KEYNOTE INTERVIEW

Access for all

The democratisation of private equity is about broadening access to the asset class, both in terms of who can invest and the ways in which they do so, says Peter von Lehe, head of investment solutions and strategy at Neuberger Berman Private Markets

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Q How would you describe private wealth investors' current appetite for private equity?

We have long seen strong interest in the asset class from private wealth investors. We believe this has been driven by the robust historical performance that private equity has demonstrated on both an absolute and relative basis over time, as well as private equity investing being all about growing and improving businesses.

Many wealthy individuals and their families can attribute their success to entrepreneurship, and so this business-building theme can resonate strongly with them.

Until recently, it has only been the ultra-high-net-worth and family office components of the private wealth space that have been able to access the asset class.

However, the circle is now expanding to include the mass affluent and even retail investors. In part, this is because there is greater awareness of private equity and the potential benefits it can offer – which, understandably, means people are questioning why these potential outsized returns should be restricted to institutions and the very wealthiest individuals.

People are, quite rightly, asking: why should private equity be for the few and not for the many?

Q Are you seeing an increased supply of products that cater specifically to private wealth investors?

We have certainly seen extensive structural innovation that is facilitating greater accessibility for private investors. This has coincided with a relative slowdown in the institutional investor fundraising market.

We don't believe that appetite for private equity has diminished, but due to a slowdown in distributions, many institutions have reduced capacity to commit to new funds. This has inevitably heightened managers' interest in tapping into this newer group of investors, which we believe is driving the supply of products catering to the private wealth market.

Q What role is the regulatory environment playing in supporting the democratisation of private equity?
Regulation is an important aspect of the democratisation process, but education and market acceptance are equally key. The three are intrinsically entwined. What's more, the concept of education and market acceptance applies to private individuals themselves as well as to the advisory community, including private banks and wealth managers, who are often the natural entry point to the asset class.

Q What are the fundamental structural options available to private investors today?
There are three main types of vehicles available to private investors. The first is the closed-end fund, which comes with capital calls and distributions: this is the traditional limited partnership model, typically with a 10-year fund life, five-year investment period and fees charged on a two and 20 basis. We have seen some adaptation of these terms over the years, with different investment periods and fee structures, but the model has remained largely unchanged: money is committed upfront and then called when the manager finds a deal. The money is then distributed back to the investor when the manager decides to sell.

Another type of vehicle that has been around for a long time, albeit less prevalently, is the exchange-listed closed-end fund focused on private equity investments. The UK is by far the largest and deepest market for this type of fund, which can be an interesting opportunity for investors with the ability to invest in London-listed shares.

Where we have seen the most innovation in recent times is in the creation of open-end funds, where investors buy into an existing portfolio, gaining all the exposure to the underlying assets, before exiting through a redemption or tender feature. Of course, putting illiquid assets into a fund that has subscription and redemption features doesn't stop the underlying assets being inherently illiquid, so investors need to look carefully at how that liquidity is being provided and the limits to it.

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Q Do evergreen funds present opportunities for institutional investors as well?
Absolutely. There is a commonly held misconception that evergreen vehicles are retail products, whereas institutional investors must follow the capital call and distribution model. We don't see one as intrinsically better for institutions and the other as intrinsically better for private individuals: there are merits and considerations to both, for all investors. It is simply a question of understanding what the client is looking for and therefore what the best fit will be.

One of the key benefits of an evergreen fund is that the investor has flexibility regarding when they gain exposure to the asset class. Equally, these vehicles provide the investor with the ability to reallocate at permitted times of their choosing, not only when managers make distributions. In other words, allocation decision making is much simpler than is the case with a closed-end fund. It is also more akin to the allocation process found in more 'traditional' asset classes.

Another important consideration is that an evergreen fund internalises the reinvestment process, allowing investors to have greater precision and efficiency in their private equity exposure. Historically, investors had to pursue an overcommitment strategy in order to reach their desired level of exposure to the asset class across multiple closed-end funds, because the manager was in control of when money was called and distributed. Investors in closed-end funds can therefore expect much more variability in their exposure at any given point in time.

In an evergreen vehicle, by contrast, the investor only needs to allocate

Q Are there any reasons why a private wealth investor would choose to take the closed-end route instead of the evergreen route?

Not every private equity strategy is suited to an evergreen vehicle. In our view, there are certain strategies that are typically only available in the traditional fund structure: buyouts, co-investment and secondaries, for example, can all be executed relatively well in an evergreen context, but if an investor wants exposure to certain other specialist areas, those may only be provided by managers running traditional closed-end funds.

Further, there is inherent time diversification associated with investing in a traditional capital call structure. In other words, when a vehicle is calling down capital to fund investments through the life of the fund, that valuation risk is spread over a wider time period, creating a diversification effect. On the flip side, when you are allocating capital to an evergreen vehicle, you are taking valuation risk at a single point in time. However, that evergreen fund would also provide a level of time diversification through the recycling of reinvestments and deploying new capital from net inflows.

What's more, the operational simplicity and internalised cash management that an evergreen fund offers isn't something that all investors necessarily require. In this case, a traditional closed-end fund may be entirely appropriate. ■

capital once, and then the manager, who has better knowledge of when individual investments and realisations are likely to happen, can internalise the reinvestment process on their behalf. In our view, this lends itself to evergreen funds being more operationally efficient. Investors don't have to worry about funding capital calls or receiving distributions; there are far fewer flows of funds that need to be processed.

Q At what stage is the private equity industry on its democratisation journey?

In our view, we're early in the democratisation journey. In the near future, we expect to see both a proliferation of structures created for the asset class and a broader range of investors who will be able to access private equity.

This journey requires ongoing education, and that education can take various forms. Regardless of whether we are speaking with a private individual or an institution, education on the use cases for an evergreen vehicle compared to a traditional fund should be part of the narrative.

For investors new to the asset class, education means learning about not only the potential advantages that private equity can offer, but also the possible constraints. Yes, private equity provides an opportunity to generate attractive absolute and relative returns, but it is also an asset class that is inherently illiquid. That is unavoidable, and so investors need to understand the true nature of the asset class and be able to tolerate the illiquidity component.

For experienced investors, education means learning about the different ways in which the asset class can be accessed in addition to the closed-end fund structures they are already familiar with. The traditional limited partnership model has persisted simply because it is the way that things have always been done, but it is not the only way.

Understanding that there is a unique skill set required to effectively manage an evergreen fund is also an important component of education. Evergreen funds are structurally different, and the internalised cash management component requires more extensive capabilities than that required of a traditional capital call structure. Investors should look for managers that understand which private equity strategies are most appropriate for an evergreen structure and have the appropriate level of dealflow and capital deployment capabilities necessary to properly manage a perpetual fund.

Lastly, investors and their advisers need to step back and think about which of these structures make the most sense based on a particular investor's specific needs. That is where we are focusing our attention today in pursuing the democratisation journey: what are our clients looking for from their private equity exposures, how does that fit with the inherent nature of the assets, and what is the optimal structure in any given situation? ■

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