The Allure of Private Capital Meets the Structure of Certificates: A Potential Match?

by**Salvatore Bruno** — April 22, 2024 Reading Time: 3 mins read

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Private capital could combine investment certificates with the underlying listed securities that are part of this asset class, as has already been done with ETFs. However, the launch of certificates that refer to illiquid products would require more work to structure, **Giovanna Zanotti,** scientific director of **ACEPI**, the Italian Association of Issuers of Certificates and Investment Products, said to *BeBeez*. "The issuers of the Certificates with whom we discussed the possibility of convergence between these products and the world of private capital believe that these instruments could serve specific purposes of some institutional investors interested in channelling resources into this asset class. The current objective, therefore, concerns investment and portfolio diversification. Furthermore, since these instruments have an illiquid underlying, they are unsuitable for retail customers. The complex structuring for this type of product is directly proportional to the complexity of the payoff calculation, as it requires the purchase of exotic options then incorporated into a single instrument. Therefore, it is simpler to issue benchmark or tracker-type certificates with a listed private capital fund as the underlying stock".

However, a few fund managers who wished to remain anonymous said to *BeBeez* that the curiosity about the possible use of investment certificates for private capital asset classes dates back to the first half of the 1990s and has been quietly growing ever since, without generating any real convergence between these two sectors. The fund managers pointed out that the crucial point is that the certificates have very standardised structures, so much so that the investor community finds it almost pointless to read prospectuses. The case would be different if the underlying were unlisted private capital funds. The fundraising processes adopted by private equity, venture capital and private debt players often rely on detailed legal agreements and private placement memoranda to outline the terms, conditions and risks associated with the investment. Funding strategies in private markets also emphasise the fund's past performance, investment strategy and operational capabilities.

Some certificate features, such as guarantees and barriers of varying degrees to capital protection, could put all parties involved in private capital investments on the same page, even in secondary markets, and make Limited Partnerships more liquid through coupon flows.

'The certificate market is undoubtedly in a strong growth phase, and 2023 was an excellent year for placements in the primary market in the wake of a more significant rise in the last two years,' Zanotti further said. The last **ACEPI Report** highlights that in 2023, market volumes amounted to **25,764 billion euro** (the best annual result since 2019, when the value was 17,166 billion), up 59% from 16,236 billion in 2022. The increased need for protection structures due to the uncertainty of the geopolitical and macroeconomic environment in 2022 may have acted as a driver for this robust growth. The 1546 issues in 2023 (+21% yoy) followed the trend of steadily rising since 2020, when were 830 products on offer. The market, therefore, appreciates the instrument.

Certificates are **securitised** options to purchase (call) or sell (put) that incorporate several financial contracts into a single, liquid, exchangeable instrument. For example, in the case of products incorporating a limit on the rise of the underlying (cap), the investor has implicitly sold a call option with the strike equal to the maximum limit of the certificate. A peculiarity of **Conditionally Protected Capital Certificates (CPCs)** consists in the "barrier options", particularly of a put nature, which allow investors to protect themselves against a fall in the underlying price within the limit imposed by the barrier. These products allow investment in multiple asset classes, incorporating refined financial strategies into a single instrument, all with a simple and advantageous tax treatment. Certificates offer various risk/return profiles to meet different investment needs. Some of the elements that make up these instruments are exposure to changes in the price of the underlying; coupons that pay annuities during the life of the instrument; callability, i.e. the possibility of early redemption with a premium paid to the investor; varying degrees of guarantee (full, partial or conditional) of the capital invested at issuance; and a redemption premium at maturity.

Vontobel, Banca Akros, Intesa Sanpaolo, Banca Cesare Ponti, BNP Paribas, Leonteq, Barclays, Mediobanca, Societe Generale, and **Unicredit,** ordinarymembers ordinary di ACEPI, act as issuers and market makers of the certificates and assume the obligation of payments of the flows due under the terms of the prospectus. **Intermontane, Spectrum**, and **Fideuram** deal with the distribution of the product while trading takes place in the same way as buying and selling shares and bonds on markets in Italy, which are SeDeX and EuroTLX.

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