The retailisation revolution of private markets

Through a combination of regulatory reform, technological advances and global macro-economic factors, the retailisation of private markets is giving retail investors the chance to participate in exciting alternative investment opportunities for the first time.

In this article **Karen McSorley** discusses how retailisation is impacting global private markets, how the secondaries market is coming of age, and how tokenisation and other emerging technology are reshaping the alternatives landscape.

Spare a thought for company COOs and CFOs currently in the middle of trying to deliver a stock market listing. In the world of corporate finance, has pricing IPOs and share placings ever been more challenging or uncertain than they are right now?

Just when markets were beginning to recover confidence after COVID, along came Putin's invasion of Ukraine, leading to inflation hikes eating into company and household budgets. Add to that rising tensions between China and the US, and the yet to be understood consequences of AI and its impact on future employment levels, and it's a heady brew for company boards and their advisors considering raising public equity right now.

While global equity markets feel particularly volatile at the moment, their decline has actually been slow and steady over the past 20 years. Just look at the figures. In 2003, there were 2,101 companies trading on the London Stock Exchange's full board. Today, that number has roughly halved to 1,097. This lower number reflects not only fewer new share listings, but also that more companies are choosing to delist their shares and take themselves private.

The reasons for fewer publicly quoted companies are numerous and more complicated than simply these recent macro-economic events. But what cannot be disputed is the long-term strength of private markets as a cost effective and reliable source of expansion capital for investors.

One factor supporting private market growth is the increasing involvement of retail investors who are quietly revolutionising their operations. Faced with fewer listed companies to invest in, retail investors have long been eager to participate in exciting new private investment opportunities.

Breaking down the barriers for retail investors

While retail investors take many shapes and forms, most prefer convenient access to their funds for set piece moments in their lives. For example, they want to be able to sell holdings if they have a large tax bill to settle or annual school fees to meet, or if they need to raise cash to fund a mortgage deposit for their children.

Before the advent of retailisation, the red tape imposed on Alternative Investment Fund Managers and the long lock-up periods required by private closed ended funds prevented the majority of retail investors from participating in many private market opportunities. Instead, they invested in the more retail-friendly, publicly-invested UCITS funds which gave them faster access to their capital.

Another former barrier to retail investor participation was that investment thresholds were set too high, sometimes well beyond the pocket of all but the highest net worth individuals.

But the times they are a changin', and private investors can now increasingly gain access to asset classes including private equity, venture capital, private debt and infrastructure, and at more affordable sums.

The demand to participate in private markets by retail investors is clearly growing, and asset managers in our industry are keen to support. This is shown by a recent EY survey in which 73% of asset managers said that non-accredited individuals should be able to invest in private markets so that they can achieve better diversification.

Reshaping the regulatory landscape

Regulators are aware of the need for more opportunities for private investment from retail investors and have acted accordingly. In the US, research in 2019 by Blackstone indicated that the SEC had acknowledged that retail investors should have better access to private market funds, and therefore broadened the definition of 'accredited investor.' Moreover, a number of US fund managers have launched retail strategies, worth billions of dollars now in AUM.

In Europe, European Long Term Investment Funds (ELTIFs) have been around for nearly 10 years now. But new regulation passed at the end of 2022 – so-called ELTIF 2.0 – now allows managers to market this product differently to retail and institutional investors, who can access long-term assets including infrastructure and debt instruments through them.

Through ELTIF 2.0, EU legislators have recognised the different risk appetites and investment requirements of professional and retail investors and have instructed managers to make this distinction more clearly.

This revision will also improve the flexibility of an ELTIF’s strategy in terms of eligible assets, the composition of the portfolio and how it can be distributed while crucially removing minimum investment requirements, making it more accessible to retail investors. ELTIFs will also permit managers to introduce liquidity windows, which will again appeal to retail investors.

The introduction of ELTIF and its recent amendment is seen as a way of further unlocking private markets to retail investors, bridging the gap between AIFM products and their UCITS counterparts.

The secondaries market comes of age

The secondaries market enables the buying and selling of pre-existing investor commitments to private equity and other alternative investment funds, increasing liquidity during the life of the fund. The operation of a maturing secondaries market has been reformed to allow retail investors to pursue their own private investment strategies.

In the secondaries market, investors no longer have to wait until a fund is wound up and the profits distributed, meaning they can sell their positions and exit their investments at earlier opportunities.

Over the last two decades, secondaries market reform has enabled a growing number of fund managers to access new streams of capital, which according to EY, could be worth up to $500bn in the next five to 10 years.

While there used to be a degree of stigma about raising money in the secondaries market, today it’s clear that it provides greater liquidity to private investors and raises significant sums of capital.

There are still some aspects of the secondary market's function that need improving: the current buy/sell discovery situation is relatively opaque and largely inaccessible to individuals, while visibility on whether fair pricing has been achieved is also less than perfect. However, as a market, it's clearly growing in popularly, and that growth looks certain to continue going forwards.

New technology is playing its part

Another key component of private markets' retailisation is the emergence of tokenisation, and digital infrastructure more widely.

Tokenisation, using blockchain technology, converts private markets funds into tradable digital securities, allowing retail and other investors to trade in very small 'fractional' units, making it easier for investors to buy and sell. The technology opens these investments to mass participation and represents a new frontier in the 'democratisation' of alternative investment funds.

It allows highly automated administration processes to operate while recording transactional data. The result is essentially a digital share register – available on a publicly accessible and distributed ledger.

Tokens are fractional amounts of a fund which would have been previously uneconomic to process. They can be traded between eligible investors quickly and compliantly through process automation – which in time is expected to facilitate greater liquidity, improving product suitability for all different investor types including retail investors.

Of course, there are challenges to be met, such as the fact that tokenisation is still new and not all components are in place to facilitate a fully digitised transaction lifecycle. For example, more central banks will need to adopt central-bank-issued digital currencies (CBDCs) which will eliminate the time lag spent reconciling fiat currency payments prior to transactions completing. Aztec's Innovation team are working on a new series of insights on Digital Assets, so be sure to stay tuned for more on this subject very soon.

Alternative funds are changing. Be it due to macro-economic factors, technological advances or regulatory change, the retailisation of private funds is opening up the market to retail investors previously unable to access this asset class. It’s early days and things are evolving rapidly. Our clients are actively looking at this, and as a business we are too. Our client facing teams are in regular contact with industry bodies and peers to discuss these matters, while our Innovation team are well placed to take the conversation forward too.

If you have any thoughts on anything you’ve read above or would like to discuss this topic further, please feel free to contact **Karen.**