Leading the shift: Transforming private markets in a retail-driven landscape

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1. Executive summary

Private markets have emerged as a significant area of interest for retail investors, who are increasingly seeking diversification and higher returns beyond traditional investment avenues. This shift marks a departure from the historical dominance of institutional investors in private markets. The growing appeal of private markets among retail investors is driven by several factors, including the potential for higher returns, diversification benefits, and the allure of alternative investment opportunities.

Key findings from our research reveal a strong retail appetite for private funds, with 97% of asset management professionals reporting strong or moderate interest. Private equity (67%) and real estate (55%) are leading the way, reflecting the growing demand for these asset classes. However, several barriers continue to restrict retail participation, including regulatory limitations, high investment thresholds, and liquidity concerns. Overcoming these barriers requires collaboration between industry players and regulators, as well as efforts to create more inclusive frameworks, such as the revised European Long-Term Investment Fund (ELTIF 2.0), which is designed to increase accessibility for retail investors.

Technology is playing a crucial role in facilitating this shift, with 69% of respondents citing improved platforms, transparency, and lower minimum thresholds as critical to expanding retail participation. Blockchain and tokenisation are seen as pivotal innovations to enhance access, transparency, and efficiency in private market investments. These technological advancements are increasingly integrating private markets into wealth management strategies, enabling broader retail involvement.

Outsourcing is also a growing trend, with 76% of firms using outsourced services in the past three years. The key benefits of outsourcing include time savings, cost efficiency, and scalability. However, concerns around data security and control persist, which must be addressed as the industry grows. Additionally, lift-out strategies are gaining popularity, allowing fund managers to streamline operations while maintaining essential expertise. These strategies provide cost reductions and access to advanced technologies, further enhancing operational efficiency.

The ongoing transformation of private markets is set to continue, driven by advancements in regulatory frameworks, technology, and product development. By addressing entry barriers and leveraging innovations, the industry is positioned to unlock substantial growth, offering retail investors more diversified and resilient portfolios.

Our Global Custodian research report provides a comprehensive examination of the transformative trends reshaping the private markets landscape. It offers critical insights into the opportunities and challenges facing retail investors and industry professionals, highlighting how these developments will shape the future of investment. Explore the evolving potential of private markets through our expert analysis and forward-looking perspectives.

2. Private markets: A new era for retail investment

Few trends within the asset management industry have captured the zeitgeist like the popularity of private markets has today. An ever-growing desire for diversification, higher ROI, and opportunities outside of the traditional investment markets has pushed alternative investments increasingly into the spotlight.

Historically dominated by the institutional investment community, the allure of private markets has now also grabbed the attention of the retail space. As that interest has grown, barriers that have previously restricted retail activity – regulatory limitations, high investment thresholds, illiquidity, and a lack of transparency – are now being stripped down. As a result, the asset management industry is in the midst of a paradigm shift, as increased retail activity has market players scrambling to develop new products and structures specifically catered to their needs.

The following research report, commissioned by Apex Group, will explore some of the key trends shaping the democratisation journey for retail investors looking to enter the alternative investment market, and the remaining barriers to further growth.

Drawing from the perspectives of 117 senior executives—spanning C-suite leaders to portfolio and finance directors—the research reflects a diverse cross-section of firms, with fund AUMs ranging from under $1 billion to over $50 billion. The majority of respondents represent US-based firms, though insights were also drawn from a range of international financial centres, including the UK, Hong Kong, and Singapore.

Accompanying research tracks both the key challenges and benefits of each trend and assesses how existing players can further facilitate the next stage of growth within the burgeoning space.

3. The retailisation of private markets

The retail investment landscape is changing. Private markets, once the exclusive playground of institutional investors and ultra-high-net-worth investors, are increasingly capturing the attention of the retail community.

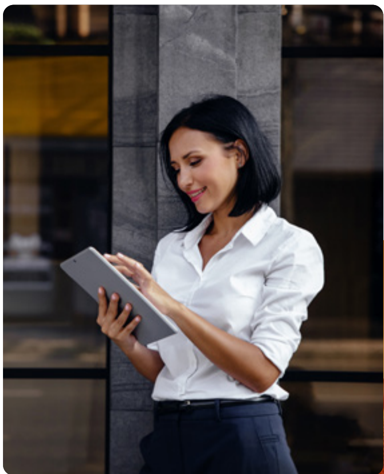
In fact, according to our latest research, some 97% of respondents within the asset management industry report either ‘significant’ (48%) or ‘some’ (49%) appetite from retail investors in the private funds space. Additionally, 86% of respondents said they expect alternative investments to make up a significant portion of a retail investor’s portfolio within the next five years.

“Alternative asset strategies are really delivering returns into the market,” explains Georges Archibald, Chief Commercial Officer at Apex Group. “The culture has certainly evolved in terms of information transparency and that has spiked the demand curve. As a result, we’ve seen an abundance of new technologies and platforms launch to market, providing investors with direct access to those different investment strategies.”

Behind the growing interest is a plethora of coalescing factors, each contributing to allure of private funds. At the top of that list, listed by 64% of respondents, is the potential for higher returns – with market data showing that private market funds are generating greater returns than their public counterparts. The venture capital or private equity segments, in particular, can yield greater returns than traditional public market investment – albeit with a higher risk profile. While higher returns are not guaranteed, the potential for substantial ROI is a tantalising prospect for investors.

According to data published by Hamilton Lane, private equity buyout transactions have outperformed public equities in every vintage year – when a fund first starts making investments – by an average of 1,079 basis points (bps), while private credit beat public leverage loans in every vintage year since 2000 by an average of 625 bps.

With this in mind, it’s perhaps unsurprising that private equity is the asset class that retail investors are the most interested in.



3. The retailisation of private markets

Diversification (listed by 53% of respondents) and risk management (47%) also ranked highly among respondents as key motivations for their interest in private markets. It's no secret that a more diverse portfolio is often a more resilient portfolio. By investing across a range of less correlated asset classes, investors are able to reduce the overall risk of their portfolios. This, in turn, increases the likelihood of more stable returns in the long term.

In addition, private markets are generally less susceptible to the market volatility that can be so impactful in the public sphere. By not being subject to continuous trading and real-time price updates, speculation and changing market sentiment that is commonplace with public investments, alternatives offer investors a holding which can mitigate the impact of short-term market turbulence.

Private market asset classes of interest to retail investors

67% Private equity

55% Real estate

44% Hedge funds

38% Venture capital

36% Infrastructure

4. Identifying entry barriers

With the demand for private markets increasing with every passing month, attention is now turning to the democratisation of alternatives – identifying the key barriers to entry and seeking to reduce or alleviate them.

"There's this ethical value in making private markets assets more accessible to wealth, retirement and ultimately to retail investors," said Peter Hughes, Founder and CEO of Apex Group, in a recent discussion with Global Custodian. "Many people think about private markets assets as being high-risk assets and therefore not suitable for some of those other types of investors.

"I personally think they can be suitable, if they're structured in the right way, with the right liquidity terms that makes sense. You can create a more balanced portfolio, whether it's a wealth portfolio or a retirement portfolio, rather than just being exposed traditionally to either bonds or long-only markets."

Regulation stands out as the primary hurdle for wealth managers looking to integrate private funds into retail investors' portfolios, listed by 59% of respondents when asked to identify the key barriers to entry. While private markets are less regulated than public markets, there remains restrictions around access for retail investors – with regulators often deeming individual investors, who may not have that high level of market understanding, to be more vulnerable than their institutional counterparts.

In the US for example, SEC rules 506(b) and 506(c) prohibit access to private offerings to only accredited investors – which requires a net worth of over $1 million and an income of more than $200,000 per annum.

Another concern for regulators is the potential liquidity mismatch in the market. Retail investors generally lean towards more short-term strategies, while private markets traditionally require longer-term hold periods.

Elaine Chim, Global Head of Closed Products at Apex Group, picks up on this point, stating, "The challenge is ensuring that regulators are happy with that liquidity mismatch to enable managers and the wider industry to create these platforms that accommodate the retail demand."

Industry collaboration with regulators will be a key driving force for market growth – as increased confidence will ultimately lead to a more favourable environment for retail investors.

Hughes continued, "The reason why we're working with so many different regulators around getting approvals for this is, is that every regulator will see the risk around this differently and it's about showing regulators that actually if it's structured the right way, on the right technology, the risk is lower, not greater, and the value of giving people access to these products actually gives them more retirement or wealth security."

5. Enabling investment

With the snowballing momentum that the retailisation of private markets now has behind it, the needle is starting to move on the democratisation of access. With the recognition that this new investor segment holds significant firepower, new products and distribution channels are being established specifically with the retail investor in mind.

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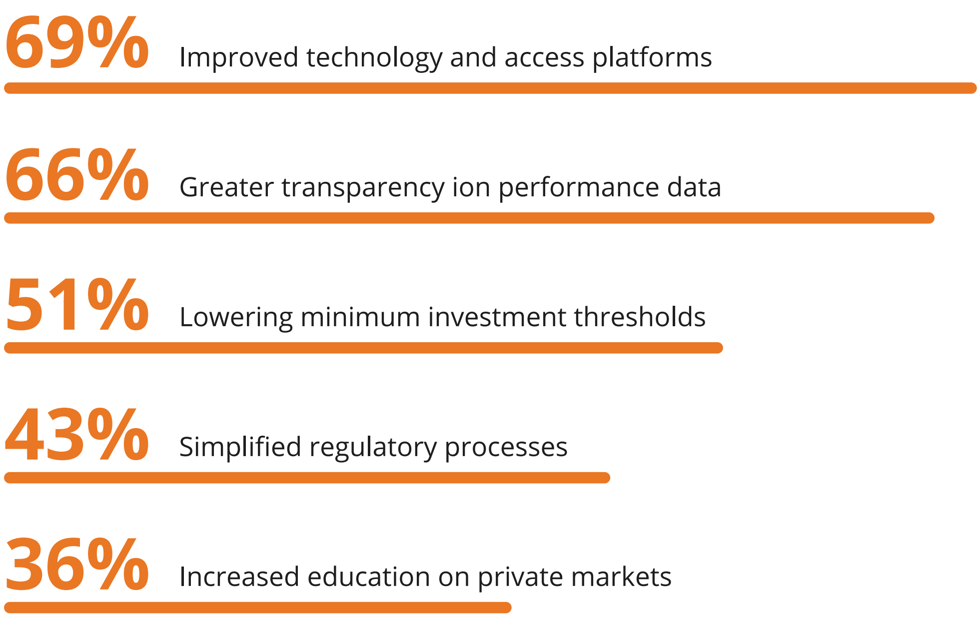
In the EU, for example, this year saw the launch of the revised European Long-Term Investment Fund (ELTIF 2.0), which aims to increase the accessibility to private assets, after the initial ELTIF failed to achieve widespread adoption. The new iteration features a number of key updates to address the restrictions of the first: increasing the scope of eligible assets, reducing investment restrictions, and lowering the minimum investment threshold for retail investors.

For participants in this research, lowering such thresholds was cited a key factor in helping to increase retail activity into private funds by 51% of respondents. This was topped only by greater transparency into performance data (66%) and improved technology and access platforms (69%).

Unfortunately, manual and paper-based processing is still commonplace across the investment landscape – a characteristic that is no longer compatible with the increasingly digital-first individual investor community. For widespread integration of private market holdings within retail strategies to be achieved, there needs to be a concerted effort within the market to use technology as a means for easing access. Automated onboarding processes, user-friendly interfaces and transparent reporting would be advantageous in streamlining the investment process and further bolster interest in the space.

Factors that could help increase retail investment into private funds



6. Private market distribution into wealth management

Looking ahead to the next five years, the asset management industry expects little let-up in the popularity of private assets, with an overwhelming 94% of survey respondents anticipating either significant or moderate growth of private market distribution into the wealth management sector, while only a small minority (6%) foresee little to no change.

To further facilitate and expedite that growth, seven in 10 respondents believe it is very important for wealth managers to offer such products within the next five years, while a further 27% consider it moderately important.

In terms of the technological advancements that will be crucial to driving private market distribution into wealth management, interestingly blockchain and tokenisation ranked highest – selected by 58% of respondents.

By tokenising assets within an investor's portfolio – converting the representation of that asset into a digital token on a decentralised ledger – there are numerous potential benefits that could help drive the distribution of private markets into wealth management – particularly around transparency, accessibility, cost efficiency and liquidity.

For Apex Group, the democratisation of alternative funds has taken two significant steps forward this year. Firstly, in February the firm collaborated with Sygnum Bank and Hamilton Lane to launch a new DLT- registered share class with a view to expanding global private market access to significantly larger and more diverse groups of qualified investors.

Secondly, the firm received regulatory approval in Luxembourg, enabling the business to oversee distribution (subscriptions/redemptions), onboarding, administration, and transfer agency tasks for alternative funds registered in the country, including using distributed ledger technology or blockchain as the registry system.

"From an efficiency perspective, the operational process and the technology are actually much more robust than existing models," says Archibald, noting the benefits of blockchain technology. "The technology serves to reduce risk, rather than to increase it. The industry needs to ensure that from a regulatory perspective, this evolving infrastructure is well understood. Once we achieve that, then questions around transparency and suitability become easier to prove."

7. The outsourced generation

As investment funds continue to grow in both size and complexity, an increasing number of managers are looking to third-party entities to deliver efficient, specialised and state-of-the-art services for their funds. By partnering with external providers, fund managers can free up both time and resources to focus on the core competencies of their business – progressing strategies and working more closely with clients.

Our latest research points to further growth in the outsourcing field, with three quarters (76%) of surveyed firms utilising outsourced services in the last three years. Of those, 77% would consider using such services in the future.

To understand the growing popularity of outsourcing strategies within the market, our research asked respondents to list the key benefits they experienced as a result of outsourcing. Time savings and cost efficiency topped the list, cited by 71% and 70% of respondents, respectively – pointing to a heightened focus on improving company-wide productivity. That's then followed by scalability and flexibility (54%), access to expertise (47%), risk management (37%), access to advanced technology (31%), and independent finance/accounting options (22%).

While the trend of outsourcing is certainly on an upward trajectory, some reservations remain around the use of third-party providers. Data security is far and away the most significant concern for industry participants, listed as the key reason for not using outsourced services by more than half of those surveyed. This is followed by a loss of control over operations, higher costs compared to in-house solutions, and challenges in communication and collaboration.

"The worries are twofold for clients," explains Chim. "Firstly, in terms of potential data breaches, but also around protection of their own data," says Chim. "That's usually one of the factors why there may be some hesitation to fully outsource, because it may be perceived as a loss of control.

"We spend a significant volume of time and money to ensure there are no concerns around data security because if that is a concern, we don't have a business. We are in the business of securely handling data and passing that data back to clients."

77% of surveyed firms have used outsourced services in the past three years

7. The outsourced generation

Key benefits of outsourced services

71% Time saving

70% Cost efficiency

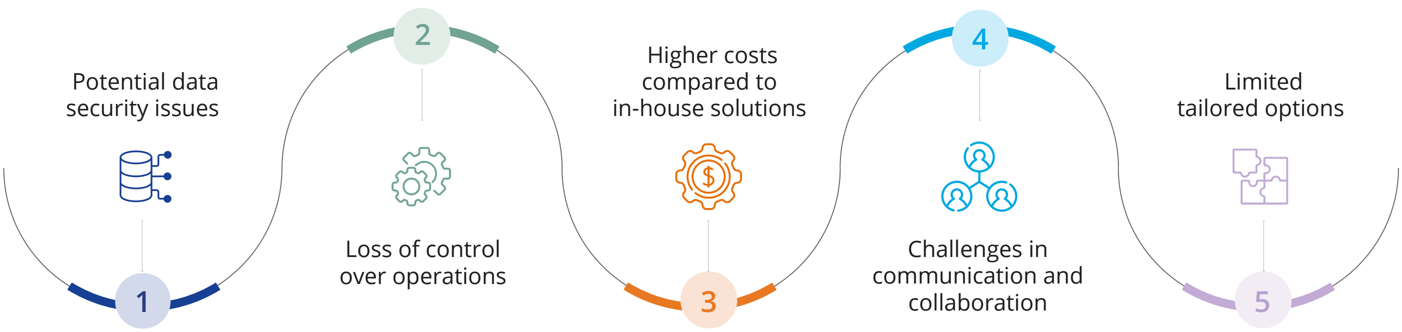
54% Scalability and flexibility

47% Access to accounting and reporting expertise

37% Risk management

31% Access to advanced technology

The main reasons for not using outsourced services:



To help combat those fears, Apex Group this year launched a GP collaborative platform called Apex Tempo, designed just for the general partner and the management company to interact better with their stakeholders. By creating a portal just for the GPs - with features like virtual data room and live chat – Apex sought to mitigate the use of processes like emails as a way to exchange documents and exchange directives to combat the threat of cyber-attacks and breaches.

Archibald adds, “What the results show is we could probably do a better job of explaining to the industry how we safeguard their data and information in a secure and reliable way.

“As a corporate, we have audit, risk, compliance, and controls around our data. We also have ongoing investment into our infrastructure. It’s certainly something that regulators have focused on too; they want to know who your service providers are, and they are mandating a certain level of reporting in order to mitigate those pitfalls around data security.”

8. Lift-outs gain traction

One particular outsourcing trend that is increasingly growing in popularity is the use of 'lift-out' strategies. A lift-out sees a business transfer its in-house operational functions – including the relevant personnel – to the external organisation selected to provide the outsourced services. By doing so, the aim is to provide a more seamless transition of functions to the third-party provider.

"From a trend perspective, lift-outs are becoming increasingly common," explains Chim. "For industry participants, there's a huge focus on managing working capital and cutting operational cost. Lift-outs offer a solution to those issues as the fund manager is able to preserve its industry knowledge and relationships, while transitioning staff costs to a fund expense."

Two-thirds of surveyed firms (65%) have been involved in a lift-out strategy in the past three years, with the main reasons behind the decision ranked as: cost reduction (listed by 58% of respondents), access to specialised talent (52%), access to advanced technology (50%), risk management (43%), and scalability (24%).

> 65% of surveyed firms have been involved in a lift-out strategy in the past three years

Main drivers behind the decision to execute a lift-out

58% Cost reduction

52% Access to specialised talent

50% Access to advanced technology

43% Risk management

24% Scalability

8. Lift-outs gain traction

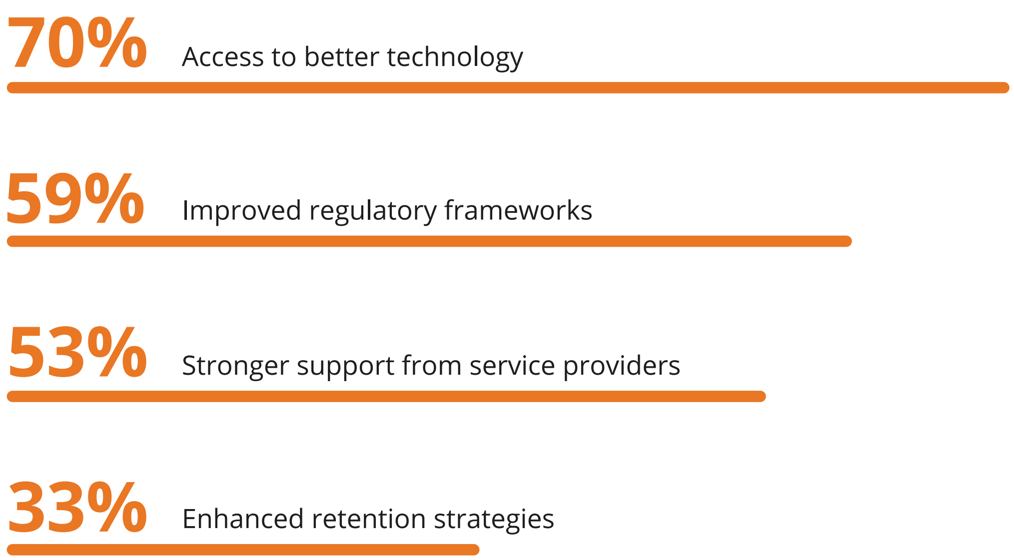
Lift-out strategies appear to have been largely successful, with two-thirds of those that have utilised lift-outs in the past would consider doing so again in the future. In terms of what would make lift-outs more attractive in the future, access to better technology was cited by 70% of respondents – followed by improved regulatory frameworks (59%), stronger support from service providers (53%), and enhanced retention strategies.

Lift-out services can be particularly appealing to asset managers who wish to maintain a certain level of control and continuity for their offering – retaining key talent and expertise while reducing overhead costs. The shift reflects a broader trend within the fund administration landscape to streamline operations and boost efficiency across service offerings. As cost and efficiency pressures continue to grow, lift-outs are poised to become a mainstay within the industry.

Chim concludes, “By lifting out your team to an organisation like Apex, asset managers gain access to a range of advanced technology solutions, regulatory expertise and industry best practices – while maintaining all the specific knowledge of your fund. That operational efficiency aspect is certainly something that institutional investors are increasingly asking for.”

As cost and efficiency pressures continue to grow, lift-outs are poised to become a mainstay within the industry

Factors that make lift-outs more attractive in the future



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