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AICA CEF Panel: Asset Managers are Fueling a Surge in Interval Funds

With advisor allocations to alternative investments currently at low tide, asset managers' use of interval funds in actively managed portfolios is helping to fuel a surge in the emerging alternative vehicle, a leadership panel at AICA's 2023 Fall Roundtable said. The less concentrated nature of the interval fund market — and its reach to high net worth and mass affluent segments — makes it possible for even small firms to raise capital, experts from XA Investments, Moonfare, Cerulli Associates, Willkie Farr & Gallagher, and Bluerock said at the November 15, 2023, event in New York City.

Those comments came during the panel discussion, *Explosive Growth in the Interval Fund Market*, in which panelists also promoted closed-end interval funds as a potentially useful addition to 401(K) plans.

Advisor allocations to alternative investments are exceptionally low and have been for a long time, according to polling from research and consulting firm Cerulli Associates. "For the average advisor it's something like a low, single-digit allocation — call it 6%," said panelist Daniil Shapiro, Cerulli's Director of Product Development. It's possible that the interval fund — a type of SEC registered, closed end fund that expands investor access to illiquid investment strategies via lower investment minimums and more frequent valuations as well as 1099 tax forms — will play a role in driving alternative investments' use.

That assessment tracks with a recent independent survey conducted by CAIS and Mercer, which found that just over 60% of advisors currently only allocate between 6% and 25% of clients' portfolios to "alts."

But interval fund alternatives are a "better fit" for advisors due to their unique structure and ability to generate income, Shapiro said. He also noted that advisors are increasing their use of alternative investments because they see it as a good way to differentiate their own practice. "Clients are wealthier, and advisors are very concerned about them going to the practice next door, which are holding out better products," he said.

Elliot Gluck, Partner, Asset Management, at Willkie Farr & Gallagher, attributed the launching of interval funds by legacy private fund managers, in part, to the increasing regulation of private fund advisers, dating back to the hedge fund adviser registration rule of 2004.

"Private fund advisers are highly regulated at this point relative to where they were, which was totally unregulated, and so we've started to see growth and interest in interval funds [from those advisers] increase," Gluck said. Gluck also attributed the growth of the internal fund market to the fact that these funds can invest without limit in private securities, noting that "the best [investment] opportunities in a lot of instances are in private securities, and … if you're a retail investor, the only way to get at them is through one of these products, so I think we'll see continued growth."

Willkie's registered funds practice provides legal services to, among other clients, closed-end funds (CEF) and business development companies (BDC), including their advisers, sub-advisers, distributors, and other service providers, as well as independent fund directors.

In comments that echoed a preceding interval fund panel, Paul Dunn, Executive Vice President, Chief Compliance Officer, at Bluerock Capital Markets, extoled interval funds' increasing retail accessibility:

"The marketplace likes the interval fund because, number one, it's available to every investor — you don't necessarily have to be accredited; and number two, it's a 40 Act fund, and [the market] likes the additional scrutiny and structure," said Dunn. "And third, regarding the liquidity requirement, you are obliged [to] … deliver a 5% distribution upon a repurchase request, but if you get an excess with that, you can in fact prorate," he added.

Kimberly Flynn, Managing Director, Alternative Investments, at XA Investments, discussed proration trends among non-listed REITs and addressed a key trade-off involved with investing in less liquid alternative products. "I think there is some negativity associated with proration, but in some ways, it's meant to protect shareholders in the fund," Flynn said. It's best to sell interval funds as medium- to long-term investments and to be up front about their liquidity constraints, she emphasized.

Describing the growth of the interval fund industry, Flynn said year-to-date there have been 19 new funds, mostly by new fund sponsors, entering a market consisting of just under 200 interval funds and tender offer funds. Flynn said the top 30 funds are all north of a billion dollars in AUM.

"I think a lot of alternative asset managers who've been maybe observing this space are now seriously considering entering

the marketplace," Flynn said, noting that most funds are situated in the credit space, currently the largest segment of the interval fund market. She continued:

"We're excited to see the growth in the interval fund market; it's fairly democratic, meaning even small fund sponsors, even if you're not PIMCO you can still raise capital," she said. "That compares or contrasts with the non-listed REIT and the non-listed BDC market, and if you follow that market, you know that most of the capital is being raised by the top two or three firms," she added.

Describing the interval fund market as "still fairly nascent," Flynn said she'd like to see more investor-driven interest in interval funds but expects sponsors and advisors to keep the market moving forward. She speculated it may, in fact, only be a matter of time:

"Interval funds, particularly credit funds don't necessarily need to wait for a three- or five-year track record to develop because they're offering attractive current yields that are higher than more traditional fixed-income investments," said Flynn. "But if you're selling a private equity or venture capital strategy, most financial advisors want to give that product a little bit of time, and so there are some really interesting total return-oriented strategies that will be hitting … milestones in 2024, and that will really lead to additional adoption and capital raising," she added.

Chirag Goyanka, Head of Intermediaries and Product at Moonfare, a digital platform for private equity investing, suggested the sky's the limit. "I think we will see new entrants into the business such as insurance companies," Goyanka said. He also noted that some are considering allowing 401(K) plans to access interval fund investments. "I think it can be one solution, amongst many others, if it's part of a multi-asset package," he added.

To hear more valuable insights from this panel, register to access a replay and review the full agenda of AICA's 2023 Fall Roundtable. The cost of the replay is $30 for access to all nine panels.

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