KEYNOTE INTERVIEW

The future of PE's democratisation

Advancements in private markets could unlock a wave of interest from retail investors and defined contribution plans, says Partners Group's US head of private wealth, Rob Collins

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Q Historically, private equity has been open to mainly institutional investors. How is this sentiment changing?
That sentiment has changed and continues to change. The backdrop to this shift is the growing interest and demand from individual investors in private markets. There has been a great deal of coverage about the number of public companies in the US, and even globally, declining in recent decades and the growth of private markets. As a result, there is now significant interest in evaluating and diversifying into private markets to complement traditional public equity and fixed income portfolios.

When you think about the growth and legacy of private equity, it is largely a cottage industry that over time has expanded into a sizeable sector of financial services. But when you look at the fundamental building blocks, the product that most investors still use is the 10-year limited partnership, which hasn't evolved in line with the growth of the industry. Such products are not suited to new individual investors that are trying to access the market.

There are several reasons why we haven't seen a great deal of innovation in terms of products until relatively recently. For many private equity firms, serving those traditional, institutional investors worked well for them, so there wasn't an imperative to spend time and resources developing new products and solutions. Also, many firms do not have the right business model to develop these innovative solutions.

At Partners Group, we like solving problems and developing bespoke solutions for different segments of the investor population that have an unmet need. That's why, in 2009, we launched

> *"Education is still needed for the retail or DC audience"*

a purpose-built private equity solution for the US private wealth market.

Q Where in the retail space are you seeing the most appetite and what is driving that?

Individual investors now have an interest in diversifying their portfolios and there is much discussion around the limitations of the traditional 60/40 model. Some firms have developed solutions for segments of the marketplace that many would call the mass affluent, or private wealth, markets, and so these are not retail per se. These investors tend to work with financial advisers, who we believe have a lot to offer such investors in terms of market education.

For those of us that work within the private equity industry, we understand the differences between a primary transaction compared with a secondary or a buyout, or venture and mezzanine. However, there is a great deal of complexity involved for those that are now coming to the market as new investors, so the role advisers play in education is an important one.

In addition, there are now many different solutions and strategies meeting different investor objectives. That amount of choice, in turn, helps to drive the growth of the marketplace.

Q What are the main barriers to retail investors and defined contribution plans accessing private equity?

There has been a great deal of research supporting better outcomes for employees and retirees if they have a more diversified portfolio, which is something that many in the traditional institutional defined benefit market already have experience of.

Looking globally, a major challenge has been that the defined contribution market tends to have a specific industry structure that is quite different to other market segments. For example, in the US, there is a preference for daily liquidity and daily pricing. That creates an additional hurdle from a product development perspective.

There have been beneficial regulatory changes in the US for wider adoption, for example the 2019 Secure Act, which introduced pooled employer programmes similar to those found in other markets around the world. There was also an important milestone in 2020 when the US Department of

Q What future developments do you anticipate around retail and DC investment in private equity?

The future is the advent of digital assets. We have been committed to making private markets more accessible, to allow all savers the opportunity to invest. We think blockchain technology could help enable that and provide these products at lower minimum investment sizes and in a more operationally robust and scalable manner.

For example, blockchain technology could eliminate much of the friction in the system. The paperwork and processing investors face could become more efficient if you are able to transact using blockchain technology, which reduces the effort that goes into purchasing and selling funds. However, there is a long road ahead to get to that environment, and regulation will need to be put in place globally. We are seeing such regulation developing at different rates around the world, but that is one piece of the puzzle that is missing.

Blockchain technology tokenisation is the new frontier, and it is going to further democratise private markets. It is hard to say when this will take place, perhaps in five or even 10 years. However, the retail and DC markets of the future will look fundamentally different to today, just as 15 years ago it would have been difficult to imagine that an individual investor would have access to a diversified private markets portfolio.

Labor issued regulatory guidance to DC pension plan sponsors that confirmed how they can incorporate private markets into DC plans. That was guidance that many plan sponsors felt they needed before they could move forward in adopting these investments.

Q What kinds of products are being developed for these new investor groups?

The products that have already been developed are hybrid in a certain way. They take aspects of traditional mutual funds in the US, which are well understood by a broad sector of the investor population, particularly individual investors, and combine those with aspects of traditional limited partnerships and evergreen funds, which are simple, effective and much easier to implement than traditional limited partnerships.

These products are somewhat easier to understand, but when you think about some of the underlying content of such funds, education is still needed for the retail or DC audience. That is why we like working with financial advisers because, in many cases, they work with firms that have made significant investments in education. For example, developing educational materials and events to facilitate the greater understanding necessary amongst end investors when using products that are new to them.

Q How can private equity meet the needs of DC schemes?

The overarching aim is to get the best possible outcomes for employees that are saving for their retirement. In the US, over the last couple of decades the focus has been on engaging people and getting dollars into the system.

With more assets in the system, it was important that employees had the benefit of professional asset allocation and manager selection and the growing use of target date funds and other similar professionally managed portfolios, such as managed accounts, has provided that. Now we see plan sponsors and consultants working hard to ensure that these portfolios have access to a broad set of investments that you would typically find in a DB plan.

Many chief investment officers who have a DB and DC plan can look at the DB plan, where they have seen the beneficial returns and risk characteristics private markets and other diversifying investments have provided, and bring those insights into the DC plans. Here again, education is important, and these plan sponsors are focused on educating their employees on the importance of a diversified portfolio.

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Q How do you see an influx of these new types of investors shaping the private equity landscape?

We expect to see greater adoption of evergreen funds and have already seen growth in both the number and types of funds available. Some of the innovation in the private wealth market is also flowing into the institutional marketplace. We see more and more institutional investors adopting these evergreen strategies, which enable them to invest and compound their portfolios in a simple and effective manner.

If we look further into the future, there are some exciting technological changes that could further simplify the delivery of these funds in new segments of the market, for example through blockchain technology. With blockchain, you can see a future where retail investors come into the marketplace because funds would be available with significantly lower minimum investments.

This technology would also be able to deliver some of those funds with greater simplicity, thereby solving part of the scalability challenges facing the industry today. This is an area where Partners Group has been in the vanguard – we tokenised a portion of an existing private equity fund in 2021. ■