

Jun. 19, 2025

Alternative Mutual Funds

Advances and Challenges in “Retailization” of Alternative Investment Products

By Vincent Pitaro, *Hedge Fund Law Report*

Private funds and alternative investment strategies have traditionally been off limits to retail investors. Many private fund managers would like the opportunity to tap the retail market for capital. Investment advisers and broker-dealers would welcome access to investment products that offer the prospect of higher returns. However, fitting complex and illiquid investment strategies into the rigid regulatory regime governing registered funds remains immensely challenging.

A panel at Sidley Austin LLP’s Private Funds 2025 event examined the key challenges in giving retail investors access to alternative investments; demand for publicly traded alternative investment vehicles and strategies; and prospects for a more accommodating regulatory environment. The program featured Sidley partners W. Hardy Callcott, Benson R. Cohen and Nathan J. Greene; Smriti Kodandapani, deputy GC at First Eagle Investments; and Peter M. Sullivan, associate GC at BNY and chief legal officer at BNY Investments. This article synthesizes their remarks.

See “[A Look at the State of the Industry on the 75th Anniversary of the First Hedge Fund’s Launch](#)” (Oct. 24, 2024).

Distribution Remains a Primary Challenge

“The evolution of alternatives over the years has been continuously in the direction of more and more retail access,” said Cohen. A recent indication of the “retailization” of the industry is the SEC’s March 12, 2025, [no-action letter](#) facilitating verification of accredited investor status for purposes of offerings under Rule 506(c) of Regulation D under the Securities Act of 1933.

See “[Impact of the SEC’s No-Action Letter on Verification of Accredited Investor Status](#)” (Apr. 24, 2025).

Inconsistent Rules for Advisers and Broker-Dealers

The biggest issue in providing retail access to alternative investments is distribution, continued Cohen. Investment advisers traditionally have sold directly to institutional investors through their own investor relations teams. Distributing registered funds adds significant challenges.

Most distribution is through broker-dealers, explained Callcott. A significant problem is incomplete harmonization between investment adviser rules and broker-dealer rules. For example, FINRA's rules for communications with the public do not mirror the [Marketing Rule's](#) approach to performance presentations by investment advisers. Consequently, "you often end up seeing two different decks, one deck that the investment adviser is using to market [itself], and then a second, dumbed-down, deck that [its] broker-dealer distribution participants have to use," noted Callcott.

See "[SEC FAQs Clarify Marketing Rule Treatment of Extracted Performance and Portfolio Characteristics](#)" (Apr. 24, 2025).

Additionally, broker-dealers must comply with Regulation Best Interest (Reg BI) even when selling to extremely wealthy individuals, continued Callcott. Alternative investments are complex products. Broker-dealer representatives must understand those products and document how they compare such products to other available products they are considering for customers. Consequently, managers of alternative investments must work with broker-dealer partners to help them address those requirements.

See "[Reg BI Risk Alert Focuses on Deficient Policies and Procedures](#)" (Oct. 26, 2023); as well as our two-part coverage of the Division of Examination's risk alerts on Reg BI and Form CRS: "[What to Expect in Future Exams](#)" (May 28, 2020); and "[Key Takeaways for Broker-Dealers and Advisers](#)" (Jun. 4, 2020).

Performance Advertising

Presentation of performance when marketing registered alternative investment products is a significant challenge, said Sullivan. Registered funds are required to present performance using standardized measurement periods. Alternatives managers use different time periods; different metrics, including internal rate of return; and targeted or hypothetical performance. Consequently, they will not be able to employ the standard decks used in mutual fund distributions.

Notably, FINRA rules only permit broker-dealers to present certain types of performance claims to institutional investors or certain highly qualified individuals, noted Sullivan. Consequently, marketing decks must include appropriate disclosures and content appropriate for the designated audience. Further, firms must have controls to ensure that, once released, the decks will remain solely with the intended audience.

See "[Performance Advertising Is a Significant Pain Point Under the Marketing Rule](#)" (Oct. 24, 2024); and "[FINRA Proposes to Permit Use of Performance Projections and Target Returns in Marketing](#)" (Jan. 18, 2024).

AML/KYC

"I can't think of a regulatory obligation that's more sensitive for banks and broker-dealers" than anti-money laundering and know-your-customer (AML/KYC) requirements, continued Sullivan. In mutual fund distributions, there are often several financial intermediaries between the funds and the third-party broker-dealers whose clients invest in those funds.

To satisfy applicable AML/KYC requirements, many fund platforms and wire houses rely, in part, on the AML/KYC screens conducted by their third-party broker-dealers on their customers. The banks and broker-dealers in the chain of intermediaries have additional obligations under those regimes. Alternatives managers will need contractual terms focused on policies and procedures to ensure the intermediaries remain in compliance whenever they handle the managers' money.

The Financial Crimes Enforcement Network (FinCEN) has adopted **final anti-money laundering rules** for investment advisers with a compliance deadline of January 1, 2026. It remains to be seen whether, in the current regulatory environment, they will take effect as planned, added Callcott.

See our two-part series on FinCEN's final AML rules for investment advisers: "**Parsing FinCEN's Final AML Rules**" (Nov. 7, 2024); and "**Understanding the Implications for Hedge Fund Managers**" (Nov. 21, 2024).

Mental Shift Needed

Moving from private to public funds requires "a mental shift," said Kodandapani. Private fund managers will not be dealing with a sophisticated investor base, even when working through intermediaries. The large wire houses such as Morgan Stanley, Merrill Lynch and Wells Fargo may have sophisticated investment diligence teams on the investment adviser channel level. Others may not. There is a spectrum of knowledge, and "education of the intermediaries [and] education of underlying investors becomes really paramount," she said.

Different Timing

Speed of execution is another concern, continued Kodandapani. Private fund managers move quickly. "Let's get launched. Let's get money in the door," remarked Cohen. In contrast, launching a registered fund is a complex process with many moving parts, cautioned Kodandapani. A manager should not expect to set up a registered fund in weeks or even a few months. It is likely to take six to 12 months to establish the infrastructure for navigating the panoply of additional regulations applicable to registered funds. Managers must develop viable strategies not only for the proposed product and its distribution but also the requisite operational and retail distribution infrastructure. It is "a long-term game," she noted.

See our three-part series on launching an alternative mutual fund: "**Keys to Successful Launch**" (Apr. 30, 2015); "**Structures and Regulatory Concerns**" (May 7, 2015); and "**Due Diligence Concerns**" (May 14, 2015).

Demand for ETFs and Interval Funds

There is an ongoing shift from traditional mutual funds to exchange traded funds (ETFs) and alternative products, noted Callcott. In fact, some of the larger open-end mutual fund managers have seen drops in their assets under management for several years. "The two hottest products in

registered fund land at the moment are interval funds and active ETFs,” which are experiencing striking growth, said Greene. Business development companies are also popular.

In 2024, ETFs had positive inflows of \$1 trillion, a significant proportion of which was into active ETFs, which have grown by 50% in each of the past five years, continued Greene. Some alternative investment managers are seeking to pursue alternative strategies through active ETFs instead of mutual funds. Notably, interval funds have also grown at the rate of 40% per year over the last decade.

“In ETF land, ticker symbols are actually critical,” said Greene. They are a shorthand way to brand a product. Ticker symbols generate very strong opinions among marketing people, noted Kodandapani. Greene offered a few notable ETF ticker symbols and the funds’ strategies:

- HDG – hedge;
- PRIV – private credit;
- ARB – arbitrage
- LSEQ and EQLS – long/short;
- EVNT – event driven;
- CTA – managed futures;
- BKLN – bank loans; and
- BTC and IBIT – bitcoin.

See “[Regulatory, Business and Tax Considerations for Converting a Mutual Fund to an ETF](#)” (Apr. 22, 2021); and “[Interval Alts’ Combine Benefits of Alternative Mutual Funds and Traditional Hedge Funds](#)” (Jul. 16, 2015).

Hot Strategies

Advisers and broker-dealers have been eager to find ways for traditional retail clients to get exposure to alternative strategies, which are no longer available solely to institutional investors or high net worth individuals, said Callcott. “Ultimately, [retail investors] are really just looking for [access to] the potential of enhanced returns and enhanced yields that private strategies can provide,” he noted.

Hot markets include private credit, real estate, infrastructure and general partners, according to Callcott. The mismatch between very illiquid positions and the need to provide liquidity to the investor base is very challenging. One way to manage that liquidity mismatch is to include a large sleeve of cash investments, but that dampens returns.

“The industry is exploding right now,” but compared with the established mutual fund space, the alternative credit registered fund industry is “in its infancy,” noted Kodandapani. Substantial challenges have arisen trying to fit new products into existing infrastructure. Part of the challenge is cultural, she added.

Favorable Regulatory Environment

According to some estimates, there are 2.8 million qualified purchasers, 27 million accredited investors and about 110 million Americans who invest, noted Cohen. Under the Trump administration and the current SEC, there will be “more opportunities for more people to be in asset classes that, historically, they have been excluded from,” predicted Callcott. The regulatory policies of the Trump administration are “going to open up these markets even more for a broader set of people. I think the momentum is there,” he said.

The traditionally strong distinction between institutional and retail investors is likely to break down over the next four years, added Callcott. This will bring greater scrutiny from lawmakers and regulators. For example, when retail investors have a bad experience in a product, distributors may face scrutiny under Reg BI.

See [“What Hedge Fund Managers May Expect From the SEC in 2025”](#) (Jan. 16, 2025).

Accredited Investor Definition and Private Fund Exemption

One potential regulatory change that would increase retail investors’ access to alternative investments would be expanding the definition of accredited investor, observed Callcott. For example, it might include a knowledge test in lieu of, or in addition to, the current wealth test. Another would be to increase the number of permitted beneficial owners – currently 100 – of a fund relying on the Section 3(c)(1) exemption from registration under the Investment Company Act of 1940 (Investment Company Act). Incoming SEC Chair Paul Atkins and Commissioner Hester M. Peirce have both supported such initiatives. A majority of the SEC is likely to support such measures.

Funds industry associations are working on the issues they want to raise with the SEC, said Greene. Not only is the recent no-action letter on verification of accredited investor status substantively important, but it is also “significant as an indication that the SEC is ready to be different,” he said. “Over the last four years, the view was if you needed regulatory relief from the SEC, you weren’t going to get it. . . . I think we’re in a place right now where you have an opportunity to get things.”

See [“Morgan Lewis Attorneys Discuss Updates to Exempt Offering Framework and Broker-Dealer Registration Issues”](#) (Jun. 3, 2021); [“SEC Adopts Incremental Expansion of Accredited Investor Definition”](#) (Sep. 17, 2020); as well as our two-part series on the SEC concept release on the exempt offering framework: [“Review of the Concept Release”](#) (Sep. 5, 2019); and [“Key Takeaways From the Concept Release for Private Fund Managers”](#) (Sep. 12, 2019).

Co-Investment Relief

The industry is looking closely at so-called co-investment relief, explained Greene. At present, a credit fund manager with both private and registered credit funds must seek relief from the SEC to avoid running afoul of Section 17(d) of the Investment Company Act, which prohibits certain transactions with a registered fund’s affiliates. The current process for obtaining such co-investment

relief can seem “clunky,” but “a much better version appears to be right around the corner,” he observed.

See “[ACA Panel Reviews Affiliated Transaction Rules \(Part One of Two\)](#)” (Sep. 6, 2018).

Chaos at the SEC

Although the SEC is expected to be more accommodating to the funds industry, “I cannot overemphasize enough the level of chaos at the SEC right now,” observed Callcott. “There are definitely opportunities now that have not existed in the last four years. There are also challenges in obtaining that relief.” Senior staff are taking buyouts, and experts are leaving. The agency is losing some of its institutional knowledge and wisdom – including the people the industry would traditionally have approached on regulatory relief initiatives.