Asset & Wealth Management Benchmarking Insights | Alternatives

Management Companies

September 2022

pwc

Table of Contents

1

Overview

Overview

PwC's Asset & Wealth Management practice is pleased to publish the results from our ***Asset & Wealth Management Benchmarking Insights Series for Alternatives***.

Our benchmarking series is designed to **gather, analyze and share information** about key industry trends and metrics. This report summarizes industry practices related to **alternative fund asset management companies**.

Throughout the report we may bifurcate responses for larger and smaller alternative fund asset management companies where relevant. **Larger** and **smaller** participants are defined as those with **greater than $5 billion**, and **$5 billion or less** assets under management (AUM), respectively.

The information reflected in this report leverages the knowledge and experience garnered from providing audit and tax services to leading alternative fund asset management companies. Our alternative fund asset management companies report captures information from approximately **30 US based alternative fund asset management companies** across various product types and strategies representing **over $740 billion of AUM.** Participants primarily have calendar year ends and include a of combination strategies such as hedge, private equity, credit, and venture capital.

Because of the diverse nature of alternative asset managers, **these results should not be considered representative of all alternative fund asset management companies.** Furthermore, many of the concepts in this report are influenced by the specific facts and circumstances of each participant. Accordingly, these results should be viewed as directional, rather than authoritative, and do not necessarily represent practices that are applicable in all situations. Should you have any questions about the data herein we encourage you to reach out to our team. Refer to the back of the report for our contact information.

We hope that you find this report interesting and useful as you evaluate your organization on the topics highlighted herein.

Executive Summary

Included in this report are details about trending topics and practices employed by alternative fund asset management companies, including information about the parties that **prepare and review** profitability metrics, the **timing** and **frequency** of budgeting and reporting, and how firms **incorporate technology** into these processes. As the industry experiences an influx of capital, many alternative asset managers are seeking ways to make their processes more efficient and scalable, and the implementation of technology in the processes can be a beneficial way to do so. **61%** of survey participants noted that technology has transformed **flexibility** in the workplace.

We looked at how survey participants evaluate **profitability**, including at what level profitability is measured and the metric used to do so (**44%** of participants measure profitability at the individual fund/account level).

We then examined the budgeting process and found that while **92%** of participants have a formalized budgeting process, only **7%** of participants utilize data analytics to enhance this process.

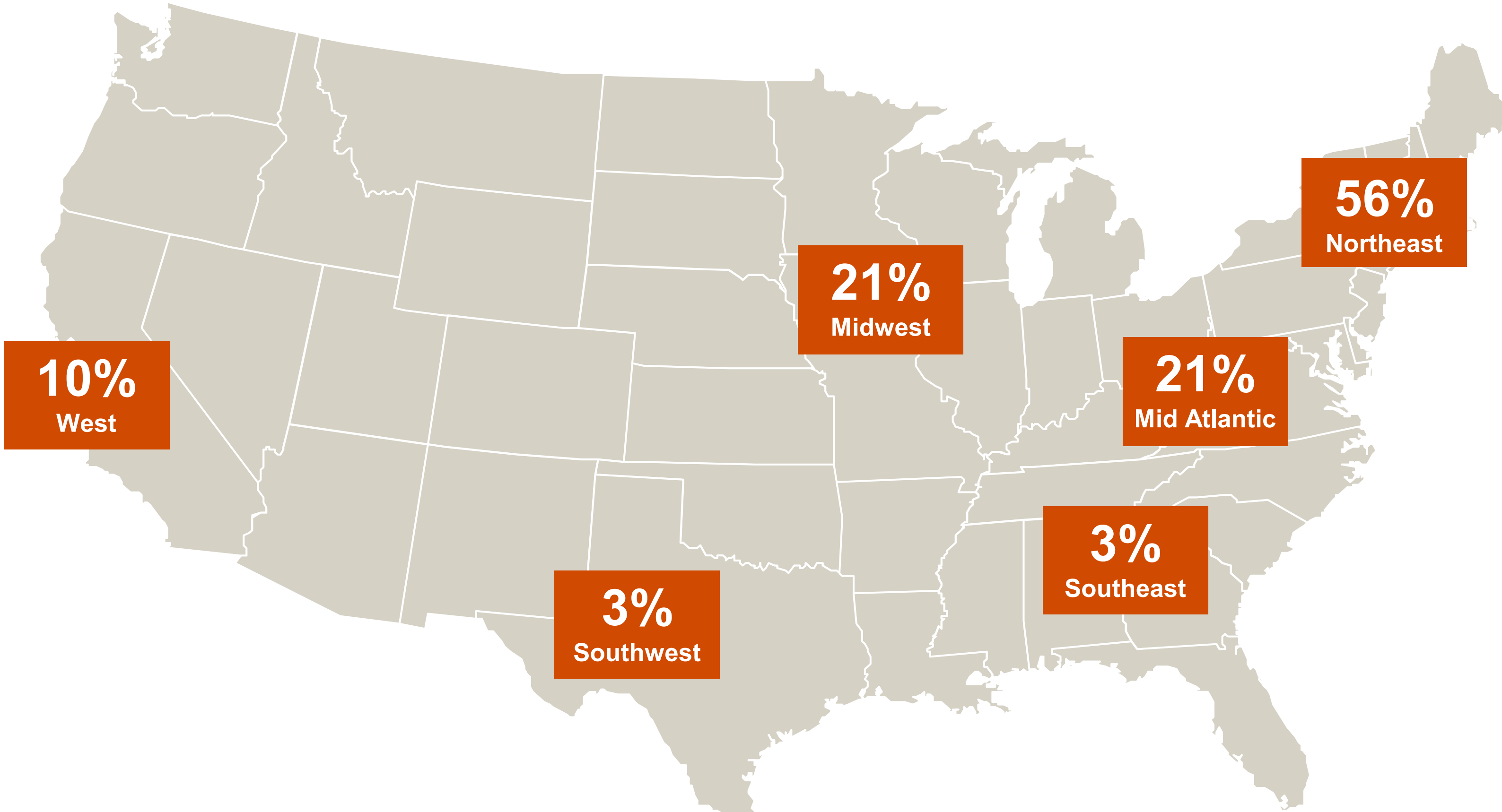
We analyzed **carried interest**, including the allocation of carried interest to company employees and how such plans are accounted for. **75%** of participants award carried interest / incentive fees to employees.

Our report concludes with a look at turnover at financial reporting and tax functions (**50%** of participants with significant turnover encountered difficulty rehiring into these roles) and examined related compensation increases.

2

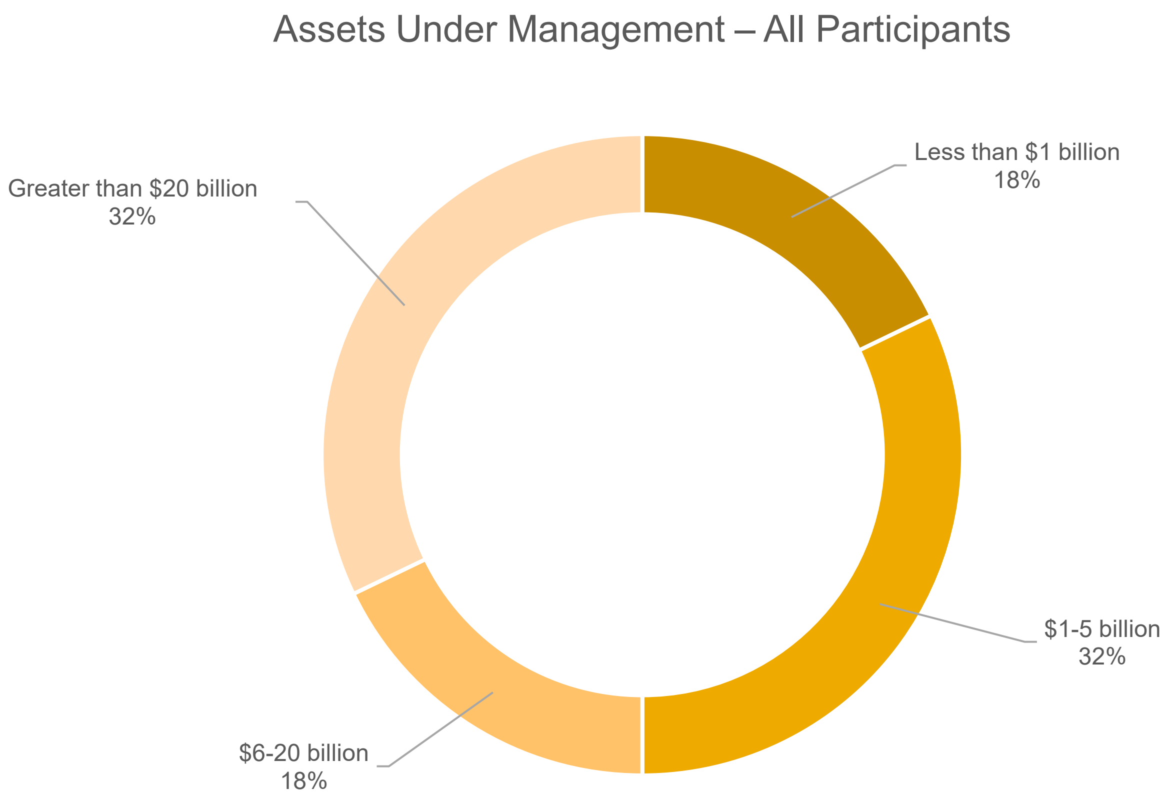
Participant Demographics

Participant Locations

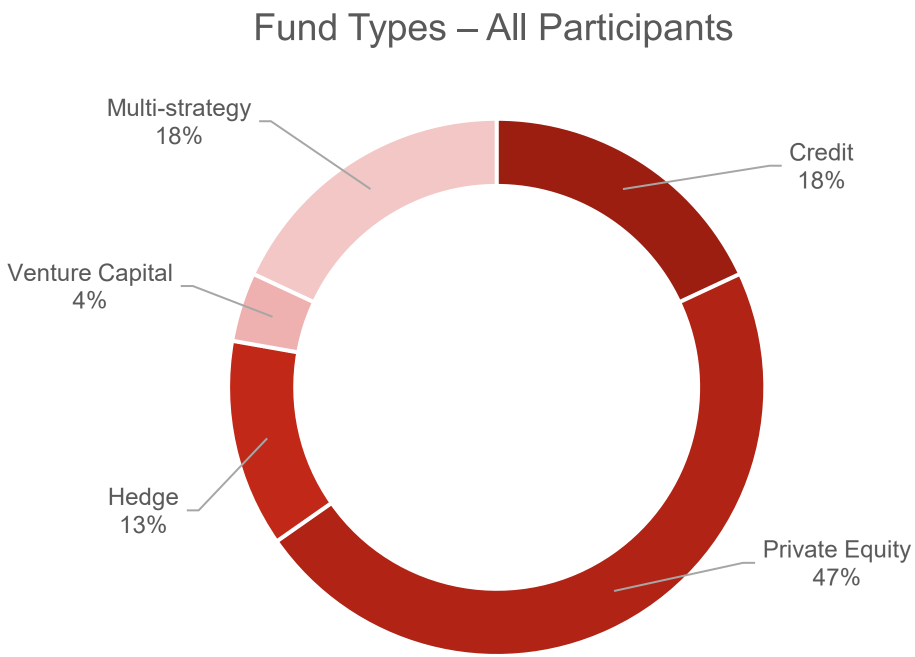


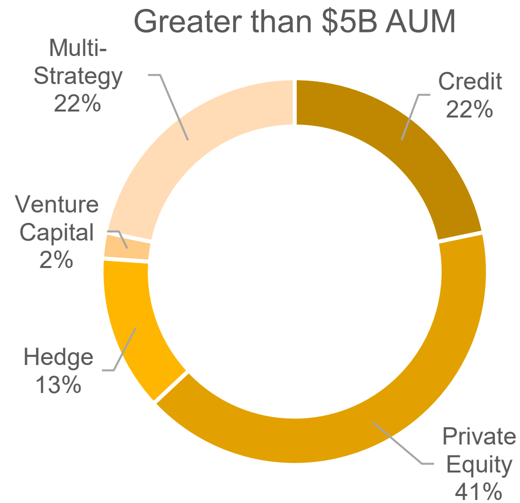
NOTE: Participants were given the option to select multiple locations. Therefore, percentages will not sum to 100%.

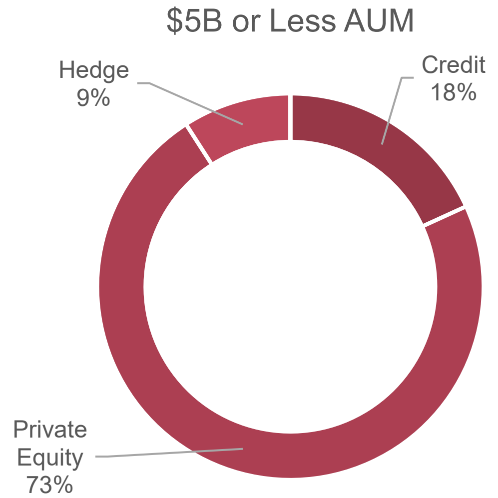
Participant Demographics



Participant Demographics







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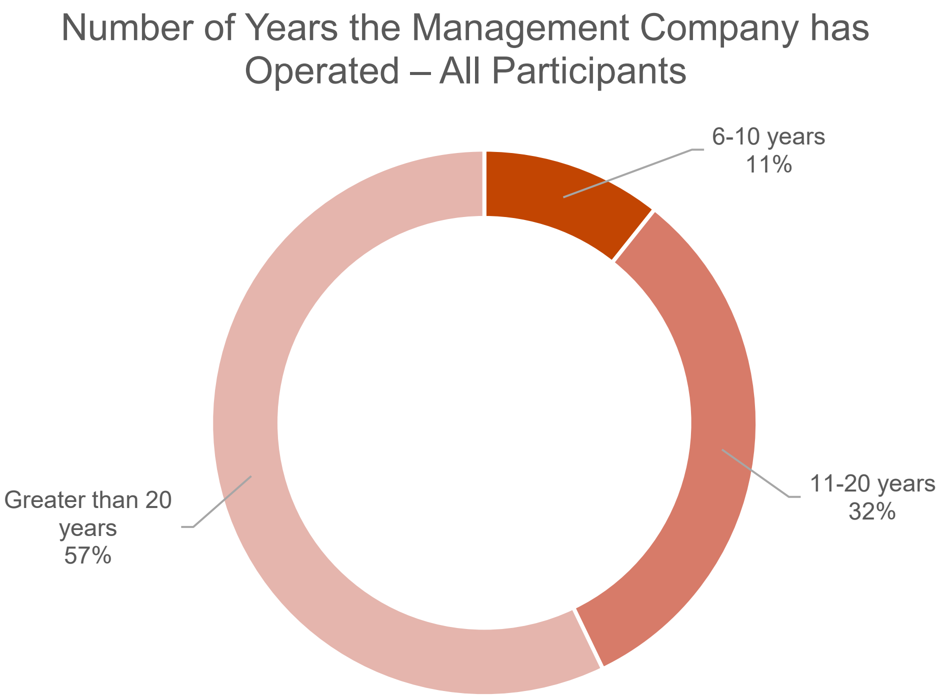
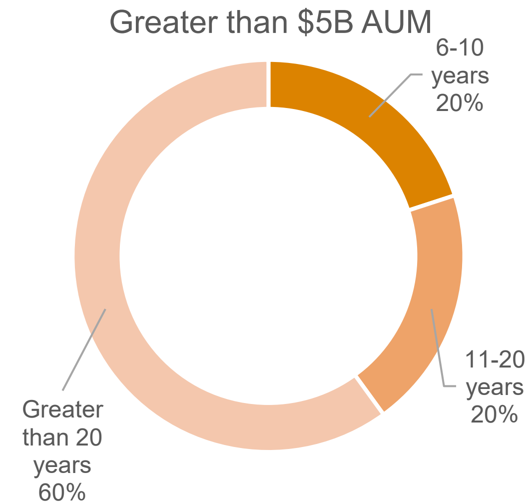
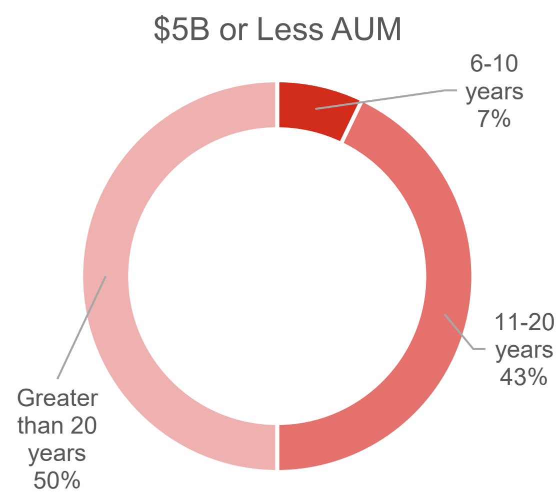
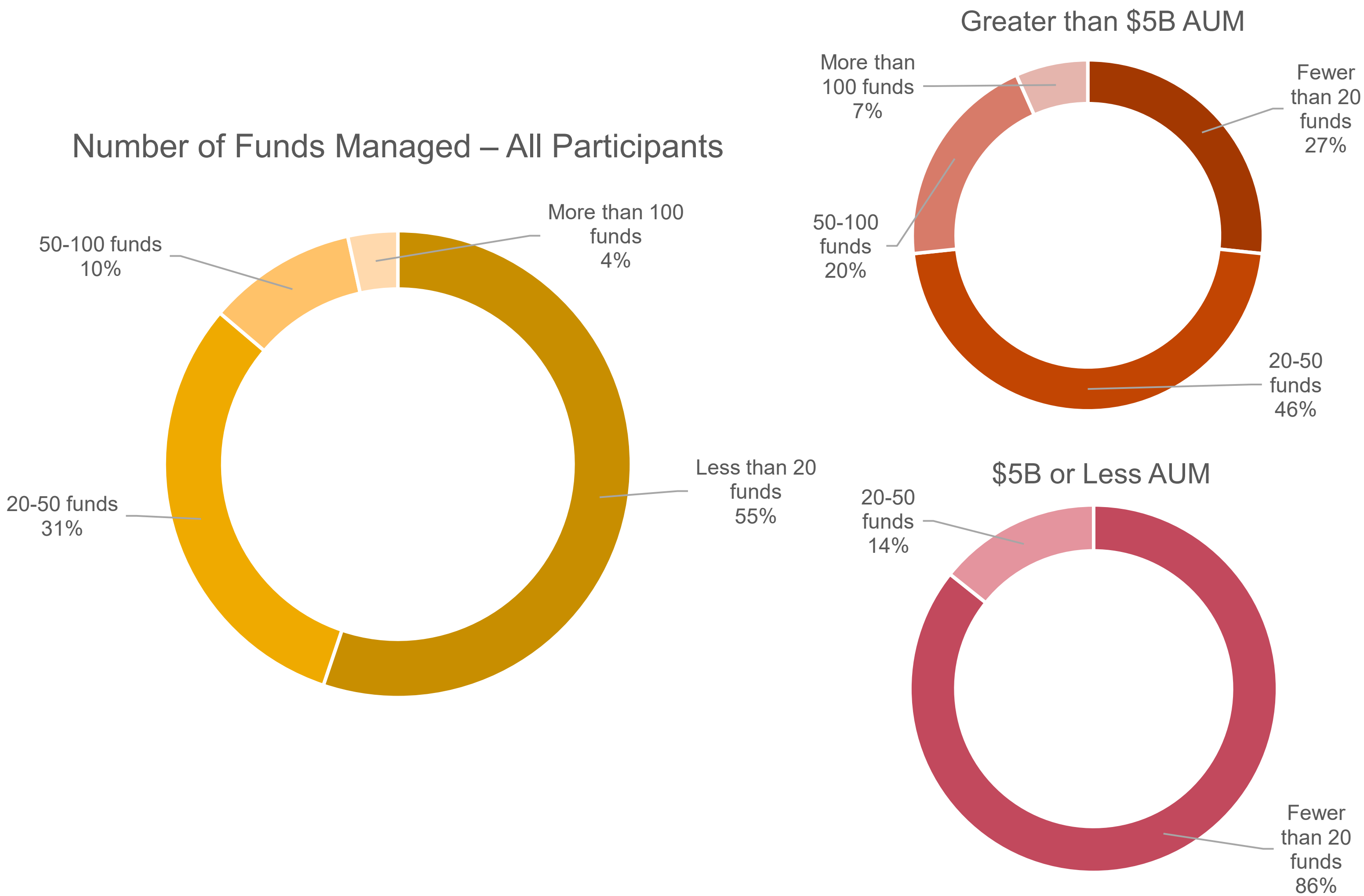






Participant Demographics



3

Profitability Measurement

Profitability Measurement - Metrics

44%

of all participants measure profitability at the fund/account level

Profitability metrics are key decision-making benchmarks for determining product development decisions, infrastructure spending, and incentive compensation. These metrics can also support fee discussions with investors and increase accountability.

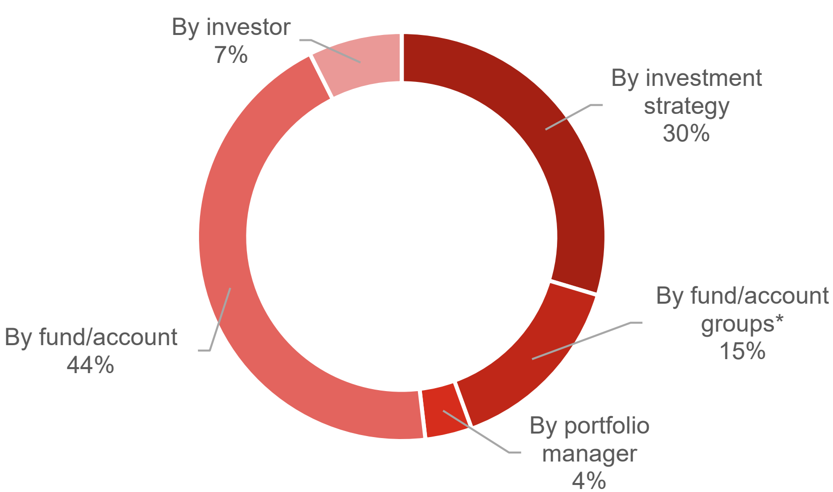
Many survey participants face challenges in enhancing their profitability measurement capabilities, including the manual nature of the process or simply a lack of priority on that function. While there is variability in the review process for profitability metrics among survey participants, most participants have multiple levels of review for such metrics.

Profitability Measurement

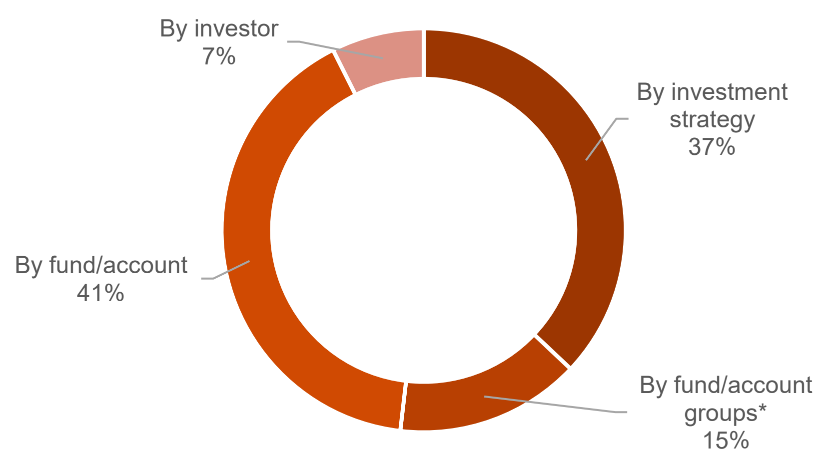
Overall profitability (net income) is the ultimate measure of a company's profitability. However, there are other metrics that survey participants consider and monitor in assessing the profitability of their management company business. Profit on realized performance fees (e.g., carry, incentive, performance) and profit on recurring fees (e.g., management, administrative, monitoring, etc.) are the **top two** other metrics used to measure profitability across survey participants. Other metrics considered by certain management teams are profit on unrealized performance fees (e.g. carry, incentive), distributable earnings, economic/adjusted net income, multiples on invested capital (MOIC), Platform IRR, and performance of individual client accounts and investment strategies.

There is also variability among survey participants as to what level profitability is measured, and how profitability metrics are calculated, as shown in the charts below. In comparing larger vs. smaller managers, we note that larger managers will more often measure profitability at the portfolio manager level and not the investor level, whereas we observe the opposite trend for smaller managers.

At what level is profitability measured?

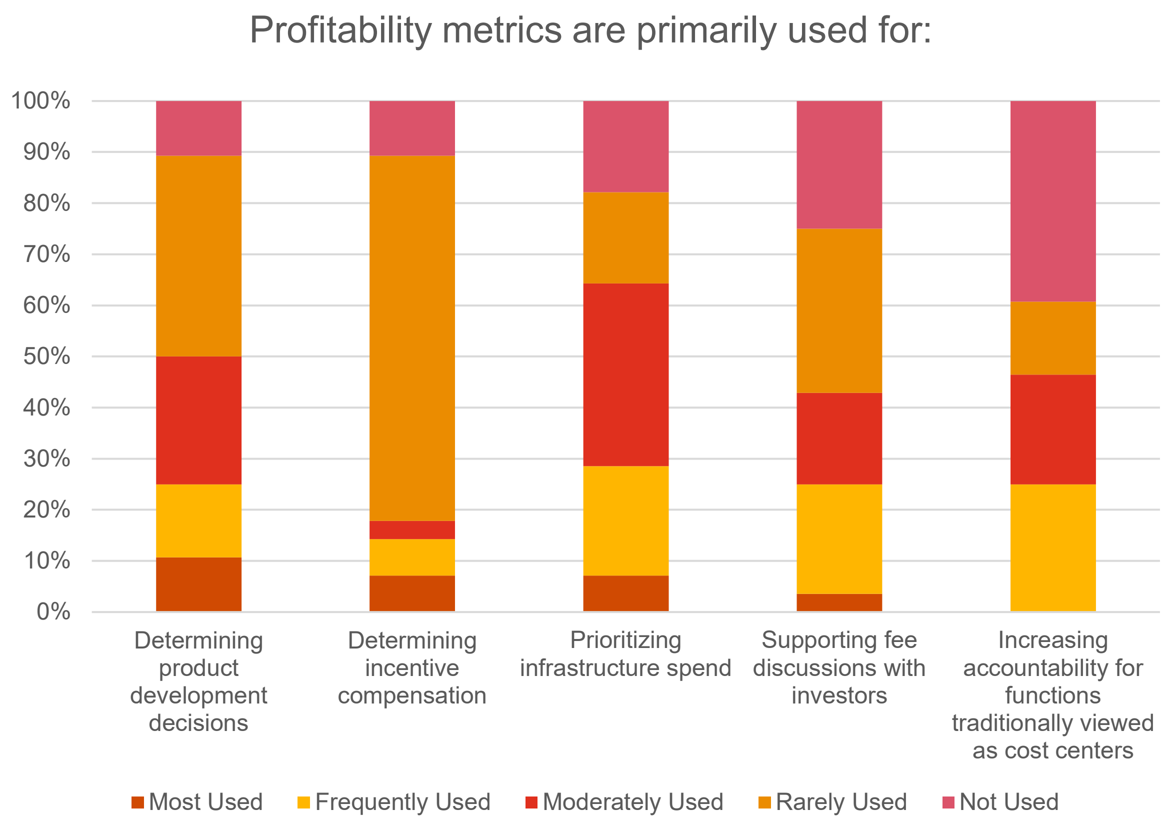


How are profitability metrics calculated?



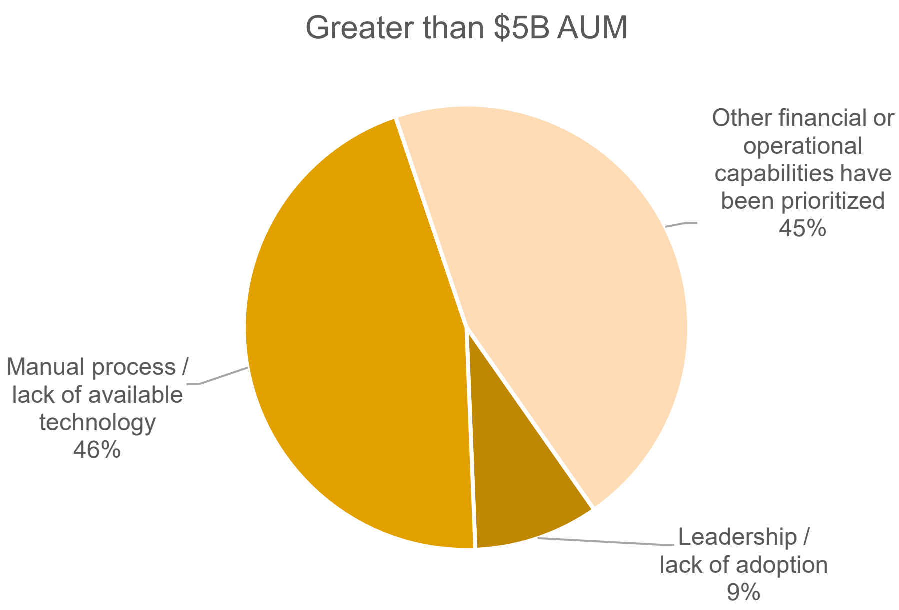
*"By fund/account groups" represents a level below investment strategy to bifurcate separately managed accounts and parallel/co-investment vehicles, etc.

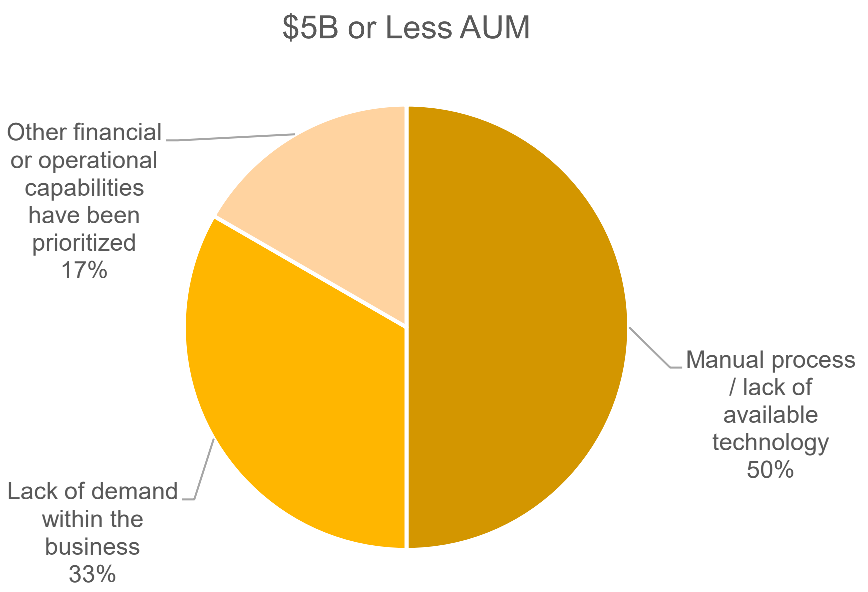
Use of Profitability Metrics



Use of Profitability Metrics

What challenges exist in enhancing existing profitability measurement capabilities?

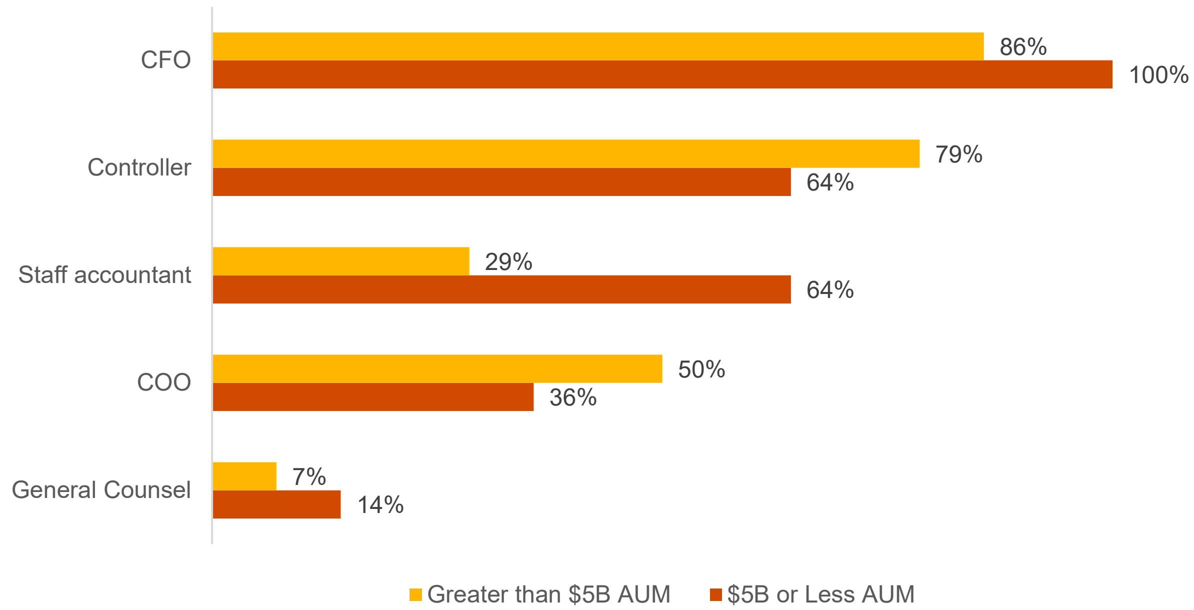




A manual process/lack of technological investment was noted as the primary challenge in enhancing measurement capabilities. Many alternative fund asset management companies still rely on manual processes to calculate and monitor profitability and noted many activities that could be automated.

Profitability Measurement

Individuals that perform a review of profitability metrics



NOTE: Participants were given the option to select multiple reviewers. Therefore, percentages will not sum to 100%.

75% of participants indicate that accounting teams are responsible for calculating profitability metrics, while a few noted that financial planning and analysis (FP&A) and corporate strategy teams are involved in the process. More than **50%** of survey participants have **4 or more** individuals responsible for reviewing profitability metrics. **39%** of participants have **2-3** reviewers and **7%** only have **1** reviewer. Generally, the larger the alternative fund asset manager, the more reviewers there are.

4

Budgeting and Allocation of Expenses

Budgeting and Allocation of Expenses

92%

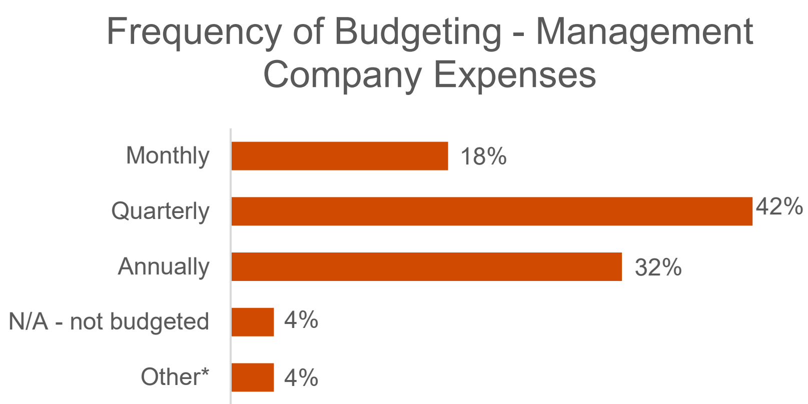
of all participants have a formalized budgeting process for management company expenses.

For many survey participants, budgeting is an important part of running an alternative fund asset management company. Most participants noted a formalized budgeting process is in place for management company expenses, and 71% also reported utilizing budgets for managing fund-level expenses as well.

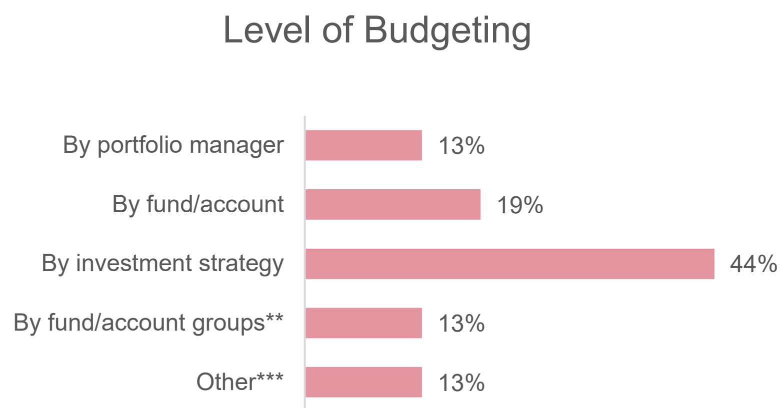
There is variability in how budgeting is performed – in the subsequent pages we show data on how frequently budgeting is performed, at what level it is performed, and how budgets are monitored and compared to actual results.

The allocation of company expenses is another key process for many survey participants as it aids in the budgeting and performance evaluation process. When the use of data analytics is aligned with the budgeting process, companies are able to derive real time data and develop a more robust basis for future budgeting decisions.

Budgeting



** Other represents a per-request basis*

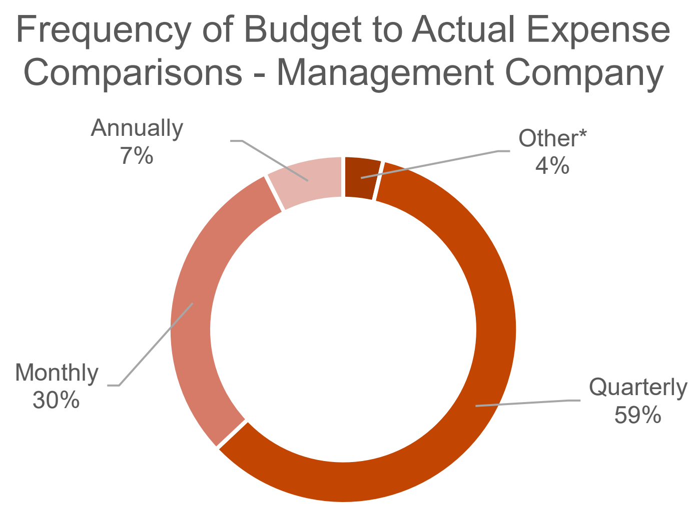


***By fund/account groups represents a level below investment strategy to bifurcate separately managed accounts and parallel/co-investment vehicles etc.*
**** Other includes cost centers and departments*

Budgeting decisions are made at many different levels which can be driven by the needs of asset managers and their investors. For example, firms may choose to budget at the fund/account level for separately managed accounts to monitor expenses more closely for these investors. The use of leverage may also lead to different budgeting decisions to manage cash flows for investors and the investment manager.

We observed that larger managers primarily budget management company expenses monthly or quarterly whereas smaller managers will more typically have a quarterly or annual process.

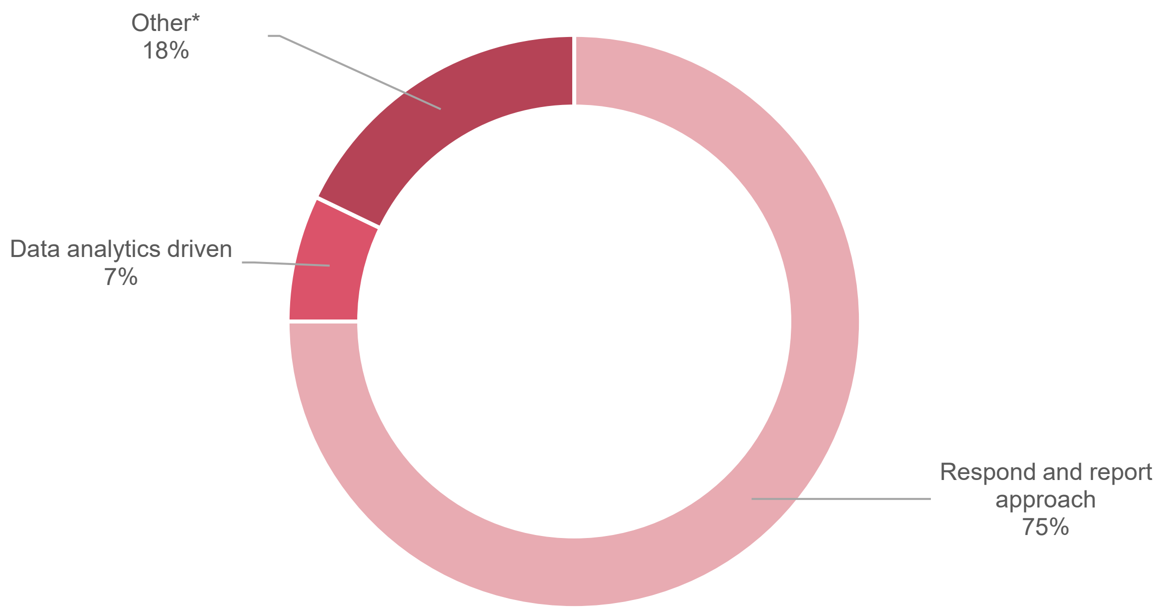
Budget to Actual Analysis



The above charts only represent participants who indicated that they perform budget to actual comparisons.
** Other represents a per-request basis*

Budgeting is a valuable exercise that survey participants use to manage expenses. 97% of participants surveyed perform budget to actual analyses. The frequency of budget preparation varies between the management company expenses versus fund-level expenses and may not necessarily be in line with the cadence of interim reporting (e.g., monthly or quarterly). Furthermore, budgeting is typically calculated on the level of investment strategy (e.g., private equity, credit, etc.) and by fund/account groups (e.g., open-end funds, closed-end funds, etc.). Participants indicated that the frequency of comparing budgets to actual expenses is typically quarterly. We note that when these results are viewed by size of manager, larger managers are more likely to perform a budget to actuals analysis monthly or quarterly, while smaller managers primarily perform this analysis quarterly.

How are budgets and budgets vs. actuals used?



** Participants that selected "Other" as their answer indicated that budgets can be used in various ways, such as a combination of data analytics and respond and report approach, bottom-up approach, and a general headcount to carry out the business efficiently.*

The respond and report approach is the process of organizing data into summaries for review and monitoring. Data analytics can enhance this process and help users better understand and improve performance. Some larger participants indicated that they are leveraging technology tools, such as business intelligence, corporate performance management, and visualization tools, to streamline the collection and presentation of data in a digestible way for cost center managers. The use of technology allows for the firms to have a more centralized process for developing and collaborating on budgets.

5

Growth and Strategic Planning

Growth and Strategic Planning Trends

In this section we analyze how firms plan for growth, estimate and track progress, and we highlight trends that have improved overall efficiency within the business. We also gauge the impact of recent SEC proposals.

68%

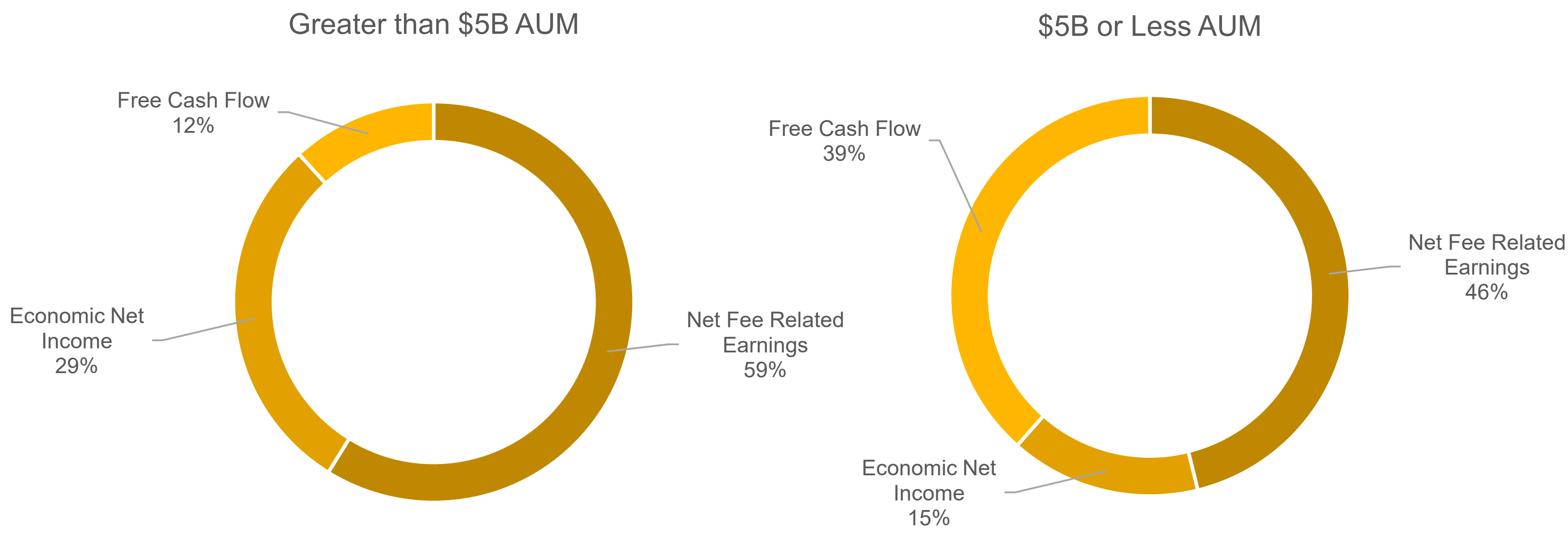
of all participants anticipate that the growth of their business in the next 5 years will be driven in part by **new investment strategies.**

Many asset managers are continuing to invest in fundraising, a sign of the ever-evolving nature of the industry and the efforts being made to drive growth.

Participants have indicated potential for efficiency across all operational functions through the implementation of technology. These efficiencies are not limited to internal operations but can also impact the fundraising process as investors have a continued focus on ESG and D&I.

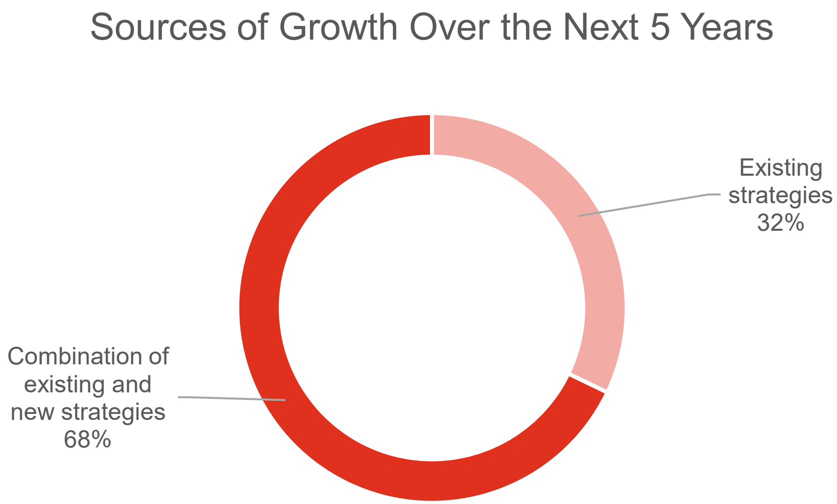
Revenue Benchmarks

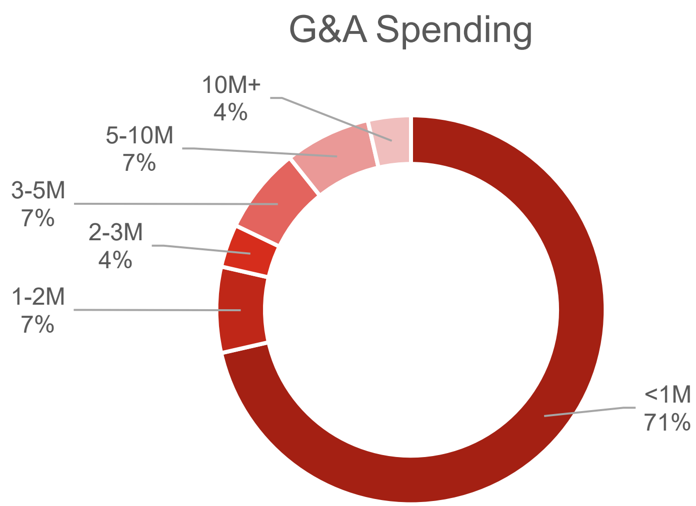
Benchmarks used to estimate Future Revenue Projections



Many participants indicated that Net Fee Related Earnings (NFRE) is used to project revenue. While this benchmark represents the primary revenue stream for alternative fund asset management companies, there are other factors to consider. Economic Net Income (ENI) and free cash flows provide more granular insight into the profitability and cash needs for firms.

Growth and G&A Spending

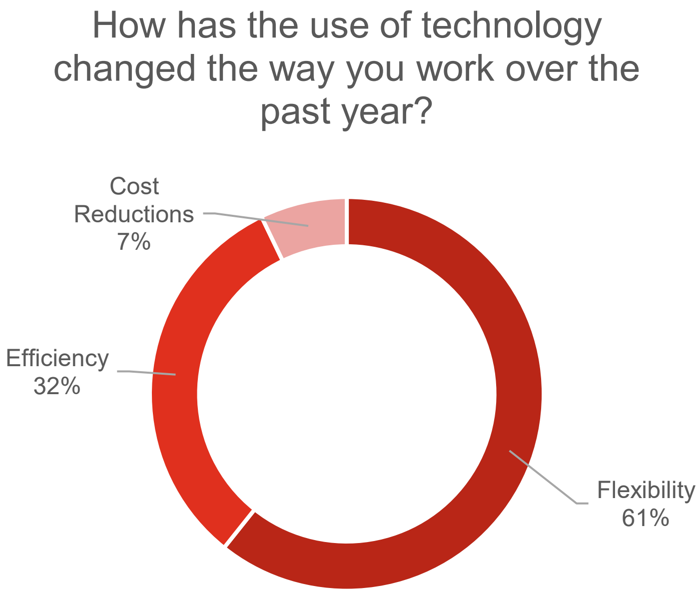


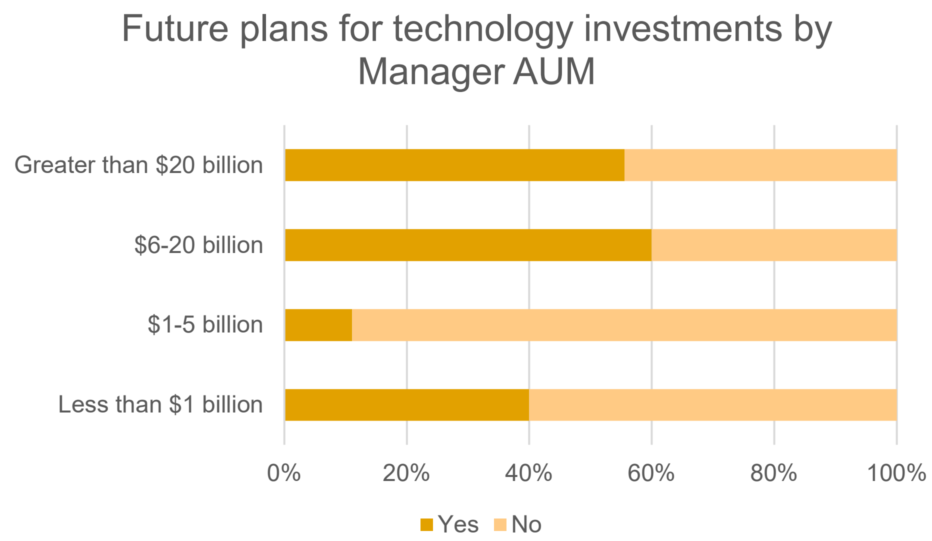


Most participants indicate that they foresee growth from a combination of new and existing strategies. Firms may be looking to new strategies to drive growth due to the increased emphasis on ESG by investors, increased prices of commodities, and prevailing conditions of the market. Most larger managers indicated they expect growth from new and existing strategies whereas smaller managers are more evenly weighted towards both.

Larger managers comprised the majority of participants spending more than $1 million annually on G&A.

Technology Planning





53% of larger managers noted improvements in efficiency due to technology over the past year, whereas 79% of smaller managers indicated technology has improved flexibility with little improvement to efficiency. For those participants who have plans for future investments in technology, many noted a desire for additional workplace flexibility, efficient systems, and cost reductions. Technology allows for the automation of routine functions, the improvement of processes, and the flexibility granted from cloud-based platforms. Further, participants are in the process of making investments in technology to shift towards a more agile and adaptive way of working, allowing companies to move product offerings faster to meet market demands.

Roadmaps

Use of technology roadmaps among those participants that have plans for future investments in technology

27%

of **larger** managers utilize a roadmap.

7%

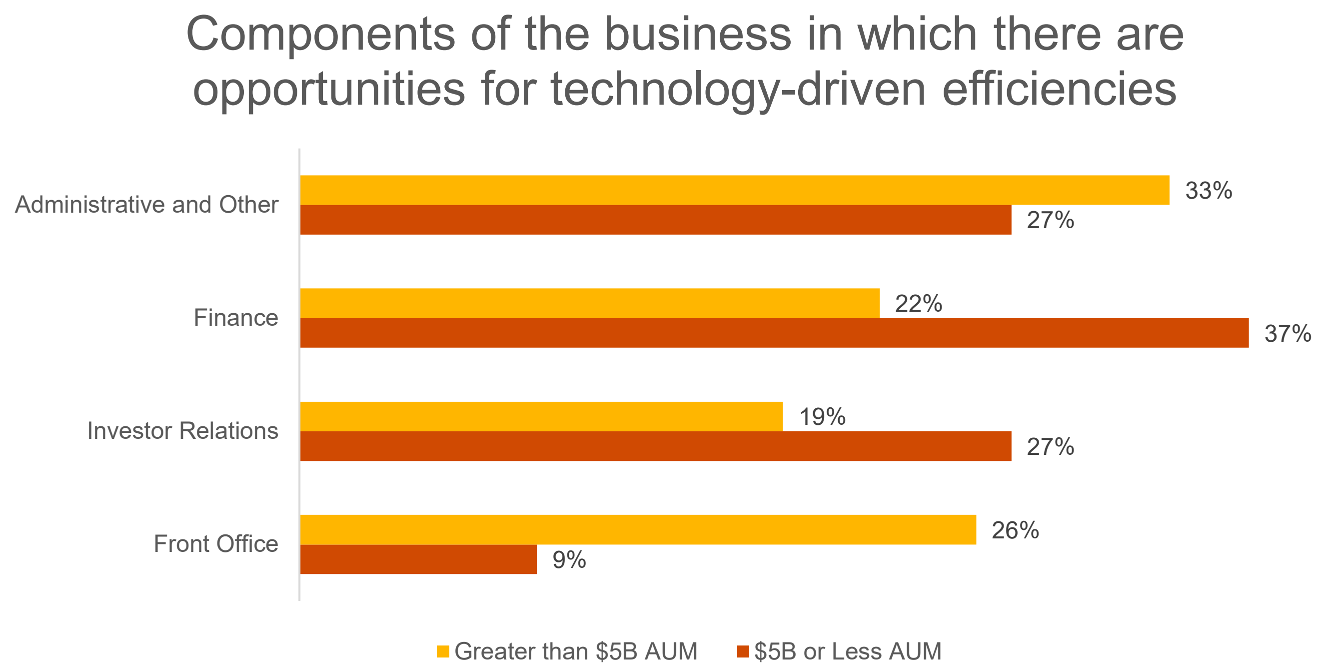
of **smaller** managers utilize a roadmap.

Larger and smaller participants are defined as those with greater than $5 billion, and $5 billion or less assets under management (AUM), respectively.

A technology roadmap is a plan that illustrates the technology adoption plan for a firm. Participants indicated that few firms use a technology roadmap as a means of tracking the ongoing projects and future developments. Most survey participants that do utilize technology roadmaps have an AUM of greater than $20 billion and noted that either the CTO, COO, or CFO is the one responsible for maintaining and overseeing this roadmap.

The technology roadmaps in place among survey participants vary in their time horizon, between 1 year to 5+ years.

Technology and Efficiencies



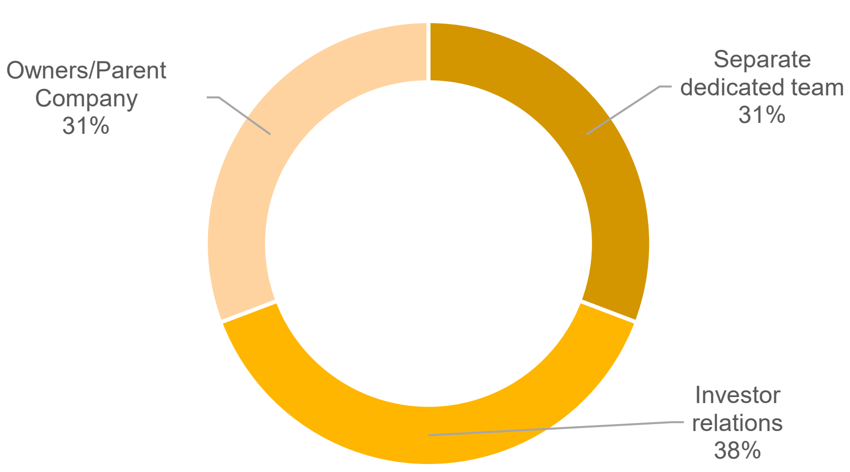
We also asked survey participants to describe ways their firms are working to simplify their current operating model. Most participants indicate that they intend to achieve this through the continued implementation of technology. Some participants also noted outsourcing operational functions to third party vendors and reducing the number of vendors as key strategies toward achieving this goal.

D&I, ESG, and Fundraising

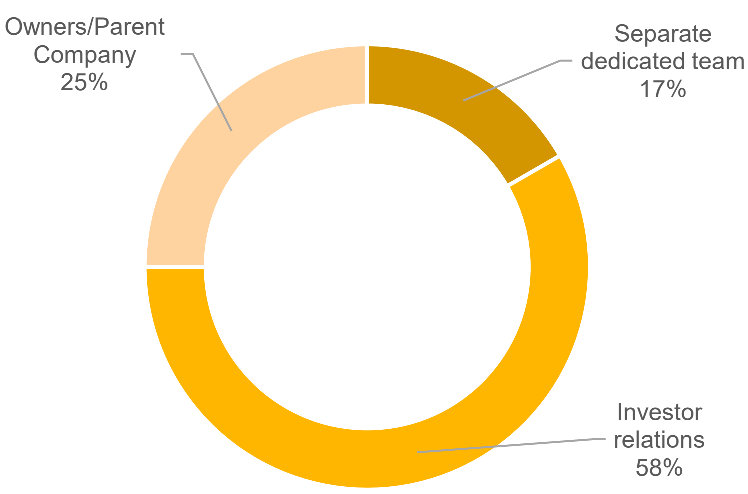
In the current environment, with the proliferation of environmental, social, and governance (ESG) and diversity and inclusion (D&I) initiatives, some investors in the alternative investments space have been expanding their due diligence procedures. This can require more time spent by asset managers to fill out more expansive fundraising questionnaires or to address specific investor requests. We asked survey participants about whether these changes have impacted their business and if so, how they are adapting to these changes. 47% of larger managers and 64% of smaller managers indicated significant increases in the level of detail required from fundraising questionnaires.

How are firms dealing with increasing interest in D&I and ESG diligence?

Greater than $5B AUM

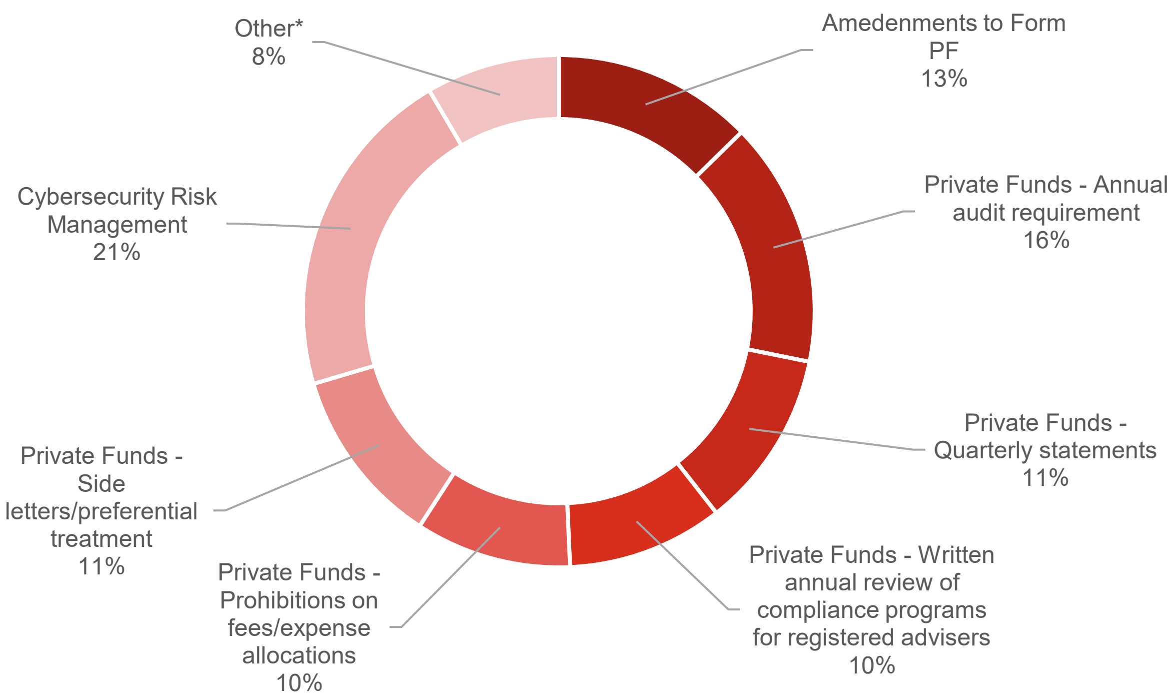


$5B or Less AUM



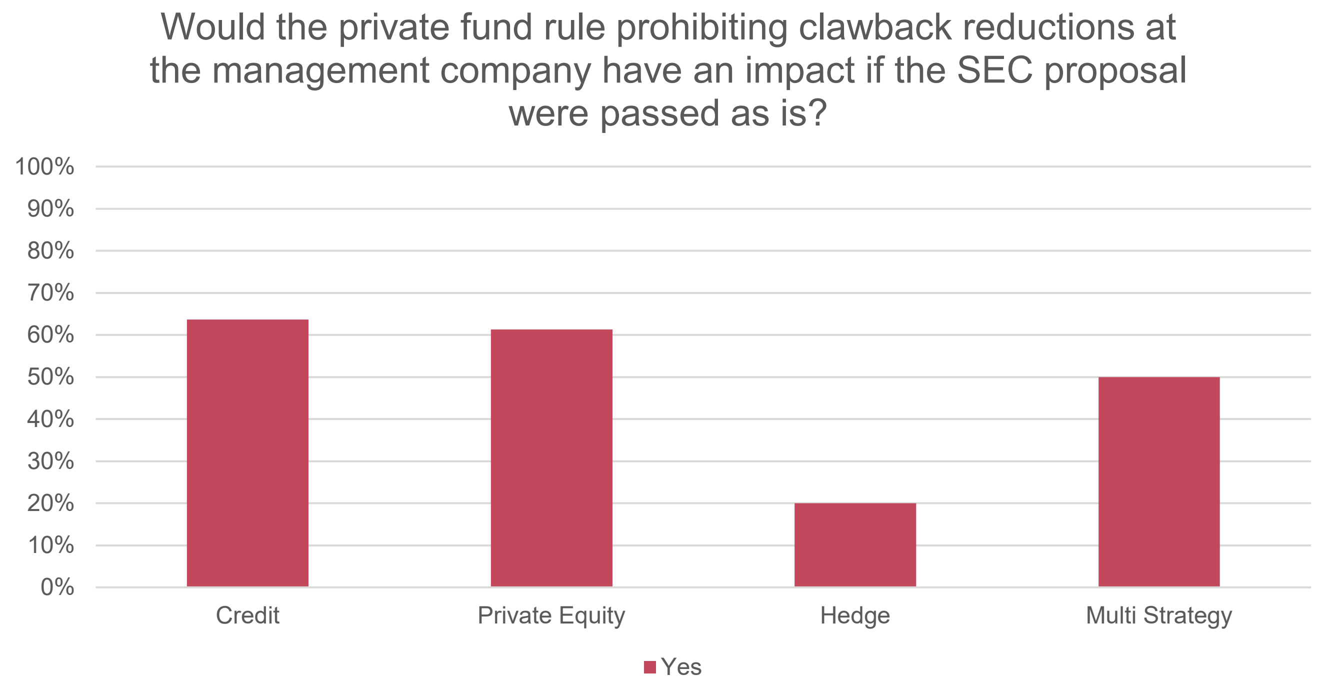
SEC Proposals: Most Impactful

In early 2022 the SEC issued new proposals that could impact the way alternative fund asset management companies and their funds operate. We surveyed participants on which SEC proposals are expected to have the most significant impact to their business. Participants noted that cybersecurity risk management, private funds – annual audit requirement, and amendments to Form PF were expected to be the 3 most impactful changes being proposed by the SEC.



** Other represents fairness opinions, prohibitions on clawback reductions, and prohibitions on indemnification or limitation of liability by the fund or its investors.*

SEC Proposals



This proposal could have a pervasive impact on total performance-based compensation and the timing of carried interest/incentive fee payments for many advisors. Advisors who rely on carried interest tax payments to reduce total clawback exposure would be the most impacted.

SEC Proposals

Have steps been taken to comply with the recent SEC proposals for private fund investors?

13%

of **larger** managers have taken steps.

7%

of **smaller** managers have taken steps.

Larger and smaller participants are defined as those with greater than $5 billion, and $5 billion or less assets under management (AUM), respectively.

In regard to the recent SEC proposals for private fund advisors, certain firms have taken action to prepare for the proposed changes by engaging with counsel, compliance consultants and peers to understand and assess implications of potential changes. Through their proactive consultation, companies can learn and demonstrate best practices to adhere to these proposals.

6

Organizational Structure

Organizational Structure

In this section we analyze the organizational structures of participants, including how functional areas are viewed, in-house and outsourced operations, and ownership of management company entities.

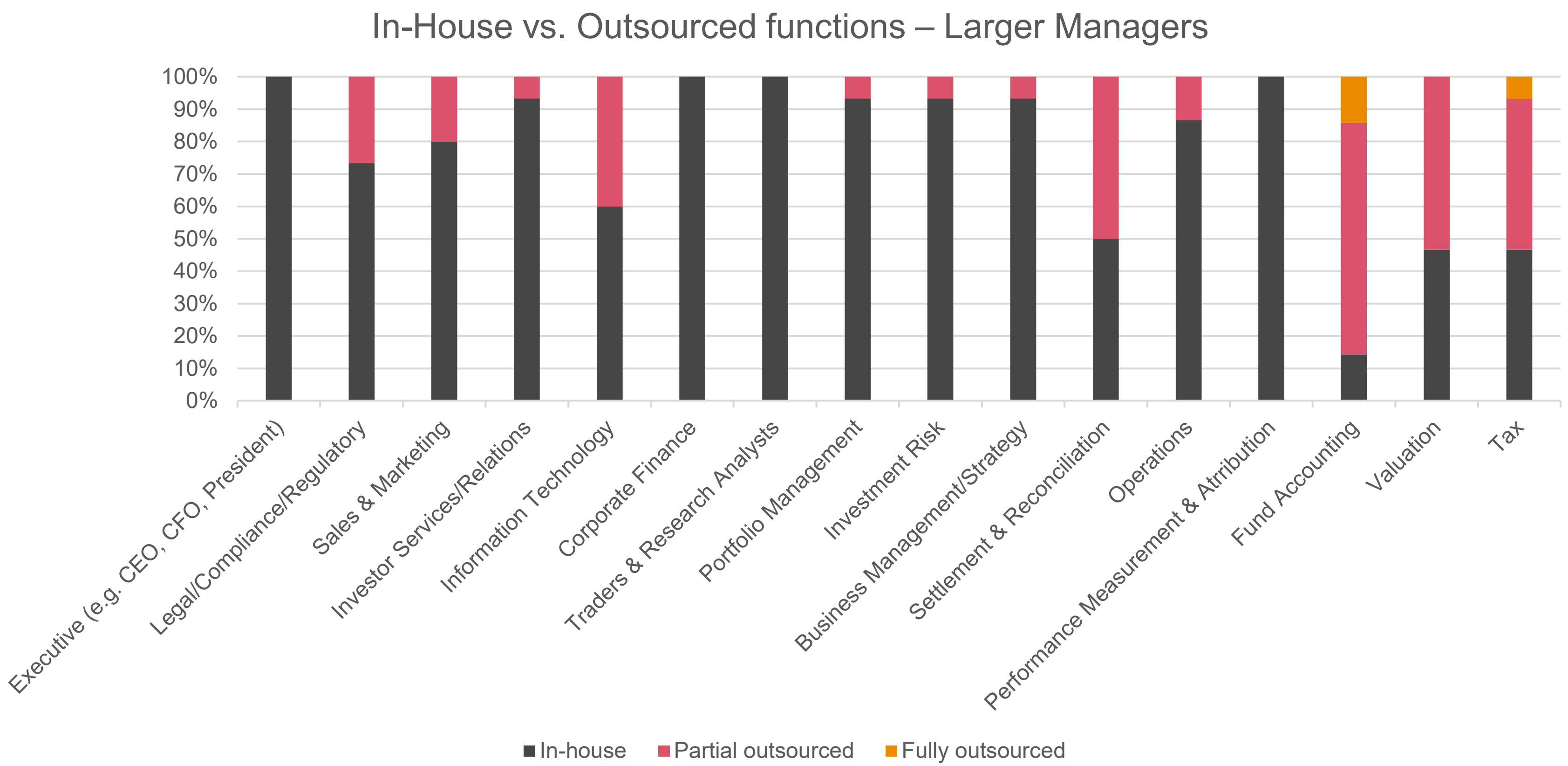
71%

of all participants begin succession planning within five years in advance of senior management retirement.

As expected, total headcount of participants is closely correlated with assets under management, providing certain exceptions for parent-owned alternative fund asset management companies.

Many participants have external investors in the form of minority ownership or significant influence relationships.

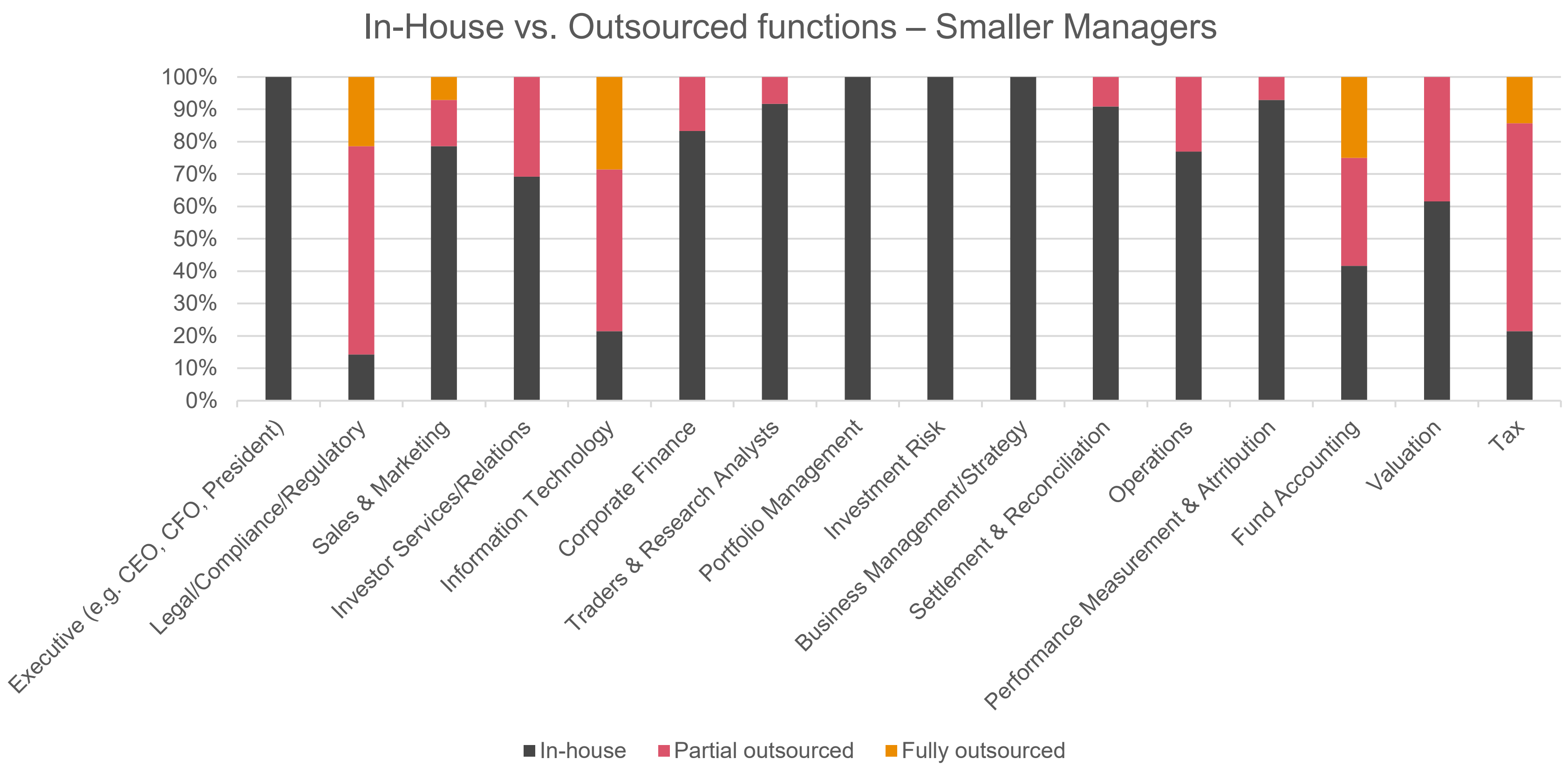
Outsourcing



The graph above includes only those participants that have the functional area at their company.

Larger and smaller participants are defined as those with greater than $5 billion, and $5 billion or less assets under management (AUM), respectively.

Outsourcing



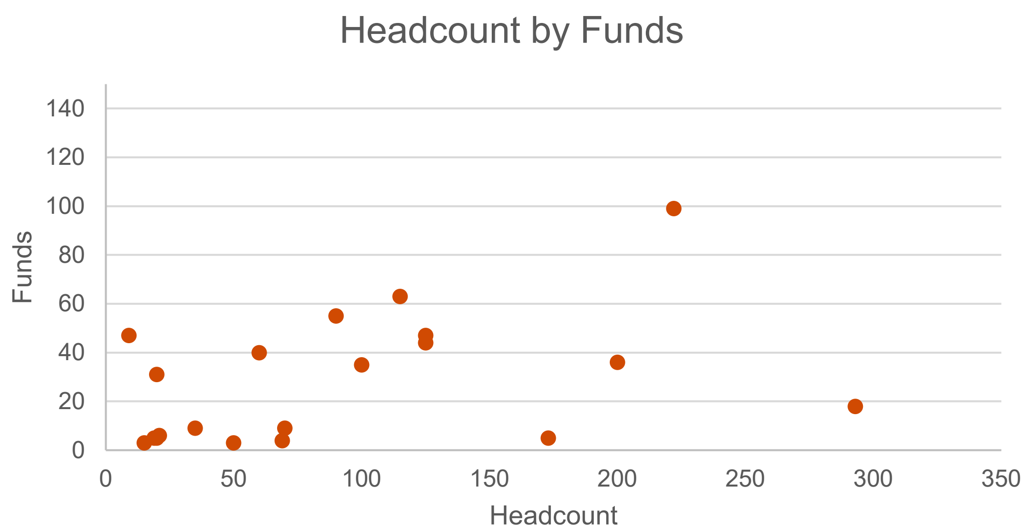
The graph above includes only those participants that have the functional area at their company.

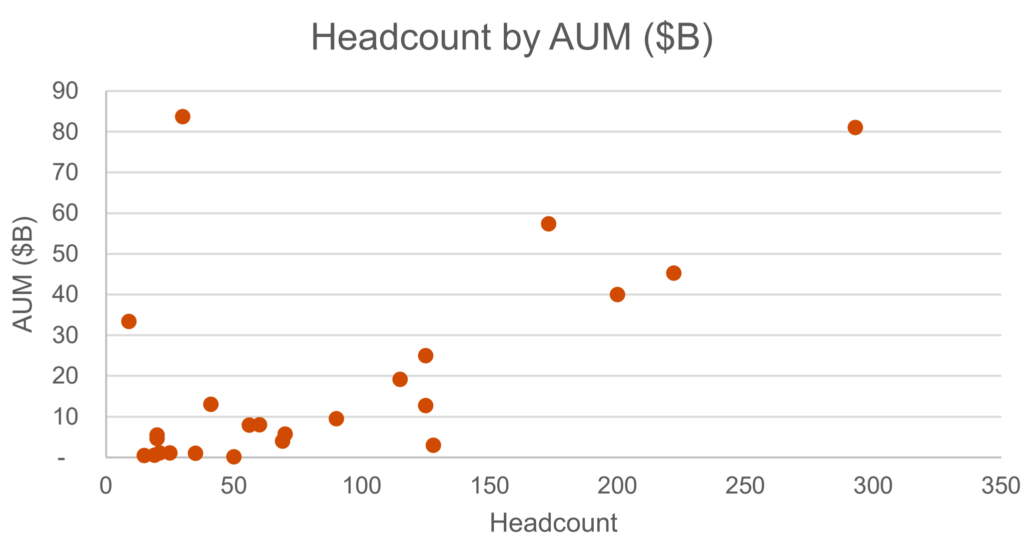
Larger and smaller participants are defined as those with greater than $5 billion, and $5 billion or less assets under management (AUM), respectively.

Headcount

We have observed that the increase of headcount generally correlates with the increase in assets under management.

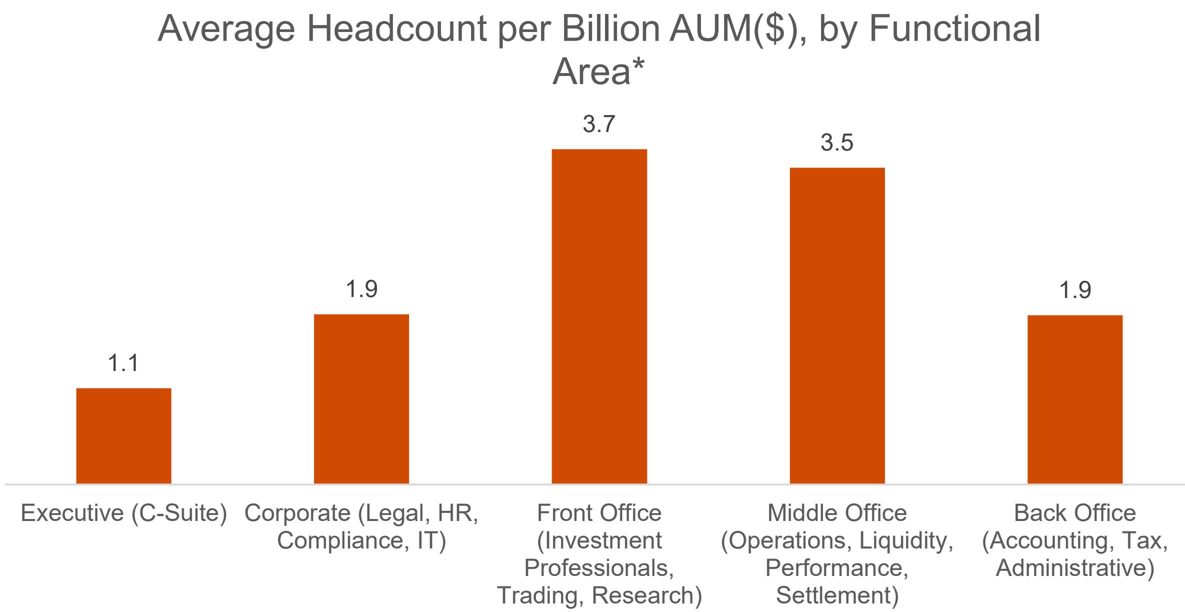
It should also be noted that total headcount may vary for differing asset managers due to the nature of their investment strategy.





The charts above exclude certain participants who did not provide headcount data.

Headcount by Area

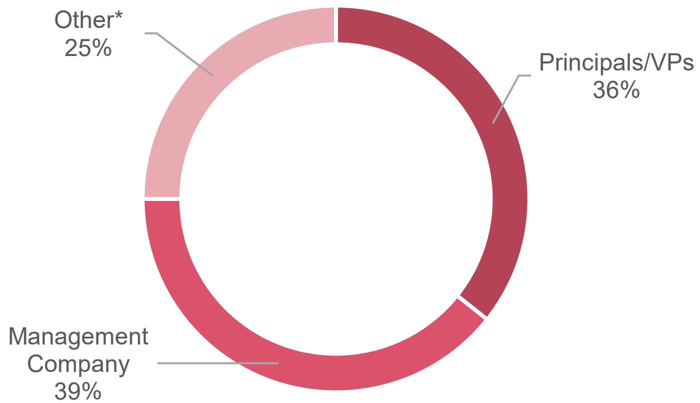


	Executive	Corporate	Front Office	Middle Office	Back Office
Average of Lowest 20%	0.1	0.4	0.8	0.6	0.3
Average of Highest 20%	3.7	6.1	11.1	13.6	5.6

*Advisors with less than $1 billion AUM have been excluded from the data set in the above chart.

Ownership

Ownership of General Partner Entities



Other includes founding partners and the parent entity of the alternative fund asset management company. Founding partners hold equity in the company, whereas principals/VPs typically do not.

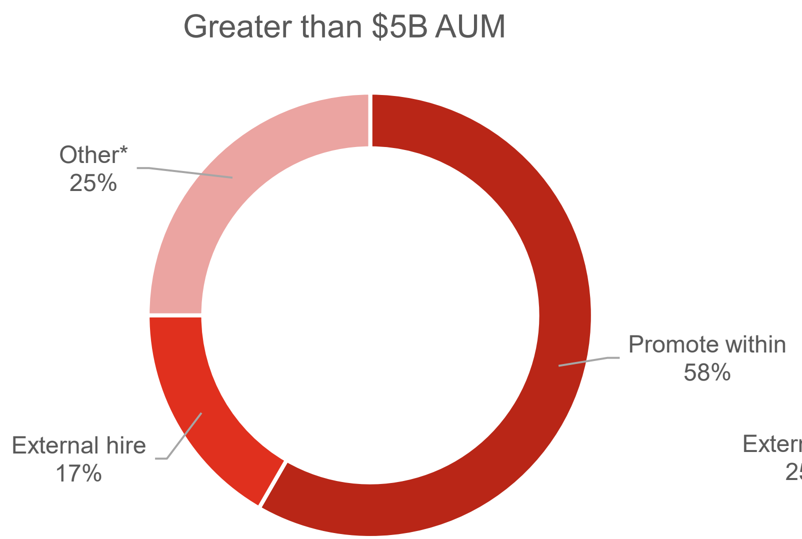
60% of participants with **greater than $5B AUM** have third party investors in the Management Company.

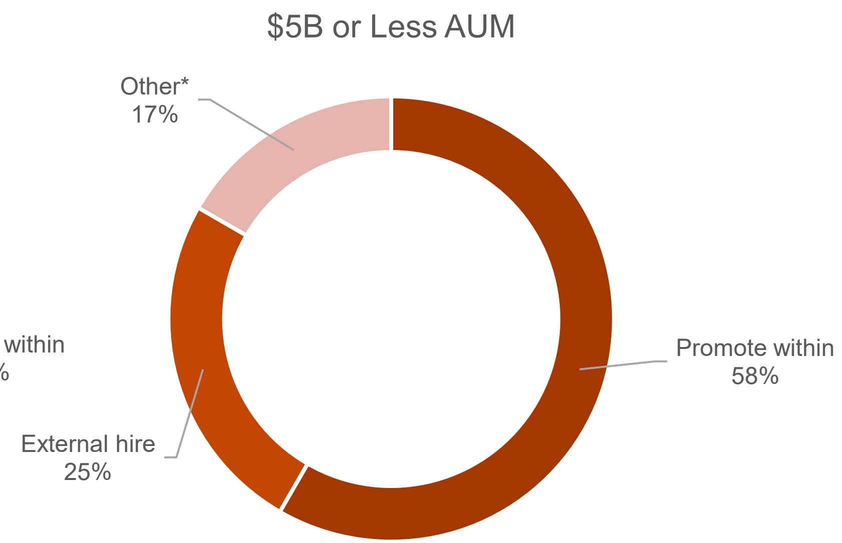
29% of participants with **$5B or less AUM** have third party investors in the Management Company.

When comparing larger alternative fund asset managers with smaller managers, we noted for smaller managers it’s more common for Principals/VPs to have ownership in the General Partner entities. Of the survey participants who have external investors in the management company, most indicated that the external investors have a minority interest. Over half of all participants with third party investors noted that the ownership by third parties amounted to less than 20% ownership in the management company.

Succession Planning

Succession Planning and Transition Strategies for Senior Management**





**Other includes survey participants who indicated that it depends on the role.*

***Senior management includes managing and founding partners.*

In aggregate, 71% of participants indicated succession planning begins less than five years in advance of senior management retirement. 20% of larger and 35% of smaller managers begin succession planning 5-10 years in advance of senior management retirement.

7

Carried Interest / Incentive Fees

Carried Interest/Incentive Fees

In this section we analyze carried interest/incentive fees, and how these performance-based awards are allocated to employees.

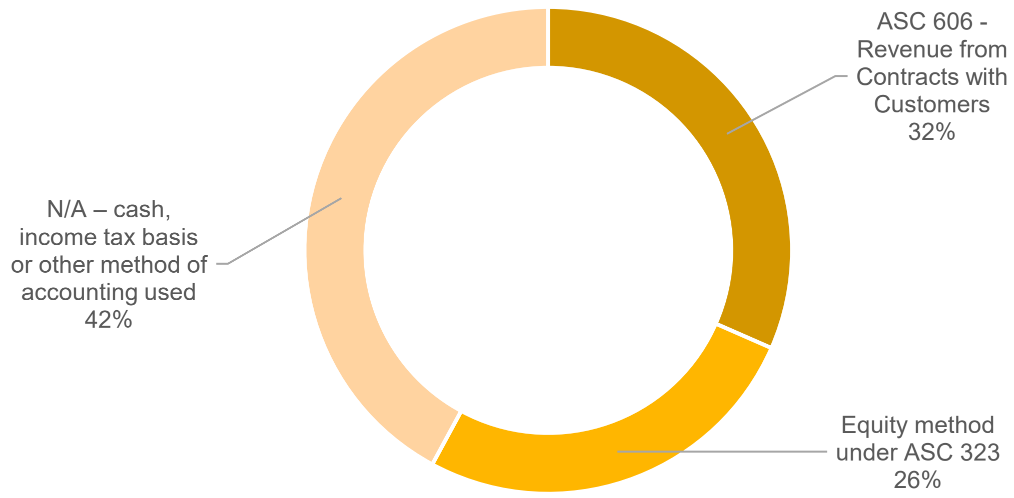
75%

of survey participants award carried interest / incentive fees to employees.

Performance-based awards can be in the form of points, dollars, or both. Generally these awards are reserved for upper management. Few individuals receive these awards, but the size of the manager is an important factor.

Unrealized Carried Interest/Incentive Fees

Does the Management Company follow ASC 606 or use the equity method under ASC 323 as it relates to the accounting of unrealized carried interest or incentive fees?



All of the 26% of participants who applied equity method under ASC 323 are **private equity** entities. Those who applied ASC 606 – Revenue from Contracts with Customers were a combination of the following fund types: **credit**, **hedge**, **multi-strategy** and **private equity**. The participants that applied the cash, income tax basis or other method of accounting were spread amongst all strategies. 50% of participants with AUM greater than $5 billion indicated they follow ASC 606 while 64% of participants with AUM of $5 billion or less indicated they follow the cash or income tax basis of accounting.

Governing Documents

Is a sample calculation of carried interest within the Governing Documents?

33%

of **larger** managers surveyed provide a sample calculation of carried interest or incentive fees within the governing documents.

18%

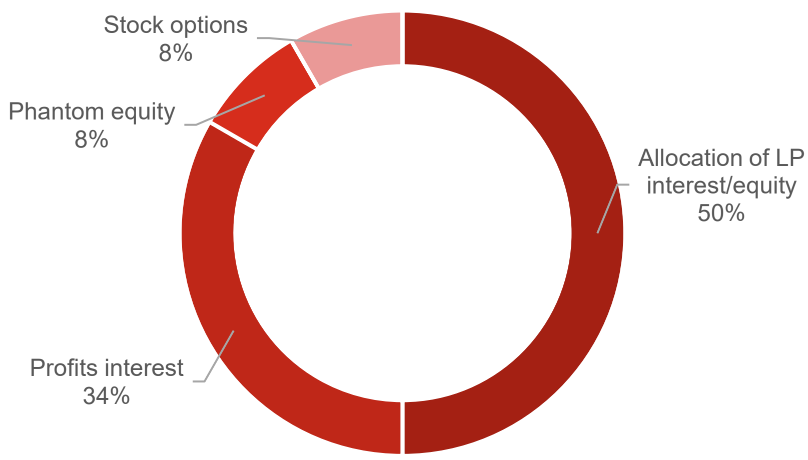
of **smaller** managers surveyed provide a sample calculation of carried interest or incentive fees within the governing documents.

Larger and smaller participants are defined as those with greater than $5 billion, and $5 billion or less assets under management (AUM), respectively.

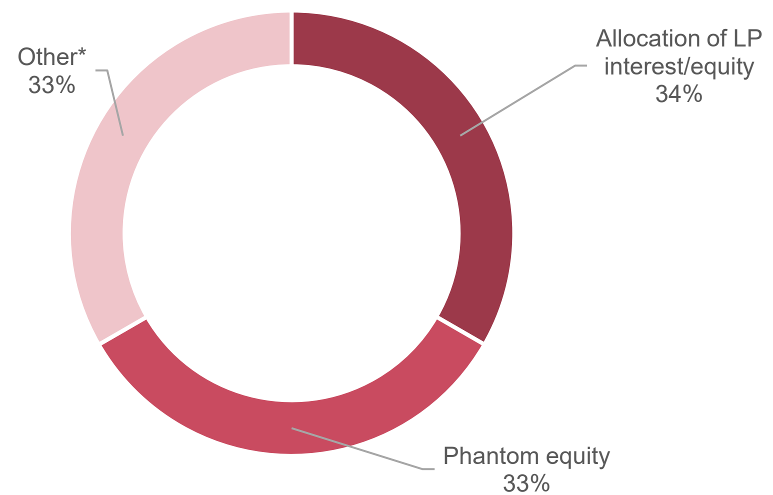
Profit Sharing

For participants that grant other forms of profit-sharing compensation, excluding bonuses, those other forms are:

Greater than $5B AUM



$5B or Less AUM



**Other includes survey participants that provide long term incentive plans linked to carried interest success.*

80% of larger and 55% of smaller managers surveyed had other forms of profit-sharing compensation granted to employees of the management company outside of carried interest/incentive fee allocations. Only 15% of all participants have a management equity plan in place whereby the management company gives an equity-based incentive award in the management company to employees.

8

Miscellaneous

Miscellaneous

In this section we analyze trends in the way participants have adapted to recent changes in how we work. We also examine how turnover has impacted tax and financial reporting functions.

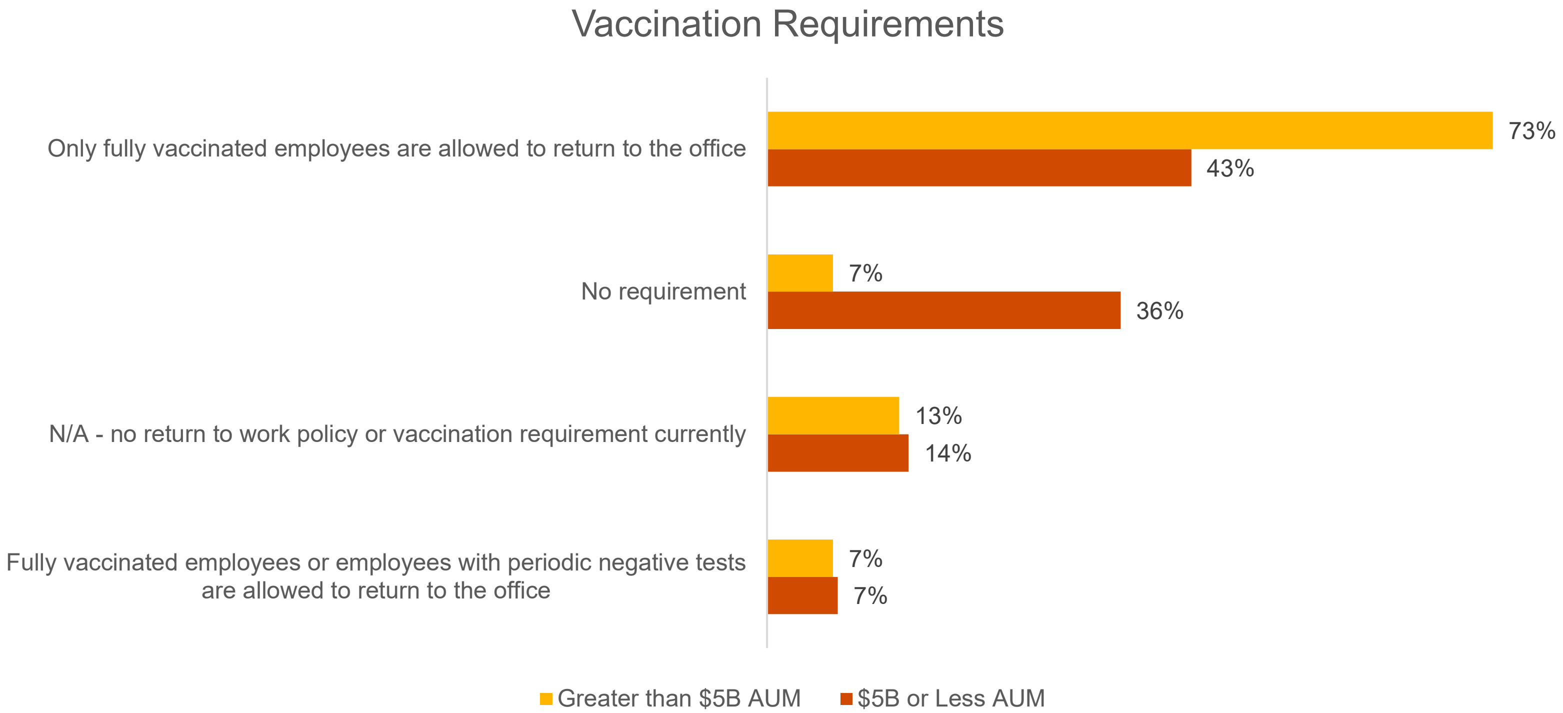
89%

of all participants have implemented a flexible work plan.

Flexible work demands and vaccination requirements have impacted businesses across sectors greatly over the past few years and could be a change that is here to stay.

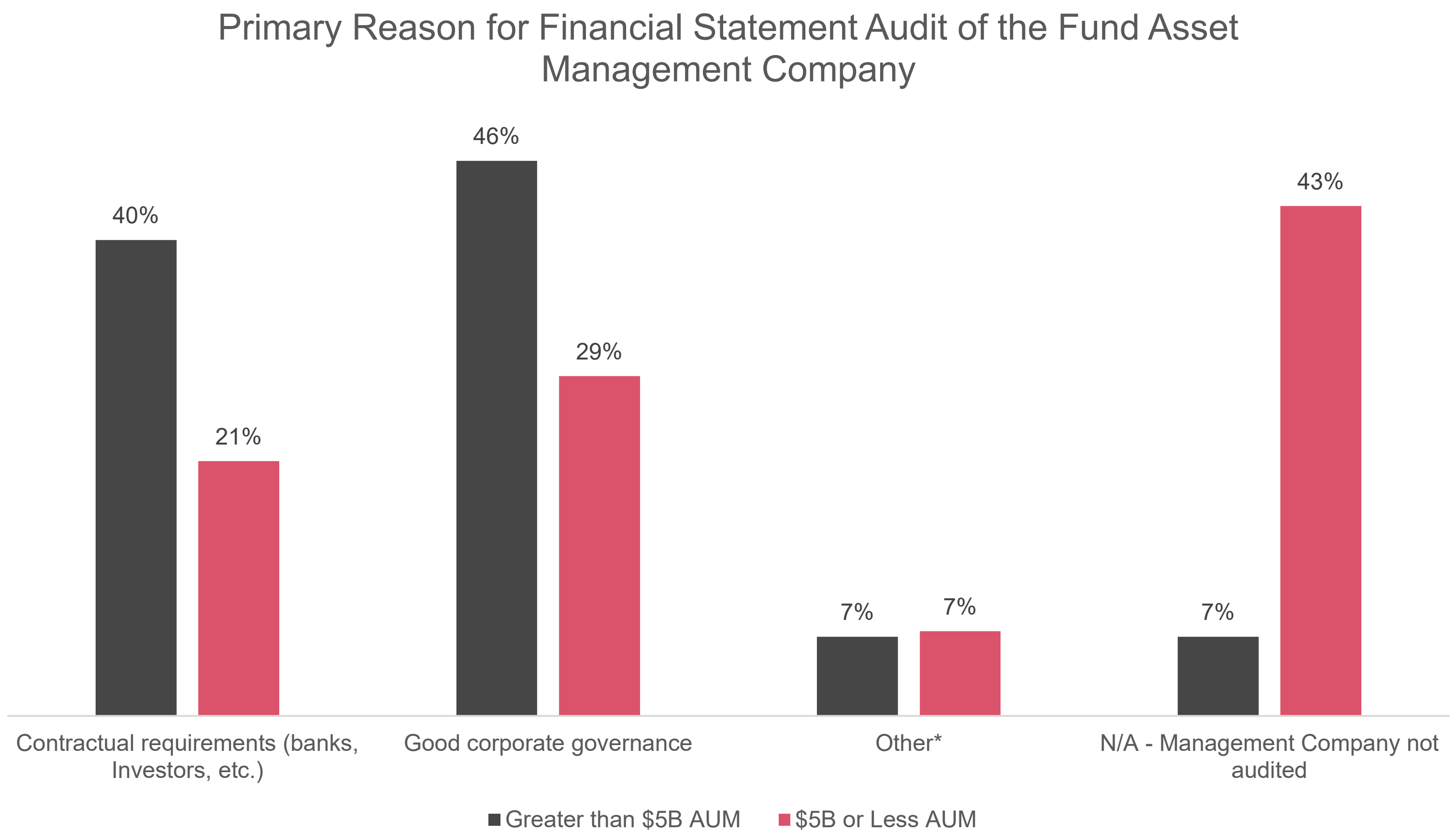
Turnover and competition for talent are also increasing the demand for higher salaries in functions including tax and financial reporting.

Work Policy



There has been a drastic shift in the way employees work over the past few years. Most survey participants have shifted to implement flexible work policies. Many firms are now grappling with whether to require employees to return to the office or whether to continue allowing remote work. 89% of all participants have implemented a flexible work plan (1-4 days in the office per week), while 7% are fully remote and 4% are in the office everyday. Most survey responses were received in May and June of 2022.

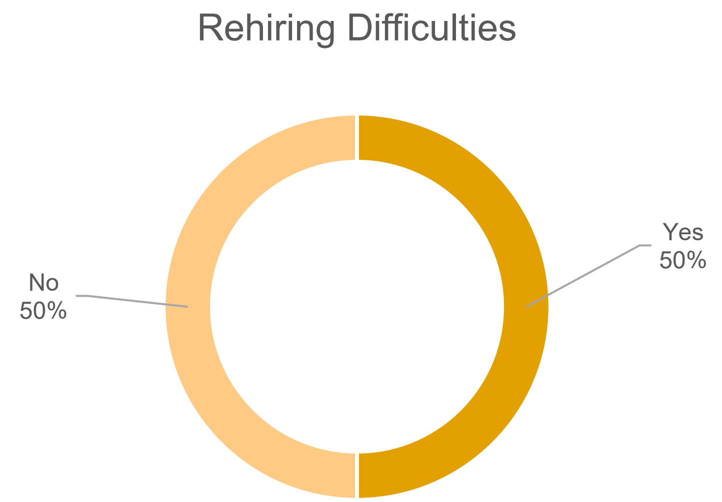
Annual Audit

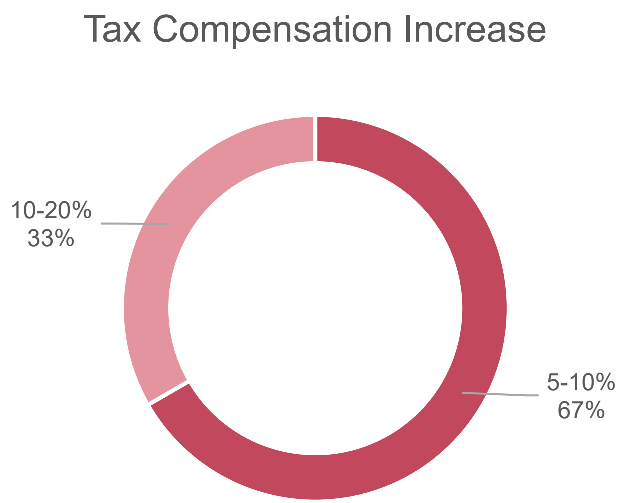


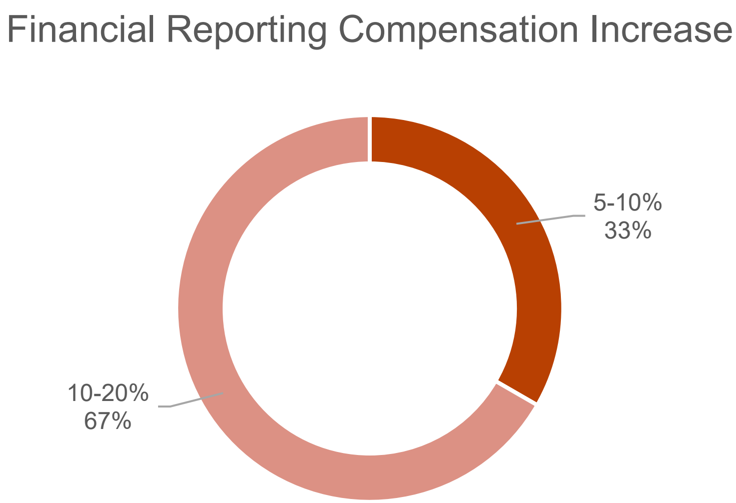
** Participants that selected "Other" as their answer indicated their annual audit is performed at the request of their parent company.*

Rehiring Difficulties & Compensation Increases

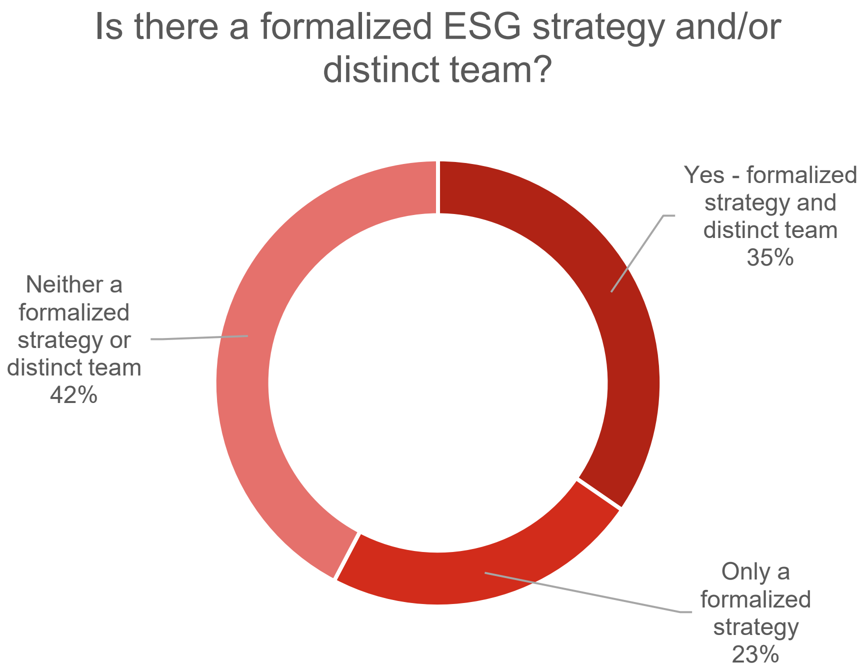
60% of larger managers and 36% of smaller managers have experienced turnover in their finance functions over the past two years. The majority of participants indicated a 0-5% turnover rate in these functions. 18% of these participants indicated turnover of greater than 20% for the financial reporting function. For asset managers that have experienced turnover, some have had difficulty filling open positions, and many have reported an increase in average compensation as a result of either making new external hires or promoting internally.







ESG Strategy



What is ESG?

ESG stands **E**nvironmental, **S**ocial and **G**overnance

These **three key factors** are used to evaluate companies on measuring the **sustainability and ethical impact** of an investment in a company.

ESG issues are not only important when measuring the sustainability of the non-financial impacts of investments – they may also have a material impact on the return profile and long-term risk of investment portfolios.

What are firms doing around ESG?

There is an increasing portion of investors that are investing in ESG products, with more than 50% of participants indicating they have made changes within their organization, whether by forming a distinct ESG team or formalizing an ESG strategy (or both). 43% of larger participants indicated they have both a formalized strategy and distinct team, whereas only 23% of smaller participants noted the same. Further, 62% of smaller participants had neither a formalized strategy or distinct team.

SEC Proposals Index

The following SEC proposals have served as the basis for certain questions throughout our report.

Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers

Private Fund Regulatory Reform

Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies and Business Development Companies

PwC Contacts

Joe Wiggins
Partner
Global Alternative Funds Leader
joe.wiggins@pwc.com

Allen Minzer
Partner
allen.h.minzer@pwc.com

Adam Cunningham
Director
adam.b.cunningham@pwc.com

Elizabeth (Ellie) Burns
Director
elizabeth.c.burns@pwc.com

US_AWM-Benchmarking-Insights@pwc.com