An Investor's Guide to Private Markets Evergreen Funds

January 2025

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Definition

Evergreen private market fund structures have experienced dynamic market growth since the early 2000s. However, it has taken nearly 20 years for semi-liquid fund structures to establish themselves in the private markets, and we are still in a pivotal phase of the market's development.

Intuitively, the nature of the underlying assets is crucial in determining the choice of fund vehicle, with open-ended structures historically being preferred for liquid and closed-ended structures for illiquid assets. Evergreen funds combine elements of both open-ended and closed-ended fund structures. **Evergreen private markets AIFs may be either open-ended or closed-ended vehicles as defined under the AIFMD**. As a result, evergreen vehicles exhibit a wide range of structural variations, from NAV-based open-ended structures to hybrid concepts that combine features of traditional closed-ended and open-ended funds and vintage structures. The latter are closely aligned with the principles of closed-ended funds but are designed to seamlessly transition investors from one fund cycle to the next, eliminating the need for a new investment. **The term "evergreen fund" is, therefore, rather unspecific. There is no uniform structure or definition**.

The key question is how fund managers integrate and align the various characteristics of liquid open-ended funds and illiquid closed-ended funds. **Therefore, evergreen funds can be classified as hybrid vehicles between traditional closed-ended and open-ended structures**.

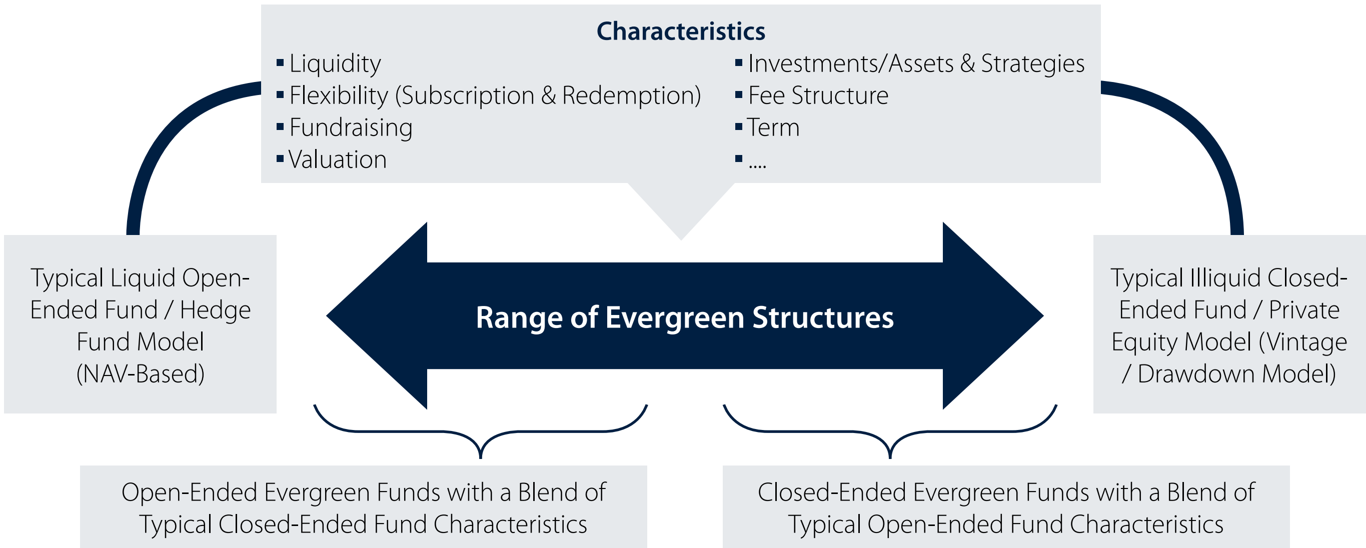

Figure 1: Wide range of evergreen structures between traditional open-ended and closed-ended AIFs.

One key characteristic is the fund's liquidity. Evergreen funds typically operate as open-ended investment vehicles with no fixed term, allowing investors to subscribe and exit during the fund's lifetime. **Fund managers have various mechanisms to create a liquidity profile that appropriately reflects the illiquidity of the underlying assets**. At the same time, investors are offered flexible exit options throughout the fund's duration without waiting for its maturity, although redemptions may be subject to certain restrictions. As a result, the liquidity of these vehicles is generally more limited than that of a traditional open-ended fund structure.

BAI surveys among German institutional investors indicate that many are still uncertain whether they intend to invest in private markets via evergreen funds in the medium term. In this context, investor type, assets under management, and experience in private markets play crucial roles. This paper aims to provide investors and asset managers with a guide to private market investments through evergreen funds. We outline market developments and demand, define the key characteristics of evergreen structures, explain their differences and potential advantages and disadvantages compared to traditional closed-ended private market funds, and illustrate possible applications of evergreen strategies.

Market Development

Due to the lack of a uniform structure and definition of evergreen funds, presenting a homogeneous picture of market developments is challenging.

Through surveys conducted among asset managers within the BAI and German institutional investors, we can outline both the supply and demand for private markets evergreen structures.

BAI Member Survey: Do You Plan to Offer Evergreen / Semi-Liquid Private Market Funds in the Medium Term?

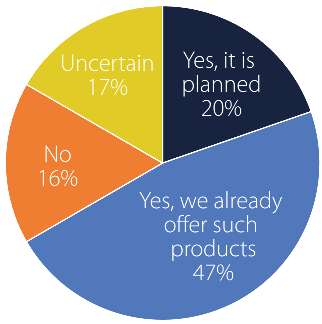

Figure 2: BAI survey among member firms (GPs) in late summer 2024.

Nearly every second asset manager within the BAI already offers evergreen solutions for its clients, and an additional 20% plan to launch such products. A comparable survey conducted by Dechert, AIMA, and ACC among credit fund managers confirms the findings of the BAI survey. Just over half of the credit fund managers surveyed already include evergreen or semi-liquid funds in their product portfolios, providing investors with a certain level of liquidity by granting the right to early redemption. Furthermore, 48% of the credit fund managers surveyed indicated that they expect a continued increase in demand for innovative liquidity solutions.

BAI Investor Survey: Do You Plan to Invest in Private Markets via Evergreen / Semi-Liquid Funds in the Medium Term? Cluster Analysis: Investor Type

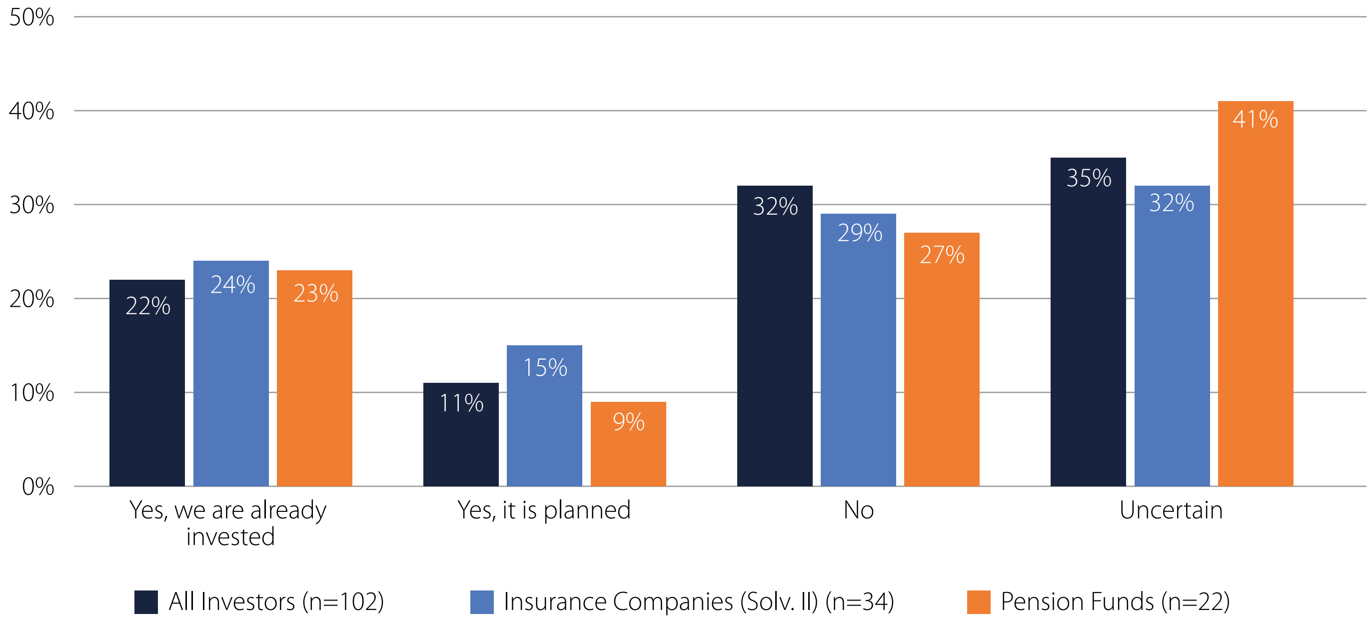

Figure 3: BAI survey among German institutional investors in late summer 2024.

BAI Investor Survey: Do You Plan to Invest in Private Markets via Evergreen / Semi-Liquid Funds in the Medium Term? Cluster Analysis: Assets under Management

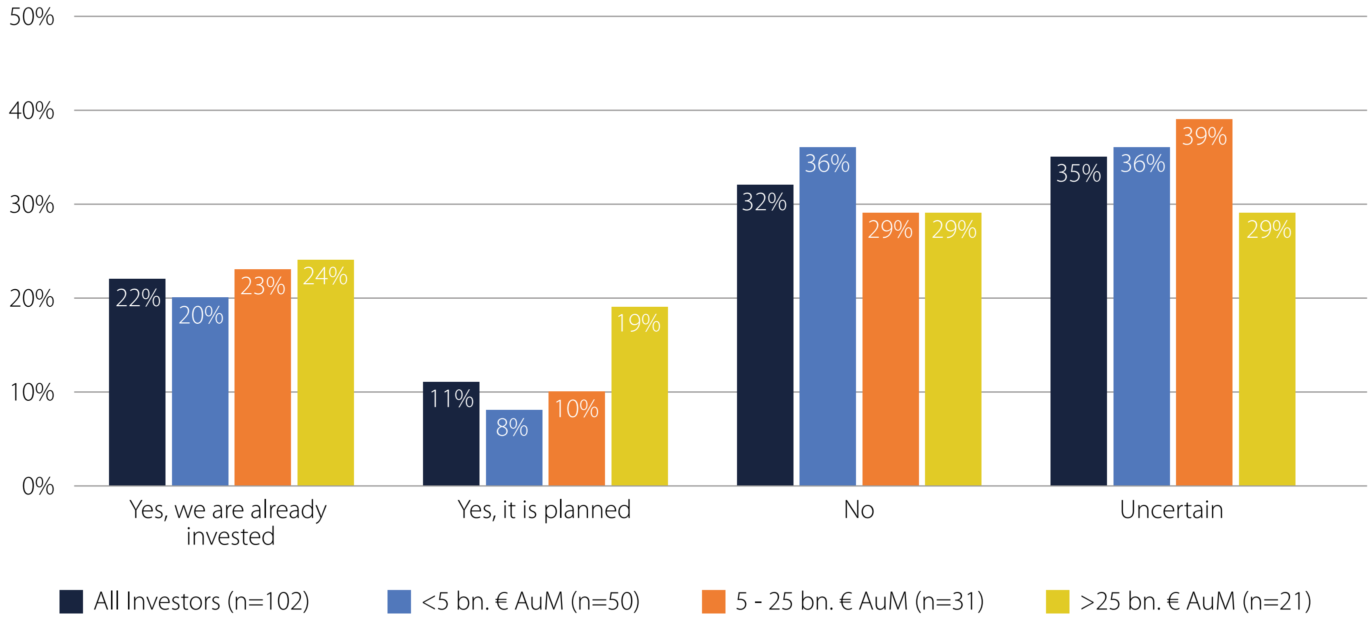

Figure 4: BAI survey among German institutional investors in late summer 2024.

BAI Investor Survey: Do You Plan to Invest in Private Markets via Evergreen / Semi-Liquid Funds in the Medium Term? Cluster Analysis: In-house Experience regarding the Alternative Portfolio

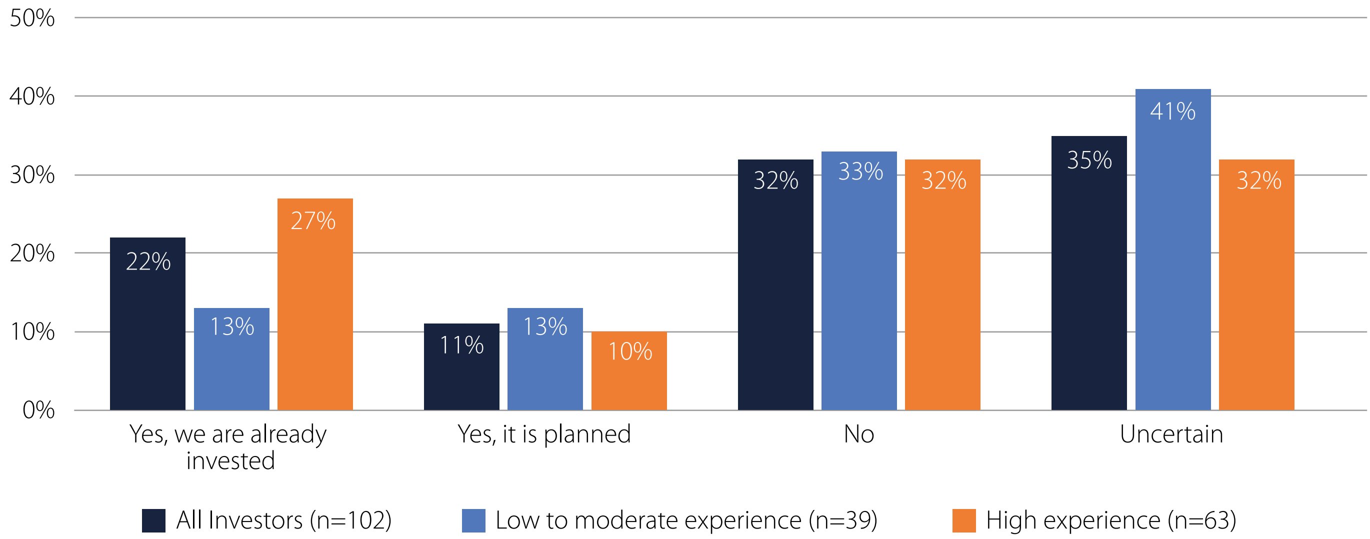

Figure 5: BAI survey among German institutional investors in late summer 2024.

In late summer of 2024, the BAI surveyed more than 100 German institutional investors regarding their evergreen plans as part of the BAI Investor Survey. **The results showed that 22% of German institutional investors already invest in private markets through evergreen structures**, while 11% have concrete investment plans. **Insurance companies and pension funds are at a more advanced stage compared to other investor groups, exhibiting higher allocation rates**. The size of an investor, measured by assets under management, may also play a role, **as larger investors are more frequently invested in evergreen products** or are actively planning such investments. The same correlation applies to the investment team's experience in alternative investments - **more experienced investors are more likely to have an existing evergreen allocation**. Conversely, less experienced investors remain uncertain about whether they intend to invest in private markets through evergreen funds in the medium term.

Furthermore, we surveyed German institutional investors and BAI members regarding the primary motivations for institutional private market investments through evergreen structures. Investors and product providers agree that **the advantages in liquidity management and the greater flexibility of investments** are among the most significant benefits of innovative evergreen vehicles. Additionally, **potential cost advantages** should not be overlooked. These may arise from a reduction in the number of investment decisions, lower due diligence efforts, and standardized reporting processes.

BAI Investor Survey: What Are the Main Reasons for Investors to Invest via Evergreen / Semi-Liquid Private Market Funds

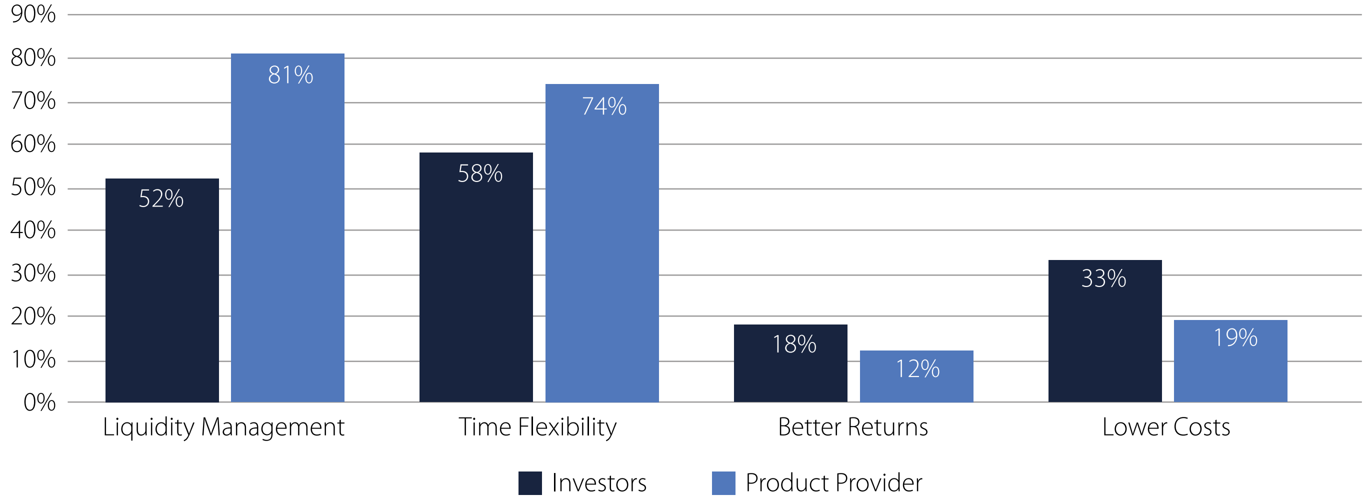

Figure 6: BAI survey among member firms (GPs) and German institutional investors in late summer 2024.

Preqin has also been surveying international investors for several years regarding the demand for evergreen structures. The Preqin database categorizes evergreen funds under open-ended private market funds. The survey results from recent years indicate an overall positive trend, although fluctuations across asset classes are significant.

Preqin Survey: Percentage of Investors planning Open-Ended Fund Investments by Asset Class

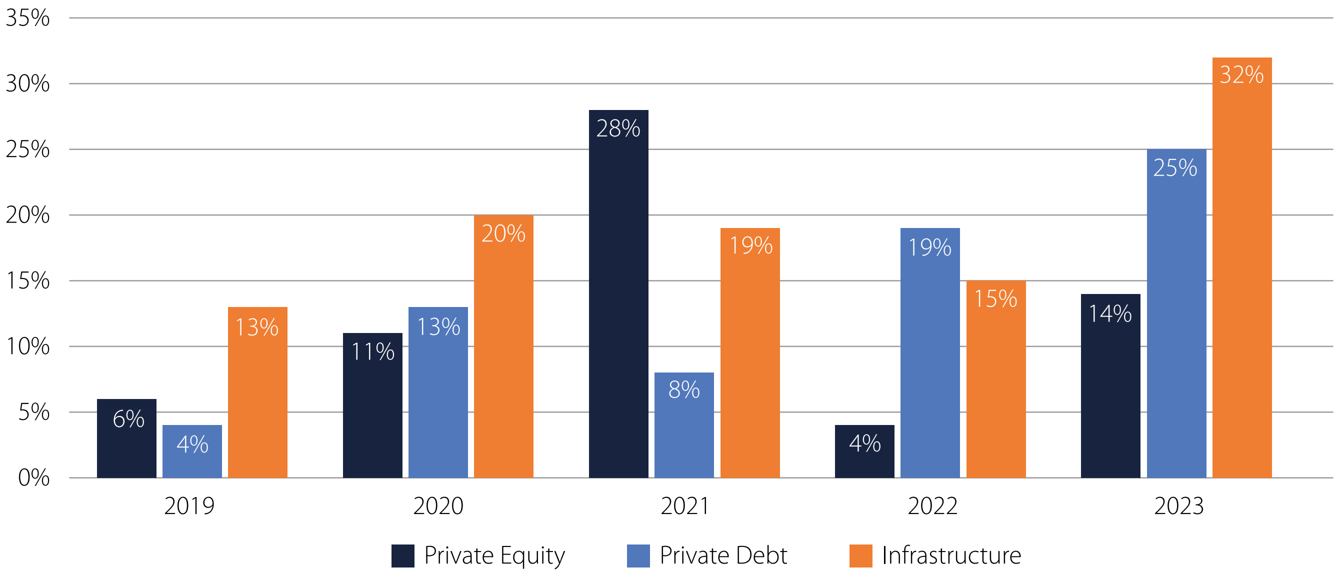

Figure 7: Preqin Investor Outlook H1 2024.

Surveys can outline the plans of asset managers and investors. However, mapping the market presents a greater challenge. This is due, on the one hand, to the lack of a uniform definition of evergreen funds and, on the other hand, to the inherent opacity of private markets, making it impossible for any available database to provide a comprehensive representation of the evergreen market. Nevertheless, data from Preqin at least reveals the market growth of recent years.

Cumulative Number of Evergreen Fund Structures (Excluding ELTIF and LTAF)

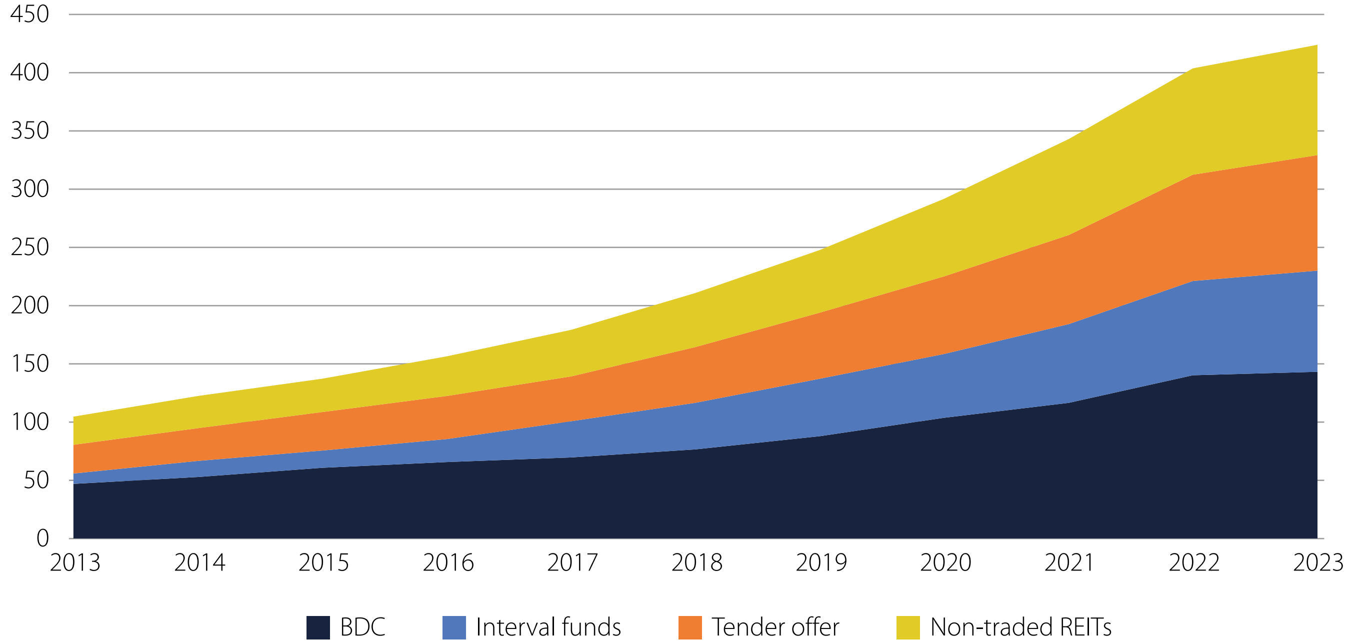

Figure 8: Fundraising from Private Wealth 2024: A Guide to Raising Capital.

Additional insights can be found in selected statistics from ESMA and the ECB. Unlike private equity funds—where 96% of the EU AIF NAV is held in closed-ended vehicles—approximately 42% of EU-domiciled credit funds have an open-ended structure. According to ESMA and ECB data, the redemption frequency of open-ended private market EU AIFs ranges mostly from weekly to quarterly. Further survey data on credit funds is available from KPMG Luxembourg in collaboration with ALFI. While the data shows significant fluctuations over time, it remains highly relevant, as Luxembourg is the most important and largest fund domicile for credit funds in Europe. A comparison between Preqin and KPMG data once again highlights the varying definitions of evergreen funds. KPMG classifies evergreen funds as both open-ended and closed-ended vehicles. The 2024 KPMG survey covers over 1,300 Luxembourg-based credit funds or sub-funds, including approximately 340 open-ended credit funds (26%) and around 170 evergreen funds (13%).

KPMG Luxembourg: Share of Evergreen and Open-Ended Credit Funds in the Luxembourg Credit Fund Market

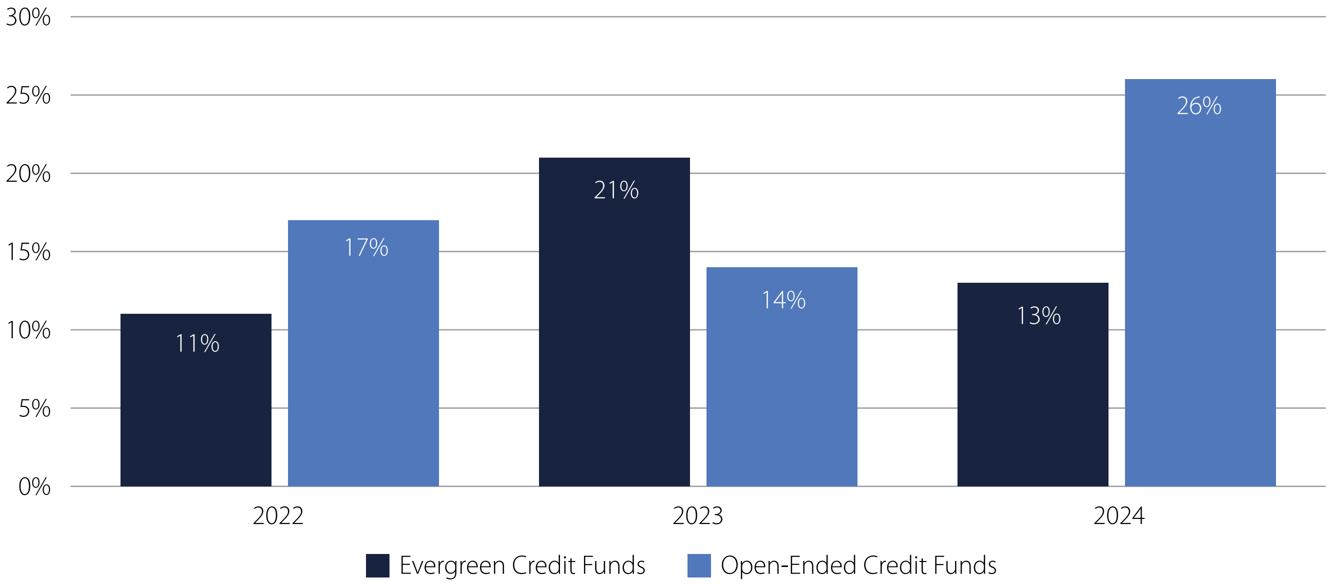

Figure 9: KPMG Luxembourg / ALFI: Private debt fund survey 2022-2024.

The data suggests that the markets for Evergreen structures will develop differently depending on the sub-asset class. ESMA and KPMG data indicate strong growth for private debt vehicles. Preqin's investor survey also points to high demand for evergreen infrastructure funds. **The sub-asset class (or the underlying assets) often plays a crucial role in the structuring and complexity of an evergreen fund**. A notable example is the liquidity structure. Private debt managers find it easier to provide investors with regular liquidity options and greater flexibility in capital calls than private equity. This is due to the ongoing coupon payments and the relatively high asset turnover, which is driven by the average loan maturity.

Characteristics: Evergreen Funds Compared with Traditional Closed-ended Market Funds

◆ **Potential Advantages**

◆ **Potential Disadvantages**

◆ **Notable Differences**

Potential advantages, disadvantages, and differences compared to traditional closed-end private market funds (the typical private equity fund model) depend largely on the evergreen fund's structure and underlying assets. As noted at the outset, the range of possible structuring options for evergreen vehicles between traditional open-ended and closed-ended fund models is vast.

Returns & Valuation

◆ Many investors are accustomed to measuring their total return over a specific period. Therefore, NAV-based evergreen funds can be effectively **compared with traditional investments** with straightforward cash flow profiles, such as ETFs and mutual funds.

◆ A potentially higher **Multiple on Committed Capital (MOCC)** can be achieved through rapid capital deployment and regular capital reinvestment while maintaining a minimal liquidity buffer.

◆ For investors, **more frequent market valuations** provide a more accurate and timely representation of the fair value of their investments.

◆ In a short-term market shock scenario, evergreen structures can help mitigate potential denominator effects in the overall portfolio compared to traditional closed-ended private market funds with capital calls (drawdown funds) by providing more timely market valuations.

◆ It is crucial that the regular valuations of the underlying assets are fair and accurate, as they serve as the basis for pricing shares for buyers, sellers, and existing investors, as well as for calculating management fees and performance-based compensation. However, **residual uncertainties in valuations**, which investors face when acquiring or selling existing positions, **can never be entirely eliminated**.

◆ **Management Fee**: Unrealized appreciation of assets can be considered when calculating management fees. These fees are paid either on invested capital or based on the NAV.

◆ **Performance Fee:** A potential annual performance-based compensation allows for faster payouts to the investment team than a traditional "back-end" compensation structure. Alternatively, the performance fee can be distributed over a multi-year period and structured with a hurdle or benchmark rate, with or without "catch-up" provisions.

◆ Evergreen funds that invest in the same assets as a traditional closed-ended private market fund (drawdown fund) would likely achieve a lower **internal rate of return (IRR)**, as they generally need to maintain a liquidity buffer, which can dilute returns.

Cashflow

- Easier operational planning of investments and a reduced workload for investors due to the absence of significant capital calls.

- **Timing and management of cash flows** (in & out) are more challenging for fund managers and require an adequate liquidity buffer.

Investment Strategies at the Fund Level

- **Minimize the J-curve** effect by allowing investors to enter a mature, diversified portfolio from the outset.

- LPs and GPs are increasingly seeking creative and scalable ways to generate more **significant value creation**, allowing them to retain profitable companies in their portfolios for extended periods.

- An imbalance in capital allocations or **vintage concentration** may occur, for example, due to excessively rapid fundraising without a corresponding adjusted investment strategy. Investors should ensure the fund maintains a well-balanced mix of mature and newly acquired assets.

- As perpetual investment vehicles, **evergreen funds** must continuously invest in new transactions to maintain an attractive investment level. The fund manager must ensure that the investment pipeline—both in absolute size and in the number of investment opportunities—is sufficiently large to sustain a steady investment pace and adequate diversification. If this is not the case, an **evergreen fund** risks having an underinvested or insufficiently diversified portfolio.

- Evergreen funds should have the same access to the investment platform as any other investment offering managed by the fund manager. Investors should ensure a full **pro-rata allocation**, preventing closed-ended flagship funds from being favored over their evergreen counterpart, for example, through preferential preemptive rights.

- Due to **potential regulatory and structural constraints**, certain investment strategies remain exclusive to traditional closed-ended drawdown funds. For example, leveraged evergreen credit funds must consider the new AIFMD 2 leverage rules when structuring the fund. These rules impose a leverage cap of 175% for open-ended credit funds and 300% for closed-ended credit funds. As a result, managers may need to avoid classification as an open-ended fund or, alternatively, structure the investment portfolio in a way that prevents the fund from falling under the definition of a debt-originating fund.

- **Leverage**: Particularly in the current interest rate environment, investors should more than ever ensure, through a cost-benefit analysis, that fund managers demonstrate an efficient use of capital.

- Leverage in evergreen vehicles can **enhance returns and serve as a liquidity instrument** for redemptions and capital deployment.

- A potential **dilution of existing investment shares** may occur if the manager does not carefully manage and balance new capital commitments from investors with new investment opportunities.

Liquidity

- **Variable liquidity options** for investors throughout the fund's duration, with regular redemptions potentially subject to certain restrictions (see below).

- Globally, nearly 75% of private equity investments are made by insurance companies and pension funds. These key investors' risk profiles and investment behavior naturally help mitigate liquidity risks in general for open-ended private market funds and evergreen structures, thanks to their **long investment horizons**.

- **Lock-up periods**: Redemptions are restricted for a predetermined period, typically at least one year.

- **Gates**: A predefined limit on the amount of invested capital that a single investor (investor-level gates) or all investors in a fund (fund-level gates) can redeem at one time. The complexity of these gates increases with the illiquidity of the underlying assets.

- **Predefined redemption intervals**: Investors can redeem their shares only at specific intervals, typically monthly to quarterly.

- **Notice/redemption periods**: Investors must adhere to specified notice periods when submitting redemption requests.

- **Under "slow pay" provisions**: Redemption of an investor's shares in the fund's assets aligns with the maturity of the underlying assets, for example, on a run-off basis.

- **Potential liquidity shortage[1] in stress situations**: Investors should ensure that an evergreen fund undergoes routine and independent stress testing and, if applicable, has already experienced prolonged market stress and managed it effectively. Otherwise, the manager should demonstrate the ability to generate sufficient liquidity in a significant stress scenario while minimizing the negative impact on the portfolio.

- A fund's liquidity profile (redemption frequency) does not yet account for the availability of additional liquidity management instruments, such as lock-up and notice periods or redemption deferrals, which can further mitigate potential liquidity mismatches.

- A **liquidity buffer** typically reduces returns at the investment level and leads to higher operational expenses. An evergreen fund's liquidity buffer can consist of cash, a credit facility with associated costs, or more liquid investments that deviate from its core strategy. Dilution of private market returns due to liquid investments should be minimized as much as possible.

- In **overly concentrated portfolios**, there is a risk that assets may need to be sold earlier than initially planned during the fund's lifetime to ensure the required liquidity at the fund level.

1 The ESMA defines liquidity shortage as the sum of liquidity deficits at the fund level that liquidity surpluses cannot offset. The measure of the liquidity shortage is equal to the sum of liquidity mismatches for all funds where investor liquidity exceeds portfolio liquidity. The resulting amount is then divided by the NAV of all funds.
The ESMA generally assesses the liquidity of private equity and other private market funds very positively. It estimates the liquidity shortfall for EU private equity and other AIFs over a one-week time horizon to be approximately 5% of NAVs.

Flexibility

- Ongoing capital raising provides investors with greater flexibility and precise **timing** of their investment, as they can enter the fund or increase their participation at different times.

- A typically **lower minimum investment** provides investors with greater flexibility and enables a broader group of investors to access private markets strategies.

- The increased flexibility could lead to reduced **operational stability** at the fund level. Significant capital outflows (e.g., during run-off phases) and the resulting limitations on share redemptions to manage liquidity constraints may **erode investor confidence**. Product providers must carefully analyze such scenarios during the structuring process and incorporate them into the design of the evergreen vehicle.

- Investor flexibility may be limited if the manager carefully controls the fund's growth, potentially leading to a **waiting list** for subscriptions in the case of top managers and successful open-ended funds. Investors should also consider whether new capital calls are processed pro-rata or through a waiting list on a first-come, first-served basis.

Reporting

- **Valuations** of evergreen funds occur at shorter intervals, typically at least monthly.

- Potentially **greater transparency** and comparability through **standardized reporting**, which is often or partially made publicly available.

- Potentially less flexibility and customization in reporting, resulting in less detailed information on individual portfolio investments.

SAA / Investment strategies at the investor level

- Simplified access to private market investments for **retail investors**.

- Target allocation can be reached quickly („**fully invested from day one**") while simultaneously reducing the blind pool risk.

- **Continuous reinvestments** mitigate the reinvestment risks typically associated with drawdown funds by allowing evergreen funds to reinvest a portion of the proceeds from realized investments.

- Evergreen vehicles enable investors to control their investment amount better, as each subscription flows into a fully funded portfolio.

- **Over-commitment strategies** become unnecessary.

- **Underinvestment periods**, which often significantly reduce overall portfolio performance, can be more easily avoided.

- Reduction in the number of investment decisions and **decreased due diligence effort**.

Additional Remarks on the Liquidity of Evergreen Funds

The liquidity profile of private market funds compares investor liquidity and portfolio liquidity across different time horizons. For a fund that offers daily redemptions, investor liquidity over one day would correspond to 100% of NAV.

A **liquidity mismatch** occurs when the liquidity offered to investors exceeds the portfolio liquidity over the same time horizon.

Data from the ECB and ESMA on evergreen funds indicate that these funds generally offer liquidity at 100% of the most recent NAV without transaction costs at regular intervals, usually monthly, quarterly, or, in some cases, weekly.

It is important to note that liquidity is limited to a portion of the fund (rather than the investor's entire investment). Liquidity can vary significantly between funds and depends on many factors, such as the fund's duration. Commonly chosen options range from 5% to 15% per quarter.

Liquidity can be further restricted through initial lock-up periods, early redemption fees, and provisions that allow fund managers to suspend or limit redemptions under certain conditions. If demand for liquidity exceeds the available amount, all investors requesting liquidity generally receive capital distributions on a pro-rata basis according to their redemption requests. To ensure redemption opportunities, evergreen funds typically use one of two approaches: **liquidity matching or maintaining a reserve of liquid assets**.

In liquidity matching, also known as the "slow pay / fast pay" mechanism, the fund's liquidity corresponds to that of its assets. When investors seek to redeem their shares, the fund transfers a portion of its assets into a separate tranche. This new portfolio returns capital to investors upon the maturity of the underlying investments. This approach reduces the need for a liquidity reserve within the fund but increases uncertainty regarding the timing of capital repayments.

With a reserve of liquid assets, the fund manager allocates a portion of the capital to liquid investments that can be sold to ensure timely redemptions.

Potential Applications of Evergreen Funds

The discussion around evergreen vehicles is not about replacing traditional private market funds. Instead, innovative evergreen structures expand existing product offerings and enable investors to allocate capital to private markets more efficiently and effectively.

Evergreen funds can be beneficial in the early stages of building a private markets portfolio, as they allow for a faster capital allocation. **They are often more broadly diversified and provide early access to a more mature portfolio—both of which can be particularly beneficial in the initial phases of portfolio construction**.

For experienced institutional investors, evergreen funds can complement their existing portfolio of traditional drawdown funds. For instance, they can allocate uncalled capital to evergreen funds, enabling them to achieve investment and strategic allocation objectives earlier and more efficiently while simultaneously enhancing portfolio diversification.

Over-commitment strategies become less critical, and periods of underinvestment—which often significantly reduce overall portfolio performance—can be more easily avoided. **Data from the BAI Survey indicate that investors benefit from greater flexibility and liquidity at fund and portfolio levels**. Additionally, in the best-case scenario, they may even reduce the overall ongoing costs of the portfolio, partly by decreasing the number of investment decisions required and lowering due diligence efforts.

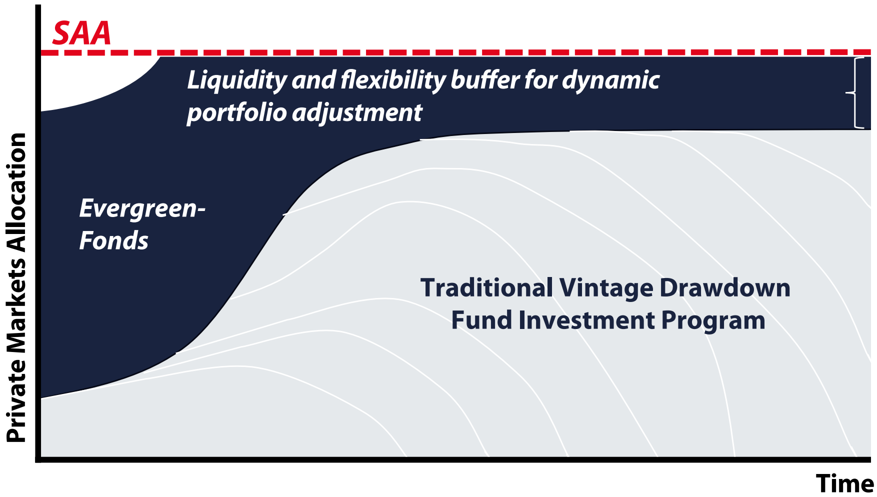

Figure 10: Potential Use of evergreen funds for the rapid and efficient achievement of SAA objectives while building a traditional private markets investment program with closed-ended AIFs (drawdown funds).

The traditional closed-ended fund still represents the majority of assets under management in the industry. While these structures have served institutional investors well, it does not hold true to the same extent for retail investors. This imbalance has led to a growing demand for a structure that better meets the needs of individual investors. **The liquidity features of an evergreen structure, as well as the typically lower minimum investment requirements, also better cater to the individual needs of retail investors**. The growing trend of HNWIs and retail investors actively entering the private markets is prompting asset managers to launch hybrid products such as evergreen vehicles, which redefine the boundaries between traditional liquid open-ended investment funds and private market funds. **ELTIFs, which often follow an evergreen structure, are a prime example of this development**.

Beyond this, the meaningful use of evergreen structures in individual investor distribution may also be analyzed. This guide provides a simplified overview of the range of differences among various evergreen structures within the spectrum between open-ended and closed-ended alternative investment funds, but further elaboration is required. Additionally, significant structural differences that can ultimately lead to materially different net returns for investors have not been analyzed here. These differences must be carefully considered during due diligence and continuously monitored.

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- We are improving the level of public awareness for alternative strategies and asset classes.
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- We are representing the interests of the industry to politics and regulators.
- We are serving as a catalyst between professional German investors and recognized worldwide providers of Alternative Investments products and services.
- We are supporting scientific research in the field of Alternative Investments.
- Founded 1997 in Bonn, the association's members are resident in any field of the professional Alternative Investments Business. Over 300 national and international companies are members of the BAI. The members directory can be found here.

Upcoming Flagship Event

- BAI Alternative Investor Conference (AIC) Mai 6-8th, 2025, Kap Europa, Frankfurt

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