



Agile and resilient: Alternative investments embrace the new reality

**2020 KPMG/AIMA Global Hedge
Fund Survey: COVID-19 special edition**

KPMG International

home.kpmg/hedgefunds2020



Foreword

The environment and implications from COVID-19 demonstrated that — in times of market volatility and business uncertainty — alternative investments fulfil an important role in an investor’s portfolio. Throughout the pandemic, the Hedge Fund industry has shown its ability to manage risk and volatility while still producing above-market returns for investors.

Moreover, the sector proved itself to be highly adaptable and resilient in the face of massive market disruption. Operations not only continued in an unprecedented decentralized setting, but worked almost seamlessly with little or no interruption. Trades were executed during periods of record volume, margin was extended, collateral was posted, and trades were settled. Subscriptions and redemptions took place as normal, Net Asset Values were issued, and risk information was exchanged.

Indeed, the COVID-19 experience has proven that many managers’ operations and their ecosystem’s capabilities are robust, that some processes can be managed virtually, and that — even during the lockdowns — the industry remains agile and resilient.

The data, and KPMG firms' and AIMA's conversations, with industry players suggest the environment is creating new opportunities for the industry. Many see the current market disruption and dislocation as an opportunity to attract new talent to their firms. They see opportunities to re-evaluate their existing business operating models and adjust their core processes, cost structures and work environments. They are channeling increased investment into their Investor Relations (IR) functions to enhance their capabilities. And they are finding ways to propagate their culture and encourage collaboration in a decentralized environment.

At the same time, the data points to an accelerating bifurcation in the industry. Generally speaking, the survey suggests that larger, more established players are better postured to attract increasing amounts of talent and capital. Smaller, less established players, on the other hand, may be seeing competitive advantages flow from less complicated operating models and greater flexibility.

In the summary that follows, we share the high-level results from eight key themes that have been underscored by the Alternative Investment management industry as a result of COVID-19. From talent acquisition and changes to the IR model through to technology investment and cost management, this report provides key insights into how the industry is finding opportunities in a decentralized environment.

Significant uncertainty may remain, but the conversations with fund managers and data suggest the industry remains adaptable and resilient and is taking prudent steps in order to embrace the new reality.

To understand more about the research — or to discuss your unique challenges and opportunities — we encourage you to contact either AIMA or your local KPMG member firm.

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The eight topics
defining the Hedge
Fund Manager’s
agenda

1

Attracting and
retaining talent

2

Embracing a
new reality

3

Smart
sourcing

4

Innovating the
IT environment

5

Returning to
the office

6

Investor
Relations 2.0

7

Driving for
efficiency

8

Planning for the
future

The eight topics defining the Hedge Fund Manager's agenda

- 1. Attracting and retaining talent
- 2. Embracing a new reality
- 3. Smart sourcing
- 4. Innovating the IT environment
- 5. Returning to the office
- 6. Investor Relations 2.0
- 7. Driving for efficiency
- 8. Planning for the future

About the research

This survey is part of an ongoing series of research initiatives conducted by KPMG and AIMA since 2012. This year we elected to focus on the threshold issues facing the Alternative Investment management industry as a result of COVID-19. This survey was 'in field' through July 2020, allowing AIMA and KPMG professionals to gather real-time data throughout the pandemic.

For this survey, 144 managers were interviewed accounting for an estimated US\$840 billion in Assets Under Management (AUM) and representing more than a quarter of the industry's total AUM.

Responses were divided by order of size. Larger managers (where the firm's assets under management (AUM) exceeded US\$1 billion) accounted for 59 percent of all responses, while smaller managers (where AUM was up to US\$1 billion) accounted for the remainder; 41 percent. From a geographic

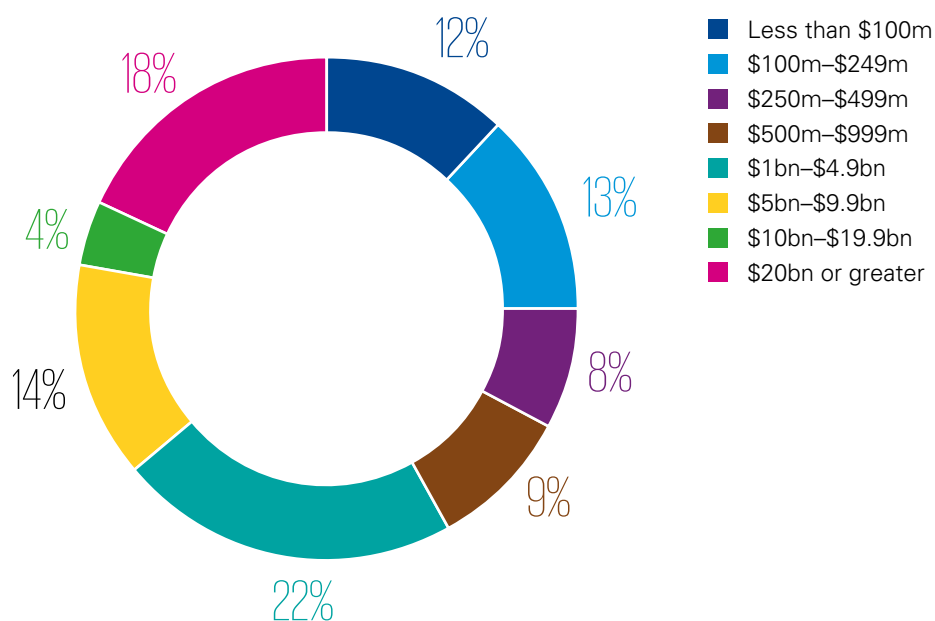
perspective, nearly half (46 percent) of all respondents were from North America; 37 percent from EMEA; and 17 percent were headquartered in Asia Pacific.

In addition, KPMG and AIMA professionals canvassed the views of the industry via one-to-one interviews with Hedge Funds, investors and key ecosystem players, including technology companies, prime brokers, fund administrators and law firms to provide additional context to the survey findings. Excerpts from those discussions are included in this report.

Thanks to our participants

On behalf of KPMG and AIMA, we would like to thank everyone that participated in the survey and shared their insights. The views you shared have been vital in helping form this unique and valuable report.

What is your firm's aggregate AUM in US dollars (based on the net asset value of the funds your firm manages?)



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG International & AIMA Survey 2020

1 Agile and resilient: Alternative investments embrace the new reality

The eight topics defining the Hedge Fund Manager's agenda

1
Attracting and retaining talent

2
Embracing a new reality

3
Smart sourcing

4
Innovating the IT environment

5
Returning to the office

6
Investor Relations 2.0

7
Driving for efficiency

8
Planning for the future

1

Attracting and retaining talent



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

2

Agile and resilient: Alternative investments embrace the new reality

COVID-19 may have resulted in some job losses across the financial services industry, but the data suggests that Hedge Fund managers continue to seek out the best talent while remaining mindful to also look after their own people.

Fifty-seven percent of all managers say they have either hired or are trying to hire new talent since the pandemic began. Those headquartered in North America and those with AUM of more than US\$1 billion are the most likely to say they had hired since the start of the pandemic.

“We are seeing a lot of talent migration,” notes a prominent New York Hedge Fund Lawyer. “Those Hedge Funds that are prospering in the current volatility and market dislocation are actively hiring, with some talent moving from firms that have endured a more challenging period.”

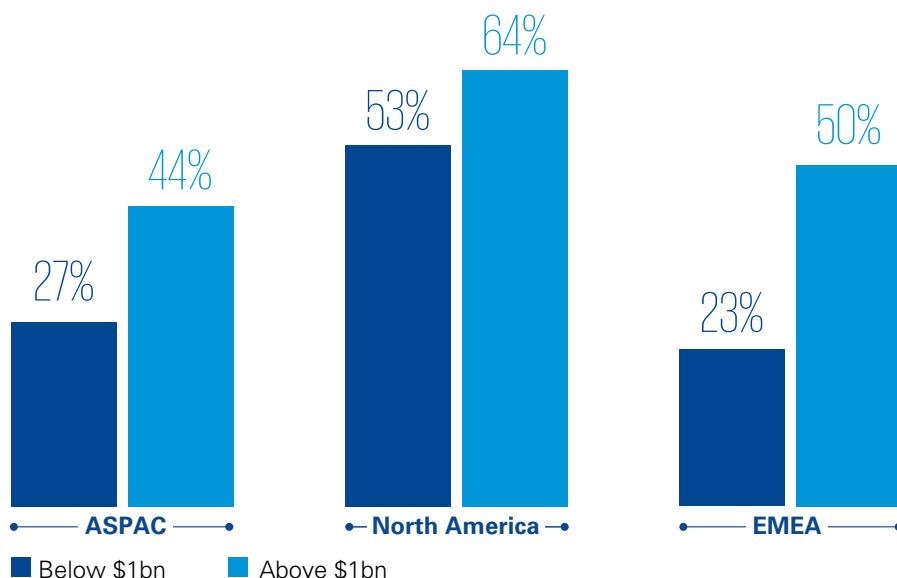
According to one North American fund manager, firms are continuously searching for “front-office revenue-generating professionals that can make a real difference to the business.” In particular, during the one-on-one conversations with managers throughout this period suggest that firms are eager to discover strong Portfolio Managers, IR professionals and researchers.

While the data suggests a broad trend towards hiring, our conversations with fund managers and fund service providers indicates many are just as concerned with retaining their current talent. Hedge Fund managers seem to be taking steps to ensure their talent is secure and actively engaged.

According to a recent global survey of CEOs conducted by KPMG International¹ since the pandemic began, talent risk now ranks as the greatest risk facing organizational growth over the next 3 years. At the beginning of the year, talent risk was ranked 11th in the minds of CEOs — just a few months later, it has skyrocketed to the number one risk.

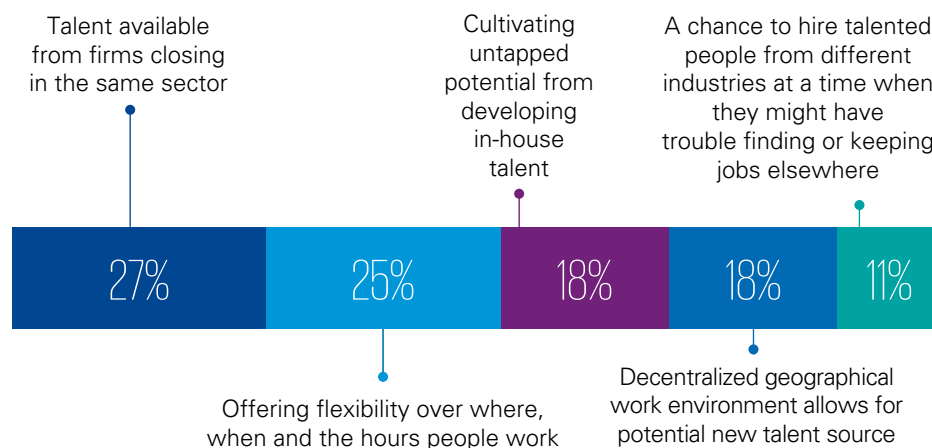
Recognizing this, approximately 30 percent of the fund managers in this research also suggest a willingness to either ‘grow’ their existing internal talent or to source and train new talent from outside the industry. The decentralized

"Yes, we have hired additional staff during this period."



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020

Which of the following choices below is the greatest opportunity for the firm when attracting and/or retaining talent during this period?



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020

nature of the current operating model has also created opportunities for managers to reach outside of their normal captive locations in the search for new talent.

Speaking with one hedge fund manager based in the Northeastern United States who acknowledged that the relative

success of being able to work remotely has prompted them to consider hiring key investment professionals from outside their home office vicinity. Yet, at the same time, they also want to be mindful of the importance of culture and collaboration at the firm.

¹ KPMG 2020 CEO Outlook COVID-19 Special Edition



The eight topics defining the Hedge Fund Manager's agenda

1 Attracting and retaining talent

2 Embracing a new reality

3 Smart sourcing

4 Innovating the IT environment

5 Returning to the office

6 Investor Relations 2.0

7 Driving for efficiency

8 Planning for the future

While optimistic about their hiring and talent development potential, fund managers are also managing a number of new talent challenges related to the pandemic. Forty-one percent say they are struggling to on-board new employees remotely; North American and UK managers face particular concerns with remote on-boarding.

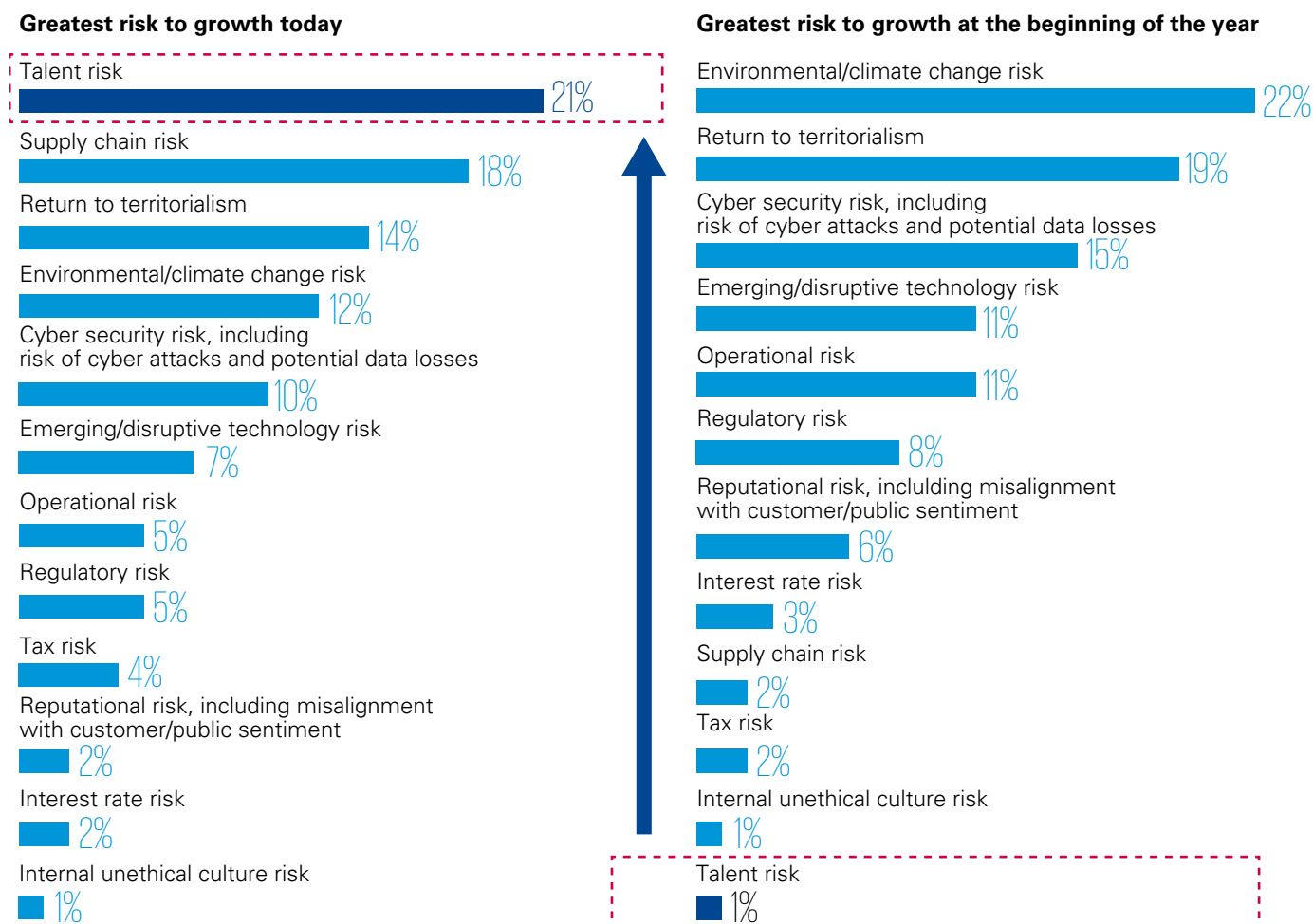
A number of managers interviewed noted the importance of getting people back into the office as a way to help new employees build the relationships and collaboration skills they require. And while industry talent is clearly willing to consider new opportunities during the pandemic, 30 percent of fund managers say they are worried that people may be less willing to move firms at this time.

Interestingly, both large and small firms seem to be benefiting from shifts in social expectations and norms. Conversations with smaller managers suggest they feel their firm’s flexibility and culture give them an advantage. Larger managers, on the other hand, believe they will benefit from brand recognition and security in a time of market uncertainty.

What has been particularly interesting through this pandemic has been the focus on employee health and safety. While managers are still clearly focused on maintaining and enhancing performance, our conversations indicate that many are equally concerned about the more ‘human’ implications of working in a decentralized environment — employee mental health, morale, work-life balance and teamwork, for example.

“What has been particularly interesting through this pandemic has been the focus on employee health and safety. Employee mental health, morale, work-life balance and teamwork are top of mind for everyone.”

Greatest risk to an organization’s growth over a 3-year period



Source: KPMG 2020 CEO Outlook COVID-19 Special Edition



The eight topics defining the Hedge Fund Manager’s agenda

1 Attracting and retaining talent

2 Embracing a new reality

3 Smart sourcing

4 Innovating the IT environment

5 Returning to the office

6 Investor Relations 2.0

7 Driving for efficiency

8 Planning for the future

Our collective view suggests fund managers will need to be creative about their talent strategy; prospective hires are looking at the firms that are recruiting them and assessing how they are responding to this disruption — in particular, whether the firm’s culture and values align with their expectations.

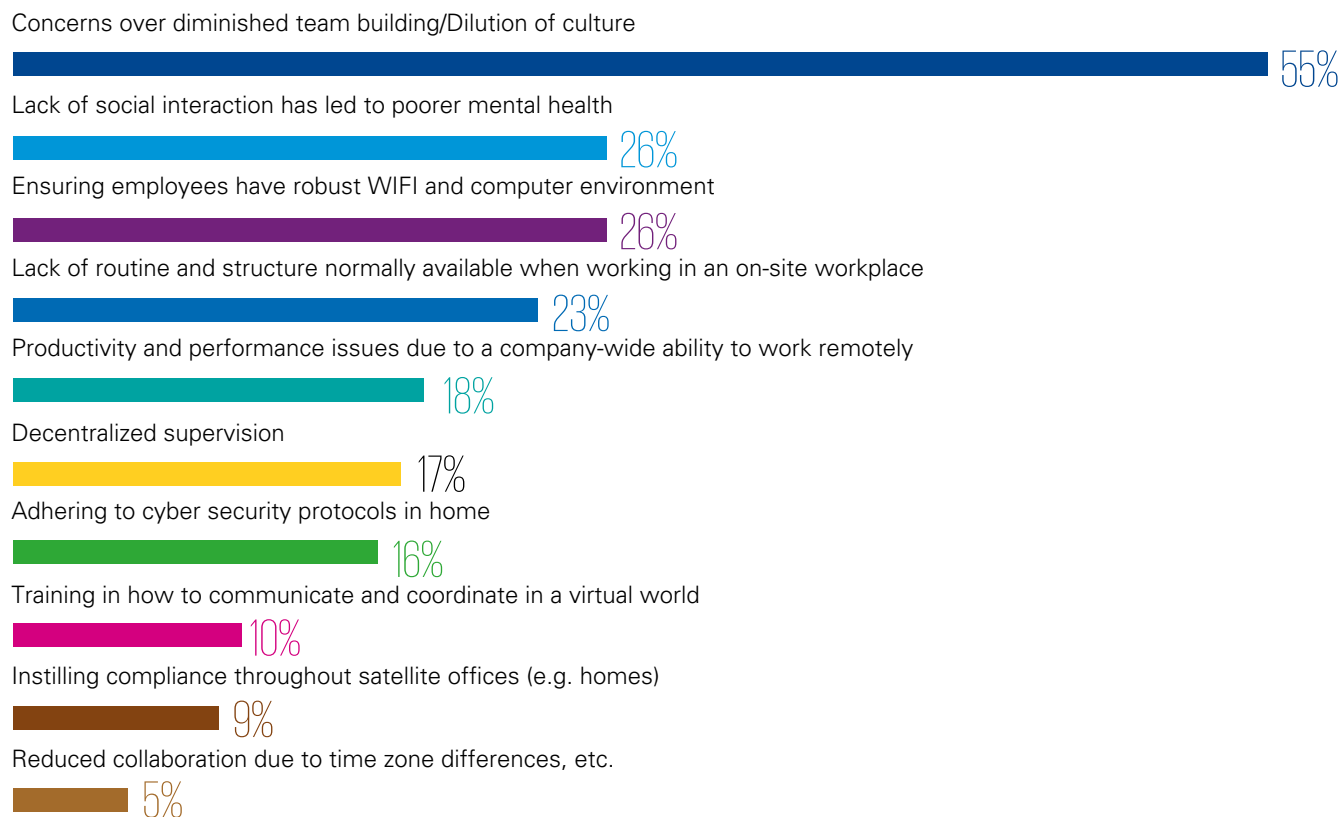
Almost every executive that KPMG and AIMA interviewed noted the impact that a decentralized work environment was having on their performance culture. “The value of culture, collaboration and face-to-face interaction cannot be underestimated,” says one large fund manager. “Not just for the overall success of the organization, but also for the well-being and mental health of employees.”

Managers are particularly concerned about their ability to maintain a high level of engagement with their employees. In fact, 55 percent of the survey respondents say they have concerns about diminishing team building and culture.

While working from home does have its benefits (being closer to family and zero/little commute time, for example), many employees seem unable to ‘switch off’ from the job, working longer hours. One-in-four firms are concerned that the lack of routine and structure, together with long periods of isolation from colleagues, is starting to have a negative impact on the health of their employees.

Conversations with industry leaders highlighted some of the key concerns firms have about employee stress and mental health, particularly if they are exposed to further lockdowns. Many talk about encouraging employee engagement through events like Zoom Socials, weekly quizzes and team catch-ups; the fund managers interviewed stressed the importance these initiatives play in ensuring employees remain motivated, engaged with their colleagues and embedded in the firm culture.

Which of the following has been the greatest challenge for the firm (when most staff have had to work remotely)? Please select your top two choices.



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020



The eight topics defining the Hedge Fund Manager’s agenda

- 1 Attracting and retaining talent
- 2 Embracing a new reality
- 3 Smart sourcing
- 4 Innovating the IT environment
- 5 Returning to the office
- 6 Investor Relations 2.0
- 7 Driving for efficiency
- 8 Planning for the future

2

Embracing a new reality



The eight topics
defining the Hedge
Fund Manager's
agenda

1

Attracting and
retaining talent

2

Embracing a
new reality

3

Smart
sourcing

4

Innovating the
IT environment

5

Returning to
the office

6

Investor
Relations 2.0

7

Driving for
efficiency

8

Planning for the
future

The pandemic has brought about significant changes in the way many fund managers operate. Decentralized work environments, virtualized channels, increased reliance on digital technologies and the potential for continued rolling lockdowns are catalyzing most managers to adapt to a new reality.

Many have adapted quickly. Given their size and presence of operations, larger managers may have been able to do so quicker than the smaller-sized firms; one-in-three smaller firms are having to spend more time ensuring their employees have the technology and connectivity they require in order to stay connected, compared to one-in-five of the larger firms.

When compared to their larger peers, smaller firms are also spending more time working with their employees to ensure they adhere to cyber security protocols while working remotely (an issue we discuss in more detail later in this report). However, our discussions suggest none of this has been a major operational impediment to firms of any size during this situation.

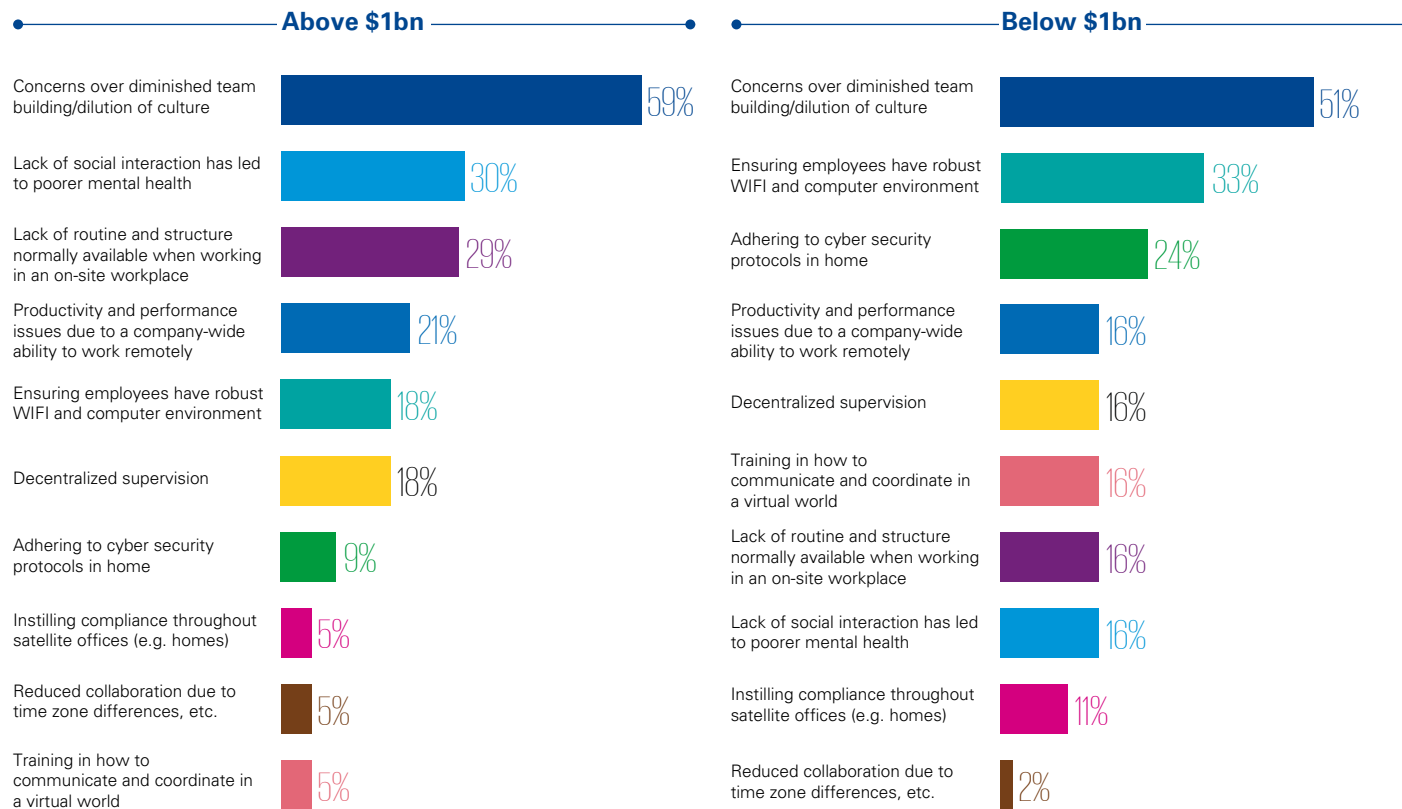
Many fund managers see a silver lining to the ongoing disruption. Some have indicated that their employees are enjoying a greater work-life balance and greater job satisfaction as a result of remote working. Almost half of our respondents say they see their new work arrangements having a positive impact on sustainability and employee mental health.

“Working from home (WFH) has proven to be far more effective than we originally expected, particularly for the portfolio management side of our business,” notes an Australia-based Asset Manager. “Staff have been very happy with the flexibility WFH brings and are enjoying a much better work/life balance.”

“The COVID-19 pandemic has thrust flexible operating models into the limelight. However, at an infrastructure level, this is not breaking new ground for our sector. So the focus has been, and needs to be, on supporting our human capital into the new normal.”


Dan Page,
Head of Asset Management Advisory,
KPMG Ireland (London)

Which of the following has been the greatest challenge for the firm (when most staff have had to work remotely)? Please select your top two choices (by AUM).



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020

7 Agile and resilient: Alternative investments embrace the new reality

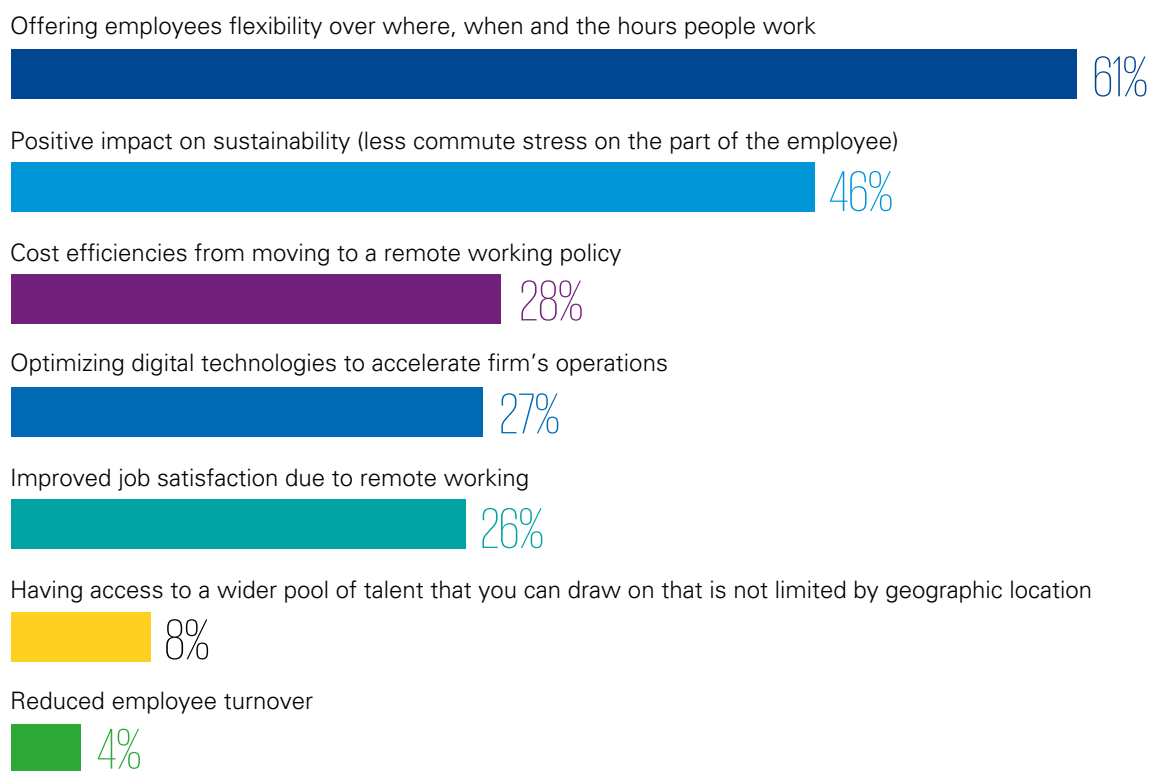
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- The eight topics defining the Hedge Fund Manager’s agenda
- 1
Attracting and retaining talent
- 2
Embracing a new reality
- 3
Smart sourcing
- 4
Innovating the IT environment
- 5
Returning to the office
- 6
Investor Relations 2.0
- 7
Driving for efficiency
- 8
Planning for the future

However, others admit they are judging their employees' WFH performance based on very little actual data. "Right now, it's really just a gut feeling that everyone is pulling their weight and doing their jobs. We don't have a lot of detailed data on individual employee performance when we're not in the office."

Interestingly, just over a quarter of the firms in our research report they are enjoying positive cost benefits from working in a decentralized environment. Conversations with managers indicate that some are enjoying cost savings from making changes to the margins of their operations, including renegotiating contracts with service and data providers.

Which of the following has been the greatest opportunity for the firm because of remote working? Please select your top two choices.



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

3

Smart sourcing



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

9

Agile and resilient: Alternative investments embrace the new reality

COVID-19 demonstrated to many fund managers that not everything needs to be operated in-house. In fact, some processes and functions might actually perform just as well in a remote and virtualized environment.

An overwhelming 71 percent of respondents agree that the current experience of working remotely has convinced them they could achieve better cost efficiencies if they outsource some of their operations. Approximately one-in-five firms say their outsourcing decision is being influenced by employee health concerns related to returning their own people to the office environment.

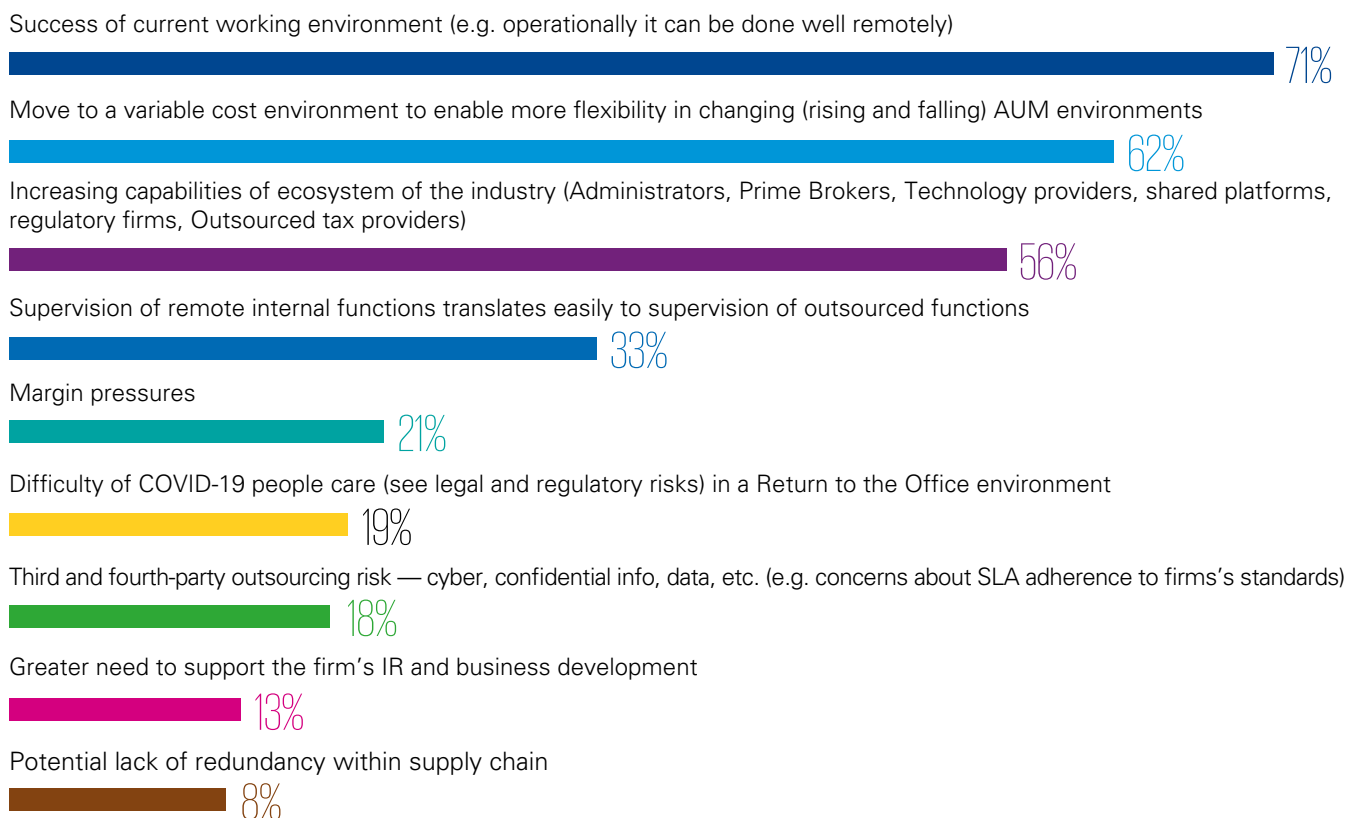
Interestingly, this is catalyzing fund managers to consider which functions are best performed in an office environment and which can continue to be managed remotely in light of employee health and safety. Many are exploring various 'hybrid models' that allow some functions to work remotely irrespective of whether they are part of the firm or outsourced to a third party.

Many firms also point towards potential cost and business agility benefits of outsourcing. One-in-five admit they are moving towards outsourcing additional functions to better manage margin pressures. As one North American manager sensibly noted, "those that get the balance to outsourcing right will be able to scale their costs both during this disruption and going forward."

Managers at bigger, more established firms suggest that COVID-19 has accelerated, but not changed, their existing outsourcing models and strategies. "The more established firms have been outsourcing for years now and have not really made any changes based on COVID-19," observed the CEO of one of the world's largest global private wealth management firms.

“
71 percent agreed that the current experience of working remotely has convinced them they could achieve better efficiencies if they outsource some of their operations.”

**Which of the following have been your firm's greatest reasons for outsourcing?
Please select your top three choices.**



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020

10 Agile and resilient: Alternative investments embrace the new reality



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

Smaller-sized firms, on the other hand, seem to be more motivated about moving towards a more variable cost environment and are more confident in the strength and efficiency of the fund management ecosystem, suggesting a broader adoption of outsourcing as a long-term business strategy.

The data suggests that not all functions are being considered for outsourcing, however. For example, 61 percent of respondents say they are likely to outsource their administrative services and 55 percent say they will likely outsource their tax and accounting services. Yet less than 5 percent of respondents say they are likely to outsource their Trading or CFO/Treasury functions.

However, KPMG and AIMA professionals conversations with industry insiders suggests greater use of outsourced CFO, Treasury and Trading functions than this data indicates. In fact, there appears to be a remarkable uptick in demand for outsourced trading, in particular, in both the Americas and Europe. Many are also now working closely with their outsourced Administration services providers to widen the scope of their collaboration.

As one global fund administration services provider noted, “Alternative fund managers are looking at increasing their use of outsourced operational and technological solutions to drive efficiency and generate cost savings within their operations.”

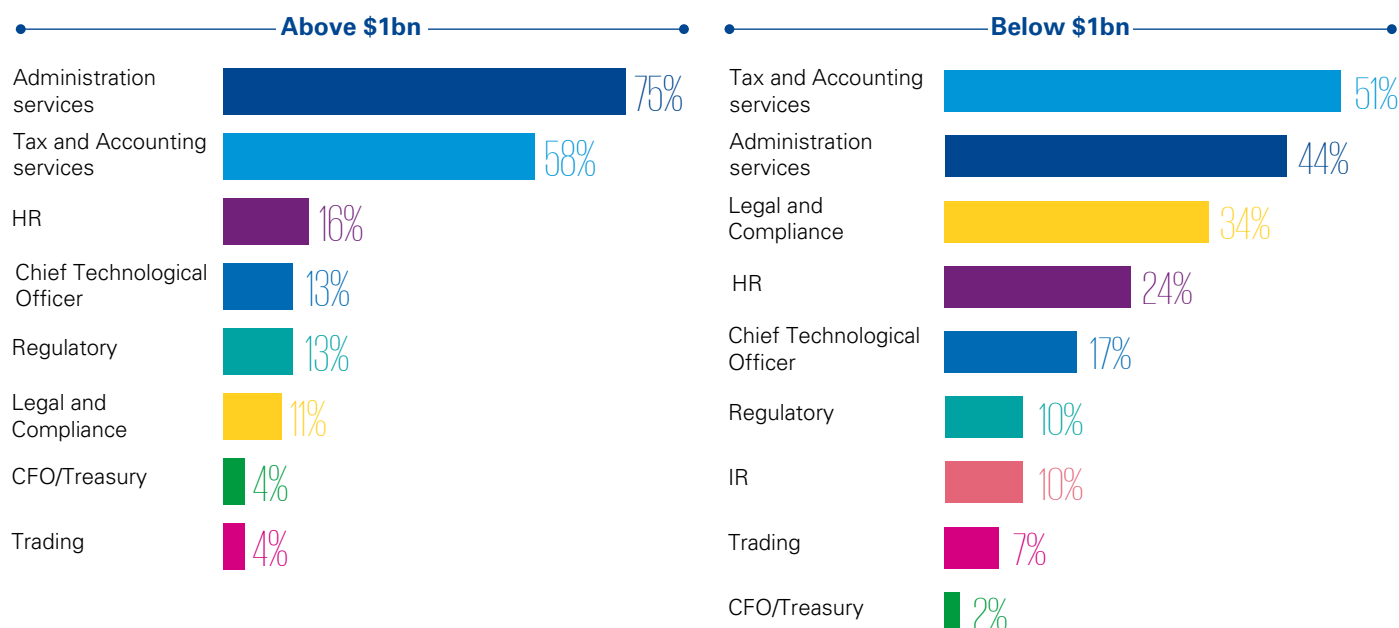
Yet few expect to outsource their existing IR functions. As is noted later in this report, many funds see IR as key to driving growth in a decentralized environment. Conversations reinforce this notion. “Investor relations, in particular, should be kept in-house,” stated an executive at a large global fund. “Their connections to people and history with enterprises proved very valuable in the remote working environment.”

Indeed, the fund managers we interviewed seem focused on reducing the complexity of anything they deemed non-core to their specific business. But they also understand that — while these roles can be delegated — the responsibility and ownership remains with the firm. Simply put, it is the fund managers that will ultimately need to answer to any issues regarding non-compliance. Expect the role of the COO to expand even further as these leaders oversee the supply chain requirements of the outsourced functions.

“The vast majority of emerging managers and firms start with the assumption that they will be outsourcing key functions from the very beginning. It’s that cost scalability that underpins their business model. Investors understand this and — as long as the managers are able to integrate with their providers — are very comfortable with the approach.”

Christopher Mears,
Partner, National Emerging
Manager Practice Leader,
KPMG in the US

Which of the following functions of the firm are more likely to be outsourced? Please select your top two choices (by AUM).



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The eight topics defining the Hedge Fund Manager’s agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

4

Innovating the IT environment



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

COVID-19 made the importance of having a strong technology backbone and infrastructure clear. Had this pandemic happened just 10 years earlier, few doubt the industry would have responded so resiliently.

Not surprisingly, the results from the survey suggest that many fund managers and industry participants are placing significant focus into ensuring their IT and infrastructure continues to allow their people to deliver on their mission without distraction.

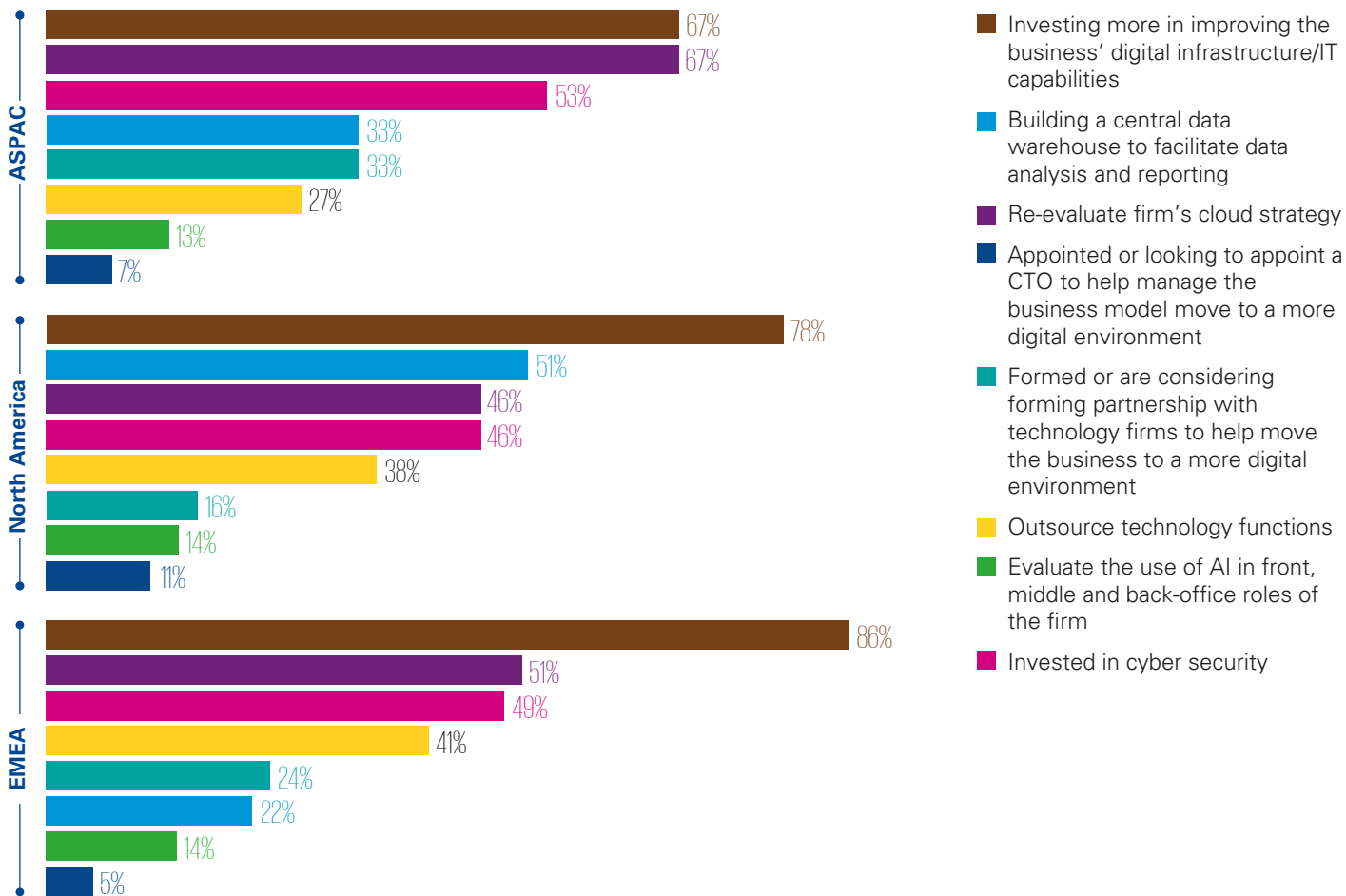
More than 80 percent of the respondents to the survey say they are now investing more into improving the business's digital infrastructure and IT capabilities. Half of the firms say they are investing in cyber security and one-in-three firms say they are building a central data warehouse to facilitate their firm's data analysis and reporting.

At the same time, half of all the firms in the research admit that, while their cloud technologies may have allowed them to operate effectively to this point in the pandemic, they are now re-evaluating their firm's cloud strategy to see how they can improve their use. According to one IT service provider, "The operational requirements created by the current remote working environment has highlighted the importance of cloud-based technologies." Almost 40 percent of firms also say they are outsourcing their technology functions, with smaller firms almost 10 percentage points more likely than larger peers to consider this approach.

“The regulators in Hong Kong (SAR), China are very focused on cyber security and, throughout the COVID-19 experience, they have been emphasizing the need for financial services firms to protect customer and financial data.”

Bonn Liu,
Head of KPMG's Asset Management practice in the ASPAC region and KPMG China

What changes have you made to your firm's IT/infrastructure strategy during this time? Please select your top three choices (by Firm HQ).



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The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

The need for enhanced cyber security in a decentralized environment is, however, causing increased concern. The survey indicates that nearly three-quarters of all managers are concerned that their new decentralized work environment is increasing the risk environment. Seventy percent of all respondents worry that their employees may be more susceptible to attacks while working from home.

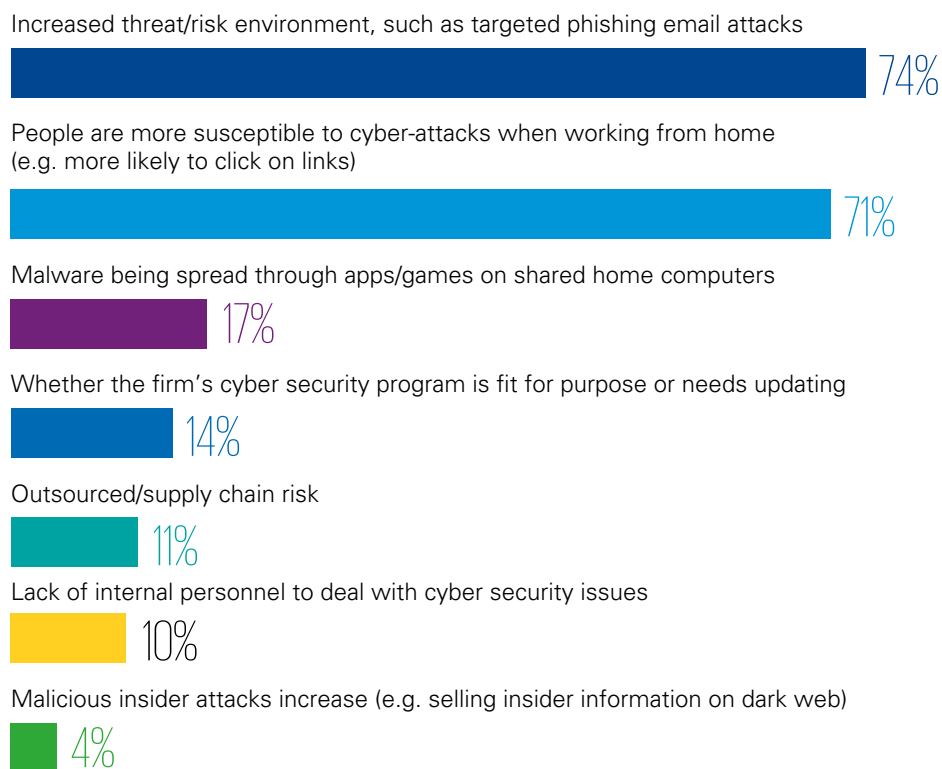
Many technology and cyber professionals are concerned about the challenges they will face securing their perimeter as employees work from a variety of locations over the next 18 months.² As one US-based fund manager put it, “everyone is at greater risk from a cyber security standpoint.” However, our shared view suggests those firms with employees operating largely on firm-issued devices, secured routers and compliance protocols may be in a somewhat more defensible position.

While cyber security may be a top concern for the managers in the survey, KPMG and AIMA professionals conversations with industry players suggests most are confident with their current cyber security stance. Additional vigilance will be required, which may include increased focus on training and testing if working from home continues for a protracted period.

“We had already outsourced much of our technology needs prior to the pandemic,” noted a large Asia Pacific fund manager. “We remain vigilant about the cyber threat, but we don’t think we need to invest more at this time.”

Interestingly, concerns regarding risk from outsourcing came low down the list with just 11 percent of respondents noting third party risk as a concern. Given the current move towards a greater adoption of outsourcing, one might expect this issue to rank higher on fund managers’ agendas.

Which of the following has been your firm's key cyber security concerns arising from COVID-19? Please select your top two choices.



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020

² <https://www.infosecurity-magazine.com/news/identity-governance-return-work/>



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

5

Returning to the office



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

While fund managers and executives are bullish about their ability to maintain their firm’s operations and performance in a decentralized environment, many are looking forward to an eventual return to the office.

However, conversations with managers conducted since July suggest few believe this will be any time soon. Firms that once believed they would get back ‘as soon as possible’ now say they don’t expect a full return until ‘sometime in 2021’. Some of the leaders we talked to seem resigned to the idea that they won’t get back to business-as-usual until the summer of 2021 at the earliest.

Many survey respondents and interviewees are concerned about the impact this may have on staff morale and mental health. “Remote working is wearing people out already and, with social distancing, you can’t even go out to blow off steam or take a vacation,” replied one manager. “Burn out is a very serious concern.”

At the same time, the survey suggests many are concerned about the compliance-related aspects of re-opening the office. Thirty-nine percent say they are concerned about updating their business continuity plans to properly address pandemic response and remote working.

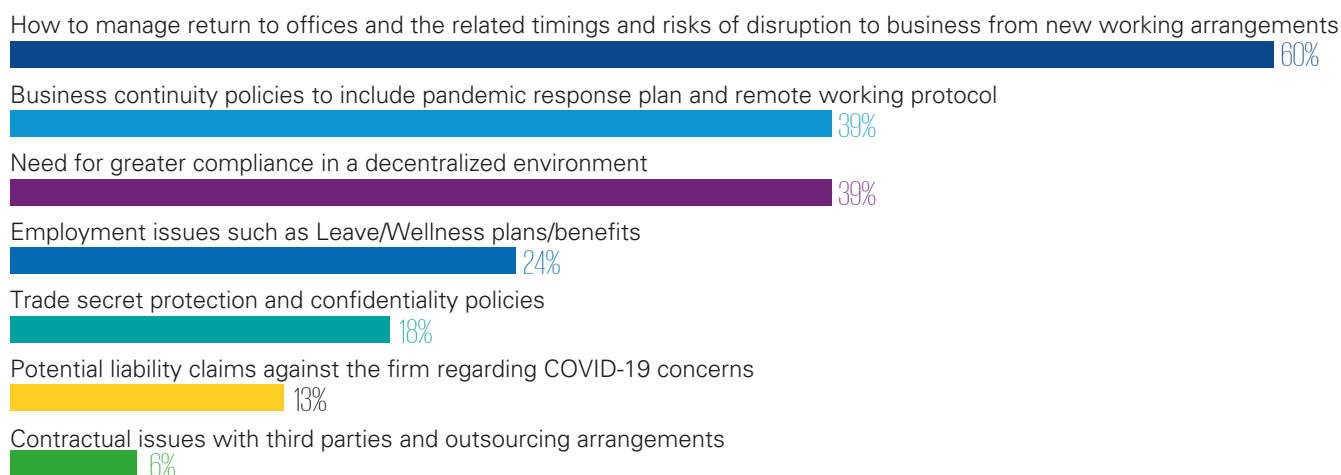
Interestingly, less than two-fifths of respondents noted concerns regarding their ability to maintain a high level of compliance in a decentralized environment. While regulators may currently be focused on keeping economies liquid and orderly, KPMG’s and AIMA’s conversations suggest it will not be long before they start reviewing how various industries performed from a compliance perspective. Our discussions indicate compliance will almost certainly move up the agenda as the pandemic evolves.

Contracts, liability waivers and workplace protocols are also increasingly coming under the microscope. One-in-four managers say they are concerned about the impact of remote working on employee wellness plans and benefits. Managers have also been talking about what liability waivers may be required from employees in order to indemnify the firm when employees do return. A small number (6 percent) are also considering whether they will face contractual issues with third parties (such as landlords) as they change their operating models.

“The managers KPMG Professionals are talking to are certainly ardent to get their people back into the office as soon as it is safe to do so. Not just to interact with clients and LPs, but also to help ensure they can continue to maintain their culture and encourage investment collaboration.”

Andrew Weir,
Global Head of Asset Management,
KPMG International

Which of the following has been your firm's key compliance concerns arising from remote working? Please select your top two choices.



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The eight topics defining the Hedge Fund Manager’s agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

Regardless of whether employees return to the office, the majority of managers believe they will need to deal with a wide variety of new workplace considerations. More than 60 percent of survey respondents say they are considering modifications to the workplace in order to meet the social distancing guidelines being imposed.

Even where offices never fully closed or where businesses are slowly returning, the wider implications of COVID-19 are having an impact. "Having kids out of school is putting additional strain on parents trying to work from home," cautioned a lawyer at one Chicago-based firm, suggesting firm diversity may be

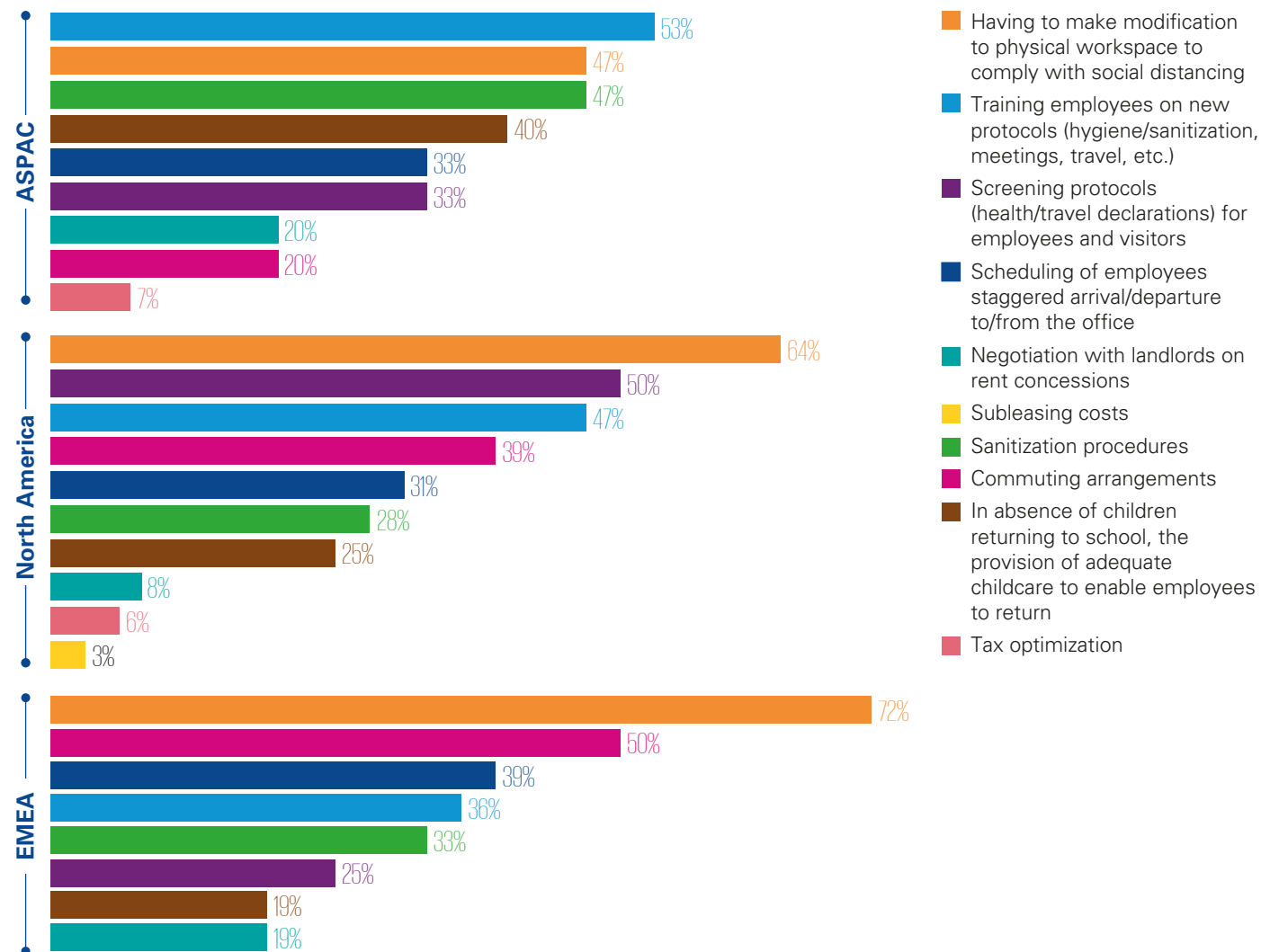
eroded as a result. "Our management team's greatest concerns are around finding appropriate child-care for employees and finding them secure transportation to the office," pointed out one US-based manager.

Particularly for offices situated in the US Northeast and in London, UK, concerns about getting employees to and from the office safely are having a massive impact on the timing for firms returning to work. Forty-two percent say they are thinking about employee commuting arrangements with one-in-three firms saying they are considering staggering the arrival and departure times of employees.

Many managers are also thinking about health and safety. Almost half of all firms (44 percent) say they will need to train employees on new protocols. A third of all respondents say they are considering implementing new sanitation procedures and screening protocols.

KPMG firms and AIMA experience suggests the leading Hedge Fund managers are taking a very flexible and collaborative approach to developing their 'return to the office' plans. Rather than appointing a single individual, most firms are working in committees that bring together key positions and functions including risk, compliance, HR and operations.

Which of the following issues is the firm considering as staff return to the office? Please select your top three choices (Firm HQ).



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

6 Investor Relations 2.0



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

A significant part of any client-facing role is — just that — being in front of clients and prospects. For IR teams, it is often easier to assess responses to questions, understand body language, and relay complicated messages when they are in the same room as their clients. There is no real replacement to being in the company of someone you are trying to discuss an opportunity with.

However, Hedge Fund IR teams have also clearly proven they have evolved since the last financial crisis. Procedures have been enhanced and lessons have been learned.

In part, the enhanced response of the IR function is due to the significant work that has taken place over the past decade to enhance investor reporting (depending on the strategy or fund structure, this can be as frequent as daily, monthly or quarterly), including position-level risk reporting or other forms of portfolio attribution.

“The end goal of risk management is to integrate data and analytics from all parts of the investment process through a single platform,” suggested an executive at one risk management services firm. “That allows you to make informed decisions of the market, credit, liquidity and other risks faster.”

The shift to the decentralized workplace has added some new complexities to the IR function. With face-to-face meetings now all but impossible, it is perhaps not surprising that the majority (58 percent) of Hedge Fund managers say they have needed to optimize their use of digital tools (such as video conferencing and data rooms) within the IR function.

That being said, the lack of in-person meetings has forced many managers to rethink the way they manage investor due diligence and reporting. Around one-in-five say they are working to enhance the transparency and risk reporting of their underlying funds. One-in-ten say they are considering offering bespoke reporting and services if required.

“Going virtual has leveled the playing field,” suggested one mid-sized Australian fund manager. “It was always difficult to persuade investors to travel to conferences or to meet in person. Now, investors seem much more open to meeting virtually.”

During this period, investment managers are stepping up not just to provide portfolio transparency but also to be knowledgeable partners during this crisis. Regularly scheduled meetings are being moved to calls or video conferences, while operational due diligence meetings are proceeding via lengthy video conferences.

The flexibility of the virtual outreach is benefiting both investors and managers. For the former, it is allowing them to meet many more prospective clients via video conference than having to travel and meet them in person.

“COVID-19 clearly demonstrated the need for strong IR professionals. They were the ones talking to clients throughout the initial market volatility.”

Morag MacLeod,
Director, Asset Management
Advisory practice,
KPMG Ireland (London)

“The concern is that, without the ability to do sufficient in-person due diligence, most investors will simply stick to what they already know and that will favor the bigger, more established players in the market. Less established managers are going to have a tough time raising capital from new investors over the next year.”

Ed Hollywood, Managing Director, Asset Management, KPMG in the US



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

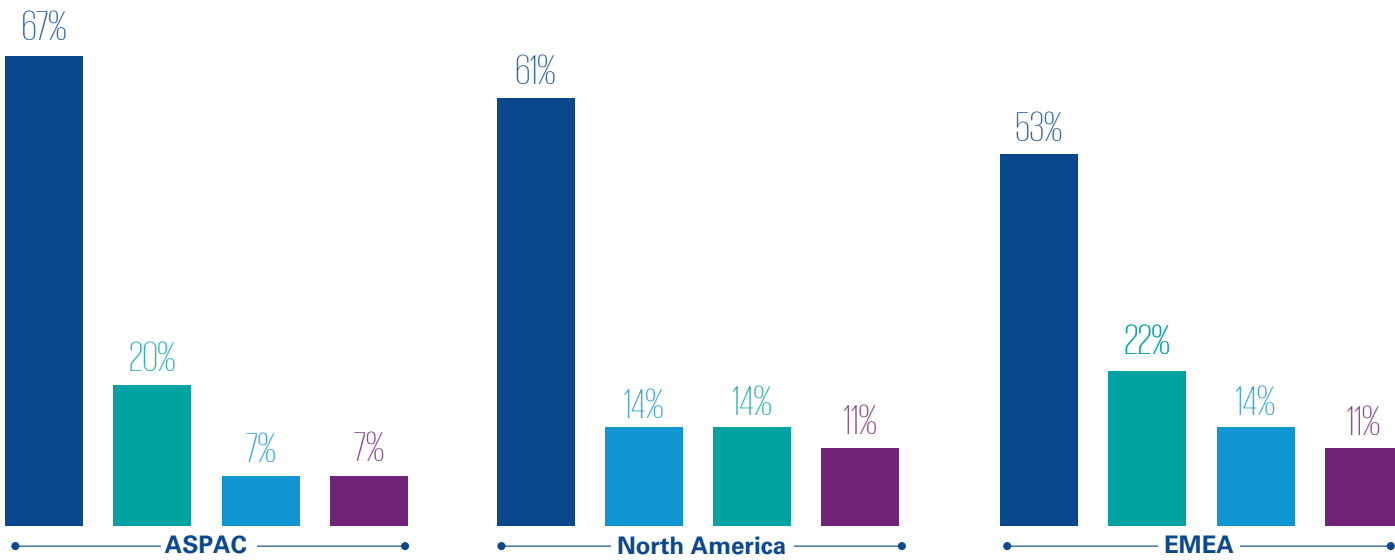
For the latter, going virtual enables the CEO and CIO to interact more regularly with many more investors. Conversations with allocators and industry polls reveal a high level of satisfaction with GP communications during this period.

This period is likely to further boost the appeal of a more customized arrangement between firms and their investors. We expect to see managed accounts and other bespoke arrangements become even more popular, given the greater

transparency and control these offer investors. Further, the prime brokers that we spoke to mentioned that co-investment deals continue to rise in popularity.

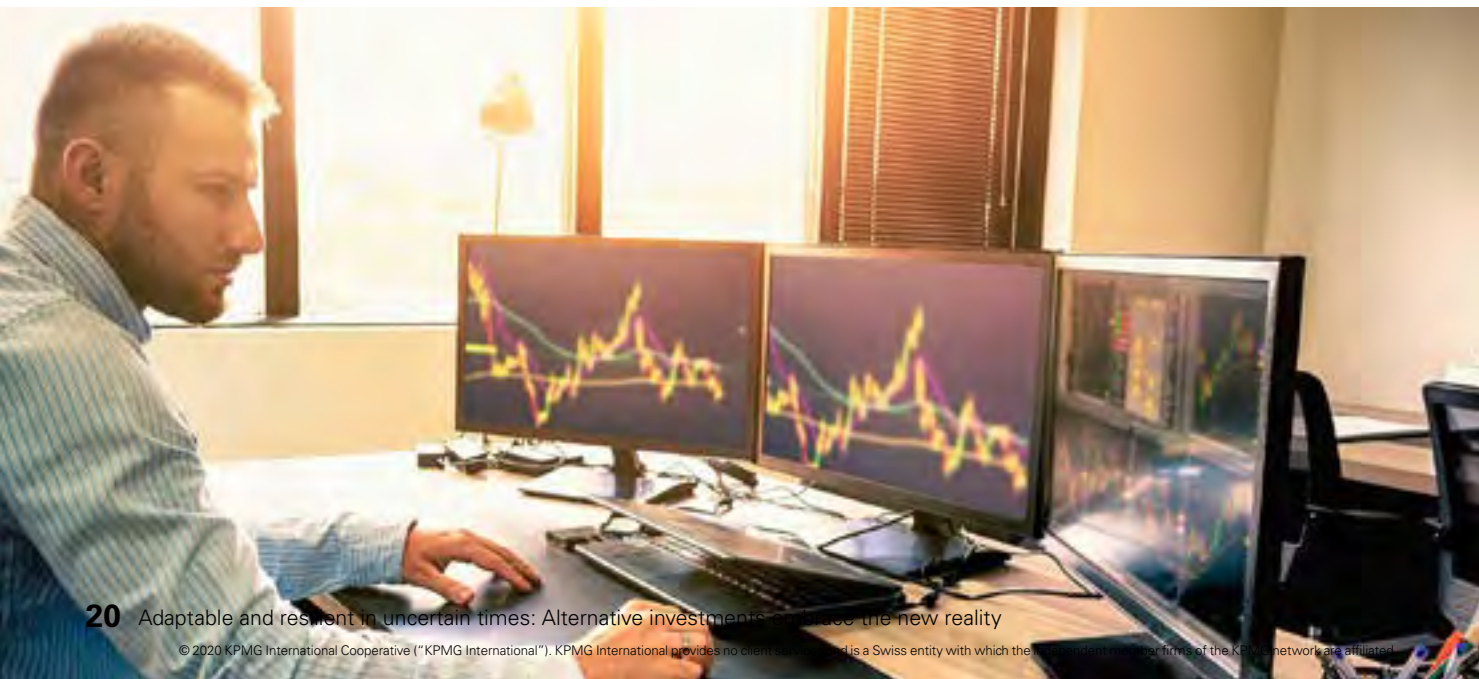
Market data suggests COVID-19 has not reduced investors' appetite for alternative investments. Funds continue to flow into the industry. As the last chapter of this report illustrates, the industry has performed well in helping investors reduce risk and manage volatility.

Which of the following changes have you made to improve the firm's IR model during this time? Please select your top choice (Firm HQ).



- Discussing new investment products to capture current, possible, opportunities
- Enhanced transparency and risk reporting of underlying funds
- Offering bespoke reporting and services for different investor types
- Optimizing use of digital tools (i.e. video conferencing, data rooms)

Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

7 Driving for efficiency



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

Even before the pandemic, Hedge Fund managers had been feeling the pressure of margin compression. While the fundamentals of the market remain the same — those that can consistently outperform the market tend to enjoy significant fee elasticity — the pandemic has forced many managers to further examine their cost structures.

Margins remain under pressure and most managers continue to look at ways to improve their cost ratios and structures. As highlighted earlier, a significant number say they will manage costs through outsourcing while others will likely reduce some costs now that employees are largely working from home.

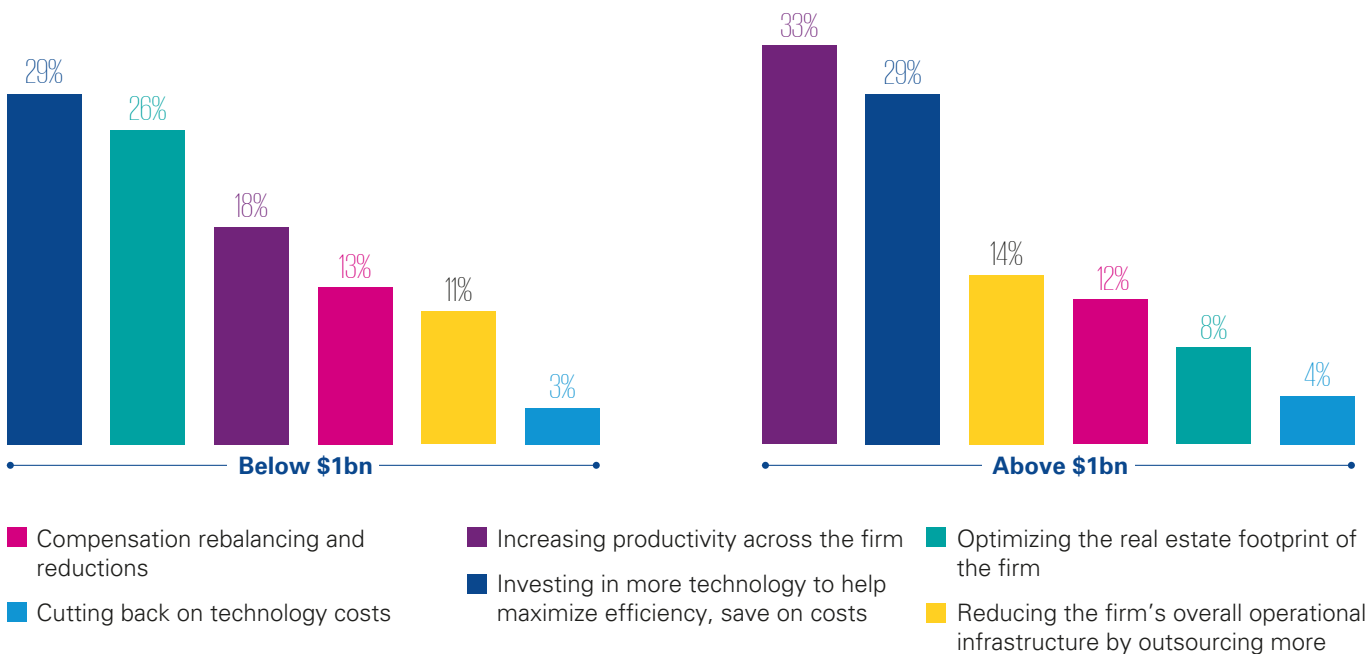
However, the majority expect to manage margins by increasing productivity and efficiency. More than a quarter of our respondents say they have plans to increase productivity right across the firm by using new technologies which they hope will deliver the efficiency enhancements that they require.

Smaller firms and larger firms diverge on their plans to manage margin compression going forward. Smaller firms (those with AUM of less than US\$1 billion) are three times more likely than larger firms to be optimizing their real estate footprint. Larger firms are almost twice as likely as their smaller peers to be planning for productivity gains.

“Interestingly, KPMG Professionals have heard very few managers complain about fee compression during this pandemic. As long as managers are sticking to the strategy and continue to perform at — or above — market average, investors are willing to continue to pay the management fees. Serious investors aren’t expecting a COVID-discount.”

Steven Menna,
National Hedge Fund Segment Leader,
KPMG in the US

How is your firm managing any margin compression it is experiencing during this disruption? Please select your top choice (by AUM).



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020



The eight topics defining the Hedge Fund Manager’s agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

The data indicates that most fund managers are working towards cost sustainability and tighter margins. Like most businesses at this time, some are having to make tough decisions to manage their business through this period.

For example, 14 percent say they are considering making reductions to their compensation in order to manage costs (a strategy that will likely erode employee engagement and undermine talent strategies) while three percent say they will reduce their investments into technologies (a move which seems counterintuitive in a digital environment).

“Should this period of remote working become more protracted, it will be interesting to see whether fund managers will start to reconsider their rent costs and office footprint in the new reality. Most managers we talk to say they plan to return to the office. Some never left; however, should this situation continue as lease agreements come up for renewal, some may decide they no longer need all of that real estate.”

Joseph Fisher,
Senior Partner, Asset Management,
KPMG in the US

“Like any other business, Hedge Fund managers are being prudent about managing their bottom line. The pandemic has not accelerated this — Hedge Funds are using basic business sense to seek out additional operational efficiencies by outsourcing non-core activities and partnering with technology firms and specialist service providers.”

Tom Kehoe,
Managing Director and Global Head
of Research and Communications,
AIMA



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

8 Planning for the future



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

Of course, the biggest question on Hedge Fund managers' minds is what the future holds. Unfortunately, there are no certainties, and much depends on the course of the virus and its related impacts on the economy, investment activity and asset valuations.

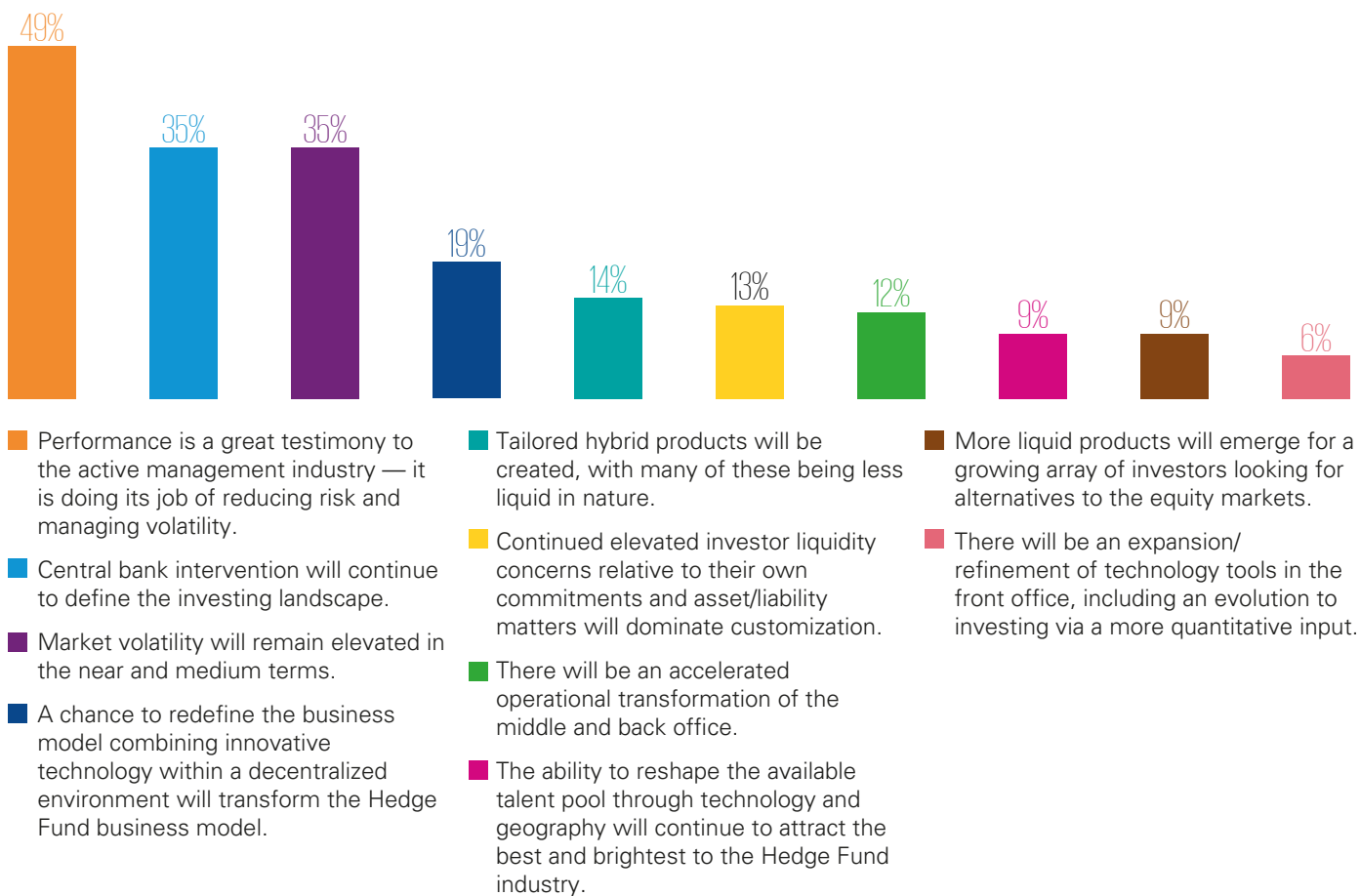
Fund managers are planning for both opportunities and ongoing disruption. Concerns about disruption are front and center with one-in-three saying they expect Central Bank interventions to continue to define the investing landscape going forward. The same number say they expect market volatility to remain elevated in the near and medium-terms.

"It's still early," sighed one manager. "Credit defaults are coming and there is still a lot of uncertainty on how things will play out."

Yet most view the current environment as an opportunity. Conversations suggest some managers expect the industry to experience significant growth over the coming 12–18 months as investors move away from a '60/40' balanced portfolio into a more diversified portfolio supported by an allocation to alternative investments that better enables them to preserve capital and/or provides the opportunity to source differentiated investment exposure with non-correlated returns.

Certain Hedge Fund strategies are witnessing a significant uptick; convertible arbitrage is seeing a resurgent level of interest³; global macro and credit strategies are also seeing a lot of attention. The latter could see significant activity over the coming years as investors look to support the COVID-19 economic recovery via an allocation to non-bank lending. Fund managers involved in the tech, biotech and healthcare sectors are also seeing a lot of interest.

Please pick out the top two statements that best summarize the Hedge Fund industry during this period of COVID-19 disruption:



Source: Agile and resilient: Alternative investments embrace the new reality — KPMG & AIMA Survey 2020

³ According to data from Refinitiv.com, global corporate bond issuance is at its highest level since 2007 with US\$89 billion issued year-to-date.



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

Out of this disruption, KPMG and AIMA also expect to see increased interest in strategies that incorporate ESG and sustainable finance considerations. Sustainability, climate change and social concerns are now considered core risks and objectives by asset managers and allocators.

The data also points to a similar sense of opportunity. One-in-five respondents say they believe this is a chance to redefine

the business model, combining innovative technology within a decentralized environment to transform the Hedge Fund operating model. Fourteen percent expect more tailored hybrid products to be created. In addition, 12 percent expect to see an acceleration of operational transformation in their middle and back office.

Ultimately, however, we see a strong future for the Hedge Fund sector,

underpinned by the industry's agility and resilience in the face of uncertainty. Indeed, the COVID-19 experience has demonstrated the strong investment case for active management. The sector's performance over the past 6 months is a great testimony to the active management industry — it is doing its job of reducing risk and managing volatility.

“

The vast majority of the managers KPMG Professionals interviewed for this report were highly optimistic about their ability to retain performance and growth in this environment. They recognize the risks ahead. But they also view this pandemic as an opportunity to reinvent their business and operating models. All signs point to a Hedge Fund sector emerging stronger as they embrace the new reality.”

John Budzyna,
Managing Director, Alternative Investment Practice,
KPMG in the US



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

Six key takeaways from this research

1



The Alternative Investment sector is resilient; Hedge Fund strategies are back in favor amongst investors; and this has enabled managers to take a measured approach to market and economic volatility.

Culture and collaboration have become key focus points as firms seek to maintain their differentiators in a decentralized environment.



2

3



The pursuit and retention of talent is unremitting and has only accelerated during this time of market disruption and employee dislocation.



4

5



Investments into the IR function are allowing leading managers to successfully and sustainably continue to interact with investors and raise capital.



6

Maintaining a high level of performance in a digital and decentralized environment requires a strong focus on data centralization and cyber security.



The eight topics defining the Hedge Fund Manager's agenda

1

Attracting and retaining talent

2

Embracing a new reality

3

Smart sourcing

4

Innovating the IT environment

5

Returning to the office

6

Investor Relations 2.0

7

Driving for efficiency

8

Planning for the future

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The eight topics
defining the Hedge
Fund Manager's
agenda

1

Attracting and
retaining talent

2

Embracing a
new reality

3

Smart
sourcing

4

Innovating the
IT environment

5

Returning to
the office

6

Investor
Relations 2.0

7

Driving for
efficiency

8

Planning for the
future

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The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with more than 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than US\$2 trillion in hedge fund or private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy, and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the alternative

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