shift.

Robert MacVicar: The US story is echoed in Europe, in part because so many of the global programmes are US-led. Plus a lot of this ties into liquidity and figuring out structures that allow private wealth to invest in an illiquid asset class with some level of liquidity.

Q How have developments in retail fund structures helped open up access for private wealth investors?

JB: One factor that has really made a difference is that investors are now much more accepting of the degree of liquidity these products offer. That liquidity is closely tailored to each underlying asset class, and building familiarity among financial intermediaries and end investors regarding how the liquidity options work took a little while. A

leap of faith was needed on both sides, by investors and sponsors, to find an equilibrium on liquidity expectations.

RM: It has required some innovative thinking as well, with sponsors coming at it in a variety of ways. Some of the large sponsors that were already running liquid credit programmes, for instance, decided to apply that model to their existing alternatives programmes. We also saw some sponsors opt for outsourced models by partnering with others to manage cash and money-market fund investments, leaving them to focus on their areas of core expertise.

There has also been concerted regulatory change in Europe in particular. Private equity and alternative assets have been recognised as critical to the economy, whether as part of de-risking bank balance sheets or in terms of supporting major public projects.

JB: You also have the current focus on defined contribution retirement schemes in both the US and Europe, with governments seeing private assets as a big part of helping individuals fund their retirement incomes.

RM: Agreed, and those drivers have flowed into regulatory change, with the European Long Term Investment Fund regime being a clear example. The ELTIF was reformed in January 2024 so that there is now no minimum subscription amount, and funds can be marketed to non-professional investors with a suitability assessment.

There is also the Long-Term Asset Fund, which is the UK equivalent of the ELTIF. The UK Financial Conduct Authority is now consulting on modernising its professional client rules to broaden out the types of investors that can invest in certain private market funds.

Q How has the industry been going about matching up strategies and structures?

JB: We have really seen how fund structures have to align with a fund's strategy and the attitude of regulators. For instance, some investment strategies permit taking a holding company or conglomerate approach, which opens up funds' access to investors that would not traditionally have been able to invest in alternatives. However, this approach does not work for all strategies and can require special structuring below the funds.

RM: You just have to look at the Luxembourg UCI Part II funds to see this process in action. These funds cannot be marketed to non-professional investors like ELTIFs, but they are attractive to a lot of sponsors because of their versatility in terms of investment strategy and permitted leverage, as well as their global marketability and their familiarity to financial intermediaries.

Q What are the major considerations when looking at different fund structures or terms?

RM: It's important to ensure there is clarity around the key terms of the product, particularly regarding the extent and nature of liquidity, given the nature of the investor base. Sponsors have to make sure distributors are on message and that end clients are getting the right product for them.

Another consideration is that these products operate very differently from a lot of closed-end funds, with managers needing to manage a liquidity pool. For example, they will have to value the investments more frequently and balance regular inflows and outflows using available cash, warehousing and leverage. The level of sophistication required around reporting will also be materially different. All that needs to be worked through holistically at the outset.

JB: Two other major considerations are making sure the liquidity of the structure matches up to the liquidity of the underlying assets, and also the regulatory regime under which you are offering the fund. We also caution our GP clients that before accepting retail money, they should expect a higher level of regulatory scrutiny, to which many alternatives sponsors may not be accustomed.

Q Finally, what opportunities and challenges lie ahead for the industry when it comes to private wealth investors?

RM: The most obvious opportunity comes from the growth potential: there is an under-penetration of alternative assets in individual investors' portfolios. The data typically shows single-digit percentage exposure on average, and some of the large sponsors are expecting about half of their inflows to come from that investor base in the coming years. That is a significant scale-up.

JB: Some themes may be opportunities as well as challenges. Firstly, consider the relationship between alternative and traditional asset managers. On the one hand, they are partners working to grow the pie, but they sometimes also view each other as competitors. It will be interesting to watch the different approaches taken there.

Secondly, we need to watch out for regulatory changes, as well as changes to regulators and administrations. Right now, we have a tailwind pushing this forward, but it is quite possible that could become a headwind in the future. The winds can shift very quickly.

RM: Finally, one new challenge for many alternative investment managers is ensuring the visibility of their brands with end investors and distributors. That is not something alternative investment managers are used to focusing on. It will require a bit of a shift in mindset and some carefully considered regulatory advice. ■

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