CAIS

Custom Funds

Accessing alternative investment offerings through custom funds

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For decades, alternative investing was reserved for large institutions and the few ultra-high-net-worth investors with the right connections.[1] Independent financial advisors who invested their own time and resources could sometimes gain access for their clients to top alternative investment managers, making a name for themselves and carving out their niche within the broader wealth management space. Thanks to shifts across the industry,[2] the stakes have since heightened. As access to alternatives has democratized,[3] simply offering a menu of alternative investment options may now be more of a requirement for an RIA or independent broker-dealer than a potential differentiator.

Creating branded, custom fund structures may help those experienced in alternatives maintain their advantage. According to a survey conducted by CAIS and Mercer in October 2022, nearly nine in 10 financial advisors (88%) are planning to increase their allocations to alternative asset classes over the next two years.[4] In other words, the advisors already well-versed in alternatives—who were once ahead of the curve just by offering their clients access to top alternative asset managers and strategies—may face increased competition. They now have an opportunity to update their approach and scale through improved operational efficiency by launching their own custom funds.

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This paper will briefly explore two ways that RIAs, RIA aggregators, bank and trust companies, or independent broker-dealers may customize their firm's alternative investing offering to grow their business and serve their clients:

1. **Customizing a white-labeled multi-manager fund program**
2. **Creating a single-manager feeder fund**

While neither option is necessarily new to wealth management, the methods for executing each have evolved in the last several years. Advancements in access to institutional-quality managers and alternative investing technology have changed the game.[5] Previously, firms with significant internal resources, operational expertise, and a robust manager network were generally at an advantage in that they were better equipped to handle the inherent complexities of implementing these vehicles. Now, firms of many sizes may seek to build their own custom funds by outsourcing to a reliable and experienced partner.

Note that the custom fund solutions explored here may not be appropriate for every advisor or firm. Anyone who pursues such a program must still have a deep understanding of asset allocation along with the risk and reward profiles of each alternative strategy they wish to incorporate. The team must understand the various rules and regulations and have enough investment experience and resources to conduct thorough manager due diligence and perform ongoing portfolio monitoring.

Customizing through multi-manager fund of funds

Of the two options we cover in this paper, creating multi-manager vehicles, or funds of funds, may be the more complex; however, if executed well, the approach may have the most potential to scale and set an advisory firm apart. By creating a one-of-a-kind, proprietary multi-manager vehicle, a financial advisor can play the role of asset manager—identifying, sourcing, and managing a diversified combination of funds and/or managers that seek to match their clients' unique portfolio needs.

An advisor or firm can typically customize a multi-manager vehicle using one of two main structures, depending on the asset classes they wish to access and the liquidity needs of their clients. A private market "vintage" fund is typically set up as a limited partnership with a drawdown, or capital call, fund structure, mirroring the underlying structure of the funds it intends to invest in.[6] This structure is common in asset classes such as private equity, private real estate, and private debt.[7] It may provide the RIA or independent broker-dealer with the time and dry powder to identify funds and negotiate terms on behalf of all their fund's limited partners, or LPs, at once. Also, when clients become LPs in a custom multi-manager vehicle, they commit capital and meet capital calls only for that single fund instead of each underlying fund.

Through the introduction of multi-vintage funds, a financial advisor can play the role of asset manager by:

identifying

sourcing

managing

a diversified combination of funds and/or managers that seek to match their clients' unique portfolio needs.

For those who plan to invest in hedge funds and fully funded evergreen private markets funds, an evergreen fund structure may make more sense. These permanent capital structures may afford a firm's clients relatively more liquidity rights than a closed-end, or finite-life, structure and may provide greater flexibility for the firm to modify its investments over time.[8]

Diversification is typically the core objective of any multi-manager or multi-strategy portfolio.[9] The same may be true when creating a custom multi-manager fund, as an advisor has the potential to create a single vehicle that offers diversified exposure across various managers, strategies, and vintages. The fund-of-funds structure may help an advisor achieve diversification with less operational hassle than offering clients access to each underlying fund separately. Many firms that have built a multi-manager private markets allocation by facilitating investments directly into each fund have found the process to be operationally inefficient—especially when aiming for scale across a broad book of clients.

As advisors experienced in alternatives and their support staff know, every new fund introduces a new sequence of client interactions. They generally require the advisor to guide interested clients through the subscription process for each fund, assisting them with document submission and conducting anti-money laundering and client suitability checks. Advisors usually have to do subsequent work to ensure their clients meet each fund's capital calls and to manage clients' annual tax documents and distributions from each fund. An advisor aiming to diversify a client's annual private equity allocation across five private equity strategies, for example, would have five sets of paperwork, five series of capital calls, and so on.

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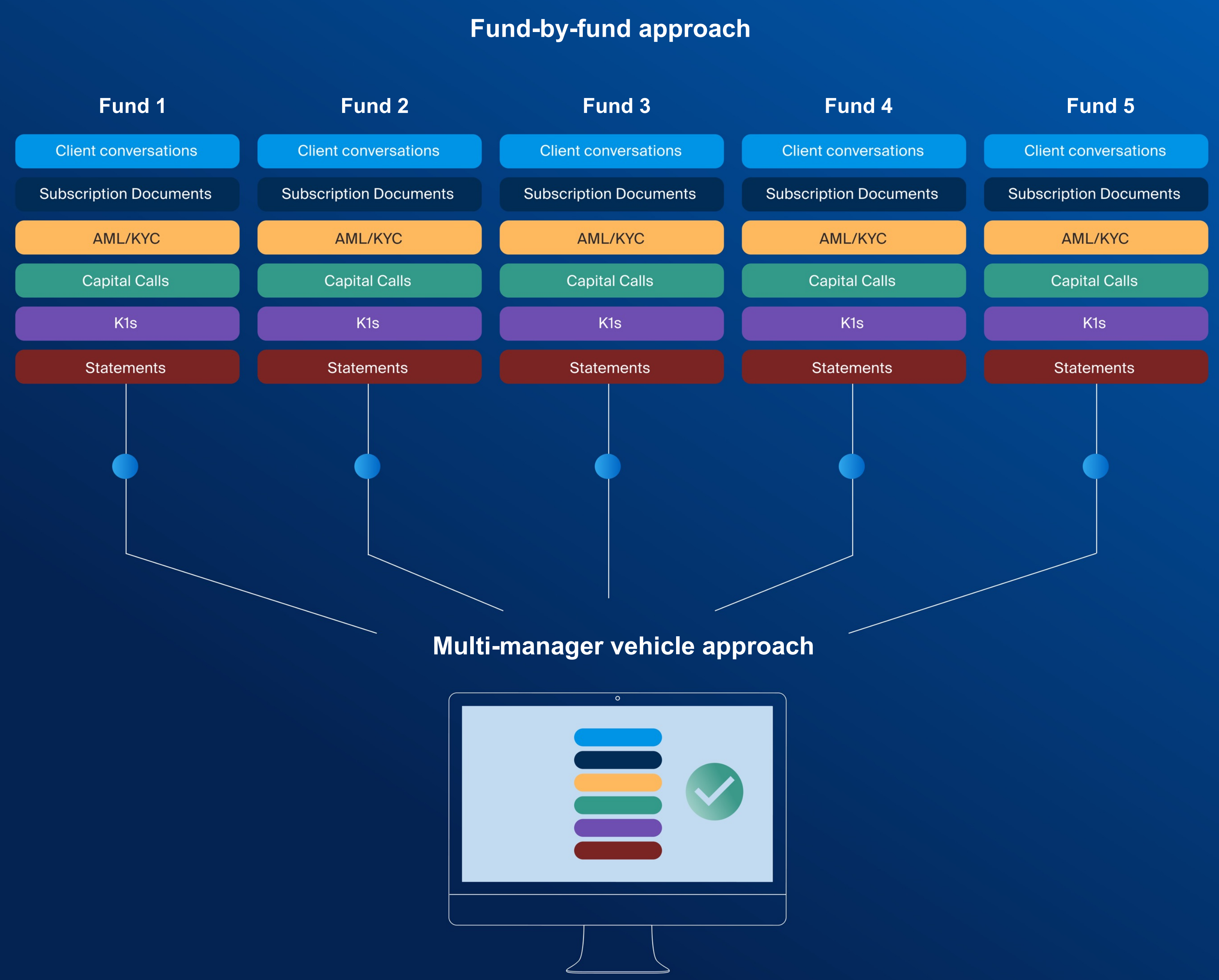

Custom multi-manager vehicles aim to simplify these burdens for home offices, advisors, and their clients. Though clients may still gain exposure to the same five strategies, as in the example above, when investing through a multi-manager fund, they would only need to complete one set of subscription documents and meet capital calls for a single fund.

In addition to the operational benefits, pooling capital into a multi-manager fund may also help a firm offer their clients access to higher-quality asset managers at more favorable terms. The dry powder in these vehicles may allow for more opportunistic allocations to certain managers.[10] Larger vehicles can also act as a single LP, equipping an RIA or independent broker-dealer with more leverage to negotiate better fees with these managers.[11]

A more experienced RIA or independent broker-dealer may not want to stop at a single multi-manager vehicle from one vintage year. Instead, with proper operational support, they could launch an ongoing multi-manager vintage fund program. In doing so, they may continue to reap these operational advantages while offering their clients a more streamlined way to achieve diversification over time. For instance, by creating a sequence of three private markets multi-manager vehicles—each deploying capital in different years—an advisor could offer potential diversification across three distinct market environments
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A firm could also design its program to focus on different strategies in each year. One vintage may include more buyout strategies; the next could have greater exposure to venture capital or private real estate, in line with the firm's evolving market views.

The quality of an individual bottle of wine is highly determined by the growing conditions in the year of harvest. Similarly, the environment in which a fund invests its capital has seemingly had an impact on its ultimate performance. Historically, vintage performance, even among higher-performing funds, has been widely dispersed.[12] Analysis of the broad private equity market suggests that deploying capital in cheaper valuation environments—recessionary environments in particular—has often led to higher-performing vintages than in richer investment environments.[13] Yet, rather than trying to time the market, investing programmatically in custom funds from different vintages may allow for diversification over time.

Ongoing multi-manager fund programs may also give financial advisory firms the chance to demonstrate their own unique investment capabilities. By creating and hosting these funds on a broader technology-enabled investment platform, firms can enable their advisors to maximize their time through more streamlined fund construction, transaction workflows, custodial asset recognition, and integration with third-party reporting providers.

Potential benefits of custom multi-manager funds:

1

Reduction of operational hurdles

Consolidating multiple funds into a single vehicle decreases paperwork and streamlines capital calls and distributions.

2

Enhancement of client experiences

Reporting and interactions with clients may be more streamlined.

3

Improved investment opportunities

Large multi-manager funds can provide advisors leverage to negotiate capacity and potentially lower fees from managers, while the availability of dry powder can allow for access to opportunistic investments with short fuses.

4

Better client experience

Advisors can enjoy a simplified interaction with their clients when they focus on one fund instead of many.

Despite the potential diversification they may offer, multi-manager vehicles carry many of the same risks inherent to the asset classes in which they invest. For example, because they tend to invest in funds from the same vintage year, they may experience the J-curve typical to many drawdown vehicles. Manager selection also remains crucial for such programs, and multi-manager funds may present volatility and illiquidity, along with other market and business risks. Note that even open-ended or evergreen funds may not be able to provide liquidity when clients need it. When customizing funds for their clients, RIAs and independent broker-dealers should also aim to minimize extra layers of fees, which tend to be customary when transacting in externally managed funds of funds.

Customizing through single-manager feeder funds

Rather than jump right into building and marketing a fund with multiple managers or strategies, a firm or advisor may instead customize a single-manager feeder fund. While this structure may be a more manageable option for those with fewer existing asset manager relationships or more limited internal investment research capacity, it could still allow advisors to offer their clients exclusive and efficient access to their fund ideas.

Feeder funds, also sometimes referred to as conduit vehicles or special purpose vehicles (SPVs), are designed primarily to create economies of scale, reducing trading and operational friction for both asset managers and those who wish to invest in their funds.[14] By pooling client capital into a custom feeder fund, which then invests into a larger, master fund managed by the asset manager, advisors may be able to create more flexibility for their clients around minimum investments, tax considerations, and other fund terms.[15] For instance, a fund with a $10 million minimum may be made available to investors with a $100,000 minimum in the feeder structure.

As with custom multi-manager funds, advisors can work with an operational partner to help them create, launch, and operate these vehicles. They can also leverage alternative investing technology to automate subscription processes and more easily monitor the fund over time.

Investors in these vehicles may still be subject to the same accreditation requirements and risks associated with the strategy and the master fund. A vehicle that feeds into a hedge fund would carry risks such as those related to market volatility, manager selection, use of leverage, and illiquidity. Therefore, advisors should ensure that they—or a reliable third party—have conducted thorough investment and operational due diligence before recommending such a vehicle to their clients.

What key services should advisors look for in a customization platform?

To serve their clients more seamlessly, firms might consider equipping their advisors with a platform that can provide access to a comprehensive suite of services to help build and deliver these customized vehicles. This calls for operational and technology infrastructure to design products, transact efficiently, and enjoy automated reporting integrations. For example:

Pre-trade support

Investment teams and/or home offices should try to create efficiencies as soon as they identify the funds they'd like to offer, leaning on a trusted partner to assist in vendor sourcing and management, fund creation, document preparation, and fund-specific education.

Trade support

During the execution stage, advisors should look for a range of features, such as fully digitized subscription documents with e-signatures, AML/KYC logic, streamlined trade and capital call processing, and dedicated client service and operations management.

Post-trade support

Management of all operational workflows is critical across the life of each fund and may further showcase the value advisors can deliver to their clients. This may include custodial asset recognition for above-the-line reporting, data integrations with third-party reporting providers, and the implementation of a centralized and accessible client document library.

CAIS is positioned to be a trusted ally when adding custom funds to a portfolio.

The end-to-end solutions offered by CAIS' Custom Funds team include comprehensive support and the operational backing of the industry-leading CAIS Platform. Our team can work with advisors to create, launch, and operate single-manager feeder funds and multi-manager funds. CAIS works closely with advisory teams to launch and support their alternative investment offerings through the CAIS Platform—facilitating efficient transactions, overseeing all operational workflows for the life of the fund, and integrating with key ecosystem players like custodians and third-party reporting providers.

As a leading alternative investments and education platform for independent financial advisors, CAIS strives to help financial advisors win new business, increase wallet share, and improve client conversations. By leveraging our wide industry network, our personalized support, and alternative investing platform infrastructure, advisors may more easily build their reputation in the increasingly competitive independent wealth market.

Learn more

Visit caisgroup.com

or contact CAIS' Custom Funds team.

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