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Bain, Ares Moves Stoke Alts Fund Arms Race

By Tom Stabile February 15, 2017

Bain Capital, Ares Management, and various private equity peers have cranked up their efforts to reach retail investors through a wave of new products and partnerships in the increasingly active non-traded registered fund marketplace.

The firms have built up their presence in the market for non-traded business development company (BDC), real estate investment trust (REIT), closed-end, and interval funds over the past year through a mix of new products, joint ventures, acquisitions, and subadvisory mandates.

The scrum in the past year also has included private equity managers such as Blackstone Group, Apollo Global Management, and Providence Equity Partners; real estate fund managers Rialto Capital Management and Colony NorthStar; and hedge funds such as Magnetar Capital and Och-Ziff Capital Management. And they are often partnering with active players in the non-traded registered alts fund business, such as FS Investments, **CION Investments**, and Griffin Capital, each of which has stepped up new product efforts.

Blackstone, Apollo, KKR, and Carlyle Group had established footholds in this market in recent years through earlier rounds of partnerships, but the range of new moves – and addition of peer firms to the fray – has created a bustle.

Stirring It Up

Private equity and hedge fund managers have been active in the past year on newly developed non-traded registered alts fund products

Private fund manager	Fund activity	Role	Partner firm
Apollo Global Management	Debt-focused closed-end fund	Main sponsor	—
Ares Management	Debt-focused interval closed-end fund	Joint venture	CION Investments
Bain Capital	BDC	Main sponsor	—
Bain Capital	Debt-focused interval closed-end fund	Subadvisor	Griffin Capital
Blackstone Group	REIT	Main sponsor	—
Magnetar Capital	Energy-focused interval closed-end fund	Subadvisor	FS Investments
Och-Ziff Capital Management*	Debt-focused closed-end fund	Subadvisor	Colony NorthStar
Rialto Capital Management	REIT	Subadvisor	FS Investments

**Colony NorthStar removed Och-Ziff as its subadvisor last month*

"There continues to be a retail invasion of the market by these big [managers]," says Rajib Chanda, a partner at Simpson, Thacher & Bartlett who specializes in registered fund law. "There definitely has been a renewed interest in the interval funds structure."

The non-traded registered product market's earlier push several years ago largely involved establishing broader fund of funds-style structures, but now there is much more activity on single funds and narrower investment options, Chanda says.

"What we're seeing now is more innovation on the credit side," he adds. "There is demand [and] interest in strategies that are hopefully non-correlated to the markets. In a lot of ways these credit strategies offer things that are attractive in a volatile market situation."

The current run has a ways to go, Chanda says. "You'll see more of these in 2017, especially with [larger] managers," he says.

Private alts fund firms are showing stronger interest in the non-traded registered fund market at a time when the product sets have been evolving quickly, says **Michael Reisner**, co-CEO at CION, which recently launched a joint venture with Ares and rebranded its BDC-focused business from its prior ICON Investments name.

"With the maturation of the industry, as fees have come down and transparency increased, the big institutional [managers] see this as a final frontier for them to grow assets from individual investors," he says.

Growing advisor interest in alternatives is also driving private fund manager moves, says Marc Yaklofsky, senior v.p. for corporate development and communications at FS Investments, which this week unveiled a non-traded REIT, its latest entry in a spurt of new products. FS Investments is already the largest non-traded BDC manager in the market, and is expanding now with two new interval funds and an alts mutual fund, he says.

"People realize that traditional portfolio construction is not going to yield what it had historically yielded, and that is requiring investors and advisors to think about alternatives more than they had in the past," he says.

The common thread is a search for income, says Kimberly Ann Flynn, managing director for alternatives at XA Investments, a new entrant that aims to bring alts strategies to the market through non-traded funds, including its first foray, a partnership with Octagon Credit Investors, a $14.6 billion alts credit manager.

"With all of these – BDCs, interval funds, REITs – you're looking for alternative income, diversifying sources of income, just more income," she says. "The theme is bringing together [1940 Investment Company Act] expertise and private fund expertise, and applying new ways of approaching the market. A lot of closed-end fund lawyers are out there testing the limits of '40 Act structures with alternative strategies."

The product innovation and experimentation has led many firms to step into new formats for the first time, Flynn adds.

For some, the push involves managers launching non-traded products on their own for the first time, including Blackstone's new non-traded REIT, Bain's BDC, and a new closed-end fund spanning virtually the entire credit market from Apollo. That planned Apollo Multi Sector Income Fund is not yet live.

Providence Equity's Benefit Street Partners credit affiliate also added its first non-traded REIT and a new non-traded BDC last fall through acquisitions of former entities of AR Global in which the private equity firm became the advisor for existing products. Benefit Street a year earlier had added a non-traded BDC through a partnership with Griffin.

Another approach is the joint venture route, which Ares and CION have taken, with a first interval vehicle, the CION Ares Diversified Credit Fund, rolled out in December and several more planned for this year, Reisner says.

And various private fund managers have signed on in the past year as subadvisors to new non-traded vehicles with existing players. Those include Bain as subadvisor for a new Griffin credit fund; Magnetar on an energy interval fund and Rialto on a REIT, both for FS Investments; and Och-Ziff, which had been subadvisor on several new credit closed-end funds with Colony NorthStar. Last month, Colony NorthStar abruptly dropped Och-Ziff, which had a rough 2016 after settling a bribery case with the Securities and Exchange Commission.

The wave of product development from private fund managers also piggybacks on the success that firms such as FS Investments and CION have had in building up sales of non-traded vehicles to advisors in recent years, Chanda says. The non-traded vehicles also allow private fund shops a way to invest in many types of illiquid assets they're used to, he adds.

"They're realizing the interval fund redemption feature is more appropriate for these assets," he says.

It helps as well that the non-traded fund marketplace has been evolving to create products that are more appealing to advisors, says John Grady, lawyer and partner at DLA Piper and current president of the Alternative & Direct Investment Securities Association. The Department of Labor's planned fiduciary rule and a new Financial Industry Regulatory Authority rule from last year have combined to push non-traded products to be more transparent on fees and develop more palatable pricing and sales arrangements for advisors, he says.

"Many firms saw interval funds as a way to respond to some of those pressures," he adds.

The Trump administration's possible scrapping of the DOL rule is not likely to reverse these product trends, because advisors, custodians, and wealth management firms have already had a taste of the new models and are unlikely to want the old ones back, Grady adds. And managers may prefer nationally regulated solutions in lieu of a patchwork of oversight across multiple states, he adds.

"The new approaches remain attractive even if the DOL rule is not in place," Grady says. "We expect product development to continue on pace."