Meet the investors: the retailization of private markets explained

Retail investors want to diversify their investment targets while alternative investment managers are looking to expand their sources of capital through new investors. Technology is key to this trend taking flight, allowing retail investors access to private funds, as Simon Ware explains.

Bain's annual Private Equity Report 2023 singled out retail and individual investors as a growing potential source of capital for private fund managers. And the numbers speak for themselves – the report stated that individual investors accounted for roughly half of the world's total assets under management (AUM), yet only 16% of this is held by alternative investment funds. The report also predicts that institutional capital allocated to alternative investments will grow annually by 8% over the next decade, while individual wealth invested in alternatives, is expected to grow 12% annually over the same period, albeit from a much smaller base.

Also, UBS's Global Wealth Report 15th edition, estimates that $83.5 trillion will be transferred intra-generationally and inter-generationally (inheritance within the same generation, as well as inheritance to the next generation respectively) over the next 20 to 25 years, with $9 trillion expected to move between spouses, and 10% expected to be passed to the next generation by women, who statistically outlive their spouses by four years.

Adding to this potential pool is the already established fundraising opportunities in single family offices. According to JP Morgan Bank Private Family Office Report in 2024, family offices are already well established in private markets, however there is still plenty of room for further growth. The report surveyed 190 single family offices with an estimated $1.4 billion worth of assets and found that 46% had their full portfolio in alternatives. With family offices deploying around $6 trillion in assets, they are also becoming an important source of capital for private fund managers.

The capital potential of these high net worth individuals (HNWI) investors and single-family offices is vast and warrants private fund managers including them in their fundraising roadshows and marketing activities, especially as macroeconomic conditions remain tough.

Changes to private fund structuring and regulation are opening the door for retail investors, with large fund managers like BlackRock and Aviva managing their own long-term asset funds (LTAF), which are UK-based alternative investments tailored to retail investors. Also, recent changes to the European Long Term Investment Fund – the so-called ELTIF 2.0 – in the EU is also creating more opportunities as the investment thresholds have been lowered for eligible investors.

This means fund managers are facing the prospect of having much larger numbers of investors holding units in their funds – and this presents its own challenges from an administrative perspective. Technology, including rapidly evolving tokenization technology, can facilitate more efficient access to alternative funds, and is particularly appealing to managers looking to market their funds to the growing retail investor base.

Meet the individual investors

So, who do we mean when we talk about individual investors? Let's break it down by wealth:

- Ultra-high net worth individuals – people with $30m or more to invest.
- Very high net worth individuals – people with between $5m and $30m to invest.
- High net worth individuals – people who have between $1m and $5m to invest.
- Mass affluent – people who have more than $100,000 to $1million to invest.

Bain estimates that by 2032, the number of individual investors who have invested into alternative funds will have risen from $4 trillion in 2022 to $13 trillion in 2032, a staggering 325% increase in just over a decade.

Meanwhile the pool of eligible investors continues to increase, in the U.S. alone people classed as high net worth individuals (HNWI) reached 12.7 million in

2022, an increase of 60% over the past 15 years according to CEG Insights. Globally the HNWI segment represents over $100 trillion of annual available capital, of which only about 1% is currently invested in alternatives, as estimated by Bain. The attractiveness of heightened returns from alternative investments and a desire to diversify portfolios both act as drivers of increased capital deployment to the alternatives sector from this investor segment.

This emerging segment of HNWIs is more likely to be made up of digital natives (those born or brought up during the age of digital technology) who have different expectations and needs than those of institutional investors. This offers innovative fund managers opportunities to woo these investors with tailored products, with an emphasis on the potential in digital assets. Read more about digital assets and changes in how they are regulated.

Family offices and alternatives

Crucially for fund managers, family offices are less constrained by liquidity considerations than some other types of investors, as often they have an outlook that spans generations. As a result longer term investments in alternatives offers a way to avoid the volatility of public markets.

JP Morgan found that large family offices in the U.S. with more than $500 million in assets had more than 49% invested in alternatives and 22% in public stocks. The report also noted that many of those with family offices began as entrepreneurs themselves and want to invest in other businesses, as well as mitigate the volatility of public markets with longer-term, smoother returns from alternatives.

The role of wealth managers

Wealth managers, both registered and alternative, are expanding their product offering to tap into this growing pool of retail investors and family offices. The PwC HNW Investor Survey 2022 found that two-thirds of HNW individuals look beyond their incumbent wealth managers when they diversify their portfolio into alternative markets. This offers an opportunity for private banks and their wealth managers to capture a share of the retail investor market.

To do this with increasing efficiency, innovative wealth managers are exploring options such as setting up semi-liquid funds and making use of secondary

markets. However, there are many factors for these managers to consider as they prepare to welcome a host of investors previously locked out of private market investing.

To build the best services for this growing, digitally savvy group of investors, wealth managers will need to collaborate with service providers who have the digital capabilities to process and serve many more investors, while maintaining high personal service standards.

Potential challenges

Educating investors – regulation, such as the Alternative Investment Fund Management Directive (AIFMD), stipulates the criteria which makes an investor in alternative funds eligible, traditionally these have been institutional investors rather than individuals. This means that, across the spectrum of potentially eligible investors, there is a lot of education to be completed to ensure those committing capital to alternative investment funds (AIFs) are fully informed and fund managers will need to prove that education has been provided.

Regulation requirements – changes in regulation, such as, in the U.S., the Securities and Exchange Commission's (SEC) 2020 ruling on broadening the definition of what an "accredited investor" is, along with changes such as those made to make ELTIF 2.0 more accessible to more retail investors in Europe, show that the direction of travel is to democratise private markets, making them more accessible to retail investors. This means investment managers wanting to service the needs of retail investors will need tools to vet investor eligibility more efficiently.

Operational challenges – for fund managers used to managing funds with a limited number of investors, this opening up of funds to more investors comes with operational challenges. These include not only identifying potential investors but onboarding larger numbers of investors in a way that's efficient, while also retaining expected service levels. This must also be done is a way that adheres to stringent AML/CFT requirements. Technology, such as Aztec Invest, is a solution to this.

Changes in fund structures – high minimum investment thresholds and fees have typically excluded retail investors. However, to market funds to these individual investors, funds are lowering fees to bring them more fee-generating

assets. To do this, funds are also looking for ways to cut costs and streamline processes, some of the solutions will lie in the use of technology, such as tokenization and AI, to automate repetitive tasks.

Branding and visibility for private equity companies – as more retail investors consider alternative investments, managers used to dealing with a small number of institutional investors only, will need to build out their public profile and do more marketing to attract them. This might require a different approach to how funds are presented in the wider market. Part of this will be how investors interact with their fund manager and this increasingly digital-first group will find those managers who are presenting innovative products coupled with accessible data.

How we can help

At Aztec we have an integrated service which creates a seamless end-to-end process for managers and investors. This process facilitates fundraising and investor sourcing by providing the tools and technology to market to individual investors.

It allows asset managers to:

- Screen investor eligibility and track interest and engagement, linking seamlessly to your CRM systems
- manage investor subscription by digitizing subscription documents, collecting KYC/AML documentation, managing onboarding through in-built workflow tools, and tracking real-time status of investors as they progress through the journey
- manage ongoing investor relations by preparing, managing and distributing investor reporting and documentation, including automating capital call notices, distribution notices and NAV updates.

You can read more about developments in tokenization here, and about the democratization of retail markets.

If you would like to discuss how we can help you with fundraising, investor sourcing, subscriptions and management, or if you'd like to discuss any of the trends in this article, please contact us below.

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