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PRIVATE CREDIT

Broadening Access to Private Assets: Regulatory Wrappers Unwrapped

INSIGHTS

The number of regulatory wrappers is growing as access to private assets broadens. When presented with different options, there are a number of considerations to keep in mind.

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Investing in private assets is an area of the asset management industry that continues to gather momentum from investors, managers, technology providers and regulators alike. This trend has been borne out of the increasing allocation from institutional clients, and more recently from the growing interest among wealth and defined contribution (DC) investors. At the end of 2020, total AUM for private markets stood at US$8 trillion.[1] While this is largely held by institutional investors (91% for private equity), individual investor participation is anticipated to grow significantly in the coming years, driven by wealth, retail and DC investors.

While investors seek to understand and educate themselves on the merits of the different private asset classes available to them, regulators are trying to support this endeavor through the creation and evolution of different regulatory frameworks to improve accessibility to these asset classes while at the same time trying to mitigate the inherent liquidity challenges given the nature of private markets.

This paper looks to identify some of the characteristics and considerations for investors to keep in mind when assessing the myriad of regulatory frameworks through which they could access their private asset class of choice.

The Private Assets Landscape

Historically, private assets have been accessed by institutional clients in closed-ended fund structures whereby the fund is open to subscriptions for a finite period. Following the initial fundraising phase, the capital is invested for a set time horizon, and at the end of this period, capital is then returned to investors as assets are realized.

During the initial capital raising period a subscription is made, however, that capital is not immediately invested, but instead the manager calls the capital from the client as and when investment opportunities arise—known as the 'committed capital' approach. This has been the primary approach taken by institutional investors and managers during the initial phase of private asset adoption.

The next phase has seen institutional investors starting to adopt open-ended perpetual structures, which allows investor capital to remain fully invested once called and provides more flexible investment horizons. This transition has also been partially driven by the reduced governance burden associated with approving one fund compared to successive approvals for closed-ended fund vintages. Like the initial phase, these structures have typically utilized a committed capital approach. However, investors are able to redeem during pre-specified windows. The two main redemption approaches are:

- The manager returning capital on a best-efforts basis as and when it is appropriate
- Through a vertical slice/slow-pay, where an investor is allocated a portion of each holding within the fund and when assets mature, the investor is returned their capital associated with that specific asset.

1. Source: BCG and i-Capital report. As of March 2022.

"The next wave of private asset adoption within Europe will be underpinned by individual investors, who have clear and distinctive preferences for accessing private assets: open-ended fund structures, periodic liquidity, and fully-funded subscriptions."

During these periods, individual investors have primarily accessed private assets through listed investments. These investments are limited to a smaller and less diverse pool of assets compared to private funds. They are also exposed to greater price volatility as the selected listed investments may trade at a discount or premium to asset value over time based on prevailing market sentiment or technicals. To the extent an individual investor is classified as a professional investor, they can access institutional-focused private funds—however, the mechanics favored by institutional investors do not necessarily align with individual investor preferences.

Private Assets Adoption by Individual Investors

The next wave of private asset adoption within Europe will be underpinned by individual investors, who have clear and distinctive preferences for accessing private assets: open-ended fund structures, periodic liquidity, and fully-funded subscriptions.

Figure 1: Key Fund Attributes

INVESTMENT HORIZON

Flexibility to tailor investment period to suit individual needs

PERIODIC REDEMPTIONS

Visibility on redemption profile including redemption % targets

FULLY-FUNDED SUBSCRIPTIONS

To remove operational burden of fulfilling numerous capital calls

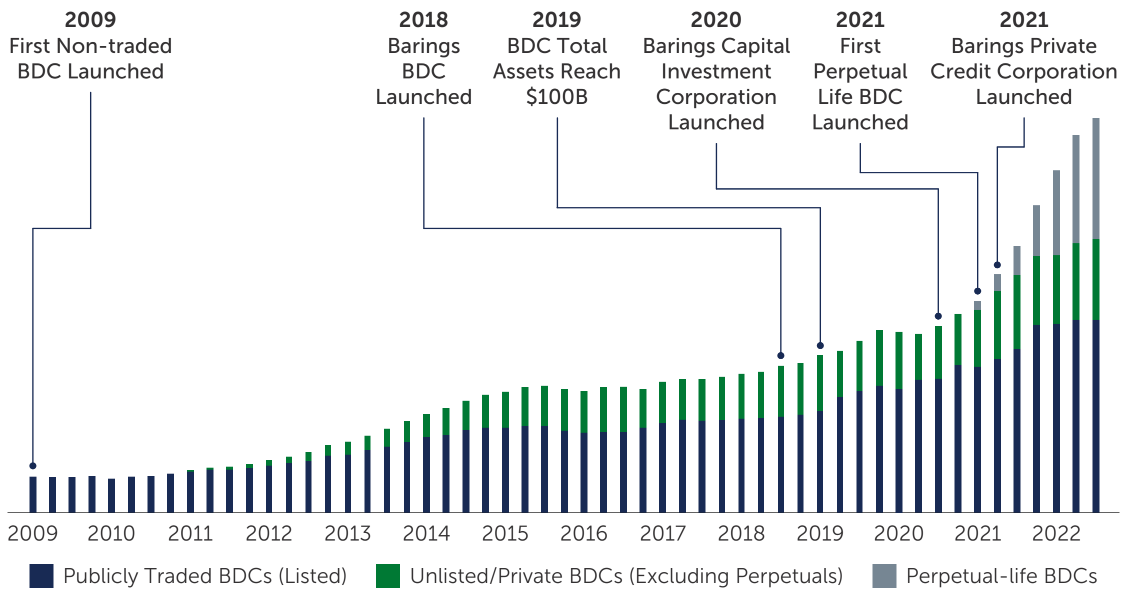
LOWER INVESTMENT MINIMUMS

To enable optimal asset allocation and avoid concentration risk across an investor portfolio

Source: Barings' analysis.

For many individual investors, the U.S. business development company (BDC) is the poster child for how private asset funds should be structured. BDCs are private credit-focused wrappers that have experienced significant growth over the past decade **(Figure 2)**. The catalyst for this growth has been the access it provides to individual investors in a permanent capital vehicle with SEC oversight, which, due to its Registered Investment Company (RIC) status, provides regular income distributions in a tax-efficient manner.

Figure 2: BDC Evolution



Source: Refinitiv BDC Collateral. As of September 30, 2022.

Among perpetual-life BDC managers, there are consistent levers that are used to support easy access and ongoing liquidity for investors **(Figure 3)**.

Figure 3: BDC Characteristics

INVESTMENT HORIZON

Open-ended vehicle enables investors to subscribe and redeem periodically

PERIODIC REDEMPTIONS

Provide quarterly redemptions up to 5% of NAV

FULLY-FUNDED SUBSCRIPTIONS

Allow fully-funded monthly subscriptions, which mitigates J-curve effect

LOWER INVESTMENT MINIMUMS

Minimums as low as US$2,500 provide greater access to individuals compared to higher institutional minimums

Source: Barings' analysis.

Private Asset Orientated Regulatory Fund Frameworks

As the wave of private assets adoption continues, regulators in Europe and the U.K. are implementing and evolving regulatory frameworks for fund structures with the aim of opening private asset classes to individual investors in a risk-controlled manner.

At the forefront of this wave are four regulatory wrappers, the EU's European Long-term Investment Fund (ELTIF), U.K.'s Long Term Asset Fund (LTAF), and Luxembourg's Reserved Alternative Investment Fund (RAIF) and Part II UCI. As part of the current focus on individual investors, there has been a recent uptick in the number of Part II UCI private asset funds and ELTIFs launched, while the RAIF continues to garner widespread adoption by institutional investors, both as a closed-ended and an open-ended structure. Given its nascency, only a small number of LTAFs have been approved by the FCA to-date.

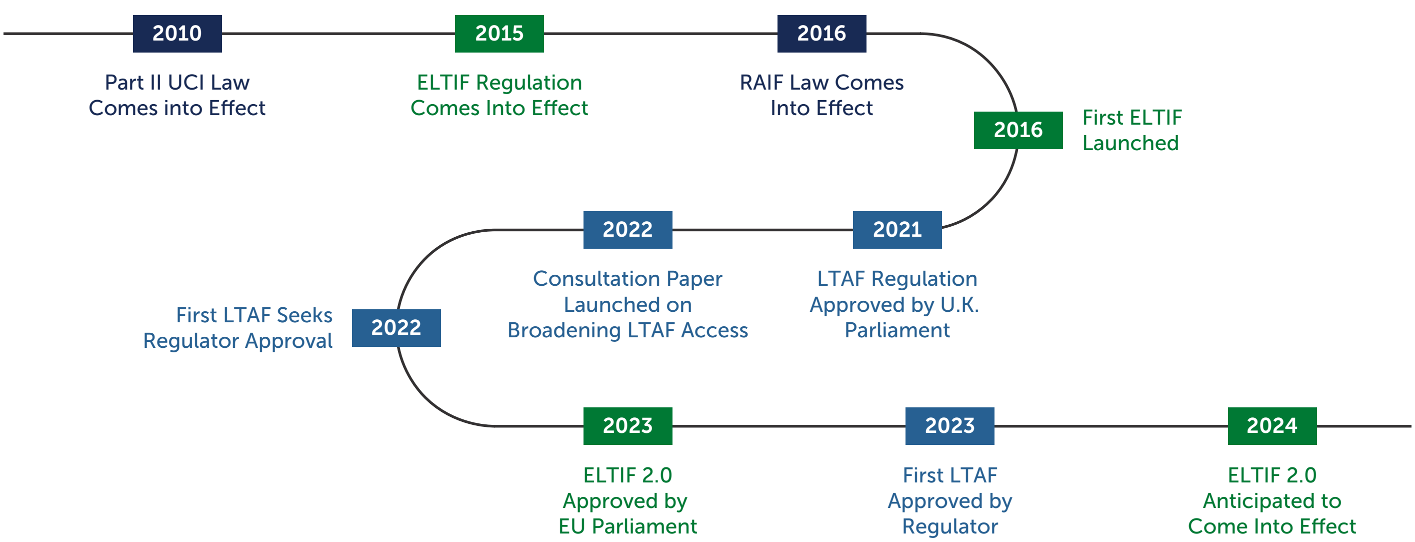
EUROPEAN LONG-TERM INVESTMENT FUND (ELTIF)

The ELTIF regulation was devised by the EU to encourage investment in long-term projects and smaller businesses in need of capital, while also broadening access to private assets. The regulation allows for the launch of closed-ended funds that can target individual investors, utilizing a pan-EEA retail marketing passport. The regulation was adopted in 2015, but there have been few launches to-date due to limitations with the distribution, investment, and structural requirements. In 2022, the EU proposed several amendments to make the ELTIF a more attractive option, with these amendments anticipated to take effect in 2024. The most significant changes include aligning distribution to MiFID requirements, broadening investment jurisdictions and types, and including additional liquidity mechanisms.

LONG-TERM ASSET FUND (LTAF)

The LTAF is a framework developed by the U.K. Treasury in order to broaden access to private assets. It is an FCA-authorized wrapper that can take the form of a unit trust, authorized contractual scheme or investment company with variable capital. Approved at the end of 2021 and currently available to professional investors—such as DC pension schemes—and sophisticated retail investors, the regulatory wrapper requires an open-ended vehicle with liquidity characteristics that align with that of its underlying portfolio investments. Although it is not currently accessible by all retail investors, like the ELTIF is, the FCA has been consulting on broadening the eligible investor base to include retail investors subject to appropriate investor safeguards.

Figure 4: Regulatory Wrapper Timeline



Source: Barings' analysis.

LUXEMBOURG RESERVED ALTERNATIVE INVESTMENT FUND (RAIF)

Since its introduction in 2016, the Luxembourg RAIF has been adopted as one of the regulatory frameworks of choice for professional investors. To invest via a RAIF, investors must meet the Luxembourg "well-informed investor" test, which typically requires a minimum investment amount of €125,000. Given these requirements, this structure may be optimal for entities who qualify as professional investors with a pool of aggregated capital, such as a private bank with a discretionary mandate from underlying high-net-worth clients, or a family office.

PART II UCI

A Part II UCI is an alternative investment fund, with direct oversight from the Luxembourg regulator, the CSSF. It can invest in a range of asset classes and be sold to multiple client types, subject to any local laws and regulations. Although it is unable to avail itself of a pan-EEA retail marketing passport like the ELTIF, certain jurisdictions allow distribution via private placement and the increased investment flexibility may be attractive to investors. As part of the recent broadening of access to private assets, several asset managers have launched Part II UCI private asset funds targeting individual investors with periodic liquidity and lower investment minimums in a regulated vehicle.

Each framework has different characteristics, ranging from eligible investor base to investment and liquidity restrictions. There is no one size fits all solution, and the optimal framework will vary depending on each investor's circumstances.

Figure 5: Features of Private Asset Regulatory Frameworks

	ELTIF*	LTAF	RAIF	Part II UCI
Fund Vehicle				
Fund Type	Semi open- or closed-ended	Open-ended	Open- or closed-ended	Open- or closed-ended
Domicile	EU member state	U.K.	Luxembourg	Luxembourg
Fund Regulatory Oversight	Member state regulator direct oversight	U.K. regulator (FCA) direct oversight	Indirect oversight via AIFM regulator	Luxembourg regulator (CSSF) direct oversight
Investor and Distribution				
Investor Eligibility	Professional and retail investors	Professional and sophisticated retail investors	Professional and "well-informed" investors	Professional and retail investors
Investment Minimum	No regulatory minimum	No regulatory minimum	€125,000	Typically €10,000-25,000
Distribution	Pan-EEA U.K. and Switzerland via private placement	U.K. Switzerland and certain EEA countries via private placement	Pan-EEA U.K. and Switzerland via private placement	Pan-EEA to professional investors Retail investors in U.K., Switzerland, and certain EEA countries via private placement
Investment and Liquidity				
Key Investment Restrictions	Must invest at least 55% in eligible long-term assets Leverage must not exceed 50% of NAV if available to retail investors (100% otherwise)	Must invest a majority of its capital in long-term assets Fund-level borrowings must not exceed 30% of NAV	N/A	Maximum leverage of 300% of NAV (50% of property value for real estate)
Investor Liquidity Features	Minimum holding period Redemptions must be limited to % of assets Can match "transfer out" requests with "transfer in" requests Liquidity features expected to align with portfolio characteristics	Maximum monthly redemption frequency with a minimum of 90 days' notice Liquidity features expected to align with portfolio characteristics	No regulatory requirements	Must offer at least monthly redemptions if open-ended

Source: Barings' analysis.
*Based on ELTIF amendments approved by the European Council and the European Parliament and anticipated to come into effect in the first quarter of 2024.
This is not an exhaustive list of all features for each wrapper.

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Key Takeaway

The current wave of private asset regulatory wrappers has seen the unlocking of investment opportunities that have been previously inaccessible to individual investors through open-ended fund structures. Regulators are cognizant of the less liquid nature of private assets and have been developing ways to encourage access in a risk-controlled manner.

While there are a burgeoning number of regulatory wrappers looking to broaden access to private assets, each of the wrappers detailed in this paper allow for the key features desired by individual investors—principally fully-funded subscriptions and periodic redemption windows. However, it is important that when individual investors and advisors evaluate private asset funds, they are doing so through the lens of not only what fund features are important to them, but also what is appropriate for the unique characteristics of the private asset class of choice. These wrappers provide flexibility for designing a fund structure and there is not a one size fits all approach.

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