IQEQ Citisoft

Alternative investments: preparing for the future

May 2024

An IQ-EQ and Citisoft roundtable write-up

Alternatives assets are used to diversify portfolios, hedge against inflation and provide an attractive source of alpha relative to traditional asset classes, both in the specialist firms as well as in traditional asset managers. According to the BCG report[1] released in May 2023, titled 'The Tide Has Turned', alternative assets represented 21% or more than $20 trillion of global assets under management (AUM) as of year-end 2022 and is expected to have a CAGR of 7% over the next five years. Alternative assets are where the money is going.

As trusted advisors in technology, operations and services for alternative investment firms, IQ-EQ and Citisoft have teamed up to understand specifically what general partner (GP) and limited partner (LP) firms are considering and how they are actively preparing their businesses for the future. To gather this insight, senior leaders in the alternative investment industry across North America and Europe participated in a roundtable event in London, UK. Using a series of survey questions as starting points, participants discussed the alignment of operations and technology investments with their business strategy and growth, data analytics capabilities and artificial intelligence.

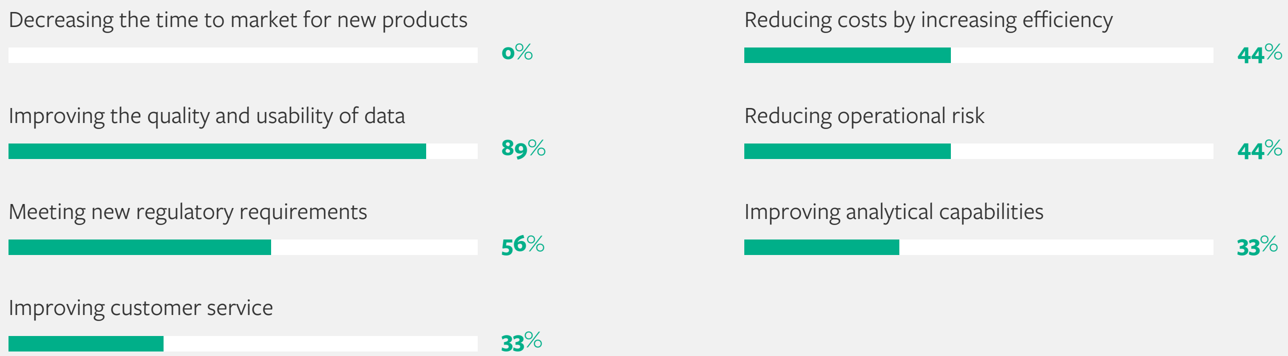
Vera Huang
Head of Data Integration Programs, Asset Owner Solutions, IQ-EQ

Chris Mills
Managing Director
Citisoft

[1] Global Asset Management 2023: The Tide Has Turned. McIntyre et al. https://www.bcg.com/publications/2023/the-tide-has-changed-for-asset-managers

Unlocking success: strategies for data quality, regulatory compliance and efficiency in today’s business landscape

What do you see as your priority operational improvement areas for the next two years? Please select your top 3 choices.



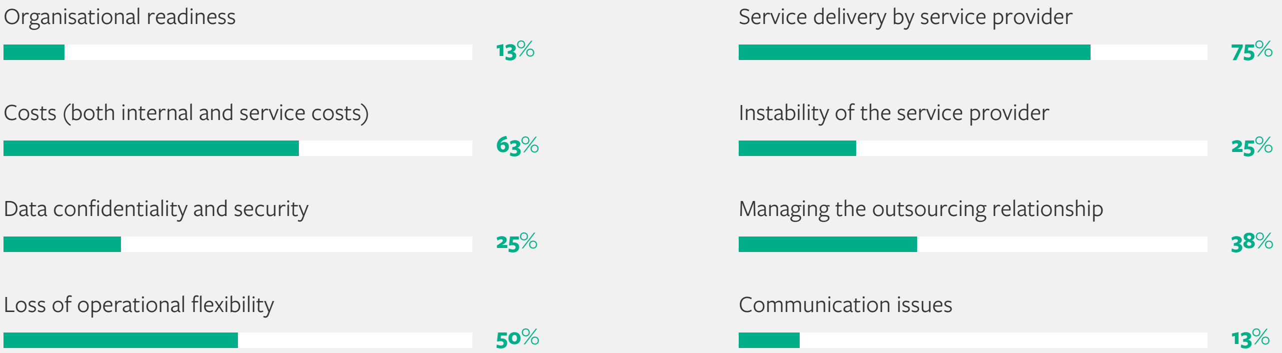
Everything starts with data. It is the oxygen of the organisation. But to be useful, the data must be clean and accessible in a timely manner. This is supported by almost 90% of the roundtable participants saying that improving the quality and usability of their data is one of their top three priorities. With one participant saying it took almost a year to get to a level of data quality they wanted, it shows how long the journey can be.

And it is a never-ending story to stay up-to-date and accurate. The need to have playbooks to ensure data entry procedures are followed, checks and balances to verify quality and using technology to help the data sourcing, maintenance and governance processes are key to maintaining a healthy data environment. Minimising the use of spreadsheets not plugged into the control process – a bugbear for most data departments – was also brought up repeatedly as one of the main pain points they are trying to address as part of this.

Improving data quality and accessibility feeds directly into meeting the ever-changing regulatory requirements. Regulation is always on the menu and a factor that 50% of the roundtable participants included in their top three priority list. Big or small, regardless of their regulatory regime, manual processes are often involved in meeting these requirements and often with shrinking deadlines (e.g., the U.S. SEC’s new 45-day reporting rule). To stay in business, all firms require their data to be reliable, correct and timely and the participants agreed that having the right processes and systems in place to help with this is critical.

The third highest priority at 44% was reducing costs by increasing efficiency. Essentially, doing more with less. However, reducing costs was not the main focus in the conversation; it was how to get people out of the routine processes and allow them to concentrate on higher-value activities. Most of the participants agreed that the first thing a company generally does is throw people at a problem and slap the data together, but that this is not a scalable solution. Perfect solutions are rare. But the pragmatist realises that you must be willing to spend on building a foundation of both technology and operating procedures to enable the desired scalability and that there are trade-offs between what you need to do in the next five years and what you need to do now. This is where the discussion turned to outsourcing some of the data function as a possible solution.

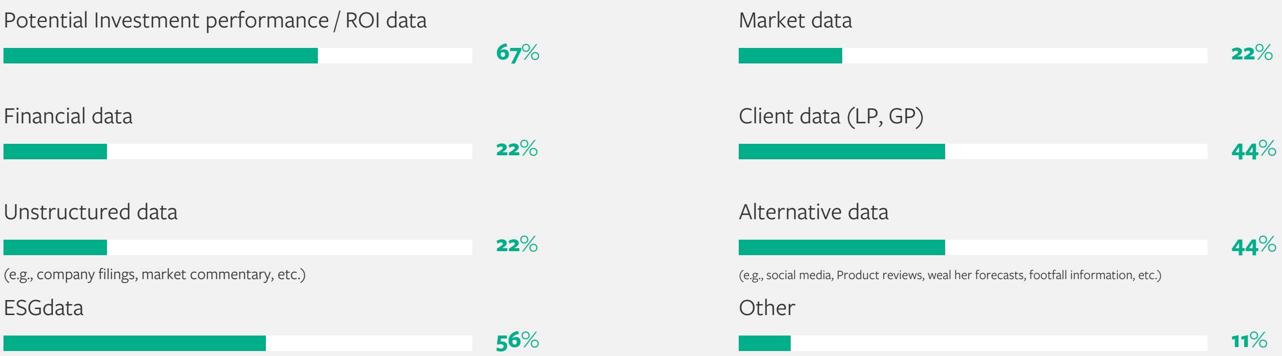
When thinking about outsourcing to an internally validated service provider, what concerns you most? Please select your top 3 choices.



There were some differing opinions around outsourcing. Some wanted to keep functions in-house to teach their technology teams about the business as they built internal systems. Most liked the hybrid approach of some functions in-house and some outsourced. At 50%, the primary concern around outsourcing was maintaining the service and quality levels over time. Will the service provider invest in new capabilities quickly as technology and market demands change (e.g. ESG), realising that what is delivered today is not what might be needed tomorrow? Costs were also a concern at 63%, especially with regards to setting up good data connectivity, investing in a good governance model and modifying their testing programmes. Loss of flexibility was also in the top three at 50% but several round the table said that operational benefits such as time zone arbitrage, which they could get with a service provider in a different location, can make up for that.

Revolutionising investment insights: harnessing predictive analytics and AI for ESG and data modelling

What types of data do you currently find the most challenging to make use of to generate insights? Please select your top 3 choices.



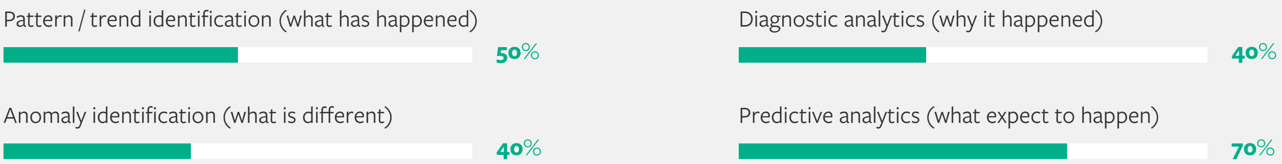
The type of funds and investments determine how much and what type of information to share with investors as the data can get stale very quickly, which is why it makes sense that 67% of respondents chose performance data as the most challenging to make use of to generate insights.

By the time you report to investors, the information is often already out of date. Because of this, more qualitative rather than quantitative updates to investors are preferred and to do this, and make the data more exciting, you need to model it using different scenarios and potentially using alternative types of data to generate macro views that investors will find interesting. Layering the model(s) into the data platform's modelling tools and letting users play with and analyse it is critical for the deal team, who are often the most difficult to get buy-in from for technology or process changes. Several of the participant's companies are working on this type of capability.

ESG data, which is always bubbling at the surface, especially in EMEA, was a concern and challenge for 56% of the round table participants. The same issues that traditional investment managers face also impact alternative investment managers – the lack of standards, the inconsistency in how rules are applied, and the fact that analysis is open to interpretation. Even more difficult for alternative investors is that they tend to get data at the GP level, who do not have the details they need. They also struggle with obtaining ESG data from the U.S., which is more challenging than in EMEA, and with working the ESG data through sometimes very complicated structures to get accurate results.

There was agreement that ESG data does not drive the investment decision in most cases. The general view was that it is just something that needs to be available for when investors ask about it, reducing it to a tick-box exercise. Relating to generating insights, the ESG data itself was not that interesting (e.g. rankings) but the impact ESG has on risk is important. For example, will this coal plant be out of commission in five years? Use ESG data but focus on the risk the data points towards, not the numbers themselves.

What type of analytics do you see as providing the most value for money to your firm? Please select your top 2 choices.



One talking point that came out of the discussion of challenging data was the need to be able to model data to make it interesting for both investors and the alternative investment firm itself. Predictive analytics were seen as giving the most value at 70%, allowing provision of pre-purchase predictions to help investors decide whether to invest, before using post-purchase data to help the investment firm improve the strength of the acquired company to increase its exit value (e.g. reducing the electricity cost by x% provides a y% increase in value in five years).

Historical pattern and trend identification came as the second value-for-money analytic at 50%, which makes sense as this information is often used for predictions. But, as anyone who reads investment statements knows, past performance does not necessarily equate to future results. And the long-term macro environment has changed recently, which somewhat limits the usefulness of historical information. This is one area where the roundtable participants thought artificial intelligence can help.

As one person said, "AI is so now!"

Navigating the AI landscape: balancing investment, risk and data quality in the Age of Artificial Intelligence

What percentage of your discretionary budget are you planning to put towards Artificial Intelligence?

0%	Up to 5%	Up to 10%	Up to 15%	15% or above
0%	56%	22%	11%	11%

What is interesting about the response to the AI budget question above is that all the firms are planning on spending something on AI. They said it's not optional not to look at it. Most, however, are planning on spending a relatively small amount of their discretionary budget, only up to 5%, as they are just starting on the AI journey. Additional money will be spent once they understand more about what applications it can be used for and what use cases it applies to so that there is more alignment with the business's actual requirements.

Generative AI, and especially ChatGPT, is all the rage now. The roundtable participants said that their businesses love it for its ability to re-work reports and create better presentations. But they are very worried about the risk of sensitive data getting out to the wider world and that public chatbots like ChatGPT are designed to always give an answer, even if it may not be accurate. Creating an internal, secured ChatGPT-like application that is limited to information certified by the firm was discussed as a potential alternative, but the consensus was that ChatGPT has muddied the water a bit around the use of AI. Other

What is the most important potential use of AI in your organisation? Please choose a maximum of 3.

Evaluating KPIs for credit risk assessments	40%
Identifying potential investment opportunities	70%
Identifying potential regulatory or compliance issues	20%
Converting unstructured into structured data	50%
Service delivery by service provider	10%
Instability of the service provider	10%
Managing the outsourcing relationship	10%
Communication issues	80%

facets of AI like machine learning, robotics process automation (RPA), optical character recognition (OCR) and natural language processing (NLP) have been used for quite some time, are well understood, are considered to be less risky and have proven uses.

AI was seen as being most useful for cases such as data manipulation, converting unstructured into structured data and automating the more routine tasks to enable people to work on more value-added activities. The low-level activities are ripe to sweep up into the AI world. One person told the story of using AI to create a target list of possible investors that were most likely to invest and how this helped the sales team to focus their relationship building activities. By creating a bigger, better and more accurate list, the team moved from a relationship to target process towards a target then relationship methodology, which was more successful.

Near the end of the roundtable discussion, it was agreed that to make their firms ready for the future, the participants need a foundational data set that is correct and controlled. Whether the goal is to improve operations, generate useful information, enhance the effectiveness of staff using AI or something else it all comes back to data quality. Alternative investment firms will address the data quality challenge in different ways – from outsourcing to internal builds to implementing new technology, etc. – but one common must-have is a thought-out and pragmatic strategy on how to reach this promised land and take advantage of all the new and evolving opportunities available.

Find out more

iqeq.com

Follow us

Reference: IH9653_May2024_02