

KEYNOTE INTERVIEW

A second look at democratisation



The secondaries market is a logical entry point for private wealth clients looking to access private markets, say UBS's Tanja von Ehrlich and Jochen Mende

Q Would you say we're heading towards a full democratisation of private markets? What are the key drivers behind this evolution?

Tanja von Ehrlich: There are three primary drivers behind the democratisation of private markets: regulatory change, supply-side dynamics and, of course, demand.

In terms of regulation, the overhaul of the European Long-Term Investment Fund (ELTIF) regime represents a really interesting development: it enables new managers who have not previously been able to offer access to private wealth customers to join the game, while also increasing optionality

SPONSOR
UBS

for those players already serving private wealth clients. We expect the new ELTIF regime to be friendly to both investment managers and clients. It is something we see as highly beneficial.

In terms of supply, firms like UBS are creating dedicated units to look after distributors who serve private wealth clients, which means our understanding of what they actually need in order to invest in private markets is increasing significantly. It isn't a question of simply opening up existing solutions, which were built for institutional

investors, to the private wealth market. It is important to adapt strategies for private investors, providing features such as lower minimum investment requirements and fully paid-in structures, as opposed to the capital call model. We are starting to see a lot more strategies coming to market that are designed specifically to mitigate some of the characteristics of private markets investing that have historically deterred this investor group.

The third driver behind the democratisation of private markets involves increased demand from private wealth clients themselves. Allocations to private assets are being increased as a result of advice from CIOs and family



Q What are the risks associated with the democratisation of private markets? Is it necessarily a good thing for private wealth investors?

Tanja von Ehrlich: As with any investment instrument, this needs to be explained properly. I think our distribution partners are investing significantly in that education process. It is particularly important that investors understand what investing in private assets really means when it comes to topics such as liquidity – or a lack thereof.

As long as information is flowing freely, then I absolutely believe that democratisation is a good thing. After all, choice is always advantageous.

offices – in fact, there is a real fear-of-missing-out phenomenon because private markets are proving so popular and are gaining wide coverage in the mainstream media. Private clients themselves are therefore actively seeking out private markets solutions, and our distribution partners are happier to commit than they would have been in the past.

Q What options do CIOs and wholesale distributors have when it comes to implementing their target allocations to private markets?

TVE: We are primarily seeing a three-pronged strategy being employed by

CIOs and distributors. In the first instance, they are offering access to hand-picked investment solutions through aggregator vehicles such as feeder funds. With this model, the only concession to the private investor is a lower minimum ticket. After that, they are expected to behave like an institutional client, for example by responding to capital calls just as an institutional investor would, and tolerating illiquidity.

Wholesale distributors are also offering strategies that provide a bit more diversification, such as multi-manager strategies – which, again, will tend to be closed-end and will require long-term investment horizons.

Finally, we are increasingly seeing

“We are starting to see a lot more strategies coming to market that are designed specifically to [appeal to private investors]”

TANJA VON EHRLICH

the advent of semi-liquid programmes, which broaden the opportunity set to include those clients who have historically shied away from private markets due to a lack of liquidity. Typically, all three of these offerings co-exist. We rarely see distribution partners favouring one over another.

Q Which private markets asset classes make most sense for private clients to invest in?

TVE: Private wealth clients interested in accessing private markets will want to be compensated for lower levels of liquidity with attractive returns. This quickly leads them to higher-returning strategies like private equity. If you then look at the areas within private equity that help private investors mitigate many of their concerns, including the J-curve effect and diversification, secondaries quickly becomes a logical contender.

Jochen Mende: When you look at the full spectrum of private markets asset classes available – private equity, real estate, infrastructure and private credit – I would agree that in terms of the longevity and returns profile of the industry, private equity makes a great deal of sense. However, some of the access points Tanja was describing remain somewhat underdeveloped, particularly semi-liquid solutions.

It is important to educate the end-investors on the fact that, even though a strategy is labelled 'semi-liquid', there is still a chance that the underlying portfolio does not produce enough liquidity to serve redemption requests. That is where private equity secondaries come in, given the shorter duration.

Outside of private equity, private real estate is probably the asset class that can best offer diversified exposure in a semi-liquid format. However, we have all seen the headlines: some are implementing outflow restrictions, and it is becoming clear that investors were expecting more liquidity than is actually available.

Q How would you describe the dealflow that you are currently seeing in the secondaries market?

JM: We are not spending much time on the LP-led secondaries market at the moment; we feel that there are still further valuation adjustments that need to come. In my opinion, private equity portfolios have not yet been fully marked to a point where valuations are robust, and there is a huge disparity between sellers' willingness to take a discount and buyers' willingness to pay for assets. As a result, we don't believe that a great deal of LP transactions are actually being concluded at this point.

However, there are statistics out there that suggest over a hundred billion dollars' worth of LP dealflow is currently being prepared for launch in the first half of next year. That should provide ample buying opportunities for liquidity providers such as ourselves. For now, we are focusing our time and attention on GP-led transactions where we believe the underlying value and asset quality are high.

Q Do you expect GP-led secondaries dealflow to continue increasing as other exit routes remain closed?

JM: That is certainly our belief. There is one question that must be asked,

“As companies stay private for longer, investors simply cannot afford to ignore private equity”

JOCHEN MENDE

though: if a fund manager is unable to exit in the usual way, is there an inherent problem with the asset? That is something we ask ourselves every time we look at a GP-led secondaries deal today.

Having said that, I think the GP-led phenomenon is only just getting started. There are a lot of use cases where GP-led transactions make a great deal of sense, be it for single-asset deals or multi-asset portfolios. Generally speaking, when GPs wanting to hold on to these assets present us with asset and value creation plans, the quality of these plans is highly credible.

We are also observing very strong alignment of interest in these transactions, which of course sends a very strong positive signal.

In the case of deals where there are question marks around asset or GP quality, or rationale for the transactions, I think these are very hard to get done currently – mainly because there are just so many other good deals out there for buyers to focus their time and attention on.

Q How do you see the democratisation of private markets evolving over the coming years? How significant a role could individual investors play in the fundraising process?

JM: My opinion is that investors simply cannot afford to ignore private equity because, among other things, the universe of public companies is shrinking. You can miss out on important sectors and diversification parameters if you don't embrace private equity.

That said, it is very hard to predict just how much volume is going to come from private investors because of the relatively limited number of strategies out there that can accommodate smaller investors, or that address the hurdles that have thus far deterred private investors from investing.

Currently, there just aren't that many products offering liquidity, small bite sizes and a fully paid-in model. However, a number of these products are in the works across the market. Once that universe broadens, it would certainly make it easier for those currently excluded from the asset class to start investing.

So, absolutely, that would be a step in the right direction.

It remains to be seen whether the current liquidity restrictions that are imposed by other semi-liquid strategies – for example, in real estate – will deter investors from embracing the same format to invest in private equity. I do think we could see some negative knock-on effects there.

Nonetheless, if investors are really serious about getting access to private assets and follow through on what they have signalled about increasing their asset allocations to private markets, then I think private clients' contribution to private equity fundraising could be very significant. ■

Tanja von Ehrlich is head of wholesale and Jochen Mende is head of secondaries in UBS Asset Management's Real Estate & Private Markets business