La démocratisation du private equity est en route

There's much talk these days about opening up private equity to retail investors. Many large PE funds have already rolled out new retail products, EU regulators are streamlining the framework related to the alternative assets sector, and individual investors themselves are showing significant interest. But as Agathe Bubbe tells us, if the much-heralded "democratization" of the industry is to be a true and lasting success, there's still more work to be done by private equity professionals.

For decades, the private equity industry didn't pay much attention to retail investors. It didn't need to. The long period of low interest rates had pushed investors to seek better returns in alternative investments. As a result, large PE funds were very successful as they focused all their efforts on a limited but powerful global client base of institutional investors, sovereign funds, and family offices, all capable of committing large sums of money for long periods of time into illiquid alternative assets.

The advantages were obvious: serving a handful of wealthy professional clients is a lot less onerous - in cost, time, and regulatory hassle - than administering to the needs of thousands of small investors, each committing less money, with a shorter investment horizon. This situation is starting to change, for three main reasons.

First, in the last couple of years many PE fund managers have seen their fund-raising efforts plateau. This is primarily because most of their institutional investors have reached the ceiling of their alternative asset allocation. That means future growth in private equity assets under management needs to come from elsewhere.

Simultaneously, retail investors – having read many glowing articles about the handsome returns of the big PE players -- are impatient to get a piece of the action for themselves, even if they can't afford the seven-digit amounts that institutional investors typically allocate.

The third factor is the role of the regulators. Until recently, investment authorities on both sides of the Atlantic had strict rules in place to protect small investors from the inherent risks of putting their savings into unlisted assets that, by definition, are illiquid and opaque. Then in 2021, the SEC began to look at how to amend the US regulatory framework to provide retail investors with wider access to private investments while maintaining appropriate safeguards.

Meanwhile in Europe, after a disappointing first attempt in 2016 to ease the rules, the EU has now drafted a new version of the European Long-Term Investment Fund regulation (ELTIF2), which will come into effect next year, opening access to alternative assets for retail investors.

Progress to democratize is well underway, but more needs to be done

These are all positive developments, certainly, but before we can hail the true democratization of the private equity industry, there is still work to be done on several interrelated points.

For example, many of the retail PE offers that have recently come onto the market continue to set a high entry ticket of at least $100 000. It's contestable how "democratic" that is. One reason the PE funds continue to demand such large entry tickets almost certainly lies in their concerns about the burden of administering many small accounts. The solution here lies with the advent of new, agile digital platforms starting to emerge that will allow the funds to "industrialize" the administrative tasks related to first signing on, and then servicing, new customers.

Another shift already underway lies with a broader acceptance of unlisted assets within unit-linked vehicles. Life insurance is the preferred savings vehicle for individuals. In France alone, life insurance policies totaled €1,876 billion by the end of 2021, so it is essential for private equity players to work with insurance companies to make their funds available in this medium. This requires strong confidence from the insurance company to manage the liquidity of this investment pocket despite the illiquid nature of the asset class.

This question of liquidity is central to retail investors. PE managers understandably require a long-term commitment from their limited partners before committing funds to an unlisted company's equity or debt, or indeed before buying real assets such as property or an infrastructure project. Institutional investors are well accustomed to the concept of locking up part of their capital for a long-term horizon of five to 10 years. That's not the case for most retail investors, trying to keep up with the more short-term demands of running a family's finances.

A compromise solution does exist here, in the form of "evergreen" (or semi-liquid) funds that are structured in such a way that they can accept new investments throughout the course of their 99-year lives, while offering pre-defined liquidity windows to allow investors to access their savings under certain strict conditions.

One final obstacle on the road to real democratization of the private equity industry lies with the gatekeepers, namely the financial advisory community. They are the ones who ultimately hold the keys to persuading their clients about the merits of private equity. It's important for their sake, therefore, that we within the industry need to continue our efforts as ambassadors for PE, explaining and educating about the asset class as clearly and often as possible to all our distribution partners what it is we do, why private equity is an important tool in building the economy, and why the asset class can be a viable and rewarding investment for retail investors.

Agathe Bubbe

Director - Wealth Solutions - Investment Partners

Pour en savoir plus et prendre contact avec les conseillers de Maubourg Patrimoine :

- ✉ info@maubourg-patrimoine.fr
- F. 01.42.85.80.00