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FUNDS & FIRMS

Private Eye: Growing menu of feeder funds draws billions

By David M. Toll

Feeder funds tend to flourish during bull markets. And they are big business yet again.

For evidence look no further than **iCapitalNetwork**, which was founded in mid-2013 and began offering its first products about two years ago.

From that start the firm has raised some 50 feeder funds, both single-fund and multifund feeders, from an online network that includes more than 13,000 registrants — some 500 registered investment advisers, 150 family offices and hundreds of individual qualified purchasers with portfolios of at least $5 million.

Altogether the firm has channeled about $2.1 billion to funds sponsored by some 35 to 40 managers, including **Apollo Global Management**, **Cerberus Capital Management** and **Warburg Pincus**.

StepStone, which acquired a big part of Citigroup's private equity advisory business in 2010, has also seen big demand for feeder funds. The firm has attracted more than $4 billion in commitments to its feeder funds, Partner Michael Elio says. The firm has about 29 feeder funds under management, raised from a network of some 13,000 wealthy investors.

"What we're trying to do is democratize this asset class," said **Lawrence Calcano**, CEO of iCapitalNetwork, which in mid-December said **BlackRock** would be leading its next investment round.

Feeder funds have been around since at least the late 1990s, and they flourished in the years leading up to the financial crisis. Major feeder-fund sponsors over the years have included **Deutsche Bank, Goldman Sachs** and **UBS**. One difference in the current feeder boom: the growing number of online platforms, such as iCapitalNetwork and **Artivest** and **CAIS**, that make it easy for investors to comparison-shop and to invest without necessarily having to go through the private banking arm of a Wall Street investment bank. Minimum commitments also appear to be coming down.

Back in 2007 *Buyouts* reported that $250,000 was a typical minimum for single-fund feeder funds. But minimums at iCapitalNetwork are just $100,000. And Calcano said the firm in early 2017 plans to introduce a product for accredited investors, a category that includes people with net worths of at least $1 million, not counting the value of their principal residences. Minimum commitments for those products would be "considerably less than $100,000," said Calcano.

In offering alternative investments to accredited investors, iCapitalNetwork would join a growing number of managers offering so-called 40 Act funds, including **Carlyle Group**, **Kohlberg Kravis Roberts** and **Partners Group**. Such funds can have minimum commitments as low as $50,000 or $25,000.

The variety of feeder-fund options for investors also appears to be growing. iCapitalNetwork, for example, has offered access to everything from venture capital to buyout to turnaround to real estate to hedge funds operating worldwide. Underlying fund sizes have ranged from $500 million to $12 billion. StepStone's Elio observed that feeder funds aren't just channeling money to established, brand-name funds. They're also backing new spinout groups, especially where the partners have pedigrees that include stints at Carlyle, Goldman and other well-regarded shops.

Investors that want exposure to a complementary group of funds — perhaps ones

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that provide early distributions — can invest in multifund feeders. Both iCapitalNetwork and StepStone offer them. “We think that model is a very attractive model to our investors,” said iCapitalNetwork’s Calcano. “Not only does it create diversification, it does so at a low minimum and a low fee.“ On both its single-fund and multifund feeders iCapitalNetwork charges a management fee of 50 to 75 basis points per year, no carried interest and no up-front placement fee.

Assuming investors prove they’re qualified, iCapitalNetwork tries to make investing in the asset class as simple as possible. The firm provides what Calcano calls “institutional-grade” due-diligence materials to investors to help them pick funds, and it has automated the process of reviewing and signing subscription documents. The firm handles the administration of draw-downs and distributions. Once committed to partnerships, investors can track performance through the iCapitalNetwork portal or even through a supported third-party platform, such as Fidelity’s wealth platform; iCapitalNetwork and Fidelity have a “strategic relationship,” according to Calcano.

So, what could go wrong? For the wealthy investors in feeder funds, much. Some will inevitably run into financial troubles, even absent a severe bear market. Penalties for defaulting on a commitment can be harsh, options for selling a partnership interest limited.

“The whole point of joining into these products is that you accept the long-term illiquidity,” said StepStone’s Elio. “If for whatever reason you have to have a distressed sale, you have to take the consequences of a distressed sale, and you have to take the haircut that goes with it — if you can find a buyer.” iCapitalNetwork tries to arrange for sales for buyers that need to, while StepStone manages a secondary fund that could potentially step in. But there’s no guarantee.

Meantime, many top funds are highly selective about their backers and don’t need to take money from feeders. That potentially leaves wealthy investors with a pool of less desirable funds to choose from, in an asset class that’s notorious for having a wide spread of performance between top and bottom funds.

Calcano calls that less a criticism of feeder funds than a “reality” for all investors in the asset class, even public pensions. “We think [our] track record is clear that we’ve been able to get access to really top-shelf funds … to the benefit of our network members,” he added.

Given the long-term nature of the asset class, it will be several years before investors know for sure whether feeder funds have been worth the price. ❖