THE INVESTMENT ASSOCIATION

PRIVATE MARKETS

A POLICY EXPLAINER FROM THE INVESTMENT ASSOCIATION

January 2022

ABOUT THE INVESTMENT ASSOCIATION (IA):

The IA champions UK investment management, supporting British savers, investors and businesses. Our 270 members manage £9.4 trillion of assets and the investment management industry supports 114,000 jobs across the UK.

Our mission is to make investment better. Better for clients, so they achieve their financial goals. Better for companies, so they get the capital they need to grow. And better for the economy, so everyone prospers.

Our purpose is to ensure investment managers are in the best possible position to:

- Build people's resilience to financial adversity
- Help people achieve their financial aspirations
- Enable people to maintain a decent standard of living as they grow older
- Contribute to economic growth through the efficient allocation of capital.

The money our members manage is in a wide variety of investment vehicles including authorised investment funds, pension funds and stocks and shares ISAs.

The UK is the second largest investment management centre in the world, after the US and manages 37% of all assets managed in Europe.

WHAT ARE PRIVATE MARKETS?

Private markets are investments made in assets not traded on a public exchange or stock market. Examples of these types of investments include:

PRIVATE EQUITY

These are investments made directly in private companies, in public companies that become private, or in real assets such as infrastructure or real estate.

The company investments can include early-stage venture capital through to mid-market investment and investment in mega-cap firms. Investors may look to take either a minority or majority stake in an investee firm. Such investments offer a range of returns, from highly geared funds looking to generate high levels of capital growth to long-term income generating investments.

Likewise, real assets investments can include highly-geared speculative ground-up development with most return from capital growth, all the way through to ungeared stabilised income-producing assets with long leases providing a high level of secure income.

PRIVATE DEBT

Where investors lend directly (usually in the form of a bond or loan) for which there is no market to sell on that loan/bond. Often these will be privately negotiated transaction which may be to a company, secured on a real asset or a pool of financial securities.

These encompass a range of investable opportunities such as in companies, infrastructure, real estate, natural resources and commodities, and other related assets. It is worth noting that what determines whether investment is private or not is whether the instrument is unlisted rather than the company being invested in – it is possible, for example, to invest in private debt in a publicly-listed company.

THE GROWTH OF PRIVATE MARKETS – WHY ARE PRIVATE MARKETS GROWING AND WHO IS INVESTING IN THEM?

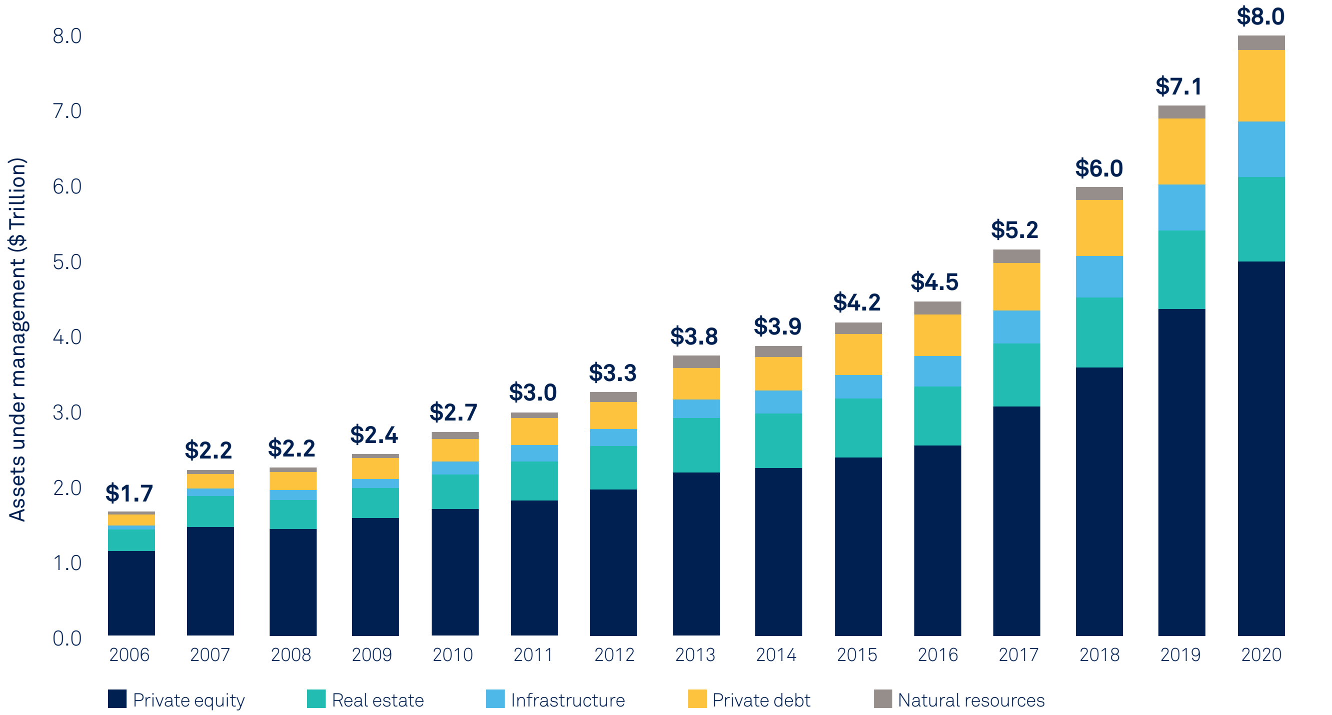
Private markets have experienced rapid growth in recent years. PwC have estimated that assets under management (AuM) in private markets will expand by between $4.2-5.5 trillion between 2021 and 2025, to reach between $13.7-15 trillion in total, more than 10% of global AuM.[1]

Investors looking to invest in private markets will typically do so for the following reasons:

- Potential for superior returns compared to public markets, especially private equity style investing.
- To diversify their portfolios – private markets tend to have a low correlation with other assets, allowing for a spreading of risk and a smoothing effect on total portfolio volatility. Low volatility compared with public markets.
- High levels of capital growth from closed-ended private equity-style funds.
- High levels of income distribution from open-ended funds.

Private markets are invested in by the full range of institutional investors (DB and DC corporate and government pension funds, Sovereign Wealth Funds and insurance companies) and retail investors (High Net Worth individuals and retail investors advised by Wealth Managers). However, some of these investors – particularly DC and retail – have historically been limited in the way they can access these investments owing to an inability to invest in them directly, or as a result of restrictions on the distribution of private-market focused funds. The UK's new Long-Term Asset Fund regime starts to address these issues by widening access to private markets through an FCA-regulated fund structure. This will help broaden and democratise access to private markets.

FIGURE 1: GLOBAL ASSETS UNDER MANAGEMENT IN PRIVATE MARKETS (2010-2020)



[1] PwC, "Prime time for private markets: the new value creation playbook", Jan 2021

WHY ARE PRIVATE MARKETS OF INTEREST TO INVESTMENT MANAGERS?

By choosing to invest in private markets, the investment industry directly supports the development of new infrastructure projects, social housing initiatives, and start-ups looking improve their productivity and grow their business.

Both supply and demand factors are driving this change. On the supply side, market-based finance has been more widely used since the Global Financial Crisis and there are also signs of a decline in the proportion of companies wanting to publicly list.

On the demand side, the drivers have been fairly clear. Pension schemes and other institutional customers are looking for more diversified sources of return and income, reflected in greater interest in alternative strategies and asset classes. Some of this is cyclical, particularly in the context of low interest rates post-2008 and a hunt for yield which has been a key feature of investor behaviour over the past decade.

In addition, private markets offer an opportunity to access companies throughout their lifecycle of development and growth, which is being sustained longer in the private ownership space. Private markets also offer different forms of exposure at different stages, i.e. equity, as well as the opportunity for direct lending and lending to the private equity ecosystem.

WHY ARE PRIVATE MARKETS BENEFICIAL TO GOVERNMENT AND THE ECONOMY?

As mentioned, private investment can help provide vital capital for companies, including start-ups looking to grow their business. As bank finance has declined along with the number of publicly-listed companies, there has been a growth in unlisted companies seeking investment capital.

Likewise private investment can play a key role in helping the Government to meets its Build Back Better, Levelling Up and Net Zero objectives, supporting infrastructure and social projects and generating new jobs, while at the same time reducing the amount of public spending necessary.

Particularly in terms of financing the UK's infrastructure and housing pipeline, private finance is expected to provide a significant proportion of the total capital necessary.

THE
INVESTMENT
ASSOCIATION

The Investment Association
Camomile Court, 23 Camomile Street, London, EC3A 7LL

www.theia.org
@InvAssoc

January 2022