KEYNOTE INTERVIEW

Structuring success in private wealth

The innovation taking place across private markets to enable engagement with new investor segments is raising plenty of fresh considerations, says Northleaf Capital Partners' Nadim Vasanji

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Q How do different client segments access private markets at present, and to what extent are new investors engaging with the asset class?
Institutional investors have long benefited from investing in private markets, which have historically offered attractive returns and diversification benefits relative to traditional stocks and bonds.

Over the past few years, we have seen an increased appetite for alternative investments from individual investors and an acceleration in alternative asset managers looking to meet this demand. This trend has been a key driver of the development of evergreen funds in the market.

From a product perspective, across alternative asset classes, we observe a spectrum developing. Sophisticated institutional investors continue to engage primarily with closed-end funds, whereas evergreen structures, including hybrid and semi-liquid funds, are gaining popularity with smaller institutional investors and individuals. For individuals and advisers looking for ways to access private market investments, this evolution has introduced the potential for enhanced liquidity terms, access to seeded pools of assets, and a buying experience that more closely resembles that of traditional funds.

The next phase is a transition towards integrated solutions. Private asset managers are increasingly collaborating with public asset managers to incorporate private asset exposure into models. This approach can offer individual investors more direct access to private markets by utilising the liquid assets available in typical portfolio models while retaining sophisticated exposure to private assets.

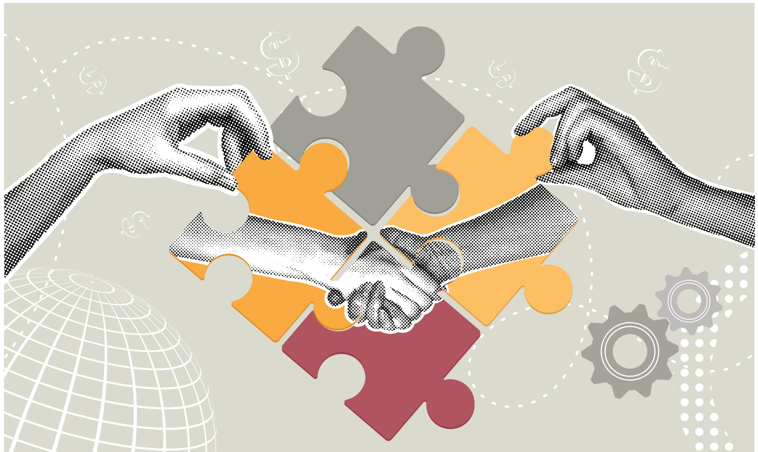
Q Regarding product development, how are private markets firms differing their approach across the retail, high-net-worth and institutional channels?

A key product consideration for firms is liquidity and the approaches they can adopt to enhance it. For example, by blending private and public assets within a portfolio, managers can improve the liquidity profile of a strategy, enabling shorter lock-up periods. Managers are curating products with different mixes of public and private exposure, with some prioritising enhanced liquidity terms (more liquid assets) and others creating structures that offer more "pure-play" exposure, although they may have lock-ups and capital calls as a result.

A related consideration is how capital is invested. Traditional closed-end funds rely on commitments from institutional investors, with capital being drawn down and invested gradually over several years. This cadence allows managers to match capital investment with dealflow. By contrast, open-end funds draw the full commitment of investors' capital either immediately upon investment or within a significantly shorter timeframe.

As a result, firms raising substantial amounts of capital in open-end structures must find highly productive ways to put that to work over a much shorter period. This shift has profound implications for the investment process, demanding greater agility and precision in sourcing and executing opportunities, and in some cases in finding new sources of dealflow.

Another significant difference between institutional and retail clients is around cost to serve. Servicing an individual client, who may invest as little as $25,000, requires a fundamentally different cost structure. Depending on how GPs are taking products to the retail market, the vast majority of that cost will be related to a much higher cost of distribution. Distribution teams, advisers and partners throughout the channel will have to be incentivised to reach more individuals in order to raise the same amount of capital.



Q To what extent might recent regulatory changes affect private markets' appeal among individual investors?

Regulatory environments across many jurisdictions are increasingly supportive of expanding individual investor access to private markets. In Canada, for example, ongoing dialogue with regulators has focused on the development of new fund structures and potential exemptions from legacy rules that were not originally designed with asset classes such as private equity, private credit and infrastructure in mind. In Europe, meanwhile, initiatives to introduce a new category of fund structures (LTAFs and ELTIFs) reflect a growing regulatory commitment to properly and safely enabling individual investor access.

In the US, the focus on introducing private assets to the defined contribution retirement market is part of this evolution and is certainly going to inspire further innovation. This shift is already prompting new product development considerations, such as how you include these illiquid assets in a traditional glide path or target date structure.

Additionally, firms are investing significant time and resources into educating the market. That's going to be a crucial piece of this – making sure that, when adoption occurs, people are aware of what they own. We believe regulators will certainly be keen to see that.

Q How can firms respond to these challenges?

It's important to recognise that not all assets or ways of building traditional portfolios are easily transferable to the new fund structures. For example, if you are looking to build a traditional buyout portfolio with 10 to 20 investments, it typically requires a multi-year horizon to invest that capital. This approach relies on capital certainty, which is not typically available in retail models, where investor commitments are less predictable.

One solution to that challenge is secondaries. These transactions allow managers to quickly build exposure to a diversified pool of assets. Many firms are trying to figure out how they can leverage secondaries in product and portfolio design, because it's a very attractive tool, with systematic deployment to better manage retail flows.

> *"Secondaries are a very attractive tool, with systematic deployment to better manage retail flows"*

Q Despite all the work being done to accommodate individual investors, to what extent will a degree of compromise be necessary? After all, these aren't public investments and will behave differently to what individual investors may be used to.

There is an element of that. Any time you deviate from the traditional closed-end fund structure, you start to make compromises – especially around liquidity, volatility and valuations.

Greater liquidity can mean higher volatility, which can compromise the long-term stability that investing in private assets typically offers. In addition, it can dilute the exposure to private markets, limiting potential diversification and denting returns.

Valuations are another consideration: private assets are not marked to market daily and are often more expensive to value. The shift towards evergreen structures has precipitated a similar evolution in approaches to reflecting the fair value of a portfolio, in order to account for the periodic ins and outs.

In addition, private investments often involve more intricate structures, longer lock-up periods and unique tax implications. While platforms are simplifying access, individual investors may still need to compromise by accepting a steeper learning curve or relying more heavily on advisers.

Ultimately, while access is improving, it's important for investors to recognise the spectrum of investments available to them, and to understand the pros and cons of each, because they're not all the same.

Q Some alternative asset managers are ahead of others when engaging new client bases. What lessons can be learned from them, and what will continue to widen the gap between the winners and losers?

There are multiple vectors of competition in the individual investor segment, but building appropriate distribution is really important right now. With institutional distribution, you can do well with a relatively lean team. That's not the case when accessing individual investors. Smaller firms may need to partner with wealth platforms and distribution partners to reach individual investors. We've seen some of the largest alternatives firms invest in hiring hundreds of distribution professionals to capture retail market share.

Brand is clearly another vector. This marks a notable shift for many alternatives managers, which have not really leveraged traditional B2C marketing tactics before. Some of the larger alternatives managers have now started to use TV advertising, sponsorships and other strategies to build their brands, taking a page out of the traditional asset management playbook.

Education is another vector. Managers are ramping up efforts to educate retail investors and to increase transparency. Individuals need to be kept informed about the risks, structures and expectations of alternatives – a vital step as retail participation grows.

Also, given the shift in capital mix and the pressure on deployment within these new product structures, it is important to ask some key questions, including: which variables could affect investment outcomes and performance? How are firms able to maintain disciplined investment selection and pacing? Are they effectively leveraging secondaries to deploy capital? Are they able to build the right portfolio management capabilities?

Over time, we will likely see a greater bifurcation of outcomes, with the winners being those who have built good products and distribution capabilities, and who continue to be disciplined in their investment management.

Q The industry is facing fundamental changes – how do you see this playing out over the long term?

The lines between traditional asset managers and alternative asset managers are blurring. This is driving consolidation and strategic partnerships, with a lot of firms trying to figure out how to ensure they are best positioned to participate in what is expected to be a period of meaningful growth.

It is worth noting, too, that the vast majority of new capital formation over the next decade is still expected to come from traditional institutional investors. The institutional market remains robust and continues to play a dominant role in capital allocation. The retail segment, though growing at a faster pace, is starting from a much smaller base and will complement – not replace – the institutional landscape.

Over the long term, managers will pursue different approaches to creating sound products that are accessible and suitable for this audience. Creating these innovative solutions – while continuing to find new ways to engage and educate – will differentiate those that can navigate this industry shift and capture a new group of investors in private markets. ■

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