Apollo, Ares: Separate Accounts Go Prime Time

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By Tom Stabile

Private equity separate accounts are moving from an off-menu special offered to elite customers to part of the regular business revenue stream at big players such as Apollo Global Management and Ares Management.

Separate accounts made up a hefty share of first quarter inflows at Apollo, which – in addition to its high profile $5 billion managed account mandate with the Teacher Retirement System of Texas – is now regularly racking up new partnerships. And Ares is touting how private equity managed accounts will make up a big chunk of its new capital this year.

Large alts managers no longer view these arrangements as perks they can use to deepen relationships with key clients, but instead as a distinct revenue stream, albeit one very integrated with their fund businesses, says **Lawrence Manson Jr.**, CEO at **NexTier Consulting Solutions**, a Chicago-based marketing and strategy consultant.

"They're going out and looking for this business," Manson says. "They're saying to their clients, 'We've got all these tools and access to data to create the product that matches the terms and risk requirements you have.' I don't think they're being passive and waiting for the client to come to them, but rather helping the client to come up with new ideas."

Fund managers likely are aware of considerable institutional investor interest in private equity separate accounts, as least as a concept. A recent Preqin survey of current limited partners found that 40% of those with $1 billion to $5 billion in private equity assets already invest in separate accounts, with 11% more considering the option. For investors with $5 billion or more, 69% already have separate accounts and only a quarter do not invest in them, the Preqin survey shows.

Fundraising for separate accounts across the private equity, private debt, and real assets markets has risen steadily from $13.6 billion in 2013 to $41.1 billion last year, according to Preqin data. Already this year, 43 separate accounts have tallied $24.6 billion in aggregate capital, on pace for the biggest fundraising year ever for these vehicles.

Just last week, Callan Associates launched a $500 million real estate separate account search on behalf of the $110 billion New York State Teachers' Retirement System, which indicated the various U.S. and European mandates could grow beyond that size after initial investments. And even smaller institutions are looking at the vehicles, such as the $4.3 billion **Ventura County Employees' Retirement Association** in California, which, at a meeting this month, announced it is seeking a manager to run a private equity separate account as part of a planned hike in its allocation to the asset class from 5% to 10%.

The $781 million in new or add-on managed account relationships that Apollo brought in during the first quarter made up more than 17% of its total $4.6 billion in inflows, and that's not an isolated showing, said **Josh Harris**, senior managing director at the company, during its recent earnings call.

"[It's] an area of continued interest from our [limited partners]," he said. "Our pipeline remains strong, and we are in active dialogue for additional mandates."

Apollo's separate account business concentrates especially on unconstrained credit mandates, Harris said. But it also has a broader alts separate account mandate with Texas Teachers.

Separate accounts make up nearly $3 billion of the $16.5 billion in uninvested capital at Ares, according to its first quarter earnings report earlier this month. And these accounts are expected to prime growth, said **Michael Arougheti**, president at Ares.

"What's… really going to be a big driver through the rest of 2016 and 2017 is the separately managed accounts," he said during the earnings call. "That continues to be a big area of focus for us, and the amount of inbound inquiry that's coming across the platform has been pretty significant."

Both existing and prospective clients are seeking the options, Arougheti said. "[It's] particularly in our recently combined credit group, as investors seek our expertise on finding value across liquid and illiquid credit strategies," he said.

The interest in separate accounts makes sense for both investors and fund managers, NexTier's Manson says. Fee pressure in the commingled fund world is pushing managers to look for other ways to bring in revenue from their clients, and to seek ways to make those assets stay put, he says.

"People are trying to get closer to the client," he says. "With separate accounts, the money is stickier."

Institutions are drawn to the concept as well because they want more personalized attention for not only their investment needs, but their administrative operations as well, Manson says.

"They get the opportunity to close the investment deals faster, not waiting for the whole party in a fund to come together," he adds.

The advantage for many fund managers aiming to make a more regular business out of separate accounts is that they likely won't have to hire a different sales force, Manson says.

"The same team that brings the commingled funds [to the market] can explain how these products might not capture all the needs a client may have," he says.

The pitch could be around customizing investments or other features, such as different levels of tailored reporting or plans mapped out to match a plan sponsor's specific allocation and deployment schedule, Manson says.

For now, it's an open question as to how far "down market" these pitches – and the offer of separate account features – may go in the private equity business, Manson says.

At Ares, the separate account is for now "a much more prominent part of the conversation" with its largest investors, Arougheti said. But the requests are getting more creative.

"'Give us a large managed account that allows us to invest in both liquid and illiquid credit in direct lending, structured credit, tradable credit, et cetera,'" he said of today's limited partner requests, noting that some of the current demand is from clients tilting away from closed-end funds.

Separate accounts are a mature offering already in other parts of the private equity market, especially among fund of funds managers such as Adams Street Partners, Manson says. The key for the model to spread to primary fund managers is much the same.

"They need to get close to the client to know what the needs are," he says. "And then somebody has to bring out a good investment idea."