WHITE PAPER

Democratization of Private Markets and Private Assets: A Pathway to Inclusivity

Executive summary

In the realm of capital growth and investment, the beacon of opportunity today shines on private markets and private assets, particularly as they open doors to a broader audience. The democratization process marks a significant shift in investment norms, presenting both challenges and exciting prospects. This white paper examines where private market firms stand in this evolution, exploring the operational and servicing advancements essential to harness the growing private wealth sector. We envision a future where private market investments align with the ease and accessibility of public market platforms, fostering an inclusive financial ecosystem.

The current state of private markets

Traditionally, private markets have been the exclusive domain of institutional investors, but the winds of change have been steadily increasing accessibility. Big-name management firms are now courting private wealth with tailored offerings, signalling a new paradigm.

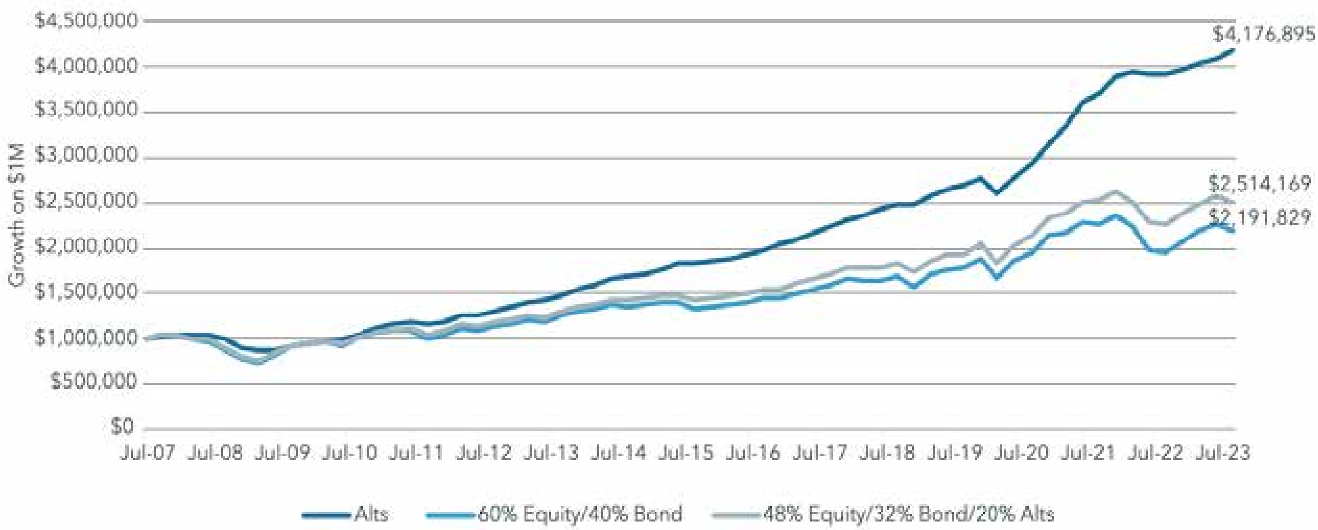
Growing interest from management firms

Amidst a backdrop of recovery, the fundraising landscape is not only poised for recuperation but also stands on the brink of significant growth. The drive to diversify investor capital sources heralds a promising frontier of inclusivity and extended reach beyond traditional institutional investors. A report by Bain & Co. shines a light on the lucrative potential awaiting fund managers—a staggering $270 billion in additional annual revenue. This potential windfall comes from broadening their investor base, which is anticipated to swell assets under management along with an uptick in fee-based revenue and carried interest. Furthermore, the expansion opens new revenue avenues, such as in the burgeoning secondary market, underscoring the manifold benefits of diversification and inclusivity in investment strategies.

Over the last few years, macro trends have resulted in a "denominator effect" – sharp declines in the value of public market portfolios limiting new investment commitments from institutional investors. In 2023, the denominator recovered but failed to alleviate over allocations due to the "numerator effect" as the global private markets net asset value increased 10% year over year as of June 2023.[3] A weak exit market reducing distributions back to investors has further contributed to the slower fundraising environment that has continued for its second year in a row. Institutional investors also have less head room with allocations to private markets averaging 27%, compared to non-institutional investors averaging only 6%.[3] Larger asset managers have generally fared better and while this is mostly attributed to the phenomenon of investors tending to favor known names, it is also in part due to their greater success in raising non-institutional capital.[3] Given the recent prolonged challenges in the overall fundraising environment, the value of a diversified investor base is well cemented and many fund managers are responding with dedicated teams to cater to the needs of the wealth markets. More than half of the Preqin top 20 fund managers by capital raised have now launched or announced wealth arms or funds targeting the wealth markets and eligible individual investors.[1,2]

An allocation to alts would have improved outcomes for a 60/40 portfolio since 2007

Growth of $1 million from different portfolio allocations, Q3 2007 - Q3 2023



Sources: iCapital, based on quarterly index data from Preqin, Cliffwater, MSCI, Bloomberg, NCREIF, and HFRI, as of Sept. 30, 2023. For illustrative purposes only. Past performance is not indicative of future results. Future results are not guaranteed.

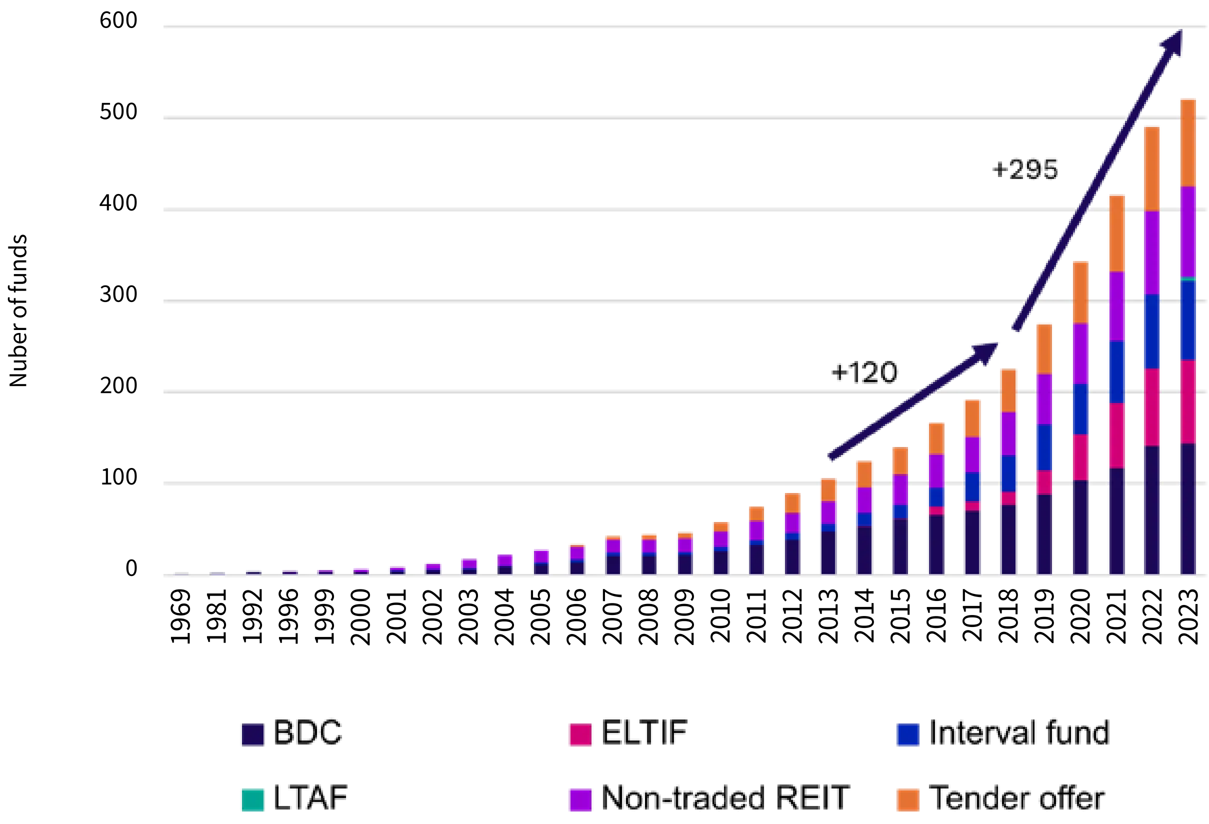
Changing investor profiles

The investor pool is now more individual-centric, with a notable increase in individual investors engaging with private markets. While the $53 trillion in global non-institutional assets[3] remains largely untapped, the appeal of private markets coupled with the recent increase in accessibility is steadily shifting the investor base to the individual profile. Historically, education, access, liquidity management and utility have been barriers to individual investors, but as these barriers are removed adoption is increasing and the demand to increase exposure to the private markets remains strong. A 2023 EY-Parthenon survey found 55% of high-net worth (HNW) investors want access or better access to alternatives. The findings come as no surprise, given historical analysis shows the performance of a traditional 60/40 equity to bond portfolio allocation would have significantly improved with a 20% allocation to alternatives driving both higher returns and reduced volatility.[7]

Wealth managers have taken note, with several increasing their recommendations for allocation to alternatives. This trajectory is expected to continue with individual investors' share of capital invested in alternatives assets under management expected to grow from $4 trillion to $12 trillion over the next decade.[8]

The trend underscores the critical importance of enhancing the investor experience for individuals. This goes beyond delivering impressive returns; ensuring a positive, holistic investor experience. This proactive approach isn't just about ensuring a premium initial experience—it's also about achieving the operational efficiencies and scalability needed to accommodate growing investor volumes and the diverse range of their demands.

Evergreen Fund Structures

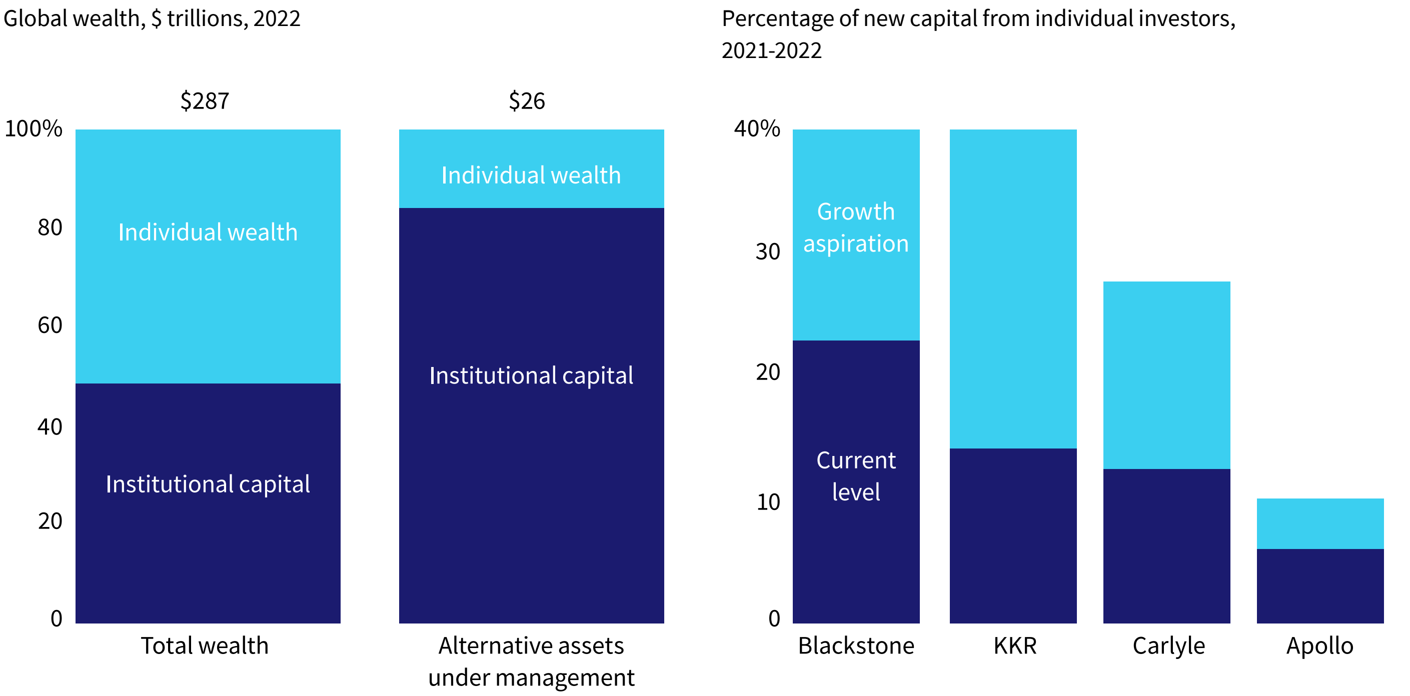


Source: https://www.preqin.com/insights/research/blogs/evergreen-capital-funds-hit-record-high-at-350bn-on-private-wealth-demand

Adapted investment vehicles
Products such as hybrid and evergreen funds are designed to attract retail investors, featuring lower investment minimums and enhanced options for liquidity. Through various changes to the structure and terms of a fund, the burden of cash flow forecasting and management partially shifts from the investor to the fund manager. In Europe, recent regulatory changes have eased minimum investment and diversification requirements for European Long Term Investment Funds (ELTIFs).[3] The U.K. recently introduced Long Term Asset Funds (LTAFs) and broadened access requirements to professional investors in June 2023. In the U.S., structures like interval funds, tender offer funds and business development companies (BDCs) have continued to rise. Overall, the number of evergreen funds has skyrocketed to 520 as of the end of 2023, nearly twice the volume five years ago.[9] Secondaries also offer liquidity for investors, and secondary activity has seen a sharp rise with $255 billion in aggregate secondary funds raised over the last four years, double the prior four-year period.[3]

In recent years, a proliferation of secondary marketplaces has emerged, offering investors unprecedented opportunities to liquidate their fund commitments. This flexibility allows for the reallocation of capital and optimization of investment portfolios. Furthermore, innovative platforms have been introduced specifically for retail investors, granting them access to a curated selection of alternative assets through feeder structures. These platforms cleverly integrate the advantages of traditional funds with the efficiencies of digital technology. In certain instances, strategic partnerships with secondary funds have been established, enhancing liquidity options and providing sophisticated portfolio management tools for both individual investors and wealth managers. As the regulatory environment evolves and technological advancements continue, we anticipate further transformation in how fund managers engage with retail investors, streamlining access to investment opportunities and reshaping the investment landscape.

Individual Wealth and Investor Capital



Sources: Bain Private Equity 2023 Midyear Report; Wall Street Journal; PE International; Bloomberg; Institutional Investor; SEC filings; Prequin; Global Data

Technological breakthroughs
Innovations like blockchain and tokenization promise to revolutionize access, making entry into private markets even more seamless along with a number of benefits such as improved liquidity, faster settlement, and reduced operational costs. When implemented correctly, investors need not understand the inner operational workings of how their tokenized assets are administered, rather they just need to know how much blockchain technology is unlocking efficiencies in their investment life cycle. The next generation of investors may look upon the traditional methods of investing in private assets much like the investors of today would look upon the days of paper certificates. Since the advancements in computer technology of the late 20th century, it is now widely accepted that dematerialization of paper investment certificates provides greater security and efficiency. Similarly, there are recent developments in the programmability of money opening the door to profound innovation across the back-, middle- and front-office functions of traditional private asset investing. The benefits of tokenization hold something for everyone. Investors and wealth managers win greater access, liquidity and collateralization capabilities. Fund managers increase their direct access to non-institutional investor capital.

Fund administrators stand to benefit from increased scalability, operational efficiency and security.

While these enhancements require investment in technology to bear fruit, there is a strong case for investment from multiple angles. In a 2023 survey by EY-Parthenon, 63% of institutional investors and 59% of HNW investors ranked private equity as the first or second tokenized alternative of interest, with real estate following closely behind. The demand is not only strong, but investor preferences are also reflecting a desire for the optionality to come from their traditional providers. The survey found 88% of HNW investors and 77% of institutional investors want distribution of tokenized assets through traditional financial institutions.[4] Trusted providers that are relied upon for the backbone of private market operations today hold a critical role in the execution of these recent technological breakthroughs. But the days of hypothesizing over whether assets will be tokenized are behind us as governments and some of the world's largest asset managers are moving forward with digital currencies and tokens. EY-Parthenon found 25% of survey respondents increased their allocations to digital assets and/or related holdings in 2022, and 69% expect to increase their allocations in the next two to three years.[4]

Operational cornerstones for democratization

The expansion into private wealth requires reshaping operation models to offer not just an investment but an experience — an experience paralleling the convenience of online public market platforms.

Simplified investor onboarding
A unified authentication system streamlines the process for both investors and fund managers, significantly enhancing efficiency. The onboarding process of today requires fund managers to straddle the line between ease of submission for institutions with their own, sometimes outdated, procedures, and modern digital platforms. As we progress, we see digital adoption increasing and freeing fund managers and administrators to leverage a single point of data entry to manage investor onboarding data across multiple systems. Investors also benefit from a more flexible ecosystem that brings consistency when investing across managers, jurisdictions and asset classes. Further developments in blockchain technology could further reduce the burden as the status of an investor in meeting criteria could be both encrypted and programmed with tokens. Additionally, one of the critical challenges in investor onboarding for non-institutional investors is to be able to address the higher volumes with scalable solutions that can address the complexity of the onboarding experience with a seamless workflow.

Standardized reporting
Private capital markets have historically had less regulatory mandates on reporting methods, allowing for a far less structured and consistent approach relative to public markets. As information flows more freely between parties with recent digital innovations, a greater dependency is placed on standardization in reporting. Interestingly, several digital platforms now leverage machine learning and AI to pull largely unstructured data into more structured formats for investors as a solution to the lack of standardization. Counterintuitively, this often drives more standardization as the triggers for recognition by AI start to capture common best practices. Just as people work to identify prompts for AI, so too will we start to see greater congruence in the reporting standards and practices of alternatives that are most compatible with common platforms.

Data Strategy
It was once the case that a data strategy needed to primarily consider a single source of truth and maintain its integrity as data was transferred from one location to another. Recent evolutions in technology have enabled a more open ecosystem through the use of data streaming, data lakes, and distributed ledgers. It remains critical to have a strong strategy for maintaining the integrity of data and understanding the source of truth and governance, but the landscape of how that looks has shifted. Additionally, it becomes increasingly important to ensure that the experience is considered from multiple angles of personas, especially the investor. The new landscape should be fluid, removing any sense of lock-in with specific funds or fund managers.

Integrated fund life cycle processes
End-to-end data integration is no longer a luxury but a necessity, dictating a singular, transparent view of the investment process. The days of siloed departments by asset class and function are no longer, as the lines blur and the need for connectivity and streamlining grow in importance. Equally important is the need to leverage best-in-class technology with deep capabilities rather than trying to accomplish too much with a single platform. Hence, the need for tools that allow connectivity as a matter of configuration are critical and paramount to a successful technology strategy.

Elevating investor relationships

Investor relations must evolve, echoing the broader trends of consolidation in the industry and the desire for one-stop solutions across investment products.

Consistency across services
The move towards large, multi-strategy managers calls for a uniform service quality across all offerings. While performance continues to be the most significant factor for investment decisions, the overall sales and services experience ranks second and is far from inconsequential.[3] As markets move towards greater inclusivity for non-institutional investors, so too must considerations for the interactions through wealth advisors, distribution channels and other intermediaries.

Preserving personal interaction
The alternative investment world thrives on personal relationships, and supporting investors through the transition is pivotal to maintaining trust. Historically, service providers operating in this asset class could afford a high-touch engagement model because investor volumes were much lower at higher ticket sizes. Fund managers and investors both benefit from the personal interactions and trust as they facilitate meaningful conversations around important topics that could have a real impact on the performance of the investments, such as when looking to utilize a continuation fund. While investor volumes will undoubtedly rise when looking to raise capital at lower ticket sizes, it's still critical to maintain trust with investors and cater to the sophisticated needs of the investor base. The best solutions will allow the preservation of personal touches rather than removing them entirely to achieve scalability.

A glimpse into the future

What does the future hold? An integrated, end-to-end investment platform that mirrors the fluidity of current public market exchange platforms – a unified marketplace redefining the essence of private market investing. Individual investors are entering the private markets at increasing rates, and with this shift will come changes driven by the demands of investors with their own unique profile to that of institutional investors. Many of the benefits brought about by this trend will also serve as benefits to institutional investors. As sure as necessity is the mother of all invention, we envision a world in which investing in alternatives is an elevated and less cumbersome experience for investor, wealth manager, fund manager and fund administrator alike.

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The democratization of private markets and assets heralds a future rife with opportunity. For private market participants, this white paper is a compass pointing towards that future – a testament to our commitment to transparency, support and partnership in your investment endeavors.

Sources:

[1] FIS research

[2] Preqin Ltd.

[3] McKinsey Global Private Markets Review 2024. "Private Markets: A slower era" McKinsey & Company. March 2024 https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2024/mckinsey-global-private-markets-review-2024.pdf?shouldIndex=false

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[10] Moonfare. "Moonfare and Lexington Partners Launch Digital Secondary Market for Individual Private Equity Investors" 26 January 2021. https://www.moonfare.com/blog/moonfare-lexington-launch-digital-secondary-market

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