Private Equity for All: The Paradoxical Push to Democratize Private Markets

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Abstract

Efforts to open private equity and other private assets to retail investors—including now through 401(k) plans—are often framed as a long-overdue democratization of superior investment opportunities. Indeed, private equity has long been viewed as special, both for its market-beating returns and its success in making companies more profitable, yet it has historically been off-limits to retail investors. This Article argues that the push to democratize private equity is subject to a glaring paradox. The democratization narrative has it backwards: retailization erodes private equity's famed advantages in investor performance and corporate efficiency, while subjecting retail investors to new risks and imposing burdensome new constraints on the private markets. Expanding access undermines the very benefits that access aims to deliver and the very features that purportedly make private equity special, with adverse economic effects as the private markets become less efficient. The debate has become urgent. Private asset managers are hard at work selling products that thread the needle of the securities laws to target retail investors, while the executive branch is pushing for private assets to be included in Americans' 401(k) plans. Steering retirement savers away from low-cost index funds toward products that mask high fees and illiquidity and yield vastly disparate outcomes represents a step backwards in the design of our retirement system, an unearned windfall for private asset managers, and a loss for long-term economic performance.

Keywords: private equity, private markets, retail investors, retirement plans

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PRIVATE EQUITY FOR ALL: THE PARADOXICAL PUSH TO DEMOCRATIZE PRIVATE MARKETS

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Efforts to open private equity and other private assets to retail investors—including now through 401(k) plans—are often framed as a long-overdue democratization of superior investment opportunities. Indeed, private equity has long been viewed as special, both for its market-beating returns and its success in making companies more profitable, yet it has historically been off-limits to retail investors.

This Article argues that the push to democratize private equity is subject to a glaring paradox. The democratization narrative has it backwards: retailization erodes private equity's famed advantages in investor performance and corporate efficiency, while subjecting retail investors to new risks and imposing burdensome new constraints on the private markets. Expanding access undermines the very benefits that access aims to deliver and the very features that purportedly make private equity special, with adverse economic effects as the private markets become less efficient.

The debate has become urgent. Private asset managers are hard at work selling products that thread the needle of the securities laws to target retail investors, while the executive branch is pushing for private assets to be included in Americans' 401(k) plans. Steering retirement savers away from low-cost index funds toward products that mask high fees and illiquidity and yield vastly disparate outcomes represents a step backwards in the design of our retirement system, an unearned windfall for private asset managers, and a loss for long-term economic performance.

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INTRODUCTION

Private equity is special—or so we have been told for nearly half a century. As an investment strategy, it reportedly beats the returns from publicly-traded stocks. As an approach to owning and managing companies, it is said to be superior to everything from small, family-owned companies to large public companies.

The accuracy of these claims can be debated. But that has not stopped a growing chorus of voices from arguing that the federal securities laws have unfairly excluded retail investors from private equity, denying most American households access to these benefits in the name of investor protection.[1] With strong encouragement from the private equity industry, the Trump Administration has fully embraced this view.[2] New products targeting retail investors are continually being launched by private-asset managers and blessed by regulators. And in the summer of 2025, an executive order[3] directed the U.S. Securities and Exchange Commission and U.S. Department of Labor to pave the way for private equity to access a particularly massive pool of retail capital: the $10 trillion 401(k) market.[4]

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[1] *See, e.g.*, Alisa Amarosa Wood & Paula Campbell Roberts, *The Case for Private Equity in Individual Investor Portfolios*, KKR INVESTMENT INSIGHTS (Dec. 2025) ("[P]ortfolios with only public markets in their long equity bucket are missing out on a large and growing swath of value that exists in the private markets."); *Expanding Opportunities for U.S. Investors and Retirees: Private Markets*, COMM. ON CAPITAL MARKETS REGULATION (Aug. 2025), https://capmktsreg.org/wp-content/uploads/2025/08/CCMR-Expanding-Access-to-Private-Markets-08.07.25-Final.pdf ("[R]etail investors are missing out on the returns and risk-mitigation that private equity funds, and the private companies in which they invest, can offer through a well-balanced portfolio.").

[2] Dylan Tokar & Matt Wirz, *SEC Chair Signals Investor Access to Private Markets Could Soon Broaden*, WALL ST. J. (May 19, 2025), https://www.wsj.com/finance/investing/sec-chair-paul-atkinsprivate-markets-investors-d6d37e3a; Commissioner Hester M. Peirce, *Arbitration, Alternative Assets, and Aging Actors*, Remarks at the Meeting of the SEC Investor Advisory Committee (Dec. 10, 2024), https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-iac-121024 ("For too long, misguided efforts to shield retail investors from risk have prevented them from directly accessing private market opportunities."); *Recent SEC Actions Signal a Positive Shift for Expanding Retail Access to Private Market Strategies*, Debevoise & Plimpton Client Memorandum (May 2025), https://www.debevoise.com/insights/publications/2025/05/recent-sec-actions-signal-a-positive-shift-for?.

[3] *Democratizing Access to Alternative Assets for 401(k) Investors*, Executive Order (Aug. 7, 2025), https://www.whitehouse.gov/presidential-actions/2025/08/democratizing-access-to-alternative-assets-for-401k-investors/.

[4] *See Release: Quarterly Retirement Market Data, Third Quarter 2025*, INV. COMPANY INSTITUTE STATISTICAL REPORT (Jan. 15, 2026), https://www.ici.org/statistical-report/ret_25_q3.

This Article argues that the push to democratize private markets is subject to a fundamental paradox. Far from sharing the spoils of private equity with the public, opening private markets to retail investors at scale is likely to erode or eliminate each and every one of the supposed advantages of private equity over public markets—not just for retail investors but across the market. Consequently, whether private equity's appeal lies in superior investor returns or superior corporate governance, broad retail access is likely to ensure that neither one is achieved.

Consider first the claim that retail investors would benefit from private equity through higher returns.

The suggestion that retail investors have suffered from being limited to publicly-traded securities is not merely misleading, but fanciful. Few investments worldwide have performed better over the last half-century than index funds tracking U.S. public equities—an investment strategy available to all retail investors at near-zero cost.[5]

But could retail investors do *even better* by adding private assets such as private equity, venture capital, and private credit to their 401(k)s? To answer this question, it is useful to begin with the experience of sophisticated institutional investors in the private markets.[6] While it is true that private equity has historically outperformed the public markets, its best days are far behind it. Private equity returns appear to have gradually converged with public-market returns as institutional money poured in, leaving little or no outperformance today.[7] In short, private equity delivered its strongest performance when it was still a small, exclusive corner of the market. Injecting retail capital into this already crowded space should therefore worsen returns, rather than improve them. With far more money chasing the same number of deals, private equity funds will pay higher prices for acquisition targets, thereby depressing returns.

The problems for retail investors do not end there, however. Unlike the public markets, the private markets cannot be indexed.[8] Investor outcomes in private equity vary widely, depending on manager selection, access, and timing. Retail investors entering the market would therefore face the prospect of sharply divergent savings and retirement outcomes within the very same asset class—a feature that sits uneasily with the goals of a mass retirement system and should give policymakers pause. Moreover, to the extent that

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[5] *See infra* Section I.C.

[6] *See infra* Section I.B.

[7] *See* Robert S. Harris, Tim Jenkinson & Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity?*, 14 J. INV. MGMT. 14, 15 (2016); Harris et al., *Has Persistence Persisted in Private Equity? Evidence From Buyout and Venture Capital Funds*, 81 J. CORP. FIN. 1 (2023).

[8] *See infra* Section IV.B.1.a.

retail investors are at a systematic informational and bargaining disadvantage, they are likely to be disproportionately steered into higher-fee, lower-performing products—a pattern confirmed by decades of empirical research.[9]

Private asset managers respond that these concerns can be mitigated if retail investors gain exposure to private equity indirectly, through professionally managed 401(k) plans rather than through direct fund investments. In that case, plan fiduciaries—not individual savers—would be responsible for selecting high-quality private equity products. But the historical performance of 401(k) plan management offers little reassurance. For decades, whether due to inexperience, conflicts of interest, or other agency costs, plan fiduciaries directed retirement savers into high-fee, underperforming funds, imposing enormous costs on American households.[10] Only sustained litigation and regulatory pressure eventually shifted the system toward low-cost, target-date index funds—a wildly successful reform that private asset managers are now begging to disrupt.

Given that success, private equity is unlikely to attract broad retail investment as a standalone option in 401(k) plans. Instead, the promised land for private asset managers is for the high-fee, illiquid private assets to be included as a small allocation *within* target-date funds.[11] This would allow private asset managers to access retirement savers' capital at scale, while masking their products' high fees, liquidity risk, and potentially poor performance. The implicit wager appears to be that if the wound to 401(k) savings from private assets is small enough, perhaps no one will notice the bleeding.

Any remaining hope for superior returns would therefore rest on the existence of an "illiquidity premium," the higher return that investors can theoretically demand for giving up the ability to sell their investments.[12] But to the extent that any illiquidity premium has ever existed in private equity, retail investment would itself threaten to erode it.[13] Unlike institutional and high net worth investors, retail investors cannot simply have their investments locked away with no access to them during hard times, and the need for creative forms of liquidity has been at the forefront of the policy discussion in recent months.[14]

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[9] *See infra* Section I.C.

[10] *See infra* Section IV.C.

[11] *See infra* Section III.C.

[12] *See infra* Section IV.2.

[13] *See infra* Section V.B.1.

[14] *See Private Market Retail to Fuel Opportunity But Intensify Liquidity, Asset Quality Risks*, MOODY'S REPORT (June 10, 2025), https://www.moodys.com/web/en/us/insights/credit-risk/private-credit/private-market-retail-to-fuel-opportunity.html.

If "retail private equity" is unlikely to benefit retail investors, however, it may prove even more damaging to private equity itself.

Ever since its emergence in the 1980s, private equity has been touted as a superior way of owning and managing companies.[15] Its central advantage lies in managerial autonomy. Compared to public companies, private equity-owned firms operate with far greater freedom and speed, because they are exempted or better shielded from mandatory disclosure, shareholder litigation, shareholder activism, public-company governance constraints, and public scrutiny. Historically, the model functions because sophisticated investors evaluate performance ex post and discipline managers through capital allocation decisions, rather than through real-time oversight. When wielded effectively, this managerial autonomy generates significant economic value. A substantial body of empirical literature suggests that buyouts and venture capital investments have, on average, improved productivity and operating efficiency at portfolio companies and, in the case of venture capital, driven major innovation.

Injecting retail investors into private equity directly threatens the very features that make private equity special. Where retail investors tread, regulation, litigation, and public scrutiny inevitably follow. In a glaring irony, the best arguments for keeping retail investors out of private equity come straight from the horse's mouth. For decades, and as recently as the past two years, the private equity industry has repeatedly fended off calls for regulation and greater scrutiny as harmful to the investment strategy and as unnecessary in a market of sophisticated institutional investors.[16] While acknowledging that restrictive regulations are necessary in markets with retail investors,[17] the industry recently insisted that the imposition of such strictures on private funds would "fundamentally alter"[18] the industry and serve as "an elephant that tramples the regulatory framework Congress designed for private funds."[19] We think the industry was correct when it made those statements: introducing retail investors to private equity *is* likely to invite significant public market constraints while yielding none of the countervailing benefits such as market efficiency, indexing, and liquidity, thereby fundamentally altering and eroding the industry's long-time value proposition.

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[15] *See infra* Section V.A.

[16] *See infra* Section V.C.

[17] *See id*.

[18] Nat. Assoc. of Private Fund Managers et al. v. SEC, Opening Brief for Petitioners at 1 (Nov. 1, 2023).

[19] Nat. Assoc. of Private Fund Managers et al. v. SEC, Reply Brief for Petitioners at 10 (Jan. 22, 2024).

Why, then, is private equity now seeking retail money, effectively eating its own tail?

This dramatic about-face from the private equity industry stems from its current economic headwinds.[20] Higher interest rates and a growing backlog of unsold portfolio companies have strained the private equity business model. At the same time, institutional investors have largely reached their allocation limits to private equity, slowing down the flow of new capital that drives private equity firms' compensation.[21] Retail capital offers a solution: private equity funds can offload their investments on the newcomers and restart the compensation engine. For the same reasons, however, this would be a particularly inauspicious time to release retail investors into the private markets.

None of the above should be read as a critique of private equity. To the contrary, there is ample evidence to suggest that private equity and other private markets play a valuable and distinct role in the financial system, complementing the public markets in ways that can enhance overall economic efficiency. Public markets excel at providing liquidity, price discovery, and broad-based risk sharing, making them well-suited for mass participation and household saving while providing firms with access to a deep, low-cost pool of capital that supports growth and operation at scale.[22] Private markets, notwithstanding their imperfections,[23] bring concentrated ownership, long investment horizons, and intensive oversight to firms in the real economy, allowing sophisticated owners to exercise active control over strategy and innovation in ways that have been shown to promote firm value and productivity.[24] This institutional diversity has long been a source of economic strength, promoting productivity growth, innovation, and efficient

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[20] *See infra* Part II.

[21] *See* Chris Cumming, *Leave Private Equity? More Buyout Professionals Are Considering It*, WALL ST. J. (Nov. 21, 2025); Miriam Gottfried, *The 'Golden Handcuffs' Are Off: Private Equity Employees Leave for Smaller Firms*, WALL ST. J. (Nov. 20, 2025); Swetha Gopinath & Ruth David, *Private Equity Faces Endemic Payout Slump, Partners Capital Says*, BLOOMBERG (Nov. 12, 2025).

[22] *See* Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. LEGAL ANALYSIS 17 (2022).

[23] *See* Ludovic Phalippou, *Beware of Venturing into Private Equity*, 23 J. ECON. PERSPECTIVES 147 (2009); Peter Morris & Ludovic Phalippou, *A New Approach to Regulating Private Equity*, 12 J. CORP. L. STUDIES 59 (2015).

[24] *See* Steven N. Kaplan & Per Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSPECTIVES 121 (2009) (documenting operating and productivity improvements associated with concentrated ownership, strong incentives, and active monitoring); Lerner et al., *Private Equity and Long-Run Investment: The Case of Innovation*, 66 J. FIN. 445 (2011) (finding that the patents of private equity-backed firms applied for in the years after the investment are more frequently cited than patents of non-private equity-backed firms).

capital allocation. Maintaining this balance, however, depends on private markets retaining the characteristics that distinguish them from public markets.

For this reason, it behooves policymakers to be wary of taking actions that fundamentally erode the traditional private equity model, including by inviting large-scale retail investment and the constraints that will inevitably accompany it.

This Article proceeds as follows. Part I highlights the fundamental differences between the public and private financial markets and reviews evidence on investor performance in each. Part II examines the significant headwinds facing the private equity industry today. Part III briefly surveys the legal pathways through which retail investors can—or soon may—access private markets, particularly after the new executive order on 401(k) plans and private assets. Part IV evaluates the claim that retail investors will benefit from investing in private equity. Part V explains how retail participation threatens the private equity model itself and shares new survey data revealing institutional investors' skepticism toward the industry's turn to retail capital.

Retail investment in private equity seems all but inevitable at this stage. Investors and policymakers should be clear-eyed, however, that the primary beneficiaries are likely to be private asset managers, while the costs are borne by retail savers, institutional investors, and the U.S. economy more broadly. For retail investors, private equity is not a golden ticket, but a Trojan horse.

I. INVESTOR PERFORMANCE TO DATE IN THE PRIVATE AND PUBLIC MARKETS

For most of the last century, American households have largely been prevented by the securities laws from investing in private assets (which today include investment strategies such as private equity, venture capital, and private credit).[25] Instead, retail investors are generally limited to investing in publicly-traded securities, whether they invest directly or indirectly through investment funds. Institutional investors, by contrast, participate in both public and private markets.

Private asset managers are increasingly finding creative ways to circumvent the restrictions on retail capital in private markets, however, while pressuring policymakers to clear any remaining obstacles. The calls to open the private markets to retail investors typically rest on two related

[25] Most notably, the Securities Act of 1933 and Regulation D, adopted by the SEC thereunder, have largely served to restrict private market investments to "accredited investors." *See* Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2025); Regulation D, 17 C.F.R. §§ 230.501–.508 (2025).

claims.[26] First, that retail investors are unfairly excluded from earning superior returns in the private markets.[27] Second, that because the private markets have grown so much relative to the public markets, retail investors should diversify by investing in both.[28]

Evaluating these claims first requires a clear understanding of the status quo. This Part therefore begins by describing the core differences between public and private markets from the perspective of investors. Subpart A explains why public markets are uniquely well suited to retail investment, particularly for passive investors who "hold the market" through low-cost index funds. Subpart B briefly reviews the empirical literature on institutional investor performance in the private markets. Subpart C briefly reviews the literature on retail investor performance in the public markets.

A. Public vs. Private Markets: What's the Difference?

The U.S. public securities markets–home to firms such as Apple, Exxon Mobil, and Microsoft–are largely creatures of the federal securities laws enacted in response to the Great Depression. Those laws effectively produced *two* distinct financial ecosystems.[29] In the public markets, securities may be offered broadly and trade freely, subject to extensive disclosure and ongoing regulation.[30] In the private markets, by contrast, the offering and trading of securities are tightly constrained.[31] Within this framework, retail investors have been largely confined to the public markets, while institutional investors may participate in both. As described below, these two market structures

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[26] U.S. Securities and Exchange Commission, Investor Advisory Committee, *Recommendations of the Investor as Owner and Market Structure Subcommittees of the SEC Investor Advisory Committee: Draft Recommendation on Retail Investor Access to Private Market Assets* (Draft of Sept. 11, 2025), https://www.sec.gov/files/iac-private-markets-091125.pdf.

[27] Hester M. Peirce, *Let Them Ride: Remarks at the Meeting of the SEC Investor Advisory Committee* (Sept. 18, 2025), U.S. Securities & Exchange Commission (speech), https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-investor-advisory-committee-meeting-091825 (stating that retail investors "resent the fact that private markets are the exclusive reserve of the wealthy").

[28] Mark T. Uyeda, *The Diversification Deficit: Opening 401(k)s to Private Markets*, Remarks at the ICI Retail Alternatives and Closed-End Funds Conference (Nov. 20, 2025), U.S. Securities & Exchange Commission, https://www.sec.gov/newsroom/speeches-statements/uyeda-remarks-diversification-deficit-opening-401ks-private-markets-112025.

[29] For a description of the public- and private-market ecosystems, see Elisabeth de Fontenay and Gabriel Rauterberg, *The New Public/Private Equilibrium and the Regulation of Public Companies*, 2021 COL. BUS. L. REV. 1199 (2021).

[30] *See id.*

[31] *See id.*

differ in ways that matter profoundly for investor outcomes. (For the sake of brevity, generalizations are made throughout this section regarding the characteristics of each market; a more extensive treatment would cover the many exceptions and nuances to these general claims).

1. The Public Markets: Efficient Prices, Liquidity, and Indexing

The public markets provide retail investors with an extraordinary array of protections and advantages.[32] Most importantly, they plausibly approach the ideal of "market efficiency." For present purposes, an efficient market is one in which securities prices rapidly and accurately incorporate all information relevant to their value.[33] The public markets achieve this feat primarily through two core features: (1) the mandatory disclosure regime imposed by the securities laws and (2) unrestricted trading.[34] Extensive disclosure ensures that value-relevant information is broadly available, while active trading by sophisticated market participants ensures that such information is quickly impounded into prices. In this (idealized) setting, securities are in a loose sense "correctly" priced, in that they should trade at prices that reflect their expected value. The importance of mandatory disclosure is not that it allows retail investors to research investments, but, remarkably, that they can forgo investment research entirely, since they will always purchase and sell securities at the correct price, without requiring any effort, skill, or due diligence on their part.[35]

The second critical benefit of the public securities markets is liquidity. Retail investors can generally sell their holdings at any time, and at prevailing market prices.[36] Because retail investors often face shorter investment horizons and unexpected liquidity needs, this ability to convert investments into cash is critical. Liquidity allows households to invest with confidence that they can access their savings if circumstances change.

A third–and closely related–major advantage of the public markets is the ability to "hold the market" by indexing. Rather than selecting specific

[32] *See* Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. LEGAL ANALYSIS 17 (2022).

[33] *See* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

[34] *See* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 565–67 (1984).

[35] *See* Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1034–38 (2009); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1342–49 (1999).

[36] *See* Andrei Shleifer & Lawrence H. Summers, *The Noise Trader Approach to Finance*, 4 J. ECON. PERSP. 19, 25–26 (1990).

securities, retail investors can hold broad market portfolios that track the performance of public equities as a whole.[37] Indexing offers several decisive benefits over trying to "pick winners." It delivers the average rate of return across the entire public markets, yet requires no expertise or effort. It is an extremely low-cost form of investing: the annual fees for index funds are in the hundredths of a percentage point, with some major asset managers even allowing investors to index the S&P 500 (an index of the 500 largest U.S. public companies) for free.[38] It provides complete diversification across the public markets at the click of a button. Finally, it insulates retail investors from losses and foregone profits due to the agency costs and conflicted advice that have historically plagued retail finance.[39]

Taken together, these features put retail investors on a relatively even playing field with the largest and most sophisticated institutional investors. Calls to allow retail investors access to the private markets in the name of "fairness" relative to institutional investors therefore invert the logic of securities regulation. The public markets exist precisely to mitigate disparities in information, bargaining power, and sophistication between retail and institutional investors. Of course, these benefits come at a cost: mandatory disclosure and other regulation of the public markets are costly in both direct compliance costs and indirect constraints on companies' flexibility. Notwithstanding, retail investors are far more likely to match institutional performance in the public markets than in the private ones.

2. The Private Markets: Uncertain Valuations, Illiquidity, and Unequal Bargaining Power

Private markets differ from public markets in precisely the respects that disadvantage retail investors. Most notably, private securities are not continuously traded and are not subject to comprehensive disclosure obligations.[40] As a result, private markets are not informationally efficient, and valuations are often uncertain and contestable. In private equity, for example, the value of a portfolio company is typically indeterminate for years

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[37] *See* Burton G. Malkiel, *Returns from Investing in Equity Mutual Funds 1971–1991*, 50 J. FIN. 549 (1995).

[38] For example, the Fidelity ZERO Large Cap Index Fund (FNILX) has an expense ratio of zero basis points. *See* FNILX – Fidelity ZERO Large Cap Index Fund Quote, MORNINGSTAR (visited Jan. 30, 2026), https://www.morningstar.com/funds/xnas/fnilx/quote.

[39] *See* John Y. Campbell et al., *Consumer Financial Protection*, 25 J. ECON. PERSP. 91, 104–08 (2011); Sendhil Mullainathan, Markus Noeth & Antoinette Schoar, *The Market for Financial Advice: An Audit Study*, NBER Working Paper 17929 (2012).

[40] *See* de Fontenay & Rauterberg, supra note 29.

at a time, until the investment is exited. In venture capital, startup valuation is acknowledged to be highly speculative.[41] In private credit, it is common for the same loan to be reported at materially different valuations by different funds.[42] These valuation ambiguities are not incidental; they are structural features of markets without continuous trading or standardized disclosure.

Private markets also cannot be indexed. Even if all private securities could be identified and valued, issuers cannot be compelled to sell, and regulatory and contractual transfer restrictions frequently prevent secondary purchases.[43] As a result, private-market investments remain inherently undiversified, even when pooled within a fund. Investor outcomes therefore vary widely, depending on access, manager selection, and contractual terms—a sobering prospect for mass retail participation.

Finally, private issuers are generally free to treat investors differently. Prices, information rights, liquidity terms, and governance protections are often negotiated individually.[44] Larger investors predictably enjoy greater bargaining power along each of these dimensions, reinforcing disparities between institutional and smaller investors.[45]

From the perspective of institutional investors, these features are not defects but advantages. Illiquidity may generate an illiquidity premium for investors capable of bearing it. Negotiated terms allow sophisticated parties to tailor risk and control. And limited regulation reduces litigation exposure and compliance costs. These characteristics help explain why institutional investors dominate private markets–and why those same markets are ill suited to retail participation.

For these reasons, modern retirement policy has increasingly treated low-cost access to efficient, indexable public markets as the foundation of mass retirement saving.

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[41] *See* JOSH LERNER & ANN LEAMON, VENTURE CAPITAL, PRIVATE EQUITY, AND THE FINANCING OF ENTREPRENEURSHIP (2d ed. 2023).

[42] *See* Jared A. Ellias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 YALE L. J. 779 (2025).

[43] *See* Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REG. 1124, 1129–31 (2021); Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913 (2021).

[44] *See* Letter from Fifteen Securities Law Professors to Vanessa Countryman, Secretary, U.S. Securities & Exchange Commission, RE: Concept Release on Harmonization of Securities Offering Exemptions, File No. S7-08-19 (Sept. 24, 2019), https://www.sec.gov/comments/s7-08-19/s70819-6193340-192501.pdf.

[45] *See id*.

B. Institutional Investor Performance in the Private Markets

Have retail investors been treated unfairly by being excluded from the private markets? Addressing that question requires first examining how institutional investors—the primary participants in private markets—have actually performed.

The conventional wisdom is that the private markets, particularly in private equity and venture capital, generate returns exceeding those available in public markets. The evidence is far less favorable to the private markets than that narrative suggests. Venture capital—the segment most coveted by retail investors and most often invoked in calls for democratization—has underperformed public equities over extended periods.[46] Private equity leveraged buyout funds, by contrast, have historically delivered higher average returns than the public markets when measured over long horizons.[47]

Two qualifications to private equity's outperformance are critical, however. First, this outperformance appears to have diminished over time and perhaps even disappeared. As capital has flowed into the asset class and competition has intensified, returns appear to have converged toward public-market benchmarks.[48] Far from a surprising or unfortunate outcome, this convergence is exactly what asset-pricing theory would predict. Studies showing that private markets significantly outperform public markets typically rely on data from earlier periods, when private equity and venture capital were nascent asset classes.[49] More recent evidence suggests that, on average, institutional investors earn returns in private equity that are comparable to diversified public equity portfolios. While ordinary investors might well have envied institutional investors in private equity and venture

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[46] *See* Robert S. Harris, Tim Jenkinson & Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity?*, 14 J. INV. MGMT. 14, 15 (2016).

[47] *See id.*

[48] *See id.*

[49] Numerous studies have examined private equity fund performance, with mixed results. See, e.g., Robert S. Harris, Tim Jenkinson & Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity?*, 14 J. INV. MGMT. 14, 15 (2016); Steven N. Kaplan & Antoinette Schoar, *Private Equity Performance: Returns, Persistence, and Capital Flows*, 60 J. FIN. 1791 (2005); Ludovic Phalippou, *Performance of Buyout Funds Revisited?*, 18 REV. FIN. 189, 189 (2014); Ludovic Phalippou & Oliver Gottschalg, *The Performance of Private Equity Funds*, 22 REV. FIN. STUD. 1747, 1747 (2009); Berk A. Sensoy, Yingdi Wang & Michael S. Weibach, *Limited Partner Performance and the Maturing of the Private Equity Industry*, 112 J. FIN. ECON. 320, 341-42 (2014). Reiner Braun, Tim Jenkinson & Ingo Stoff, *How Persistent Is Private Equity Performance? Evidence from Deal-Level Data*, 123 J. FIN. ECON. 273, 276 (2017). Arthur Korteweg & Morten Sorensen, *Skill and Luck in Private Equity Performance*, 124 J. FIN. ECON. 535, 555 (2017); Andrew Ang et al., *Estimating Private Equity Returns from Limited Partner Cash Flows*, 73 J. FIN. 1751, 1751 (2018).

capital funds several decades ago, today the sentiment no longer appears justified.

Second, average performance obscures enormous dispersion. Unlike index investors in the public markets, private equity investors experience sharply divergent outcomes.[50] Performance depends on manager selection, timing, and negotiated terms. While some private equity funds outperform public benchmarks by wide margins, many underperform substantially. Evidence also suggests that certain types of sophisticated institutional investors achieve better performance[51] and engage in more sophisticated processes[52] than other investors.

C. Retail Investor Performance in the Public Markets

The historical record of retail investor performance in public markets is well established. When retail investors hold broadly diversified, low-cost index funds or passive ETFs and remain invested over time, they can reliably capture the returns generated by public equity markets.[53] Actively managed mutual funds, by contrast, have been found to consistently underperform passive benchmarks after costs, with very few fund managers demonstrating genuine skill in stock picking.[54] For years, the unequivocal recommendation

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[50] *See* Josh Lerner, Antoinette Schoar & Wan Wongsunwai, *Smart Institutions, Foolish Choices?*, 27 J. FIN. ECON. 1 (2007) (finding "dramatic" differences in private equity and venture capital investor outcomes).

[51] *See* Lerner, Schoar & Wongsunwai, *Smart Institutions, Foolish Choices? The Limited Partner Performance Puzzle*, 62 J. FIN. 731 (2007) (finding that endowments, and to lesser extent public pensions, are better than other investors at predicting whether follow-on funds will have high returns).

[52] *See* Da Rin & Phalippou, *The Importance of Size in Private Equity: Evidence from a Survey of Limited Partners*, 31 J. FIN. INTERMEDIATION 64 (2017).

[53] Some scholars have argued that there is more manager discretion involved in index investing than is commonly understood. But the general premise that index funds provide a low-cost way to achieve diversified market returns has not been seriously challenged. *See, e.g.*, Adriana Z. Robertson, *Passive in Name Only: Delegated Management and "Index" Investing*, 36 YALE J. REG. 795 (2019); Gabriel V. Rauterberg & Andrew Verstein, *Index Theory: The Law, Promise and Failure of Financial Indices*, 30 YALE J. REG. 1 (2013).

[54] *See* Eugene F. Fama & Kenneth R. French, *Luck Versus Skill in the Cross-Section of Fund Returns*, 65 J. FIN. 1915 (2010); Michael C. Jensen, *The Performance of Mutual Funds in the Period 1945-1964*, 23 J. FIN. 389 (1968); Martin J. Gruber, *Another Puzzle: The Growth in Actively Managed Mutual Funds*, 51 J. FIN. 783 (1996); Ross Werners, *Mutual Fund Performance: An Empirical Decomposition into Stock-Picking Talent, Style, Transactions Costs, and Expenses*, 55 J. FIN. 1655 (2000).

to ordinary retail investors has been to build their investment portfolios around simple, low-cost passive products.[55]

It took decades, but through a combination of institutional default design, regulatory intervention, and market forces, passive products have come to capture a large share of retail investor portfolios.[56] In employer-sponsored retirement plans, ERISA fiduciary duties have incentivized plan sponsors to favor low-cost index funds and passive target-date funds, especially when used as default options under automatic enrollment.[57] Over the years, Courts have interpreted ERISA's duty of prudence as requiring fiduciaries to engage in a reasoned decision-making process that gives substantial weight to costs, particularly where lower-cost alternatives are readily available.[58] This threat of litigation has institutionalized a careful fiduciary culture where plan sponsors default to offering low-cost index funds.

Unfortunately, however, when left to their own devices, retail investors have shown a long history of deviating from low-cost, passive investing and instead selecting high-fee, poorly performing products. Experimental and field evidence shows that even when investors are presented with a small menu of economically identical funds, they frequently select dominated, higher-cost options, and that making fees more salient only partially mitigates these errors.[59]

These mistakes persist in real-world settings. Mutual fund investors have been shown to respond primarily to salient features such as marketing, advertising, and recent performance while largely ignoring fund expense

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[55] *See* Burton G. Malkiel, *Passive Investing Wins Again*, FIN. TIMES (Mar. 21, 2025) ("The evidence gets stronger every year: index fund investing is an optimal strategy for the ordinary investors.").

[56] As of 2023, it was estimated that passive fund market share was 47% in the United States, an increase from 26% in 2014. Globally, passive funds had a market share of 21% in 2014 and 40% in 2023. *See* Raymond Kerzerho, *The Passive vs. Active Fund Monitor*, PWL CAPITAL (Winter 2024), https://pwlcapital.com/wp-content/uploads/2024/08/20240318-PWL-The-Passive-vs-Active-Fund-Monitor.pdf.

[57] ERISA imposes a duty of loyalty and prudence, requiring fiduciaries to make informed, participant-focused decisions and to monitor plan investments and fees on an ongoing basis. *See* ERISA §404(a)(1), 29 U.S.C. §1104(a)(1).

[58] *See, e.g.*, Cunningham v. Cornell University, 604 U.S. 693 (2025) (lowering the bar for claims against ERISA plan fiduciaries); Tibble v. Edison International, 575 U.S. 523 (2015) (finding that plan fiduciaries have a "continuing duty…to monitor, and remove imprudent, trust investments"); Hughes v. Northwestern University, 595 U.S. 170 (2022) (reaffirming ERISA plan fiduciaries' continuing duty to monitor investments and to remove imprudent ones).

[59] *See* Choi, Laibson & Madrian, *Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds*, 23 REV. FIN. STDS. 1405 (2009).

information that is far more consequential for long-term returns.[60] What is more, researchers have actually documented a negative relationship between fees and performance in the mutual fund industry where funds with worse pre-fee performance tend to charge higher, not lower, fees.[61] Unfortunately, these inefficiencies do not dissipate over time, as high-fee funds have been shown to continue to attract assets despite net-of-fees underperformance, generating substantial welfare losses for investors.[62]

Importantly, researchers have found that assistance from paid intermediaries like brokers and investment advisers often exacerbates, rather than corrects, these problems. Broker-sold mutual funds have been shown to underperform comparable direct-sold funds even before accounting for distribution costs, with fund flows shaped more by the broker's compensation incentives than by value to the investor.[63]

Taken together, the literature provides a sense of what we can expect from large-scale retail access to private markets. If retail investors struggle to select among low-cost index funds in the most transparent and liquid markets in the world, it seems unrealistic to expect better outcomes in markets that are fundamentally more opaque, illiquid, and heterogeneous.

II. PRIVATE EQUITY TODAY

Whatever your view of the historical performance of private markets, proponents and critics of private equity alike can agree on one thing: recent history has been rough for private equity and private markets more generally.[64] After years of exceptional growth fueled by low interest rates, rising institutional allocations, and favorable exit conditions, in recent years the private equity industry has found itself confronting a set of challenges that go beyond an ordinary cyclical downturn. These pressures have created a self-reinforcing cycle in which weaker exits have constrained liquidity,

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[60] *See* Barber, Odean & Zheng, *Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows*, 78 J. BUS. 2095 (2005).

[61] *See* Gil-Bazo & Ruiz-Verdu, *The Relation Between Price and Performance in the Mutual Fund Industry*, 64 J. FIN. 2153 (2009).

[62] *See* Cooper, Halling & Yang, *The Persistence of Fee Dispersion Among Mutual Funds*, 25 REV. FIN. 365 (2021).

[63] *See* Bergstresser, Chalmers & Tufano, *Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry*, 22 REV. FIN. STDS. 4129 (2009).

[64] *See* Maureen Farrell, *Once Wall Street's High Flyer, Private Equity Loses Its Luster*, N.Y. TIMES (Dec. 23, 2025) ("The sluggish deal activity has led to the once unimaginable: For the past several years, private equity's annual returns have been lower than the S&P 500's.").

tighter financing has depressed valuations, and diminished returns have further impaired the industry's ability to recover.

A. Major Signs of Problems

1. Inability to Liquidate Investments

The clearest and most consequential sign of trouble in private equity today has been the industry's growing inability to liquidate investments and return capital to investors. As discussed above,[65] illiquidity has always been part of the private equity bargain, but it has historically been accompanied by the reasonable expectation that capital would eventually be returned through exits at attractive valuations. In recent years, that expectation has increasingly gone unmet.

a. Lack of Cash Distributions to LPs

Across the industry, distributions to investors (technically, limited partners or "LPs") in private equity funds have declined sharply relative to historical norms.[66] Many funds that continue to report strong internal rates of return and net asset values have nonetheless failed to generate meaningful cash realizations.[67] For institutional investors, this divergence between

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[65] *See supra* Section I.A.2.

[66] *See* Maureen Farrell, *Once Wall Street's High Flyer, Private Equity Loses Its Luster*, N.Y. TIMES (Dec. 23, 2025) (Investors are stuck . . . because the lack of deals has meant that their money remains tied up longer than they expected. For the past several years, according to PitchBook, distributions from four-year private-equity firms have been at their lowest levels in more than a decade."); Heather Gillers, *Pensions Piled into Private Equity. Now They Can't Get Out*, WALL ST. J. (June 15, 2024), https://www.wsj.com/finance/investing/pensions-piled-into-private-equity-now-they-cant-get-out-d3ca796d ("Unable to sell without denting returns, private-equity managers are keeping workers' retirement savings locked up for longer—sometimes past the promised maturity date.").

[67] *Private Capital in Focus: Depressed Distributions, No End in Sight*, MSCI (May 22, 2025), https://www.msci.com/research-and-insights/blog-post/private-capital-in-focus-depressed-distributions-no-end-in-sight ("Assets acquired at premium valuations at the market peak have been creating headaches for general partners (GPs), who must decide whether to hold out for buyers at current valuations or stomach write-downs for a shot at quick liquidity. Net asset value (NAV) is increasingly bottled up in old funds that should otherwise be liquidating."); Eileen Appelbaum, *Private Equity: In the Doldrums and Out of Favor with Some Institutional Investors*, CENTER FOR ECONOMIC AND POLICY RESEARCH (Jan. 7, 2026) ("PE portfolio companies are overvalued, and a persistent gap between buyers and PE sellers has made it difficult for PE funds to exit their investments.").

reported performance and actual cash flows has become a source of growing frustration and concern.[68]

Cash distributions play an important role in institutional portfolio management. Pension funds, endowments, and insurance companies rely on distributions not only as evidence of investment success, but also as a source of liquidity to meet benefit payments, fund operating budgets, and make new investment commitments.[69] When those cash flows fail to materialize, institutions are forced to absorb the shock elsewhere in their portfolios—by reducing new commitments, selling liquid assets at inopportune times, taking out loans, or tolerating prolonged deviations from target allocations—each of which carries real financial and governance costs.[70]

Furthermore, when distributions slow, these investors also face a mechanical constraint: private equity holdings grow as a share of total assets in the investor's portfolio, even if no new capital is deployed. This "denominator effect"[71] can force investors to curtail new commitments, rebalance portfolios in suboptimal ways, or sell interests on the secondary market at a discount.

The decline in distributions has therefore had ripple effects throughout the private equity ecosystem and contributed to dramatically diminished fundraising and institutional investor discontent in recent years.[72] What was

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[68] *See* Hannah Zhang, *Secondaries to Help Normalise PE Distributions*, PRIVATE EQUITY INTL. (Aug. 20, 2025) ("Distributions as a share of total PE NAV have stayed below average for the past three years and are unlikely to return to normal levels this year.").

[69] *See* Eileen Appelbaum, *Private Equity: In the Doldrums and Out of Favor with Some Institutional Investors*, CENTER FOR ECONOMIC AND POLICY RESEARCH (Jan. 7, 2026) ("Institutional investors such as pension funds and university endowments rely on the return of cash through these distributions in part to fund expenditures on pension liabilities or to fund scholarships or research. The problem is especially acute for pension funds that need liquidity to pay out pension liabilities.").

[70] Heather Gillers, *Pensions Piled Into Private Equity. Now They Can't Get Out*, WALL ST. J. (June 15, 2024) ("To keep benefit checks coming on time, those managers are unloading investments on the cheap or turning to borrowing—costly measures that eat into returns.").

[71] Massimiliano Saccone, *Times Change: The Era of the Private Equity Denominator Effect*, CFA INSTITUTE (Mar. 4, 2024) ("This is the so-called denominator effect, whereby private asset allocations exceed the percentage threshold established in an allocation policy and must be corrected. The simultaneous negative cash flow cycle has reduced anticipated liquidity that latent paper portfolio losses in traditional assets have already compressed.").

[72] *See* Telis Demos, *Private Equity Firms' Stocks Are Struggling, Despite Getting Into 401(k)s*, WALL ST. J. (Aug. 19, 2025) ("Dragging out the period from investment to payback reduces investment returns by some measures. It also could extend a recent industrywide slowdown of new fundraising and fee growth. Investors who don't get their money back from an old fund can be less inclined to sign up for new ones.").

once framed as disciplined long-term investing[73] now increasingly resembles capital trapped in a system struggling to clear, with investors increasingly seeking to find creative liquidity alternatives to support their operating and investing needs.[74]

b. Lack of Exits

The shortfall in distributions reflects an underlying failure of exit markets in private equity. Traditional exit routes have become unreliable, as initial public offerings have been scarce and acquisition exits have been severely constrained.[75] Since 2010, the number of U.S. companies in private equity portfolios has more than doubled from approximately 6,000 to almost 13,000.[76] Yet during the past few years, total annual exits were actually significantly *lower* than they were in the early 2010s.[77] This drop in exit activity is especially striking when you compare it with recent highs. In 2021, the private equity and venture capital industries combined saw a total of 1,210 exits of U.S. companies for a deal value of $527.8 billion,[78] but by 2023 those numbers had fallen to only 323 total exits for a total deal value of only $100.8 billion.[79] While exits rose somewhat in 2024, the total value of those exits remained depressed at $120.4 billion.[80]

Globally, the private equity industry is reported to face a portfolio company backlog of at least 31,000 companies valued at $3.7 trillion.[81] One

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[73] *See* Alexandra DeLuca, *An Insider's Perspective on the Yale Endowment*, CHIEF INV. OFFICER (Dec. 5, 2016), https://www.ai-cio.com/news/an-insiders-perspective-on-the-yale-endowment/ ("We define the endowment model as a diversified, value-based portfolio with a long-term investment horizon. . . . Yale has implemented this approach the most successfully and probably the most publicly so it is often called the Yale model.").

[74] *See infra* Section II.B.

[75] *See Private Equity Exit Drought*, PWC CAPITAL CONSIDERATIONS (2024), https://www.pwc.com/us/en/services/consulting/deals/library/capital-considerations-private-equity-exit-drought.html.

[76] *See* Ben Glickman, *Private Equity Has More Housecleaning to Do in 2026*, WALL ST. J. (Dec. 28, 2025).

[77] Between 2010-2012, there was an average of 596 exits per year across venture capital and private equity. In 2023-2025, annual exits added up to only 407. *See id.*

[78] *See id.*

[79] *See id.*

[80] *See id.*

[81] *See* Maureen Farrell, *Once Wall Street's High Flyer, Private Equity Loses Its Luster*, N.Y. TIMES (Dec. 23, 2025).

analysis estimates that approximately 4,000 to 6,500 private equity exits were delayed globally in 2024 and 2025 alone.[82]

In response to this exit crisis, private equity sponsors were forced to turn with increasing frequency to alternative exit mechanisms. Sponsor-to-sponsor transactions, where portfolio companies are sold by one private equity firm to another private equity firm, are one manifestation of this dynamic.[83] In these transactions, assets remain within the private equity ecosystem, financed with new layers of leverage and accompanied by largely familiar private equity value-creation strategies.[84] Each successive transaction commonly occurs at a higher valuation, requiring increasingly ambitious assumptions about growth, efficiency gains, or multiple expansion.

More troubling has been the rise of a transaction structure called the "continuation fund," a mechanism through which a private equity sponsor transfers one or more portfolio companies from an existing fund—typically one approaching the end of its contractual term when investors are expecting liquidity—into a newly formed investment vehicle managed by the same sponsor. Continuation funds are used when a sponsor believes that a portfolio company has not yet reached its full value or when sponsors cannot find a favorable price for a traditional exit, allowing the sponsor to extend the holding period while providing a partial liquidity option for existing investors.

In 2025, a record one-fifth of all private equity sales involved private equity firms raising money from new investors to acquire companies from one of their existing funds through continuation vehicles.[85] This has, as discussed in detail below,[86] generated some profound conflicts of interest in the current environment.

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[82] *See Private Equity Exit Drought*, PWC CAPITAL CONSIDERATIONS (2024), https://www.pwc.com/us/en/services/consulting/deals/library/capital-considerations-private-equity-exit-drought.html.

[83] *See, e.g.*, Laura Kreutzer, *Francisco Partners Extends Exit Run With Starlims Sale*, WALL ST. J. (Jan. 13, 2026) (describing sale of portfolio company by one private equity firm to another).

[84] Several papers find a lack of performance improvements following secondary buyouts. *See, e.g.*, R. Jelic, *Staying Power of UK Buyouts*, 38 J. BUS. FIN. & ACCOUNT. 945 (2011); S. Bonini, *Secondary Buyouts: Operating Performance and Investment Determinants*, 44 FIN. MGMT. 431 (2015).

[85] *See* Alexandra Heal & Antoine Gara, *Private Equity Firms Sell Assets to Themselves at a Record Rate*, FIN. TIMES (Dec. 29, 2025) ("Roughly a fifth of all PE sales this year involved groups raising money from new investors to acquire businesses from their older funds, up from 12-13 percent the previous year.").

[86] *See supra* Section II.B.1.

2. Higher Interest Rates Have Put the Brakes on Private Equity

If liquidity constraints have been the most visible sign of industry distress, rising interest rates have been one of the most unforgiving.[87] The private equity industry that flourished over the past decade was built on cheap leverage. Low interest rates supported high valuations, aggressive capital structures, and a steady cadence of refinancings and exits. When that period ended in 2022, so did many of the assumptions that had long sustained private equity's growth.

Higher borrowing costs placed immediate pressure on portfolio companies, particularly those acquired at peak valuations and using optimistic leverage assumptions.[88] Debt service burdens have risen, refinancing has become more difficult, and cash flows that might otherwise support growth or distributions have increasingly been consumed by interest payments.[89] To the extent that there have historically been opportunities to add value to portfolio companies using financial engineering strategies that relied on cheap debt, those opportunities have generally disappeared.

At the same time, higher rates also chilled transaction activity. Deals that once would have cleared comfortably are no longer profitable and both buyers and sellers have retreated to the sidelines.[90] The result has been a further slowdown in exits, reinforcing the liquidity bottleneck described above and deepening investor frustration.

3. Over-Crowding in Private Equity

Beyond cyclical headwinds, private equity also increasingly appears constrained by the fundamental law of supply and demand in the market for

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[87] Eileen Appelbaum, *Private Equity: In the Doldrums and Out of Favor with Some Institutional Investors*, CENTER FOR ECONOMIC AND POLICY RESEARCH (Jan. 7, 2026) ("Rising interest rates have also stymied PE funds' exits. The low interest rate environment of the dozen years from 2010 to 2021 facilitated the acquisition of companies using high levels of debt. But the dramatic 5.25 percent increase in interest rates between March 2022 and July 2023, as the Federal Reserve System raised rates to bring down pandemic-induced inflation, made exiting PE investments in portfolio companies challenging.").

[88] *See* Lee Ying Shan, *Why Private Equity is Stuck With 'Zombie Companies' It Can't Sell*, CNBC (Nov. 12, 2025) (noting that these challenges have "intensified since 2022, when central banks began rapidly raising interest rates" and that "[m]any private equity firms had previously loaded up on very cheap debt in 2020 and 2021, but now face soaring debt service costs.").

[89] *See id.*

[90] Andy Jones, *Slowed Investments and Exits in 2025 Show Strategic Restraint*, PRIVATE EQUITY INFO (Oct. 27, 2025) ("Dealmakers are navigating higher borrowing costs, bid-ask valuation spreads, extended diligence cycles, and longer holding periods.").

investment opportunities. As assets under management have grown dramatically, competition has intensified and returns have become more dependent on favorable market conditions than on repeatable skill.[91] According to one estimate, the addressable market for private equity is only about one tenth the size of the public equity market, yet in recent years it became common for many institutional investors to allocate up to 40 percent of their portfolios to private markets.[92]

As discussed above, this reality has been reflected in the diminished returns of private equity in recent decades.[93] This evolution is unsurprising: it is characteristic of maturing asset classes. As capital floods in, informational advantages erode, strategies converge, and opportunities for persistent outperformance diminish.[94] In some ways, therefore, private equity has begun to resemble the public markets, where scale, efficiency, and competition limit the ability of most participants to consistently outperform.

Many of the relatively straightforward value-creation strategies that once distinguished private equity—such as basic cost reductions, governance improvements, and leverage optimization—have already been exhausted across the industry, leaving a growing share of managers reliant on favorable timing or market conditions rather than repeatable operational improvements to meet return targets.

B. Aggressive Attempts to Introduce Liquidity and Accompanying Concerns

Confronted with these mounting pressures, the private equity industry has pursued increasingly aggressive efforts to introduce liquidity into inherently illiquid markets. These efforts offer investors greater flexibility, but without embracing institutional features that traditionally accompany liquidity, such

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[91] *See* Nori Gerrardo Lietz & Philipp Chvanov, *Does the Case for Private Equity Still Hold?*, Harv. Bus. School Working Paper 24-066 (Jan. 10, 2024) (arguing that the private equity industry become increasingly similar to the mutual fund industry as it has matured).

[92] *See* Daniel Rasmussen, *Is Private Equity Becoming a Money Trap?*, FIN. TIMES (May 30, 2025).

[93] *See supra* Section I.B.

[94] Studies have identified this dynamic in private equity. *See, e.g.*, Lopez-de-Silanes, Phalippou & Gottschalg, *Giants at the Gate: Investment Returns and Diseconomies of Scale in Private Equity*, 50 J. FIN. & QUANT. ANALYS. 377 (2015); Bhardwaj et al., *Does Fund Size Affect Private Equity Performance? Evidence from Donation Inflows to Private Universities* (working paper 2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5176907 (showing that a 1% size increase reduces net IRR by 0.1 percentage points); Mark Humphery-Jenner, *Private Equity Fund Size, Investment Size, and Value Creation* 16 REV. FIN. 799 (2012).

as transparent pricing, uniform disclosure, and robust antifraud enforcement.[95]

1. Continuation Funds

The dramatic rise of continuation funds represents the most striking—and perhaps most unsettling—example of the industry's attempts to engineer liquidity without submitting to market discipline.[96] By allowing sponsors to sell assets to vehicles they control, continuation funds create profound conflicts of interest.

At a structural level, the sponsor acts simultaneously as seller, buyer, and asset manager, while also controlling deal timing, structure, and valuation. Unlike a conventional exit to a third party, continuation fund transactions lack an external market check that would ordinarily discipline price and terms. Instead, valuation becomes the product of negotiation and expert opinions that are difficult for even sophisticated investors to evaluate with confidence.[97]

Temporal conflicts further compound these concerns. Sponsors are often motivated to pursue continuation transactions as their funds near expiration without exit prospects, allowing them to extend holding periods, reset fund timelines, and in some cases crystallize performance fees, generate new management fees, or restructure carried interest in sponsor-favorable ways..[98]

While sophisticated institutional investors may be equipped to negotiate protections, commission independent analyses, or leverage reputational considerations, even they struggle to assess whether continuation fund transactions reflect genuine value maximization or managerial desperation.[99] For less sophisticated investors, these challenges are magnified substantially. The widespread normalization of continuation funds signals a more troubling reality for the industry.[100] Rather than functioning as an occasional tool for exceptional circumstances, continuation funds have become a routine mechanism for managing liquidity shortfalls and deferred exits.

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[95] *See* Harris et al., *Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds*, 81 J. CORP. FIN. (Aug. 2023) (finding that private equity buyout persistence has "become noticeably weaker over time").

[96] *See supra* Section II.A.2.

[97] *See* Kobi Kastiel & Yaron Nili, *The Rise of Private Equity Continuation Funds*, 172 U. PENN. L. REV. 1601, 1616 (2024).

[98] *See id.*

[99] *See id.*

[100] Maureen Farrell, *Investors Warn of "Rot in Private Equity" as Funds Strike Circular Deals*, N.Y. TIMES (Dec. 24, 2025).

2. ETFs of Private Securities and the Risk of Runs

ETFs holding private securities trade on a public exchange and promise investors intraday or frequent liquidity.[101] Unlike a private equity fund, these vehicles typically gain exposure to private assets indirectly—through a combination of private company shares, private credit instruments, unlisted business development companies, interval funds, or other semi-liquid private market vehicles—often alongside publicly traded securities intended to manage liquidity.[102]

Such vehicles pose risks analogous to classic bank runs.[103] Liquidity depends on investor confidence rather than continuous price discovery. When confidence falters, redemption pressure can escalate rapidly. The recent upheaval at Bluerock Total Income+ Real Estate Fund, an ETF holding illiquid private real estate assets, provides a real-world illustration.[104] After facing sustained redemption pressure it could not meet without a fire-sale, the fund was forced to convert into a publicly-traded closed-end fund. Upon listing, however, its shares immediately traded at a steep discount—approximately 38 percent—to sponsor-reported net asset value. This repricing reflected not a sudden deterioration in underlying cash flows, but investors' assessment of liquidity risk, valuation uncertainty, and pent-up selling pressure.

Run-like episodes such as this are unfortunately predictable for ETFs, interval funds, and tender offer funds that offer liquidity claims against illiquid assets without the pricing transparency of public markets.

3. Secondary Sales of LP Interests in Private Funds

Secondary markets for limited partner interests have expanded rapidly,[105] offering investors a mechanism to transfer their stakes in private equity funds

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[101] *See ETF Basics and Structure: FAQs*, INVESTMENT COMPANY INSTITUTE (Apr. 28, 2025), https://www.ici.org/faqs/faqs_etfs?utm.

[102] Daniel Sotiroff, *How Private Assets Impede the Benefits of ETFs*, MORNINGSTAR (Mar. 26, 2025).

[103] *See* Amit Seru, *Valuation Contagion is the Private-Credit Risk No One Sees Coming*, BARRON'S (June 25, 2025).

[104] *See generally* Robin Wigglesworth, *Private Market Marks, Say Hello to Public Markets*, FIN. TIMES (Dec. 16, 2025); Jason Zweig, *Wall Street's Big, Bad Idea for Your 401(k)*, WALL ST. J. (July 25, 2025).

[105] *See Secondaries Are No Longer Secondary*, PITCHBOOK: THE RESEARCH PITCH (Sept. 20, 2025) ("It is no secret that structural shifts in PE and VC have been underway for the last few years. Rising hold periods, slow distributions, and anemic exits have pushed LPs and GPs alike to seek new liquidity options. The result? Secondaries have become one of the hottest growth areas in private markets.").

to third parties prior to fund termination. Specialized secondary buyers—often dedicated funds or institutional investors—acquire existing fund interests at negotiated prices based on their own assessments.[106] The sellers gain flexibility in managing unanticipated liquidity needs, portfolio rebalancing, or regulatory constraints.

Unfortunately, these markets are, at best, a costly and imperfect substitute for genuine exits. Pricing in secondary transactions is inherently opaque, transaction costs are substantial, and sellers frequently must accept steep discounts to stated net asset value[107] that widen precisely when liquidity is most urgently needed.[108]

The growing reliance on secondary sales is itself troubling.[109] As with continuation funds and sponsor-to-sponsor sales, the industry appears increasingly dependent on internal risk transfer rather than external value realization. Liquidity is supplied by other investors, not by the monetization of underlying portfolio companies. Capital circulates within the private equity ecosystem rather than clearing through market exits, calling into question whether the model is sustainable.

4. NAV Loans

Another response to liquidity and financing challenges has been the rapid growth of net asset value ("NAV") loans[110]—credit facilities extended not to individual portfolio companies, but to private equity funds themselves, with the borrowing base determined by the fund's aggregate net asset value.

NAV loans have gained traction as traditional financing and exit options have become more constrained. As higher interest rates, tighter credit, and

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[106] *See* Rod James, *New Entrants Drive Secondary Market to Record First Half*, WALL ST. J. (July 23, 2025) (describing typical secondary market buyer-seller dynamics in 2025).

[107] *See* Sun Yu, *Private Equity Stakes Unloaded at a Discount as Investors Seek Exits*, FIN. TIMES (Apr. 3, 2024).

[108] *See* Nadauld et al., *The Liquidity Cost of Private Equity Investments: Evidence from Secondary Market Transactions*, 132 J. FIN. ECON. 158 (2019) (noting that especially steep discounts were found during the 2007-2009 financial crisis).

[109] *See* Alexandra Heal & Antoine Gara, *Private Equity Backers Offload Record Amount of Old Fund Stakes*, FIN. TIMES (Jan. 11, 2026) ("Private capital investors offloaded a record amount of stakes in ageing funds last year, as the buyout sector's difficulties in exiting investments prompted institutional investors to look for another way to cash in."); Ryan Prete, *Nearly Half of Private Equity GPs Leaning on Secondaries to Mitigate Distribution, Fundraising Challenges*, PENSIONS & INVESTMENTS (Dec. 2, 2025), https://www.pionline.com/alternative-investments/private-equity/pi-private-equity-gps-utilizing-secondaries-vehicles-dechert/.

[110] *See* Hirsch et al., *All the Rage in Private Equity: Mortgaging the Fund*, WALL ST. J. (May 11, 2024).

subdued exits have prompted fund-level borrowing as an alternative means of generating liquidity.[111]

While these tools may provide temporary relief, they further entrench the industry's dependence on deferred exits and negotiated valuations.

C. Sophisticated Market Actors Increasingly Disillusioned with Private Equity

Signs of strain are also evident in the departures of private equity's most sophisticated participants. Deal professionals—particularly at mid-market and smaller firms—have increasingly pursued opportunities outside private equity[112] as sluggish deal flow and delayed or diminished carried interest weaken the traditional compensation and career appeal.[113]

The large institutional investors that have historically anchored private equity have likewise reassessed their exposure. Public pension plans, having increased allocations aggressively over the past decade, now face mounting liquidity constraints.[114] Even elite endowments long associated with patient, buy-and-hold private equity strategies—including Yale[115]—have reportedly sold or considered selling significant holdings on the secondary market, sometimes at meaningful discounts. Such sales mark a departure from

[111] *See* Bobby V. Reddy, *Private Equity and Net Asset Value Loans – Ticking Time Bomb or Ticking All the Right Boxes?*, 15 HARV. BUS. L. REV. 699 (2025); *GPs, LPs Turn to Controversial NAV Loans*, PITCHBOOK (May 27, 2025) ("Dealmakers report a notable uptick in the adoption of net-asset-value loans, signaling that the once-controversial tool is increasingly favored by GPs and LPs across private markets as investors face more pressing demands for liquidity.").

[112] *See* Chris Cumming, *Leave Private Equity? More Buyout Professionals Are Considering It*, WALL ST. J. (Nov. 21, 2025) ("As private equity's slump approaches the four-year mark, more younger professionals are considering taking roles outside the industry, according to a forthcoming report on private-equity pay and job satisfaction from recruiting firm Odyssey Search Partners."); Miriam Gottfried, *The 'Golden Handcuffs' Are Off: Private Equity Employees Leave for Smaller Firms*, WALL ST. J. (Nov. 20, 2025); Swetha Gopinath & Ruth David, *Private Equity Faces Endemic Payout Slump, Partners Capital Says*, BLOOMBERG (Nov. 12, 2025).

[113] *See* Alexandra Heal & Mary McDougall, *Pension Funds Scoop Up Ex-Private Equity Executives*, FIN. TIMES (Oct. 23, 2025) ("Big pension funds are scooping up private equity professionals seeking refuge from a downturn in the sector that has restricted the carried interest payments that traditionally made up most of their pay.").

[114] *See See* Heather Gillers, *Yale's Trendsetting Private-Equity Strategy is Getting Harder to Pull Off*, WALL ST. J. (Aug. 31, 2025) ("Several top schools, including Yale, are selling or contemplating selling private-equity assets early at a discount—something Swensen never did.").

[115] *See* Maureen Farrell and Lauren Hirsch, *Yale is Rushing to Sell Billions in Private Equity Investments*, N.Y. TIMES (June 10, 2025); Singh et al., *Yale Nears Deal to Sell $2.5 Billion of Private Equity Stakes*, BLOOMBERG (June 4, 2025).

longstanding norms and underscore the growing tension between illiquidity and practical portfolio management.

Taken together, these developments suggest an erosion of confidence among the very actors best positioned to assess the asset class's evolving risks, reinforcing the conclusion that private equity's traditional model has become increasingly difficult to sustain under current market conditions.

III. THE MOVE TO DEMOCRATIZE PRIVATE MARKETS

Although retail investors have largely been excluded from private equity, venture capital, and other private-market strategies by the structure of the securities laws, pathways for retail capital to enter the private markets exist and continue to expand. Private asset managers have already begun taking full advantage, while pressing policymakers to reduce remaining constraints.[116] In light of the executive branch's recent deregulatory posture, private asset managers' incursion into retail portfolios is likely both to accelerate and to expand in scope to reach Americans' retirement savings.

This Part summarizes how retail investors can gain exposure to private assets despite the securities laws' public/private divide[117]—and how private asset managers are positioning products to attract that capital.[118] Subpart A describes the traditional channel: the private investment fund. Subpart B surveys several vehicles through which retail investors may already access certain private assets today. Although these products represent a growing share of private asset managers' capital under management, they are not the end game. Sub-part C explains why including private assets within "target-date" funds in 401(k) plans is the true holy grail for private asset managers.

A. The Traditional Approach: Private Investment Funds

From its emergence in the early 1980s, private equity primarily served large institutional investors such as public pension plans, sovereign wealth funds, university endowments, and foundations.[119] Pooling capital from these

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[116] *See* Antoine Gara, *Private Equity to Lobby Donald Trump for Access to Savers' Retirement Funds*, FIN. TIMES (Jan. 5, 2025), https://www.ft.com/content/dddd1752-789a-40b6-9aa8-d7cf6f408c81.

[117] For an excellent description of retail-focused funds that navigate the securities laws to hold private assets, see Gabriel Rauterberg, *Can Private Funds Go Public?* (working paper, 2026).

[118] *See* Colleen Baker & Christina M. Sautter, *Democratization of the Private Markets?*, 26 TENN. J. BUS. L. 67 (2025).

[119] *See* Kaplan & Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSPECTIVES 121 (2009).

investors into investment funds, private equity leveraged buyout funds seek to acquire companies—often with substantial leverage—hold them for a period of years, and finally exit through a sale, recapitalization, or public offering.[120] These funds are generally structured as *private investment funds*: investment vehicles that are not required to register with the Securities and Exchange Commission under the Investment Company Act of 1940 (the "'40 Act"), which regulates in granular fashion funds offered broadly to the public.[121] To avoid the burdens of '40 Act registration, private funds typically rely on statutory and regulatory exemptions that, in practice, limit participation to institutions and high-net-worth individuals.[122]

Practical considerations also explain why retail investors have traditionally been excluded. Private equity funds typically make a small number of concentrated investments over the fund's life (often on the order of single digits) and those investments are highly illiquid.[123] The standard structure is therefore a "closed-end," "drawdown" fund: investors cannot withdraw capital during the fund term (often ten years, with extensions), but they must contribute capital on relatively short notice when the sponsor calls it in order to make acquisitions or pay fund expenses.[124] Large institutions with long investment horizons are better positioned than retail households to manage both the extreme illiquidity and irregular cash flows that characterize private equity investing.[125]

As private funds, these vehicles also operate with comparatively light substantive regulation. Governance and economics are largely contractual. Conflicts of interest are often permitted so long as they are disclosed and addressed through negotiated processes.[126] Fee arrangements are likewise flexible. Private equity sponsors typically receive an annual management fee (commonly around 2% per year of committed capital) plus a performance fee (often 20% of profits)—the well-known "two-and-twenty" model.[127] These

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[120] *See id.*

[121] *See* Private Equity Funds, INVESTOR.GOV–U.S. SEC. & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/investment-products/privateinvestment-funds/private-equity.

[122] *See id.*

[123] *See id.*

[124] *See* DEBEVOISE & PLIMPTON LLP, PRIVATE EQUITY FUNDS: KEY BUSINESS, LEGAL AND TAX ISSUES (2020), https://www.debevoise.com/-/media/files/insights/publications/2021/04/private-equity-funds.pdf.

[125] *See id.*

[126] *See id.*

[127] *See* Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 3–5 (2008).

levels of compensation far exceed those typical of retail-facing funds, especially index funds.

B. Retail Access to Private Markets: Existing and Emerging Channels

The federal securities laws were designed, in broad outline, to channel retail investors toward public markets while reserving private offerings and private funds largely for sophisticated investors. In practice, however, exemptions, safe harbors, and product innovation have created multiple pathways for retail exposure to private assets. For better or worse, the dyke built between the public and private markets by New Deal statutes is by now riddled with holes and at risk of collapsing altogether. This section provides a non-exhaustive overview of channels by which retail investors may currently access private assets.

1. Direct Investment in Private Companies

Retail investors have limited ability to invest directly in private companies. The federal securities laws have always exempted "private offerings," and subsequent exemptions and safe harbors have created specific pathways, including crowdfunding and intrastate offerings.[128] These pathways often impose caps on the amount raised, the number or type of investors, or the manner of solicitation.[129] Although such offerings raise familiar concerns about returns and fraud risk, they are unlikely to attract a large share of retail savings at scale, given distribution constraints, information frictions, and the difficulty of persuading dispersed households to invest directly in early-stage or opaque enterprises.

2. Investment Funds Holding Private Assets

Because most retail investing occurs through pooled vehicles rather than direct security selection, retail exposure to private assets is far more likely to occur through funds. The key regulatory question is therefore not whether retail investors can buy private securities directly, but whether they can buy fund shares that hold private securities.

[128] For a description of the various exemptions for private capital-raising, see Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 448 (2017).

[129] *See id.*

a. Special Pathways to Private Investment Funds

Although private funds have historically been the domain of institutional and high-net-worth investors, limited routes exist for retail participation in private funds under certain offering structures and exemptions.[130] As a practical matter, however, these routes remain constrained and have not historically served as a mass-market channel for broad retail inflows. Accordingly, the more significant developments involve '40 Act registered or quasi-registered fund structures that can accept large numbers of investors and large amounts of capital. The remaining sections are devoted to these types of funds.

b. Listed Closed-End Funds and Listed BDCs

The '40 Act has long permitted registered closed-end funds offered to retail investors. These funds are subject to substantial regulation, but they do not offer redemption rights; instead, investors can generally obtain liquidity by selling shares in the secondary market. Closed-end structures are, in principle, compatible with holding illiquid assets such as private equity and venture capital investments.[131] In practice, however, closed-end listed funds often trade at persistent discounts to net asset value ("NAV"), reflecting (among other factors) valuation uncertainty and illiquidity.[132]

Business development companies ("BDCs")—a distinct category under the '40 Act—are subject to a somewhat different (and lighter) regulatory regime.[133] BDCs' portfolios must consist primarily of loans to relatively small companies, although sufficient flexibility exists for them to hold a wide range of private credit and syndicated loans to companies of all sizes.[134] BDCs may be listed or non-traded. Listed BDCs (with an estimated AUM of $164 billion[135]) provide exchange-traded liquidity, while non-traded BDCs

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[130] *See, e.g.*, 17 C.F.R. §§ 230.506(c) (2025) (creating a safe harbor for private investment funds to make public offerings).

[131] Traditional closed-end funds had approximately $249 billion in AUM at the end of 2024. *See A Guide to Closed-End Funds*, INVESTMENT COMPANY INSTITUTE (Apr. 28, 2025), https://www.ici.org/cef/background/bro_g2_ce.

[132] *See* Martin Cherkes, Jacob Sagi & Richard Stanton, *A Liquidity-Based Theory of Closed-End Funds*, 22 REV. FIN. STUD. 257 (2009).

[133] *See* Jared A. Ellias & Elisabeth de Fontenay, *The Credit Markets Go Dark*, 134 YALE L. J. 779 (2025).

[134] *See id.*

[135] *See* Alexander Wright, *The ABCs of BDCs*, APOLLO ACADEMY (Aug. 15, 2025), https://www.apolloacademy.com/the-abcs-of-bdcs/.

(with an estimated AUM of $311 billion[136]) resemble the semi-liquid structures described next.

c. Semi-Liquid ’40 Act Funds: Interval Funds, Tender Offer Funds, and Non-Traded BDCs

Semi-liquid (or “evergreen”) funds that invest in private assets and welcome retail investors have grown especially rapidly in recent years. Though subject to the ‘40 Act, these funds do not trade on exchanges, but typically have indefinite lifespans and offer investors limited periodic liquidity through repurchase mechanisms.

There are two principal types of semi-liquid funds. Interval funds must make periodic repurchase offers at stated intervals (often quarterly) at the fund’s NAV, up to specified cap on the percentage of shares repurchased in any period (commonly 5% to 25%).[137] Tender offer funds, by contrast, conduct repurchase offers at times and in amounts determined by the fund’s board, within the constraints of the tender offer rules.[138] These structures allow funds to hold illiquid assets while offering a limited degree of liquidity—though not the “on demand” liquidity that retail investors are accustomed to. As of January 2026, interval funds and tender offer funds together represented $215 billion in assets.[139]

Non-traded BDCs are often structured similarly to tender offer funds. Many have already attracted substantial retail capital for private credit exposure. Blackstone Private Credit Fund (BCRED), for example, reported total investments of $82.2 billion as of December 31, 2025.[140]

d. Open-Ended ’40 Act Funds: Mutual Funds and ETFs

Given their structural novelty and limited liquidity, the fund types described above–while expanding rapidly—seem unlikely to attract a truly broad swath of retail investors. Retail investors are most familiar with open-ended funds–mutual funds and exchange-traded funds (“ETFs”)—which dominate both retirement and non-retirement savings. These products are

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[136] *See id.*

[137] Repurchase Offers by Closed-End Companies, Rule 23c-3, 17 C.F.R. § 270.23c-3 (2025).

[138] Tender Offers by Issuers, Rule 13e-4, 17 C.F.R. § 240.13e-4 (2025).

[139] *See Interval Funds: Understanding Their Structure and the Drivers of Rapid Growth*, HOULIHAN CAPITAL (Jan. 19, 2026), https://www.houlihancapital.com/interval-funds-understanding-their-structure-and-the-drivers-of-rapid-growth/.

[140] BCRED | Blackstone Private Credit Fund, *BCRED* (visited Jan. 30, 2026), https://www.bcred.com/.

popular because they are heavily regulated, widely comparable, and highly liquid. Mutual fund investors can redeem once per day at the fund's NAV; ETF investors can trade intraday on an exchange, and the creation/redemption mechanism typically keeps trading prices close to NAV (unlike in traditional exchange-traded closed-end funds).[141]

Those same features make mutual funds and ETFs a poor fit for private equity. Private equity investments–essentially, whole companies–are illiquid and extremely difficult to value reliably.[142] The cash flows from private equity investing—rare, yet large, capital contributions and distributions—are highly irregular. These fundamental features explain why offering perfect liquidity to investors in a fund focused solely on private equity poses an almost insurmountable challenge. Indeed, a fund that promises frequent liquidity while holding a substantial allocation to private equity-like assets is exposed to acute liquidity stress: if enough investors seek to exit during a period in which underlying assets cannot be sold at reasonable prices, the fund may be forced into a fire sale. The result can, as discussed above,[143] resemble the dynamics of a classic bank run.

For these reasons, sponsors are actively pursuing strategies that would place only a limited sleeve of private assets inside more liquid vehicles, as we will see below, rather than attempting to build pure-play private equity mutual funds or ETFs. Significant regulatory hurdles remain, however. The '40 Act imposes numerous burdens and restrictions that are difficult and in some cases impossible to reconcile with private equity investing, including limitations on charging performance fees, limitations on leverage, strict valuation and reporting requirements, board independence requirements, and restrictions on affiliated transactions.[144] The latter restrictions,[145] which are designed to minimize investment manager conflicts of interest, are especially

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[141] *See Exchange-Traded Funds and Products: Overview*, FINRA, https://www.finra.org/investors/learn-to-invest/types-investments/investment-funds/exchange-tradedfund; see *Mutual Funds*, INVESTOR.GOV-U.S. SEC & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investingbasics/investment-products/mutual-funds-and-exchange-traded-1.

[142] *See Private Equity Funds*, INVESTOR.GOV-U.S. SEC & EXCH. COMM'N, https://www.investor.gov/introduction-investing/investing-basics/investment-products/privateinvestment-funds/private-equity (last visited Jan. 30, 2026).

[143] *See supra* Section II.B.2.

[144] For an overview of certain of the '40 Act rules, see John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228 (2014).

15 U.S.C. § 18(a)–(c) (limiting funds from issuing debt securities); *id.* § 18(f)(1) (requiring the ratio of total assets to total debt to equal or exceed 3 to 1); *id.* § 80b-5(b)(2) (restricting the payment of performance fees).

[145] *See* Investment Company Act of 1940 § 17, 15 U.S.C. § 80a-17 (2025).

inconsistent with private equity investing, which explains why the industry is currently pressing for these rules to be amended or discarded.[146]

e. Non-'40 Act Open-Ended Funds: CITs

Collective investment trusts ("CITs") have grown in prominence within 401(k) plans.[147] CITs are typically maintained by banks or trust companies and overseen by bank regulators rather than the SEC, and thus generally fall outside the '40 Act's registration framework.[148] In practice, many CITs track familiar strategies (including index exposures) at lower cost than comparable mutual funds. Their growing role matters because they provide an additional vehicle through which private-market exposure could be embedded within retirement products—though the investor-protection and disclosure regimes differ from those applicable to registered funds

C. The Crucial Distribution Channel: Target-Date Funds in 401(k) Plans

The channels described above allow retail investors to access certain private-market exposures, but they are unlikely—on their own—to produce the scale of inflows private asset managers seek. Most retail investors default to familiar public-market products and do not actively search for alternative funds, particularly those with unusual liquidity terms or complex disclosures. As a result, absent a distribution mechanism that reduces search and decision costs, private-market retail adoption is likely to be concentrated among wealthier households and those working with professional advisers.

That is why the $10 trillion 401(k) market[149] is the decisive battleground. Gaining a place in employer-sponsored retirement plans unlocks the largest pool of household financial assets and eliminates the need for investors to discover, evaluate, and affirmatively select private-market products. Retirement plans also confer an implicit imprimatur of quality: plan

[146] For a comprehensive explanation of why the restrictions on affiliated transactions in Section 17 of the Act are incompatible with private equity, see Gabriel Rauterberg, *Can Private Funds Go Public?* (working paper, 2026).

[147] For a comprehensive description of CITs, see Natalya Shnitser, Overtaking Mutual Funds: The Hidden Rise and Risk of Collective Investment Trusts, 134 YALE L. J. 1620 (2025).

[148] *See* Collective Investment Trust (CIT), *Investor.gov: Introduction to Investing – Investing Basics – Glossary*, U.S. Securities & Exchange Commission, https://www.investor.gov/introduction-investing/investing-basics/glossary/collective-investment-trust-cit.

[149] *See Release: Quarterly Retirement Market Data, Third Quarter 2025*, INV. COMPANY INSTITUTE STATISTICAL REPORT (Jan. 15, 2026), https://www.ici.org/statistical-report/ret_25_q3.

fiduciaries curate a limited menu of options, and participants reasonably infer that listed choices have been screened for suitability.

Until recently, private asset managers have had limited success penetrating 401(k) menus. As discussed above,[150] a central reason is ERISA's fiduciary framework and the associated litigation risk for offering high-cost products, which has helped drive 401(k) menus toward low-cost index funds and passive target-date retirement funds (often set as default options).[151] Historically, DOL guidance has treated private equity and similar alternatives as difficult to justify in defined contribution plans.[152]

Target-date funds (also called lifecycle funds) are particularly important. They package diversified index funds of stocks and bonds into a single fund and automatically rebalance the portfolio over time to reduce risk as retirement approaches. (For example, the Vanguard Target Retirement 2045 Fund is optimized for an employee who plans to retire and begin taking withdrawals around 2045.[153]) The convenience and financial soundness embedded in this one-stop-shopping structure explain why target-date funds are the dominant default option in employer-sponsored plans. Morningstar estimates that target-date fund assets approached $4 trillion by the end of 2024, equivalent to the GDP of what would be the fifth largest country in the world.[154] These products are also typically low-cost because the underlying exposures are largely indexed. For example, the Vanguard Target Retirement 2045 Fund reported an expense ratio of 0.08% as of January 31, 2025 and an annualized return of 8.75% since inception in 2003.[155]

This evolution toward low-cost, indexed defaults is widely viewed as a major success in retirement policy: it allows typical savers to "hold the market" with minimal fees and no need for financial sophistication.

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[150] *See supra* Section I.A.2.c.

[151] *See* Jill E. Fisch & John A. Turner, *Making A Complex Investment Problem Simple: Robo Target Date Funds*, 5 J. RETIREMENT 40 (2018).

[152] U.S. Dep't of Labor, Employee Benefits Security Administration, Supplemental Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives (Dec. 21, 2021), rescinded Aug. 12, 2025, available at https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020-supplemental-statement.

[153] *See* Vanguard Target Retirement 2045 Fund (VTIVX), Vanguard.com, https://investor.vanguard.com/investment-products/mutual-funds/profile/vtivx (last visited Jan. 30, 2026).

[154] *See* Janet Yang Rohr, *Target-Date Funds Have Delivered*, MORNINGSTAR INVESTMENT MANAGEMENT (May 2025), https://www.morningstar.com/funds/target-date-funds-have-delivered-investors (last visited Jan. 30, 2026).

[155] *See* Vanguard Target Retirement 2045 Fund (VTIVX), Vanguard.com, https://investor.vanguard.com/investment-products/mutual-funds/profile/vtivx (last visited Jan. 30, 2026).

Recent developments, however, threaten to unsettle this equilibrium by encouraging the inclusion of higher-fee, illiquid private assets within retirement products. On August 7, 2025, President Trump issued an Executive Order opining that 401(k) investors should have access to alternative assets such as private equity, venture capital, private credit, crypto assets, commodities, and private real estate.[156] The Order directed the Department of Labor to revisit its guidance regarding the permissibility of alternative assets within asset-allocation funds offered in 401(k) plans (which would include target-date funds) and to explore ways to curb litigation against 401(k) plan managers.[157] The Order further directed the SEC to facilitate 401(k) savers' access to alternative investments.[158]

If the Department of Labor and the SEC take up the invitation extended by the Executive Order, as they are expected to, this would be the opening that private asset managers have been waiting for. With regulatory and litigation roadblocks removed or substantially lessened, 401(k) plan managers would be free to add funds with private assets to their plans. Admittedly, Congressional action would likely also be required to fully eliminate the threat of litigation against plan managers. Nevertheless, the Order may be effective in pushing 401(k) plan managers to include private assets by effectively creating new litigation risk *in the other direction*. By suggesting that prudent retirement planning requires allocating a portion of one's portfolio to alternative assets, the Order could potentially create litigation exposure for managers who fail to provide for this. Caught between competing pressures, at least some large plan managers are likely to begin adding private-market exposure, and several have already signaled interest.[159]

The approach most attractive to private asset managers—and plausibly most appealing to plan fiduciaries—would be to embed a small allocation to private assets inside target-date funds. Technically, open-ended registered funds are subject to rules that can constrain their holdings of illiquid assets. But mutual funds and ETFs may hold a limited sleeve of illiquid assets,[160] and the practical boundary of what counts as liquidity can be contested. The SEC has recently demonstrated extraordinary flexibility around these

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[156] *See* Democratizing Access to Alternative Assets for 401(k) Investors, Executive Order (Aug. 7, 2025), https://www.whitehouse.gov/presidential-actions/2025/08/democratizing-access-to-alternative-assets-for-401k-investors/.

[157] *See id.*

[158] *See id.*

[159] *See* Jason Zweig, *Do You Really Know What's Inside Your 401(k)?*, WALL ST. J. (Dec. 5, 2025), https://www.wsj.com/finance/investing/do-you-really-know-whats-inside-your-401-k-c480ec9c?mod=wsjhp_columnists_pos_2.

[160] *See* 17 C.F.R. § 270.22e-4(b)(1)(iv) (2025) (prohibiting an open-ended mutual fund or in-kind ETF from holding more than 15% of net assets in illiquid investments).

liquidity rules in a first-of-its-kind ETF that included a portion of private credit loans.[161] And CITs are not subject to any caps on illiquid assets.[162]

These developments raise familiar policy concerns. First, the possibilities for major liquidity runs in these products are severe and warrant more scrutiny from financial regulators.[163] Unlike banks, private-asset managers are inexperienced with managing liquidity in their funds, because they come from the world of private, closed-end funds. It is unclear why the SEC is confident in their ability (and incentives) to manage these liquidity problems and avoid systemic risk, in the absence of any regulatory pressure or enforcement.

Second, embedding private assets inside target-date funds risks obscuring costs: even modest sleeves of high-fee private investments can meaningfully raise all-in fees relative to index-based target-date funds, while making it difficult for participants to observe what they are paying and what they are receiving in return. As discussed in Part I, retail investors have already proven to be extremely ineffective at identifying and avoiding high-fee products even when the relevant fee information is in plain sight in registered funds.[164] If private assets are buried in target-date funds, it seems safe to assume that the vast majority of retail investors will fail to notice that they are paying more for worse performance. The cost to retail investors will be well disguised.

One wonders why policymakers would choose to gift Americans' hard-earned savings to private-asset managers in this fashion, without any real expectation that investors will benefit from it. The spigot of 401(k) accounts may be opened merely to fill private asset-managers' buckets. In short, the distributional logic of retirement plans—default options, limited menus, and fiduciary imprimatur—makes 401(k) target-date funds the most effective channel for private asset managers to reach retail households at scale. That channel is also the one in which the legal and policy stakes are highest.

IV. WILL RETAIL PRIVATE EQUITY BE GOOD FOR RETAIL INVESTORS?

The campaign to open private markets to retail investors rests on a simple premise: retail households have been harmed by being confined to public securities, while institutional and high-net-worth investors have enjoyed access to superior opportunities in private assets such as private equity,

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[161] *See* Brian Moriarty & Eric Jacobson, *Will the SEC Force Changes in the SSGA Apollo Private Credit ETF?*, MORNINGSTAR (Mar. 11, 2025), https://www.morningstar.com/funds/will-sec-force-changes-ssga-apollo-private-credit-etf.

[162] *See* Zweig, *supra* note [__] ("Some big firms are already assembling CITs that may invest up to 20% in private assets, and there's little to stop that number from going higher.").

[163] *See supra* Section I.C.

[164] *See id.*

venture capital, and private credit.[165] The implicit claim is that retail investors will improve their investment performance if they are finally permitted to participate in those markets.

That prediction is difficult to sustain. Retail access to private assets improves retail investor outcomes only if it either (1) increases expected return for a given level of risk, or (2) reduces risk for a given level of expected return.[166] Subparts A and B explain why retail private equity is unlikely either to improve expected returns or reduce risk, respectively. Subpart C then explains why routing retail investors into private assets through 401(k) plans does not solve the core problems identified below.

A. Better Performance?

Would retail investors who enter private markets at scale obtain higher returns than they can achieve in public markets, all else equal? The answer is likely no.

As Part I explains, even sophisticated institutional investors see little evidence of persistent outperformance in private equity today, and venture capital has lagged public equities on average over extended periods. That baseline point matters because it implies that retail investors are not "missing out" on private-market outperformance even under the most optimistic assumption—that they could obtain the same net returns as institutional investors.

This Section therefore takes the argument one step further. Even if one assumes that private markets generate attractive gross returns for some investors, the best-case scenario—retail investors matching institutional investors' net outcomes—is likely unattainable, for two reasons. First, a large influx of retail capital would tend to depress private-market returns for all investors. Second, even holding average private-market performance constant, retail investors would predictably earn worse returns than institutional investors due to adverse selection, weaker bargaining power, and higher effective costs.

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[165] *See, e.g.*, Hester M. Peirce, Let Them Ride: Remarks at the Meeting of the SEC Investor Advisory Committee (Sept. 18, 2025), U.S. Securities & Exchange Commission (speech), https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-investor-advisory-committee-meeting-091825.

[166] Of course, risk and return are two sides of the same coin, notwithstanding that we treat them separately in this Part IV.

1. Lower Returns for All Investors Following Retail Entry

As discussed above, private equity has been showing signs of an over-crowding problem for years as outperformance as largely disappeared.[167] The current push to broaden retail access—particularly through retirement plans—will only exacerbate this problem. In the short and medium term, the set of investable opportunities and the cash flows they can generate are relatively fixed. When substantially more capital competes for those opportunities, it serves only to bid up the prices paid for these assets. The inevitable result is therefore lower expected returns for investors going forward.[168] The primary beneficiaries of a sudden inflow would be the sellers who can exit at higher valuations. Retail investors, by contrast, would enter at elevated prices, making it harder to achieve the market-beating returns being marketed to them. Ironically, introducing retail investors to give them the benefit of superior returns is precisely the move that will push those superior returns further out of reach–not just for retail investors, but market-wide.

A second—and related—concern is that retail participation is likely to increase structural complexity in ways that further burden returns.[169] Traditional private equity funds are well matched to institutional capital, with its long investment horizons, tolerance for illiquidity, and ability to manage irregular cash flows. Retail investors, by contrast, demand greater liquidity and simpler products. Accommodating those preferences requires altered structures, whether retail and institutional funds invest side-by-side in the same deals or whether they pursue separate investments. Retail-oriented funds may shift toward semi-liquid vehicles, additional intermediation layers, shorter holding periods, minority rather than controlling stakes, or other design compromises. Those changes introduce additional costs and constraints and may limit sponsors' ability to execute the classic buyout value-creation playbook. The result is likely to be lower net performance, even apart from the price effects of capital inflows.

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[167] *See supra* Section I.A.3.

[168] The converse of this argument explains why private equity significantly outperformed the public markets in its early years: at the time, there was very little investor money competing for large potential numbers of deals. *See* Andrew Ang, Bingxu Chen, William N. Goetzmann & Ludovic Phalippou, *Estimating Private Equity Returns from Limited Partner Cash Flows*, 73 J. FIN. 1751 (2018) (showing that barriers to the free flow of capital contributed to private equity's historical outperformance).

[169] *See* Heal, Ruehl & Gara, *How Private Equity's Pioneer in Tapping Retail Money Lost Its Edge*, FIN. TIMES (Jan. 27, 2026) (referring to the "structure of dizzying complexity" involved in the retail-focused funds of Partners Group).

2. Retail Investors Will Not Match Institutional Investor Outcomes

Assume for the sake of argument that retail inflows do not reduce average private equity returns. Yet even in that counterfactual world, retail investors would not be expected to earn the same net returns as institutional investors. Private-market outcomes depend heavily on scale and sophistication.[170] Unlike the public markets, the private markets cannot be indexed. Investors must select managers, negotiate multi-year contracts, and monitor performance over time. At each stage—selection, contracting, monitoring, and enforcement—smaller and less sophisticated investors are predictably disadvantaged.[171] Moreover, private-market investors cannot easily free ride on the efforts of others. Even within the same fund, investors often obtain different economic outcomes through negotiated side letters, fee discounts, liquidity terms, information rights, or co-investment access.[172] These features help explain why private-market returns exhibit far greater dispersion in investor outcomes than public-market index investing.[173] In this environment, retail investors simply cannot expect the same outcomes as large institutional investors.

History also suggests that retail investors will often be offered systematically worse opportunities. Retail channels are especially susceptible to adverse selection and, in less regulated corners, outright fraud.[174] High-quality issuers and top-performing managers frequently prefer large, sophisticated investors because institutional capital is cheaper to serve, easier to manage, and less likely to trigger regulatory scrutiny or litigation. Retail-facing offerings therefore risk becoming a residual market: the opportunities

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[170] *See* William Clayton, *Preferential Treatment and the Rise of Individualized Investing in Private Equity*, 11 VA. L. & BUS. REV. 249 (2017).

[171] *See* Marco Da Rin & Ludovic Phalippou, *The Importance of Size in Private Equity: Evidence from a Survey of Limited Partners*, 31 J. FIN. INTERMEDIATION 64, 69–70 (2017); William W. Clayton, *High-End Bargaining Problems*, 75 VAND. L. REV. 703, 743 (2022).

[172] *See id*. (examining coinvestment and separately managed accounts); William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. REG. 67 (2020); Elisabeth de Fontenay & Yaron Nili, *Side Letter Governance*, 100 WASH. UNIV. L. REV. 907 (2023); Jessica S. Jeffers & Anne M. Tucker, *Shadow Contracts*, 1 U. CHI. BUS. L.REV. 1 (2022).

[173] *See* Jenkinson et al., *Buyouts: A Primer* (working paper, 2022).

[174] *See* Mark Egan, Gregor Matvos & Amit Seru, *The Market for Financial Adviser Misconduct*, 127 J. POL. ECON. 233 (2019); *Investor Alert: 10 Red Flags That an Unregistered Offering May Be a Scam*, INVESTOR.GOV (Aug. 4, 2014), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/investor-36 (last visited Jan. 30, 2026) (identifying common warning signs of potentially fraudulent unregistered securities offerings).

that are least able to attract institutional capital are the ones most likely to be packaged for retail distribution.[175]

3. Fees Will Consume a Large Share of Any Gross Returns

Even if underlying investments perform well, what matters for investors is net performance after fees and expenses. Private equity, venture capital, and private credit products are actively managed and typically charge high fees—often including both management fees and performance-based compensation (such as the classic 2% annual management fee and 20% share of profits or "carry" charged by many private equity fund managers).[176] By contrast, public-market index products are extraordinarily cheap, and some broad index exposures are effectively available at zero cost.[177]

This massive fee gap is reflected in private market products available for retail investment today. For example, one recent review of publicly available data found that the average adjusted expense ratio was 2.48% for interval funds and a whopping 4.45% for tender-offer funds,[178] a far cry from the extremely low fees associated with passive products.

This comparison is central because retail investors have historically fared poorly in high-fee products, even in highly transparent public markets.[179] And although competition for retail capital might eventually compress fees somewhat, retail distribution has long proven compatible with persistent high costs—even in '40 Act-registered settings with standardized disclosure.[180]

Importantly, even if fees decline over time, it cannot be assumed that better outcomes for investors will necessarily follow. Manager effort and skill are crucial in the private markets—unlike with index funds of public

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[175] As discussed in Part III, BDCs are funds that hold private corporate loans ("private credit"), and many are open to retail investors. A major draw of private credit is the understanding that the fund manager is carefully screening and monitoring the borrowers to which it lends. Yet recent studies have shown that BDCs marketed to retail investors perform materially worse in this regard than non-retail funds. *See* Benjamin Bates, *Retail Access to Private Markets*, (working paper Aug. 2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5381902.

[176] *See* Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 3–5 (2008).

[177] *See supra* Section I.C.

[178] *See* Jason Kephart, *5 Things You Need to Know About Interval Fund Fees*, MORNINGSTAR (Aug. 28, 2025), https://www.morningstar.com/funds/5-things-you-need-know-about-interval-fund-fees.

[179] *See supra* Section I.C.

[180] *See id.*

securities—so fund performance could well decline along with the fees intended to compensate these managers.[181]

B. Lower Risk?

A different argument for retail access to private assets is that private equity and other private-market strategies can reduce portfolio risk by diversifying public-market exposures.[182] That claim is also weaker than commonly assumed. To begin with, private equity is not diversified in the sense that broad public-market indexing is diversified. The private markets cannot be indexed, and in any event buyout funds typically hold highly concentrated portfolios. In addition, private-market returns are often more correlated with public-market conditions than advertised, even if they appear "smoother" in reported data. Finally, private assets introduce new risks—especially liquidity risk—that retail investors are poorly positioned to bear.

1. Diversification and the Concentration Concern

The most plausible diversification-based argument for retailization of the private markets is that the public markets appear increasingly concentrated. The number of public companies has declined over the past half-century even as the economy has grown substantially.[183] Moreover, public-market indices have become more top-heavy: a small group of massive firms accounts for an unusually high share of total market capitalization.[184] These trends raise understandable concerns that public equity returns may become more volatile or less representative of overall economic growth.

But channeling retail investors into the private markets is not the obvious solution. Moving still more capital from the public to the private markets

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[181] *See* Bates, *supra* note [ ].

[182] *See, e.g.*, Mark T. Uyeda, *The Diversification Deficit: Opening 401(k)s to Private Markets*, Remarks at the ICI Retail Alternatives and Closed-End Funds Conference (Nov. 20, 2025), U.S. Securities & Exchange Commission, https://www.sec.gov/newsroom/speeches-statements/uyeda-remarks-diversification-deficit-opening-401ks-private-markets-112025.

[183] *See* Craig Doidge, G. Andrew Karolyi & René M. Stulz, *The U.S. Listing Gap*, 123 J. FIN. ECON. 464 (2017); Xiaohui Gao, Jay R. Ritter & Zhongyan Zhu, *Where Have All the IPOs Gone?*, 48 J. FIN. & QUANTITATIVE ANALYSIS 1663 (2013).

[184] According to a recent report, the 10 largest stocks now represent a third of the total market capitalization of the S&P 500. Goldman Sachs, *Market Concentration: How Big a Worry?*, GOLDMAN SACHS RESEARCH REPORT (Nov. 25, 2024), available at https://www.goldmansachs.com/pdfs/insights/pages/top-of-mind/market-concentration-how-big-a-worry/report.pdf (noting also that the U.S. public equity markets appear to have reached "the highest level of concentration since 1932).

risks accelerating the very trends that prompt concern. And the "shrinking" of the public markets is, in important respects, a change in composition rather than a disappearance: fewer firms are public, but those that are public tend to be much larger, and aggregate public-market capitalization has grown dramatically.[185] We also lack evidence that increased concentration has, to date, rendered broad index investing materially more volatile. In any event, retail investors who wish to reduce index concentration can do so without entering private markets—for example, by using indices that tilt toward smaller firms or equal-weight large constituents.

If adding private assets to retail investors' portfolios could lower their risk for the same level of returns, it would be an important factor that would weigh heavily in favor of democratizing access. Unfortunately, we think private equity is unlikely to help diversify retail investors' portfolios for the reasons below.

a. Private Equity Cannot Be Indexed

Index investors in the public markets obtain two critical benefits: broad diversification and a common market return. Private equity offers neither. Because private companies choose their investors, transfer restrictions on private-company securities are pervasive, and the transaction costs to acquire them are high, it is infeasible to construct a true market portfolio of private-company securities.[186] On the contrary, a typical private equity fund is highly concentrated. A buyout fund may acquire only a handful of companies over its lifespan.[187] Private equity thus involves intentionally taking undiversified positions in the hope of outperformance. That can produce exceptional outcomes for some investors and disastrous outcomes for others[188]—meaning that private equity could increase, rather than decrease, volatility for retail savers who replace part of a diversified public-market portfolio with concentrated private exposures.

Retail investors could attempt diversification through funds-of-funds or by investing in multiple sponsors. But funds-of-funds add still another layer of fees for investors and have not historically been a reliable path to superior

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[185] *See* Mark J. Roe & Charles C.Y. Wang, *Half the Firms, Double the Profits: Public Firms' Transformation*, 1996-2022, 8 J.L., FIN. & ACCT. 211 (2025).

[186] *See* Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REG. 1124, 1129–31 (2021).

[187] *See* Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSP. 121, 123 (2009).

[188] *See supra* Section I. The range in outcomes between the top and bottom quartile of private equity funds is quite large. *See* Jenkinson et al., *Buyouts: A Primer* (working paper, 2022).

net returns.[189] Direct multi-manager selection, meanwhile, requires substantial resources and expertise—precisely what retail investors lack.

b. The "Smoother Returns" Narrative Largely Reflects Smoothed Valuations

Private equity returns often appear less volatile than public equity returns, which can create the impression of low correlation and strong diversification benefits. But much of this vaunted "smoothness" reflects reporting conventions rather than economic reality.[190] Public equities are continuously repriced through trading; private equity is not. Sponsors typically report valuations based on models and periodic appraisals, and those valuations are updated infrequently, if ever, in the absence of an exit. Reported returns can therefore appear smoother and less correlated with the public markets, even when the underlying economic exposures are similar.[191]

Comparing the volatility of public- and private-market returns without adjusting for valuation smoothing risks comparing apples to oranges: a market with continuous price discovery and an illiquid market in which price discovery is highly infrequent.

2. Liquidity Risk as the Likely Source of Any Residual Return Differences

If policymakers were to give all capital—both institutional and retail—unrestricted access to the public and private markets, then the returns in the two markets should equalize, except to the extent that they differ in risk. (More generally, when investor capital is free to flow where it chooses, any remaining differences in investment returns across asset classes should only come from differences in their respective risk.[192]) If, after broad retail access, private-market investments were to deliver higher expected returns than comparable public exposures—a prediction of which this Article is

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[189] *See* Robert S. Harris, Tim Jenkinson, Steven N. Kaplan & Ruediger Stucke, *Financial Intermediation in Private Equity: How Well do Funds of Funds Perform?*, 129 J. FIN. ECON. 287 (2018) (finding that, after accounting for fees, private equity funds-of-funds often underperform direct investment in buyout funds and provide little or no performance advantage over public market indices in some segments of private equity).

[190] *See* Ang et al., *supra* note 49, at 1782 (finding that volatility in private equity is equal or greater than volatility in standard equity indices); Daniel Rasmussen, *Private Equity: Overvalued and Overrated?*, AM. AFF. (Spring 2018) at 4.

[191] See Antti Ilmanen, Swati Chandra & and Nicholas McQuinn, *Demystifying Illiquid Assets: Expected Returns for Private Equity*, 22 J. ALTERNATIVE INV. 1 (2020).

[192] See William F. Sharpe, *Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk*, 19 J. FIN. 425 (1964).

skeptical—the most plausible explanation would be compensation for bearing liquidity risk.[193]

But liquidity risk is precisely the risk that retail investors are least able to bear. In normal times, illiquidity may be tolerable. In downturns, the inability to exit may be catastrophic for retail investors. Retail investors are therefore unlikely to benefit from any exposure to private assets without simultaneously being exposed to a risk profile that is poorly suited to household finances.

C. 401(k) Plans to the Rescue?

Some of the concerns above (though far from all) stem from retail investors' disadvantages relative to institutional investors. Yet retail investors need not fend entirely for themselves in the private markets. While avenues are expanding rapidly for retail investors to select their own funds and managers in the private markets (as described in Part III), an alternative would be for retail investors to invest in the private markets through funds chosen by their 401(k) plan manager. In that regard, the recent Executive Order directing the SEC and the Department of Labor to ensure that retail investors can invest in private assets, including private equity, venture capital, and private credit, through their 401(k) retirement accounts, is a game-changer. Once fully implemented, this regulatory shift should prove paradigm-shifting for two reasons: (1) it will unlock unprecedented capital to invest in the private markets; and (2) it will create the perception that such investments are suitable for ordinary retirement saving.

Would putting 401(k) plan managers in charge of retail investors' private-asset choices solve the problems of adverse selection and excessive fees in retail-oriented products? Based on the extensive research on 401(k) plans and 401(k) savers to date, that seems unlikely.

First, 401(k) managers have a very poor record of selecting products to include in their plans. In a recent working paper, Bhattacharya and Illanes find widespread and significant departures in defined contribution plan offerings from the investor ideal.[194] In earlier work, Ayres and Curtis similarly found that 401(k) plans routinely offer participants high-fee products when lower-cost alternatives exist.[195]

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[193] See Yakov Amihud, *Illiquidity and Stock Returns: Cross-Section and Time-Series Effects*, 5 J. FIN. MKTS. 31 (2002).

[194] Vivek Bhattacharya & Gastón Illanes, *The Design of Defined Contribution Plans* (Nat'l Bureau of Econ. Research, Working Paper No. 29981, 2022).

[195] Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 YALE L. J. 1476 (2015).

Second, 401(k) plan managers often lack sophistication or generate agency costs, due to incentives that are misaligned with employees'. For example, plan managers are more likely to include their own funds in their plan offerings despite poor performance,[196] and they are more likely to include high-fee products when they are permitted to share in the fee income.[197]

Third, even when 401(k) plans include appropriate options, investors make poor decisions with the offerings, including splitting their investments equally across all offered funds to achieve diversification,[198] or otherwise allocating their capital incorrectly.[199] Such errors cause employees to lose significant wealth at retirement.[200]

V. WILL INTRODUCING RETAIL INVESTORS TO PRIVATE EQUITY BE GOOD FOR PRIVATE EQUITY?

If the democratization of private equity is unlikely to benefit retail investors, might it nonetheless benefit the industry and extend its impact more broadly? Will retail capital expand private equity's efficiency-enhancing influence on markets and corporate governance around the world?

Unfortunately, we think the answer to these questions is an emphatic "no." The industry's aggressive push for the large-scale retailization of private equity is best understood as a short-term salve to address immediate challenges that will ultimately have deeply harmful consequences. The likely harm is not just lower returns, but meaningful efficiency losses for the real economy more broadly. In the end, the private equity industry's potential for strengthening private companies and boosting economic efficiency and productivity will be severely diminished, if not eliminated altogether.

Perhaps most telling of all, the private equity industry's push toward large-scale retailization marks a sharp reversal from positions it has long

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[196] Veronika K. Pool, Clemens Sialm & Irina Stefanescu, *It Pays to Set the Menu: Mutual Fund Investment Options in 401(k) Plans*, 71 J. FIN. 1179 (2016).

[197] Veronika K. Pool, Clemens Sialm & Irina Stefanescu, *Mutual Fund Revenue Sharing in 401(k) Plans* (Nat'l Bureau of Econ. Research, Working Paper No. 30721, 2022).

[198] See Bernatzi & Thaler, *Heuristics and Biases in Retirement Savings Behavior*, 21 J. ECON. PERSP. 81 (2007); Bernatzi & Thaler, *Naive Diversification Strategies in Defined Contribution Saving Plans*, 91 AMER. ECON. REV. 79 (2001).

[199] Jeffrey R. Brown, Nellie Liang & Scott Weisbenner, *Individual Account Investment Options and Portfolio Choice: Behavioral Lessons from 401(k) Plans*, 91 J. PUB. ECON. 1992 (2007); Julie Agnew, Pierluigi Balduzzi & Annika Sundén, *Portfolio Choice and Trading in a Large 401(k) Plan*, 93 AM. ECON. REV. 193 (2003); Jill E. Fisch & Tess Wilkinson-Ryan, *Why Do Retail Investors Make Costly Mistakes? An Experiment on Mutual Fund Choice*, 162 U. PENN. L. REV. 607 (2014).

[200] Ning Tang, Olivia S. Mitchell, Gary R. Mottola & Stephen P. Utkus, *The Efficiency of Sponsor and Participant Portfolio Choices in 401(k) Plans*, 94 J. PUB. ECON. 1073 (2010).

advanced to preserve its distinctive role in the real economy. For decades, the industry has argued that its ability to strengthen private companies and improve economic efficiency depends on a governance model built around concentrated ownership, sophisticated investors, reputation-based discipline, and insulation from retail-style regulation and litigation. Opening private equity to mass retail capital abandons these premises, suggesting that the industry itself now holds a diminished vision for its future role in strengthening firms and promoting long-term economic productivity.

Proprietary survey data collected from long-standing private equity investors reveal deep skepticism about the effects of large-scale retailization. Respondents overwhelmingly expect retail investment to weaken sponsor-investor alignment and depress future private equity returns. Taken together, these responses suggest that institutional investors view retailization as a troubling response to current market challenges—one that will harm the industry's ability to create long-term value through efficient governance and that could contribute to increasing market fragmentation.

A. Private Equity's Historical Advantages

Private equity has long justified its existence—and its fees—by claiming to deliver returns that are superior to public markets.[201] Whether these above-market returns actually exist is, as discussed above,[202] a matter of considerable debate. But to the extent that they do exist, they could theoretically be attributable to four advantages that private equity sponsors enjoy over their public-market counterparts.

The first is an investment selection advantage. Private equity firms have access to investment opportunities that many investors cannot reach due to the longstanding regulatory approach to private markets. In the traditional world of securities regulation, private equity funds can invest in deals that are categorically unavailable to retail investors.[203] The simple logic of supply and demand suggests that this has given private equity an advantage—particularly with respect to opportunities in mid-market businesses, startups and emerging growth companies, and family-owned enterprises, for

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[201] *See, e.g.*, *Private Equity Delivers Stronger Long-Term Returns Than Any Other Asset Class*, AMER. INV. COUNCIL RESEARCH REPORT (Dec. 8, 2025), https://www.investmentcouncil.org/new-report-private-equity-delivers-stronger-long-term-returns-than-any-other-asset-class/ (claiming that "[p]rivate equity has historically generated higher returns than public markets and other asset classes, even when accounting for fees"); *The Truth Revealed: Private Markets Beats Public Markets – Even After Fees*, HAMILTON LANE TRUTHS REVEALED SERIES (May 18, 2023).

[202] *See supra* Section I.B.

[203] *See supra* note 160.

example—since a large percentage of the world's supply of capital has been prohibited from competing for these investment opportunities.

The second advantage is a governance advantage over public markets. By taking companies private, private equity sponsors can replace the diffuse and often misaligned ownership structure of public corporations with concentrated, highly incentivized control. This aspect of private equity has been particularly emphasized by many scholars over the years,[204] and for good reason.[205] In private equity, the separation of ownership and control that has long been the source of agency problems and other inefficiencies in public company governance gives way to a model where the owners are financially motivated and intimately involved in strategic decisions.[206] At the level of private equity funds themselves, the limited life of the fund and carried interest impose strong reputational and financial incentives on private equity sponsors that simply do not exist in public vehicles.

Of course, the real-world experience of private equity governance offers a complex and nuanced story, with a long list of anecdotes suggesting that certain inefficiencies have persisted over time and that investors and other stakeholders have sometimes been swimming in challenging waters.[207] Nevertheless, it cannot be denied that the traditional private equity model offers certain significant advantages over public company governance and creates strong incentives for the efficient management of enterprise. Indeed, scholars have found that private equity has historically generated meaningful value in their portfolio companies on average.[208]

The third advantage, which is integrally related to the governance advantage described above, is the flexibility, discretion, and freedom from regulation and litigation that private equity enjoys. Indeed, some scholars have argued that the desire to avoid regulation and litigation has long been the dominant factor motivating the structure and norms of the traditional private equity model.[209] Private equity portfolio companies need not file

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[204] *See, e.g.*, Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AMER. ECON. REV. 323 (1986); Michael C. Jensen, *The Eclipse of the Public Corporation*, HARV. BUS. REV. (Sept.-Oct. 1989); Kaplan & Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSPECTIVES 121 (2009).

[205] *See* Kaplan & Stromberg, *id.* at 122 (finding empirical evidence to support the claim that private equity's unique governance structure creates economic value).

[206] *See supra* note 204.

[207] *See* Elisabeth de Fontenay, *Private Equity's Governance Advantage: A Requiem*, 99 BOST. UNIV. L. REV. 1095 (2019); William W. Clayton, *High-End Bargaining Problems*, 75 VAND. L. REV. 703 (2022).

[208] *See supra* note 24 and accompanying text.

[209] *See, e.g.*, James Spindler, *How Private is Private Equity, and at What Cost?*, 76 U. CHI. L. REV. 311 (2009) ("The very essence of private equity is exemption from the public

quarterly reports, face the market for corporate control or activist investors, or worry about stock price volatility driving short-term decision-making. This has allowed management to pursue longer-term strategies without the constant threat of shareholder litigation or the need to manage earnings expectations.[210]

Beyond flexibility at the portfolio company level, there are also significant flexibility advantages in private equity funds themselves compared to registered funds like mutual funds and ETFs. In a private fund, virtually any transaction—no matter the conflicts of interest—is permissible so long as managers provide sufficient disclosures to investors and obtain their consent. In a fund registered under the Investment Company Act, by contrast, most of the investor protections are *hard-wired* to protect retail investors from managerial opportunism. For example, registered funds impose mandatory restrictions on affiliated transactions,[211] limits on capital structure and leverage,[212] prohibitions on incentive compensation,[213] and mandatory disclosure requirements,[214] among various others. As a practical matter, these restrictions mean that registered funds must sometimes forgo potentially value-adding transactions (such as certain restructurings involving affiliates or creative capital arrangements) and must avoid certain strategies altogether because investor consent cannot override the Act's restrictions. By contrast, conflicts of interest between fund managers and investors are inherent in the private equity model, where sponsor-owned portfolio companies routinely transact with one another, and the ability to navigate these conflicts through consent from sophisticated limited partners has long been a fundamental feature of private equity.

Litigation between private equity sponsors and their limited partners has also been remarkably rare in this lightly regulated world compared to the constant stream of shareholder suits commonly seen in public companies with

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securities laws . . . Staying below the regulatory radar is paramount. The breadth of the law's reach, and what one must do to escape it, largely defines what private equity is.").

[210] *See* Lerner et al., *Private Equity and Long-Run Investment: The Case of Innovation*, 66 J. FIN. 445 (2011) (finding that the patents of private equity-backed firms applied for in the years after the investment are more frequently cited than patents of non-private equity-backed firms).

[211] U.S. Code. (n.d.). *15 U.S.C. § 80a–17* – Transactions of certain affiliated persons and prohibited transactions (Investment Company Act of 1940).

[212] *See Key issues for loans to '40 Act Funds*, CADWALADER, WICKERSHAM & TAFT CLIENT MEMORANDUM (Jan. 2021) (discussing the various leverage limitations imposed on registered funds).

[213] *See* Rule 205-3 of the Investment Advisers Act of 1940.

[214] *See* Sani et al., *Spillover Effects of Mandatory Portfolio Disclosures on Corporate Investment*, 76 J. ACCT'G & ECON. 132 (2023).

retail investors.[215] Instead, an ecosystem built primarily on reputational incentives and other alternatives to litigation has developed over time.[216]

Finally, private equity has also theoretically enjoyed an illiquidity premium. Unlike mutual funds and other registered investment companies which are required to provide daily liquidity to their investors, investors in private equity funds have historically locked up their capital for years, surrendering the ability to exit whenever they desire. In exchange, investors in private equity funds theoretically receive compensation in the form of higher returns.[217] This premium reflects not only the inconvenience of illiquidity but also the ability of fund managers to take long-term investments in assets without the pressure of frequent redemptions or the need to mark positions to market on a frequent basis, allowing them to maintain constancy in applying managerial and investment strategies across market cycles.

B. Large-Scale Retailization Will Erode Each of These Advantages

There is a grand irony in the industry's push for retail capital. If industry leaders get their way, each of the advantages identified above would be seriously compromised—if not eliminated entirely—by a massive influx of retail money into private equity.

1. The Erosion of Private Equity's Selection Advantage

The erosion of private equity's selection advantage is a predictable consequence of opening up private equity to retail capital. As discussed above, research shows that any outperformance the industry once enjoyed has largely disappeared as the industry has matured.[218] Moreover, in today's challenging environment, many private equity sponsors have resorted to selling assets back to themselves to achieve liquidity.[219] Adding retail investors to the mix would only accelerate this dynamic. While this influx of capital may provide short-term relief for current industry participants, the inevitable result will be higher purchase price multiples, thinner margins for

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[215] *See* Kastiel & Nili, *Opting Out of Court? Reputation and Informal Norms in Private Equity*, VAND. L. REV. (forthcoming) (showing the results of a study establishing that litigation against GPs is "exceptionally rare").

[216] *See supra* Section V.A.

[217] Alfonso Ricciardelli & Pedram Parhizkari, *Is Illiquidity a Blessing in Disguise for Some Investors?*, ENTERPRISING INVESTOR (Aug. 2024) ("Traditional finance holds that the more illiquid the investment, the higher the premium an investor should demand.").

[218] *See supra* Section I.A.3.

[219] *See supra* Section II.A.1.b.

error, and returns that increasingly resemble—or fall short of—public market benchmarks in the long run.

2. The Erosion of Private Equity's Governance Advantage

Private equity's governance advantage would fare no better. On one level, as private equity vehicles designed for retail investors scale up, they will necessarily hold an increasing number of portfolio companies and the managers will grow into even larger and more complex institutions.[220] The hands-on governance model that characterizes traditional private equity—where general partners work closely with management teams to drive operational improvements—becomes more difficult to replicate as portfolios grow. Instead, retail-oriented private equity funds may look increasingly like holding companies.

Perhaps even more profound, though, would be the deleterious impact of moving towards an increasingly unsophisticated universe of investors in private equity funds. For many years, private equity industry proponents and policymakers have insisted that in a highly sophisticated ecosystem like private equity, the market participants are able to negotiate for highly effective arrangements without the red tape that comes with regulatory interference.[221] Even more importantly, to the extent that sophisticated investors are able to interpret fund track records and accurately assess manager ability, it provides a powerful reputation-based incentive for managers to render their highest performance and avoid opportunistic behavior towards investors.[222] This is the most efficient form of governance of all, as investors can impose disciplinary pressure by simply voting with their feet when managers are seeking to raise their next fund. But as the investor universe becomes less sophisticated and less capable of making informed capital allocation decisions, the disciplining effect of reputation would be increasingly blunted. For the reasons discussed above, structuring retail investments in 401(k) vehicles does little to alleviate, and may very well exacerbate, this problem.[223]

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[220] ILPA anticipates that retail vehicles will typically "have more underlying investments than a traditional PE drawdown fund and seek to have greater diversity across types and ages of investments" in order to have sufficient deal flow to meet retail investor liquidity needs and to keep capital continuously invested. ILPA RETAIL CAPITAL ANALYSIS (Oct. 30, 2025), https://ilpa.org/wp-content/uploads/2025/11/ILPA-Retail-Capital-Analysis-Primer-and-Questions-to-Ask-GPs.pdf.

[221] *See infra* notes 233-250.

[222] *See* Chung et al, *Pay for Performance from Future Fund Flows: The Case of Private Equity*, 25 REV. FIN. 3258 (2012).

[223] *See supra* Section III.C.

The rise of retail capital also threatens the incentive alignment that has traditionally distinguished private equity from other asset management models. Because the '40 Act makes it challenging to charge retail investors performance fees (a fixed percentage share of *profits*), one possibility is that retail-oriented private equity funds might abandon the carried interest portion of the manager's compensation in favor of only charging a management fee (a fixed percentage of the *fund size*). This would dramatically change the manager's incentives: with the manager now receiving the same compensation regardless of performance and even in the event of major losses, there would be far less incentive to take risks and to work hard to help achieve better outcomes, all of which should be expected to alter investors' prospects.

Even if carried interest is not eliminated as described above, as a fund manager accumulates larger pools of assets under management from unsophisticated retail investors, the temptation to rely primarily on management fee income will become more acute. Not only will outperformance become increasingly difficult for sponsors to achieve as their assets under management grow larger,[224] but taking a fixed percent of management fees on a larger pool of capital may also make it easier for them to achieve high levels of compensation on management fees alone, leaving them less incentivized to earn carried interest.

3. The Erosion of Private Equity's Freedom from Regulation and Litigation

This leads to the concern that the introduction of retail capital will quickly erode the flexibility and discretion that private markets have historically afforded managers. The stubborn reality is that regulators are unlikely to permit retail investors to be exposed to the same level of risk, opacity, and potential conflicts of interest that institutional investors have come to accept as part of the traditional private equity model. This inevitable push toward increased regulatory oversight would curb the freedoms that have long made private equity distinctive.

Try as they might, policymakers would be highly unlikely to succeed in developing a regulatory approach that preserves the flexibility of the private equity model while also providing meaningful protections to retail investors. For many decades, the protection of retail investors has relied on mechanisms that are fundamentally incompatible with the private equity model. Indeed, the protective functions performed by efficient market prices, the market for corporate control, shareholder activism, and shareholder litigation in public

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[224] *See supra* note 94.

corporations are unnatural fits in private companies. And the mandatory protections and focus on redemption rights that have served retail investors well in mutual funds and other registered companies for many years are anathema to the flexibility, innovativeness, and illiquidity that has characterized private equity funds for so long.

Any efforts to integrate retail-style protections into the private equity ecosystem would yield an unsatisfying, zero-sum tradeoff. To the extent rules and regulations are imposed that provide robust protection to retail investors, the greater regulatory and litigation costs will fundamentally transform the industry by diluting its flexibility and efficiency advantages. On the other hand, to the extent policymakers seek to preserve private equity's flexibility and freedom from litigation, retail investors will face harmful conflicts of interest that they are ill-equipped to navigate. Both goals cannot simultaneously be accomplished.

4. The Erosion of Private Equity's Illiquidity Premium

Finally, any illiquidity premium that might be enjoyed by private equity would come under serious pressure. Retail investors, unlike institutional investors with diversified portfolios and predictable long-term obligations, face far more immediate and unpredictable liquidity needs. Job losses, medical emergencies, home purchases, educational expenses, and retirement planning create genuine demands for capital access that institutional investors simply do not experience.[225] These practical realities will inevitably impact the investment behavior of private equity managers, as funds will be forced to hold more cash, invest more conservatively, or create secondary market mechanisms that undermine the locked-up capital structure that justifies the premium in the first place. As discussed above, it will also add complexity to fund structuring and lead to constraints on when and how funds may act.[226] At best, the result will be a homogenization of private and public markets, further diminishing any theoretical justification for the higher fees private equity sponsors charge. At worst, the structural mismatch between retail investors' liquidity requirements and the illiquid nature of traditional private equity investments could create systemic vulnerabilities, as mass redemption

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[225] *See* Lusardi et al., *Financially Fragile Households: Evidence and Implications*, Brookings Research Paper (May 2011), https://www.brookings.edu/articles/financially-fragile-households-evidence-and-implications/.

[226] *See supra* Section III.A.1.

pressures during market downturns force fire sales of assets and potentially trigger contagion effects across the broader financial system.[227]

Importantly, many of the effects described above can be expected to affect even traditional institutional private funds that do not accept retail capital. Regardless of whether a fund chooses to accept retail capital, it must still compete with the influx of new retail capital in the market for deals, driving down returns for all private equity market participants. And if a fund manager manages traditional institutional-only funds alongside retail funds, those funds will likely invest in many of the same portfolio companies. This means that even if the funds themselves are kept entirely distinct, managers may still be incentivized to frequently sell portfolio investments earlier than is optimal due to liquidity needs of the retail vehicle, leading to lower returns for all funds invested in that portfolio investment.[228]

C. The Push for Retailization Contradicts Private Equity's Longstanding Stated Priorities

In short, if private equity gets its way and achieves large-scale access to retail investors, the future of this industry will be decidedly average. There will be little reason to expect industry outperformance compared to publicly traded investments, and society will lose out on any potential efficiency gains to the national and global economies.

Ironically, to find persuasive support for this prediction, we need look no further than to statements made by the private equity industry itself. As recently as two years ago, the private equity industry was zealously advocating for policy positions that fly in the face of the industry's aggressive pro-retail posture today. During the Biden administration, the SEC sought to impose certain regulatory interventions on the private fund industry that strongly resembled those that apply to registered investment companies with retail investors—like mutual funds and ETFs.[229] Many of those interventions

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[227] Dave Gilson, *The Democratization of Private Equity Could Create a "Systemic Risk Machine,* https://www.gsb.stanford.edu/insights/democratization-private-equity-could-create-systemic-risk-machine.

[228] *See ILPA Retail Capital Analysis* 6 (Oct. 30, 2025), https://ilpa.org/wp-content/uploads/2025/11/ILPA-Retail-Capital-Analysis-Primer-and-Questions-to-Ask-GPs.pdf

[229] For a general overview and discussion of this rulemaking initiative, see William W. Clayton, *High-End Securities Regulation: Reflections on the SEC's 2022-23 Private Funds Rulemaking Initiative*, 14 HARV. BUS. L. REV. 71 (2024).

were codified in a final rule that was adopted in 2023[230] and ultimately vacated by the Fifth Circuit in 2024.[231]

In comment letters filed with the SEC, the American Investment Council, the private equity industry's primary advocacy group, vehemently opposed the adoption of the rule.[232] AIC asserted the superiority of the traditional private equity model and its ability to outperform public markets and create value for businesses.[233] According to the AIC, the industry's historical superiority was due in significant part to private equity's special governance model. AIC's commentary also claimed that private equity outperformance could be explained by several factors, including the industry's "freedom to exercise their judgment and discretion"[234] and the "powerful reputational incentives to act prudently"[235] in the industry, consistent with the characteristics we have identified above.[236]

In pushing back against the proposed regulation, AIC made one thing abundantly clear: the superiority of the private equity ecosystem depends on the sophistication of the investors in the industry.[237] The AIC letters argued that the SEC's proposed regulation was unnecessary because sophisticated investors could distinguish between high-performing and low-performing

[230] SEC Press Release, *SEC Enhances the Regulation of Private Fund Advisers* (Aug. 23, 2023), https://www.sec.gov/newsroom/press-releases/2023-155.

[231] Nat. Assoc. Private Fund Managers v. SEC (Aug. 2025), https://www.ca5.uscourts.gov/opinions/pub/23/23-60471CV0.pdf.

[232] American Investment Council, Comment Letter on Private Fund Advisers (Apr. 25, 2022), https://www.sec.gov/comments/s7-03-22/s70322-20126669-287340.pdf [hereinafter "AIC Letter I"]; American Investment Council, Comment Letter on Private Fund Advisers (June 13, 2022), https://www.sec.gov/comments/s7-03-22/s70322-20131146-301343.pdf; American Investment Council, Comment Letter on Private Fund Advisers (July 27, 2022), https://www.sec.gov/comments/s7-03-22/s70322-20134888-306017.pdf; American Investment Council, Comment Letter on Private Fund Advisers (August 8, 2022), https://www.sec.gov/comments/s7-03-22/s70322-245759-509782.pdf.

[233] AIC Letter I at 1 ("Private equity is a proven investment strategy that has consistently outperformed public markets over the last 20 years. Private equity improves productivity by increasing capital expenditures and channeling resources to more productive uses, delivering improvements in both sales and operating margins.").

[234] *Id.* at 36 ("Having appropriate freedom to exercise their judgment and discretion has been an important component of private fund advisers' ability to generate greater returns than investors typically experience in other asset classes.").

[235] *Id.* at 33 ("Advisers have powerful reputational incentives to act prudently because they know the industry is highly competitive and unconcentrated.").

[236] *See supra* Section V.A.

[237] *See id.* at 21 (noting that private equity is "a healthy market in which sophisticated investors are able to negotiate the specific responsibilities and compensation of their investment adviser").

managers[238] and negotiate for optimal terms[239] in an environment of "robust private ordering."[240] Indeed, in focusing on the importance of investor sophistication in the private funds ecosystem, the AIC letters emphasized—both explicitly and implicitly—that markets with retail investors have a clear and legitimate need for more extensive regulation.[241] The letters also take as a given that private funds are an exception to the prevailing regulatory approach elsewhere in the market,[242] where extensive regulations are justifiably in place to protect and support retail investors.[243]

Just as we have expressed concerns above about the impact of retail capital on private equity's professed advantages,[244] the AIC letters argued emphatically that imposing registered investment company-like regulations on the private funds industry would harm the thriving private funds

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[238] *Id.* at 33 ("Investors in this sector will decline to invest in future funds with a sponsor that they—and other investors—have concluded cannot be trusted. Put simply, advisers about whom such judgments are formed do not survive.").

[239] *Id.* at 42 ("Given the sophistication of the parties, current contractual arrangements provide incentives for private equity advisers to set an optimal level of risk appetite.").

[240] *Id.* at 3 (noting that the private funds market reflects "healthy, robust private-ordering by which well-matched counterparties are able to develop and evolve contractual terms that further the unique benefits of private equity investing while satisfying the objectives of both advisers and investors").

[241] *Id*. (noting that aggressive regulatory prohibitions "might be justifiable as a prophylactic fraud-prevention rule with respect to retail investors, who typically do not negotiate advisory agreements and who typically lack sophistication and the advice of counsel").

[242] *Id.* ("Congress purposefully exempted private funds from this extensive regulatory regime. Because the 'qualified purchasers' invested in private funds are large, extremely sophisticated investors, Congress presumed they were well-positioned to appreciate and bear the risks associated with their investments, and to 'evaluate on their own behalf matters such as the level of a fund's management fees, governance provisions, transactions with affiliates, investment risk, leverage, and redemption rights.' Private funds, in other words, are set apart from other segments of the investor community—and Congress recognized that.").

[243] *Id.* ("[P]rivate funds and their investors are subject to a completely different regulatory architecture than their public, retail investor-facing counterparts. Because, in part, of the greater wealth and sophistication of private fund investors, Congress has purposely and repeatedly applied to private funds a regulatory approach that is different in kind from the thoroughgoing regulatory requirements for registered investment companies, and retail investors and their brokers.") *See also id.* at __ ("Given that the Dodd-Frank Act both reaffirmed the elementary distinction between retail customers and investors in private funds, and erected further barriers to guard against the two-masters problem inherent in creating fiduciary duties to both the fund and the fund's investors, it would be doubly mistaken to conclude that the general language of section 211(h) authorizes the Commission to do what the specific language of sections 211(a) and (g) forbids.").

[244] *See supra* Section V.B.

ecosystem[245] and reduce its returns,[246] including by increasing litigation in the industry.[247] According to AIC, such a change would be "transformative" in its detrimental impact on the industry[248] and on investors like state and corporate pension plans.[249] AIC also contended that the ill effects of imposing retail-like regulations on the private funds industry would extend beyond the industry itself and ultimately harm society more broadly by stifling innovation, job creation and capital formation in the U.S. economy.[250] The similarities between these concerns expressed in the AIC letters about the impact of retail-style regulation on private equity and the concerns this Article has outlined above about the push towards retail capital are nothing short of remarkable.

Given the private equity industry's clear disdain for the regulatory apparatus that it describes as a necessary evil in retail markets, it was a striking reversal to see the industry launch an aggressive lobbying campaign for access to retail investors less than two years later.[251] The widespread adoption of retail capital would almost certainly bring heightened regulatory scrutiny and litigation, eroding precisely the advantages the industry had so recently defended. Yet industry leaders pushed forward regardless, as soon as the Trump administration took office. This abrupt retreat from the prior positions is a remarkable reflection of just how dire the current market must be for private equity sponsors.

While we have focused on the response to recent SEC policymaking by the American Investment Council, the industry's main advocacy group,

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[245] *Id.* (noting that the SEC was proposing to "thrust upon this thriving, competitive (and even crowded) sector the most costly, intrusive set of requirements ever imposed on private funds and their advisers").

[246] *Id.* ("The Proposal would impose a number of burdensome requirements on adviser-led secondary transactions, which would have the effect of reducing the returns of private fund investors.").

[247] *Id.* (arguing that with the proposed rule, "a segment of the investment industry that has been largely free of conflict between investors and managers would be suddenly opened wide to the waste and distraction of litigation").

[248] *Id.* ("The Proposal identifies no sound reason why it is suddenly necessary to impose a range of burdensome and transformative regulations on the private fund industry.").

[249] *Id.* (arguing that the proposal "would reduce investment and returns in one of the most vibrant segments of the financial services industry, and one that is increasingly relied upon by state and corporate pension systems to meet investment return demands").

[250] *Id.* (arguing that the losses stemming from the proposed rule "would be borne not just by those investors and private fund advisers, but also by the beneficiaries of those investors and the companies they fund and support—which are a critical engine for innovation, job creation, and capital formation in the U.S. economy").

[251] *See* Antoine Gara, *Private Equity to Lobby Donald Trump for Access to Savers' Retirement Funds*, FIN. TIMES (Jan. 5, 2025), https://www.ft.com/content/dddd1752-789a-40b6-9aa8-d7cf6f408c81.

similar themes can be found in the responses by adjacent trade associations[252] and also by certain individual sponsors.[253] Many of these parties joined forces as petitioners in challenging the SEC rule and expressed similar sentiments in a brief setting out a full-throated challenge in 2024.[254] In that brief, the petitioners argued that the "market-oriented, contract-based approach" to private funds has worked "remarkably well,"[255] and that this approach is possible because private funds are open "only to the world's wealthiest, most sophisticated, and experienced investors . . . who, unlike retail investors, often are represented by the world's largest law firms."[256] The private equity trade associations argued that imposing retail-like regulations on private funds would "fundamentally alter" the way private funds are regulated in America,[257] and later characterized the imposition of such rules as "an elephant that [would] trample the regulatory framework Congress designed for private funds."[258] They argued that "not [being] part of the public securities market" is fundamental to what makes an investment fund a private fund.[259]

Interestingly, when arguing that the SEC lacked authority to impose retail-like regulations on private funds, the petitioners' position was clear: the

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[252] *See, e.g.*, Managed Funds Association, Comment Letter on Private Fund Advisers (Apr. 25, 2022), www.sec.gov/comments/s7-03-22/s70322-20126631-287270.pdf; Managed Funds Association, Comment Letter on Private Fund Advisers (Nov. 23, 2022), www.sec.gov/comments/s7-03-22/s70322-20151670-320146.pdf; Managed Funds Association, Comment Letter on Private Fund Advisers (July 24, 2023), www.sec.gov/comments/s7-03-22/s70322-233122-486744.pdf; National Venture Capital Association, Comment Letter on Private Fund Advisers (Apr. 25, 2022), www.sec.gov/comments/s7-03-22/s70322-20130106-296800.pdf; National Venture Capital Association, Comment Letter on Private Fund Advisers (Aug. 26, 2022), www.sec.gov/comments/s7-03-22/s70322-20137633-308057.pdf; National Association of Private Fund Managers, Comment Letter on Private Fund Advisers (Apr. 25, 2022), www.sec.gov/comments/s7-03-22/s70322-20126565-287200.pdf; Alternative Investment Management Association, Comment Letter on Private Fund Advisers (Apr. 26, 2022), www.sec.gov/comments/s7-03-22/s70322-20128422-291344.pdf; Alternative Credit Council and Alternative Investment Management Association, Comment Letter on Private Fund Advisers, https://www.sec.gov/comments/s7-03-22/s70322-20128423-291344.pdf.

[253] *See, e.g.*, Andreesson Horowitz, Comment Letter on Private Fund Advisers (June 15, 2022), www.sec.gov/comments/s7-03-22/s70322-20131404-301563.pdf.

[254] Nat. Assoc. of Private Fund Managers et al. v. SEC, Opening Brief for Petitioners (Nov. 1, 2023).

[255] *Id.* at 1.

[256] *Id.* at 1.

[257] *Id.* at iv, 1 and 2.

[258] Nat. Assoc. of Private Fund Managers et al. v. SEC, Reply Brief for Petitioners (Jan. 22, 2024) at 10.

[259] *Id.* at 1.

industry was protected because the relevant statutory authority "applies to retail customers, i.e., Main Street investors who are generally not eligible to invest in private funds."[260] By lobbying policymakers to throw open the door to large-scale retail investment less than 14 months after penning this brief,[261] the private equity industry is clearly also throwing open the door to retail-like regulatory treatment. By their own account, the private equity industry concedes that doing so would "fundamentally alter" the nature of private equity.[262]

We believe the industry's response to the SEC's 2023 Private Fund Adviser rule is particularly instructive because it happened so recently, and because the industry's views were so clearly and thoroughly expressed in formal comment letters. But this was certainly not the first time the industry has advanced similar arguments about the need to maintain the industry's flexibility and freedom from regulation. For example, the industry raised many similar defenses in the mid-2010s when the SEC identified industry practices that raised investor protection concerns.[263] And in 2021, the AIC offered a similarly sweeping retort[264] to the Stop Wall Street Looting Act introduced by Elizabeth Warren, which would also impose much more stringent regulations on the industry.

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[260] *Id.* at 2.

[261] *See* Gara, *supra* note 53 (taking note of the private equity industry's lobbying efforts in January 2024 at the commencement of the Trump administration).

[262] *See supra* note 59 and accompanying text.

[263] *See, e.g.*, Chris Flood, *SEC Issues Fresh Warning to Private Equity*, FIN. TIMES (May 31, 2015), https://www.ft.com/content/f47fc044-0540-11e5-8612-00144feabdc0 ("Steve Judge, chief executive of the Private Equity Growth Capital Council, a trade body, said agreements between private equity managers and institutional investors were 'the result of highly negotiated terms between sophisticated parties.'"); Jason Mulvihill, *Standardization in PE: Needed Trend or Impractical Solution in Search of a Problem?*, in AM. INV. COUNCIL, STATE OF THE INDUSTRY 9, 9 (2017) ("Calls for greater standardization of private equity documents frequently derive from a misunderstanding about the inherent transparency and long-standing success of funds vis-à-vis their investors. As a general proposition, bespoke partnership agreements reflect extensive negotiations between fund sponsors and their sophisticated investors and have served investors and managers well."); Steve Judge, *Confidentiality of Limited Partnership Agreements Is Paramount*, PE HUB NETWORK (Nov. 3, 2014), https://www.pehub.com/2014/11/confidentiality-of-limited-partnership-agreements-is-paramount ("LPAs are highly negotiated agreements between sophisticated parties and, in the case of public pensions, are entered into by individuals who have a fiduciary duty to act in the best interests of beneficiaries. So it goes beyond reason to believe that they would enter into any agreement that would violate that duty.").

[264] *See The Warren Bill Will Destroy Jobs, Hurt Small Businesses, Threaten Retirements*, Amer. Inv. Council (Oct. 20, 2021), https://www.investmentcouncil.org/the-warren-bill-will-destroy-jobs-hurt-small-businesses-threaten-retirements/.

D. Institutional Investor Concerns About the Industry Effects of Retailization

Interestingly, the record shows that many institutional investors shared several of the concerns raised by the private equity industry about the SEC's rulemaking in 2023. These investors voiced a shared desire to maintain what they viewed as industry outperformance, and they shared the concern that imposing retail-style regulations on the private equity industry would lead to the harmful effects described in the sources discussed above.[265]

But now that the industry has changed course on these issues, it appears that no institutional investors are following suit. While the shift to large-scale retailization appears to be early in its trajectory, initial indications from institutional investors suggest that they uniformly expect these changes to harm future industry returns and weaken the alignment between investors and sponsors in the private equity ecosystem. This is perhaps unsurprising given that a new source of investor capital can be expected to deplete the bargaining power of institutional investors, but the specific complaints raised by institutional investors—and their intended response to the rise of retail capital—are instructive.

In September 2025, we collected polling data from a set of institutional investors at the annual legal conference for the Institutional Limited Partners Association. Respondents included 69 senior in-house attorneys at various investor types, including public and private pension plans, endowments, family offices and insurance companies, among others.

One interesting preliminary observation from the survey results is the relative lack of satisfaction with the present-day state of the private funds industry. Far from trumpeting the virtues and superiority of private equity fund governance, these investors expressed widespread frustration with the

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[265] *See, e.g.*, Regulatory Fundamentals Group, Comment Letter on Private Fund Advisers (Apr. 25, 2022), https://www.sec.gov/ comments/s7-03-22/s70322-20126563-287199.pdf (arguing that the preferential transparency prohibition will likely lead to decreased overall transparency and the preferential liquidity prohibition provision will do more harm than good, among other things); Alaska Permanent Fund Corporation, Comment Letter on Private Fund Advisers (June 13, 2022), https://www.sec.gov/comments/s7-03-22/s7032220131069-301104.pdf ("We believe the proposal has the ability to increase, rather than decrease, our fees and expenses. We also worry it will dramatically reduce our investing opportunities and limit our ability to deliver returns to our beneficiaries.").

level of alignment in the industry[266] and, in particular, with the delay in distributions to investors in recent years.[267]

Looking to the future, nearly every respondent indicated that they expect retailization to further damage this already fragile ecosystem.[268] Investors also believe that while the performance of all vehicles (including traditional institutional investor vehicles) will decline,[269] retail investors will suffer most.[270]

Importantly, a significant percentage of institutional investors also indicated that retail investment in private funds would have at least one beneficial effect. When asked to identify the most likely outcomes from retail investment in the coming years, the two most popular answers were (unsurprisingly) that traditional investors would have less leverage in their negotiations with general partners[271] and that industry returns would fall.[272] But the third most popular response was that retail investment would offer a silver lining to existing investors by providing them with a source of liquidity to offload some of their current positions.[273] This perspective, which goes against the grain of institutional investors' otherwise dim view of retail investment, is a warning sign for retail investors, reinforcing the concern that

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[266] 81% (55 out of 68) of institutional investor respondents indicated that they were "very unsatisfied" or "moderately unsatisfied" with the current level of alignment between general partners and investors in private funds.

[267] 75% (46 out of 61) of institutional investors surveyed said that they were "very frustrated" or "moderately frustrated" with delayed private fund distributions and lack of private fund liquidity in recent years.

[268] 88% (61 out of 69) of surveyed institutional investors indicated that they expect an influx of retail capital to "substantially decrease alignment" or "moderately decrease alignment" between general partners and limited partners in private funds.

[269] 56 respondents indicated that traditional investors will have less leverage in negotiations with general partners, 29 respondents indicated that industry returns will go down, and 22 respondents predicted that 401(k) investment will help provide liquidity to existing investors.

[270] 85% (36/54) of investors indicated that they believe the private market performance of retail investors will be either substantially or moderately worse than the private market performance of traditional institutional investors in coming years.

[271] 97% (58/60) of respondents predicted that traditional investors will have less leverage in negotiations with GPs.

[272] 48% (29/60) of the institutional investors surveyed predicted that industry returns will go down.

[273] 37% (22/60) of respondents indicated that 401(k) investment will help provide liquidity to existing investors.

retail investors are being sacrificed to support the interests of current industry players and entering the asset class at the worst possible time.[274]

Otherwise, the survey responses demonstrate significant anxiety among existing institutional investors about mass retailization. So how will institutional investors respond if and when that occurs? In the responses below, investor feedback tells an interesting story.

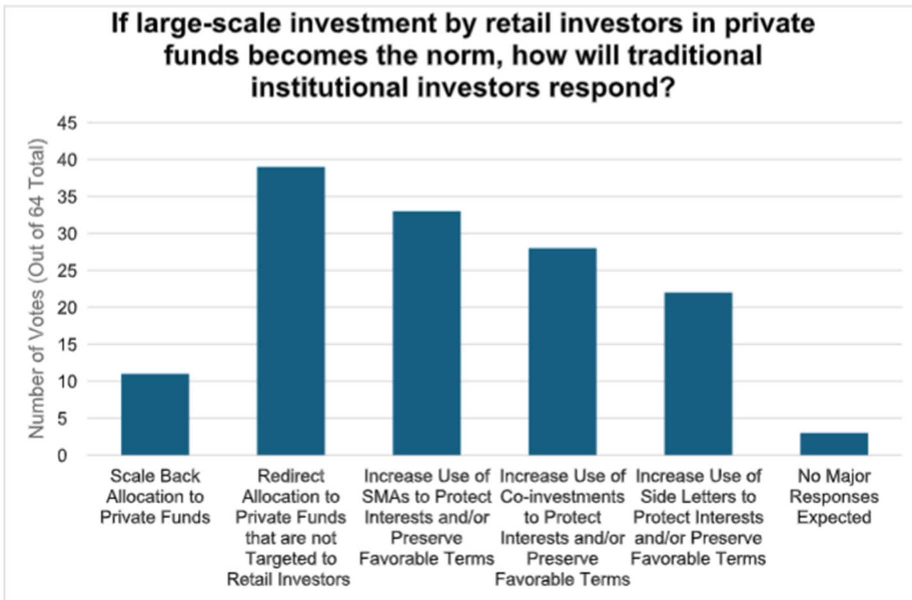

Figure 1: Institutional Investor Response to Retailization

Interestingly, institutional investors do not appear inclined to leave the industry altogether or dramatically scale back their allocation to private equity in response to retail investors. Instead, investor responses introduce a fascinating possibility: the private equity investor universe could become splintered among institutional investors, on one hand, and retail investors, on the other. One mechanism for this would simply be for certain investors to avoid managers that accept any retail capital, which would lead to a divide in the market between two types of managers.

Another possible mechanism for this splintering would be for investors to use separately managed accounts—which are individual vehicles managed solely for a single investor that frequently invest alongside a manager's pooled funds—to keep their investments distinct from vehicles with retail

[274] *See, e.g.*, Alexandra Heal, *Private Equity Founder Warns Retail Investors Risk Being Saddled With Worst Assets*, FIN. TIMES (May 21, 2025), https://www.ft.com/content/ee303801-82e8-464f-a10f-9e99dcee186b.

capital. As noted in the survey result, investors might also use co-investments to accomplish the same thing.

If such a splintering occurred, smaller retail investors could not freeride on the negotiations and capital allocation decision-making of larger investors in the same way that they would if all investors were commingled in the same vehicles and abiding by the same terms. A substantial literature establishes the reality that side contracting is an extremely common practice in private equity, creating a distinctive set of incentives throughout the industry.[275]

Thus, the polling results detailed above offer another word of caution to policymakers and retail investors. Institutional investors—those who have invested in private equity for decades and who know the industry best—are concerned about the impact retail investors will have on the private equity ecosystem and on industry performance. What's more, institutional investors also intend to avoid the vehicles in which retail investors participate. Not only is this a warning sign for retail investors, it may also be a harbinger of things to come in the future private equity market. If institutional capital systematically avoids retail-accessible vehicles, the private equity market may evolve into a two-tiered system where retail investors have access only to a subset of lower-performing managers and strategies.

CONCLUSION

The current push to democratize private equity and other private assets rests on a powerful narrative: that retail investors have been unfairly excluded from superior investment opportunities, and that expanding access—including through 401(k) plans—will correct an inequality while improving retirement outcomes. This Article has argued that the narrative does not hold up when confronted with the basic economics and institutional design of private equity. The public markets offer retail investors the benefits of market efficiency, liquidity, and the ability to index at negligible cost. Private equity, by contrast, depends on illiquidity, bespoke contracting, limited transparency and regulation, and a governance and reputation ecosystem built around sophisticated repeat players—none of which translates readily to a mass retail market.

The effort to expand retail access therefore suffers from a glaring paradox. The more private equity becomes broadly accessible, the more it is pushed toward the public-market model that it has long claimed to

[275] *See, e.g.*, Elisabeth de Fontenay & Yaron Nili, *Side Letter Governance*, 100 WASH. UNIV. L. REV. 907 (2023); William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. REG. 67 (2020); Jessica Jeffers & Anne M. Tucker, *Shadow Contracts*, 1 UNIV. CHIC. BUS. L. REV. 259 (2022).

outperform, and the less plausible it becomes that either retail investors or private equity itself will retain the benefits that democratization promises.

From the standpoint of retail investors, the claim that allocating to private equity will improve their risk-adjusted returns and allow them to better compete with institutional investors is weak. The private markets appear to be losing their famed outperformance relative to the public markets, even for institutional investors, and any remaining excess returns should be competed away as new capital floods in. Meanwhile, retail investors would face numerous disadvantages relative to institutional investors in the private markets.

From the standpoint of private equity, retailization threatens to undermine the industry's foundational advantages. Private equity has repeatedly defended its light regulatory treatment on the grounds that its investors are sophisticated and capable of protecting themselves through contract and monitoring. Yet retail money would invite litigation, regulation, and public scrutiny, all of which would constrain the traditional private equity model, causing it to more closely resemble the public markets while still carrying higher fees.

These conclusions do not suggest that private equity is socially harmful or that it should be suppressed. To the contrary, the traditional private equity model can, in some settings, improve governance and operational performance. The question is not whether private equity creates value, but whether mass retail participation is a sound way to allocate household savings and whether private equity can continue to create value once it has abandoned the very features that made it special.

Concerns over the false promises of retailization are especially acute when it comes to Americans' retirement savings. Private asset managers are poised to seek the inclusion of private assets in the target-date funds that have become the default options in 401(k) plans. This risks shifting millions of households into higher-fee products without the promise of higher returns and without their noticing.

Retailization is not a free lunch. Opening private equity to retail investors at scale is likely to drive down returns, increase the fragility of the financial markets through liquidity mismatches, and import the regulatory and litigation pressures that private equity has long sought to avoid. If private equity's promise is that it is different from public markets, then making it a retail market erodes that difference. And if private equity is no longer special, the case for routing ordinary households' savings into high-fee, illiquid products becomes correspondingly harder to defend.

Private equity is not a golden ticket that has been unjustly withheld from the public. For many retail investors, it is more likely to be a Trojan horse—one that arrives bearing the trappings of fairness and opportunity, but whose ultimate beneficiaries are the private asset managers and other intermediaries best positioned to extract fees and manufacture liquidity.

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