

# KEYNOTE INTERVIEW

## Bringing public and private together



*Hybrid fund structures are an increasingly attractive route to democratisation, say Ropes & Gray's Keith MacLeod and Capital Group's Erik Vayntrub and Clara Kang*

**Q What are the advantages of offering public-private structures for retail investors?**

**Erik Vayntrub:** At a high level, the advantage is access to the private markets – however, this is access with intentional engineering and deliberate guardrails. Historically, most individual investors were effectively locked out of private markets, either because of accreditation thresholds or high minimums or structures that were hard to understand (and sometimes even harder to use). Our view is that private markets exposure should be more accessible, more understandable and appropriately and fairly priced.

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In the conversation around democratisation, what's often missed is risk design. For us, a public markets sleeve is a feature, not just a footnote, of the structure, so we intentionally pair private exposure with a material public sleeve. About 60 percent of each of our public-private solutions bonds is devoted to public markets; that sleeve of public assets is there to help manage liquidity, dampen forced sale dynamics and support periodical purchases.

From our perspective, democratisation only works if it comes with durable investor protections, and that's what our public-private hybrid structures are designed to offer.

**Clara Kang:** What's more, companies are staying private for longer, which means value creation is increasingly happening while the company is private.

There are about 20,000 mid-market companies that receive private equity or private credit investment, but are not captured in public indices. Democratisation through public-private structures allows retail investors to participate in the value creation

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**KEITH MACLEOD**

achieved by this large swathe of companies, whereas historically those opportunities were limited to the ultra-wealthy and institutional investors.

**Q What are some of the best ways to structure funds to provide retail investors with exposure to private equity?**

**CK:** There are different ways to structure these products. Today we are seeing most of them in the form of closed-end funds, which include interval funds, tender offer funds and business development companies (BDCs). For retail investors, it’s important to offer ease of access, and so interval funds make good sense: they are more familiar to retail investors and are more broadly available through standard adviser and brokerage platforms.

Another important differentiator for interval funds is that repurchases are more or less hard-wired into the structure of the fund. Tender offer funds and BDCs do offer liquidity from time to time, but it’s discretionary. On the other hand, repurchases in interval funds are mandatory, except in exceptional circumstances. The fact that repurchases are guaranteed on a periodic basis, even if capped to a certain

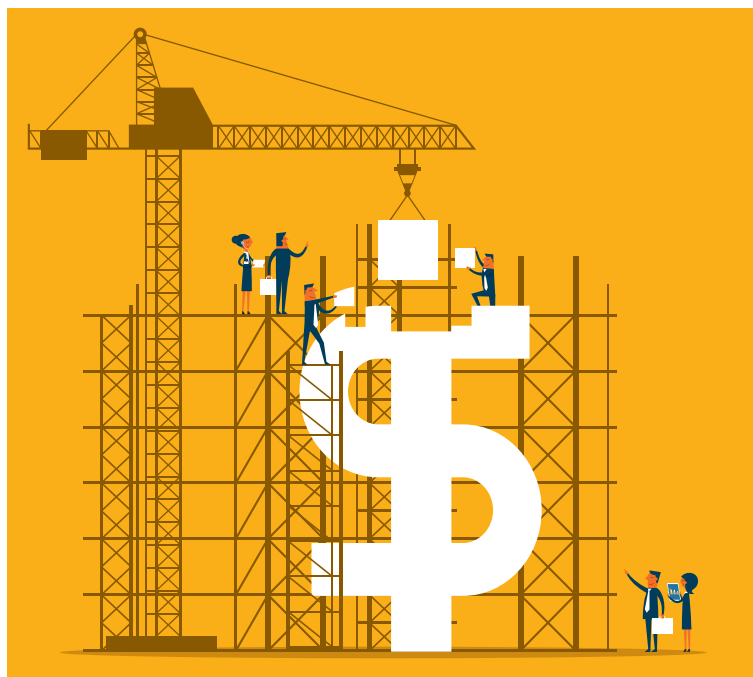
**Q How can a fund be structured to ensure the fullest possible access for retail investors?**

**KML:** Historically, 95 percent of individual investors have been locked out of private markets. Gaining private markets exposure is increasingly important, particularly as private credit takes over the role of banks. If you’re not in these markets, you’re going to miss out on exposure to a broad swathe of companies.

It’s clear that private market exposure needs to be a component of a comprehensive portfolio, so it’s important to design funds that maximise retail access.

Funds can be set up, from a legal perspective, in any number of ways: there are a host of details you can pick and choose, including whether you set investment minimums or whether you have investor accreditation and are therefore able to take a performance fee. If you’re going to commit to something that is really full retail, then you need to align around a set of decisions for lower management fees.

Interval funds are full retail products – they have very low investment minimums and there are no investor accreditation requirements. That’s possible because they don’t charge a performance fee at the level of the interval fund itself. If they were to charge a performance fee, at least on capital gains, they would have to have a qualified client standard.



limit, offers the reassurance that investors are looking for when investing in these types of solutions.

**EV:** The best structures start by matching the liquidity of the vehicle

to the liquidity of the assets in question. That’s why interval funds are a thoughtful solution for retail investors: they sit within the framework of the Investment Company Act of 1940, but they also provide periodic rather than

daily liquidity, which can be incompatible with less-liquid holdings like private credit and private equity.

**Keith MacLeod:** Having a public asset sleeve that is around 60 percent of the portfolio is important as it provides investors with assurance around the ability to meet quarterly repurchases. Interval funds provide visibility into those repurchases that BDCs or tender offer funds don't.

There are questions about funds that have put predominantly private-asset portfolios into a retail structure and whether those repurchases will be met in full on an ongoing basis. I think having a significant liquid portfolio is a differentiator: it's important to be able to offer that in an interval fund structure, as opposed to something that's more discretionary.

### **Q How can investor concerns over liquidity in the private markets be addressed?**

**KML:** It comes down to investor education. These are products designed for the long term: private markets do have the potential to generate higher returns, but in exchange, there is an illiquidity premium. These investments are not intended for short-term or unexpected liquidity needs in the way that ETFs for mutual funds or other exchange-traded securities are.

There are lots of different strategies that have been put into retail wrappers over the past few years, and the significance of the private asset sleeve of those portfolios relative to the public assets sleeve varies widely. I think it's early days in terms of seeing how repurchases react and how investors react to periods of volatility – something private markets are inevitably going to have over time. That is part of the inherent nature of something that is intended to be held through the pay down of the asset.

**EV:** Liquidity is where thoughtful design matters most, especially in light

of the recent headlines and renewed focus on liquidity in the press and in the industry at large. Our philosophy is that we simply don't pretend that private assets are liquid – we instead design around that reality.

A critical element of the design of our public-private solutions is the education component that Keith mentioned. We think that's critical to ensuring investors understand limitations on liquidity, and that their concerns are addressed or mitigated.

### **Q What would you say is the baseline level of private markets investing knowledge among retail investors and their advisers?**

**EV:** It varies quite broadly across investors and advisers, reflecting differences in experience, exposure to and familiarity with private markets. It also varies depending on the nature of the product, in terms of the level of complexity or the level of innovation in its approach. Levels of understanding are based on a confluence of those two factors.

What we're trying to do is create a more level playing field, both in terms of education and in minimising the level of complexity in the products that

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**CLARA KANG**

we think are best suited for the retail investor. We see education as a form of risk management that helps set expectations for investors.

**CK:** Education is fundamental to the whole idea of democratising private assets and enabling access for retail investors. We think it's important to commit time and resources into offering investor education.

In conjunction with the launch of our first two public-private credit funds, we launched an online education platform for advisers around the private market asset classes. This is intended to equip investors with knowledge around interval funds and repurchases, as well as some of the topics they may wish to consider when deciding how to incorporate these solutions into portfolios.

### **Q How much potential is there to expand public-private solutions beyond the US and into international markets?**

**EV:** We see meaningful potential for expansion, but we feel very strongly that any such expansion has to be approached with a high level of discipline. Public-private solutions certainly aren't inherently US-only, but any structure has to fit local rules, local distribution realities and local investor needs.

Internally, we have discussed global expansion, including development work towards bringing public-private credit solutions to both Europe and Asia, subject to local regulatory and other approvals. That said, it's critical that we don't shortcut the hard parts: in other words, local product structuring, liquidity mechanics, local tax considerations and education are key, along with the suitability frameworks that translate across markets.

The opportunity is very much real, but the bar for investor-first design stays consistent across markets. The execution very much has to be local and local compliant. ■