BNY MELLON

Bouncing Back

HOW COVID-19 IS ADVANCING ALTERNATIVE FUND OPERATIONS

PART 1: *PIVOTING IN A PANDEMIC*

The world has changed and each week seems to bring a "new normal." Featuring exclusive interviews with industry experts, BNY Mellon examines operational change for the alternative asset management industry in a time of pandemic and how the working environment could change post COVID-19.

Part 1
Black Swans Keep on Coming

The alternative assets industry entered early 2020 with a new record: global assets under management had breached the US$10trn mark, according to Preqin figures. Following a decade of rapid growth that saw investors switch allocations from traditional asset classes into alternatives – in particular private equity (PE) and private debt – the stage was set for further expansion.

A 2019 survey of alternative asset fund managers by EY[1] found that asset growth was the top priority for hedge and PE funds, cited in the top three by 69% and 71%, respectively.

Yet by March 2020, the industry, in common with businesses across the world, had a different set of priorities to manage. The pandemic, and its resultant lockdowns, forced fund managers to rapidly pivot. While many would have had business continuity plans (BCP) in place, few would have included plans for entire, global operations to make the switch from office to remote working almost overnight.

Early warning systems

To some extent, global fund managers may have had an advantage in that they had early warning of what was coming. For those with offices in Asia, previous pandemics such as SARS and the early spread of COVID-19 in the region helped firms prepare before the more widespread lockdown. "As we saw what was happening, we did a lot of planning and that turned out to be very solid," says Robyn Grew, Chief Operating Officer of Man Group. "And it has worked. Our ability to work from home across multiple jurisdictions with fast deployment, communication tools and meeting our system requirements has gone very well."

Mick Murphy, BNY Mellon's Global Head of Alternative Investment Services, echoed that the early experience in Asia provided a preview of what would be required in other regions as the virus outbreak grew into a global pandemic.

[1] https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/wealth-and-asset-management/ey-global-alts-fund-survey-final.pdf

“We were able to learn from the experiences of our Asia-Pacific based colleagues starting in early January with the execution of BCP protocols in that region,” Murphy said. “That early warning signal, along with prior enterprise BCP and resiliency exercises, helped us prepare our other regions to keep employees safe and to service clients from remote locations.”

Firms with more flexible working policies have also had an edge in switching entire workforces to remote operations. Lars Tell, Chief Operating Officer of Sector Asset Management, says that his firm was well prepared for the move. “Historically, we have always worked quite a lot from alternative locations,” he explains. “We have an office in Oslo, but some of our staff live in other parts of Norway and worked from home regularly before the pandemic. When we closed the office, we just picked up our laptops and carried on from home.”

Waiting for back-up

Despite fears for their teams – an April 2020 survey by PwC[2] found that 41% of asset managers saw the effect on the workforce/reduced productivity as one of their top three concerns over COVID-19 – the switch to remote working has been a success for most. “We have been pleased with the stability of our operational platform and our business in general while migrating to remote working,” says Francis Idehen, Chief Operating Officer at GCM Grosvenor.

There were operational wrinkles to manage in the early days of lockdown. Predictably, the initial challenges were pragmatic, such as getting employees set up with suitable equipment and ensuring they could use the systems available. “It took everyone a really straight effort to get themselves in a position where they had the right-sized monitor, the right headset and to learn how to use Slack, WebEx, Zoom or Teams,” says Grew. “They now know a lot more about bandwidth than before, too.”

Indeed, the pandemic has provided firms with a real-life test of their service providers’ capability in a crisis.

[2] https://www.pwc.com/us/en/library/covid-19/coronavirus-asset-and-wealth-management.html

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We were well-prepared to move to a remote set-up, having tested our IT infrastructure in advance. Part of this preparedness relates to our long-standing BCP procedures, which include assessing how we engage with service providers. We have found that they are well equipped to operate remotely.”

– Francis Idehen

Chief Operating Officer, *GCM Grosvenor*

Operational agility

While many were at least partially prepared, the past few months have still been a large-scale test of operational agility for alternative asset managers. Leadership teams have faced significant challenges to keep their firms running, their staff connected, and investors informed.

This period has also been a massive experiment in different ways of working, with some new practices set to endure well into the future.

Flexible working was a hot topic long before the pandemic, yet few firms had fully embraced the idea. COVID-19 has changed all that as firms have had to adapt to remote working for an extended time period. "From a technical and operational perspective, the news has been very good," says Grew. "This is going to form the basis of how we think about what work looks like going forward.

"We have moved from our people asking 'when will we go back to work?' to 'when will we go back to the office?'. We are productive - in some cases more so."

– Robyn Grew

Chief Operating Officer, *Man Group*

The usefulness of video conferencing has been one of the lockdown's major discoveries, enabling firms to organize meetings externally and internally to keep employees engaged and interacting with each other. For some, working from home has been a revelation, as employees have found more time to be with their families and pursue hobbies and interests. A recent survey of private markets professionals by MJ Hudson[3] found that 62% of respondents are enjoying not having to commute to work, for example.

Yet firms have also had to learn how to support staff remotely as the strains of living under lockdown during a deadly pandemic have made themselves felt. "Initially, everyone was very pleased with themselves if they managed to log on, be heard, unmute themselves and share their documents," adds Grew. "But for some time now, we've been trying to manage the well-being of our people. Not everyone's experience of lockdown has been the same. The challenges have been where we have needed to provide additional support for people trying to navigate their particular circumstances."

"If you have a situation where the whole of society shuts down, that clearly creates issues on a personal level," he says. "Staff who had kids at home and needed to home-school often found the situation very stressful, for example. We have had to be mindful of this."

– Lars Tell

Chief Operating Officer, *Sector Asset Management*

[3] https://www.mjhudson.com/wp-content/uploads/2020/07/Working-From-Home-Report.pdf?_cldee=dmlja3lAdmlja3ltZWVrLmNvLnVr&recipientid=contact-f5e5c77053cbea118101001dd8b71c0a-380f1f293ae94867ac75e1d9d27c26bc&esid=8b1d5492-4473-4ff7-9abd-fce2898f9254

It has also become clear that virtual working may not be the answer for everyone all the time. The MJ Hudson survey found that 61% of respondents miss the office, with 82% of these saying they missed colleagues the most. The survey also highlighted that nearly a third of private markets professionals said that working from home was negatively impacting their ability to communicate effectively with colleagues.

Culture counts

A longer-term question around remote working is how to maintain a strong business culture when staff are widely dispersed – an aspect that is particularly important in alternative investment firms where team working and ethical practices form an essential part of the modus operandi.

The enforced transition has been successful in part because it involved teams who had worked in close proximity for years previously and had forged relationships, points out Tell, who says that attendance at the firm's virtual social meetings has waned over time. "If you are managing people, you need time to be able to chat to your staff and understand daily challenges," he says. "Teams need to bond through social interaction. The longer this goes on, the more challenging it is to keep the culture of an organization. If people don't spend time together, there is a danger they lose the values of the firm."

He points to a situation where the firm brought in a new recruit. "We tried to introduce them virtually, but in the end, we had to ask them to come into the office. We've found that trying to induct and teach new employees is hopeless without people sitting near each other."

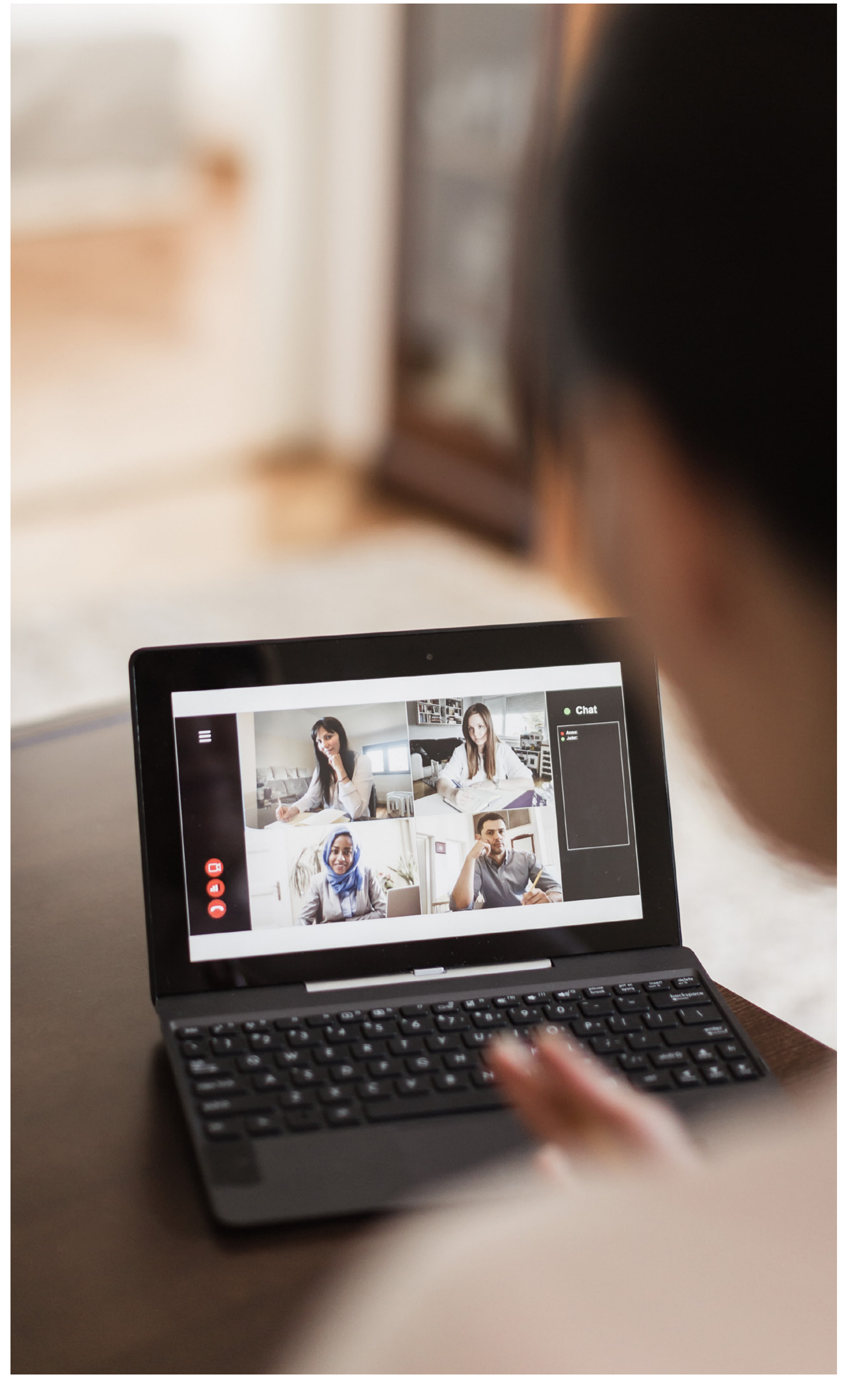
With so many employees now embracing a more flexible work-life balance plus the need for social distancing at work, the future of working in the alternative investment space looks set to be a combination of remote and office working. "This will take some careful managing. You have to be quite thoughtful about how to be agile," says Grew. "You need to make sure your systems can cross home and office environments seamlessly, especially if some are working remotely at a given point; others in the office."

Investment decisions

Another key challenge has been communicating with external parties – including with potential and existing investors and portfolio company management. While reporting on portfolios has largely been successful, with many firms opting to provide podcasts and webinars; due diligence processes have been difficult, making fundraising and attracting new capital an uphill struggle.

Many institutional investors have historically required on-site visits and in-person meetings with teams before they can make an investment or commitment with a firm. Travel bans have made this all but impossible. A survey of limited partners in closed-ended private markets funds by Probitas Partners[4] in the early part of the lockdown found, for example, that 44% of respondents were planning to continue investing but focus on re-ups, while 29% were focused on situations where due diligence was already very advanced.

As Grew says: “One of the hardest areas is not being able to meet clients and to prospect new clients in person. We are still in a space where diligence is something best achieved in person. There is a human dimension to it where you have to see the whites of someone’s eyes and their body language. It’s very hard to create relationships from your living room.”



[4] https://probitaspartners.com/research/investor-trend-surveys/

“Operational due diligence is an issue if people can’t travel,” adds Tell. “But we have heard that some investors, even if they have restrictions around this, are going to have to adapt. They are saying they will have to do virtual due diligence more often going forward.” The Probitas Partners survey backs this up. Nearly a third of respondents (29%) say they no longer require on-site due diligence and will allow video or teleconference as an alternative and a further 4% say they no longer require on-site due diligence.

And, according to Idehen, investors are getting used to digital interfaces when it comes to making investment decisions. “We can offer a single point of entry to capture the multitude, diversity and fast-changing nature of the current opportunities across asset classes, and that’s appealing to investors,” he says. “We have an operational due diligence practice and so investors can see the importance we place on operational stability.”

From a service provider perspective, the use of digital interfaces for due diligence or day-to-day service requirements has become critical—and so has engaging clients virtually during the sales process.

Dermot Finnegan, Global Head of Real Estate Fund Administration for BNY Mellon, cites an early example of remotely working through an RFP process involving a client’s real estate and debt funds in the U.S. and Luxembourg. The presentation team had to quickly pivot from preparing for an in-person client presentation to a virtual one. “We learned that it’s crucial to focus on consistency and simplicity,” Finnegan says. “Not only did that approach work well, but our team also observed a significant amount of engagement from the client during the virtual presentation—more than we typically experience during in-person pitches.”

In awarding the mandate, the client noted how well the BNY Mellon team performed under work-from-home conditions.

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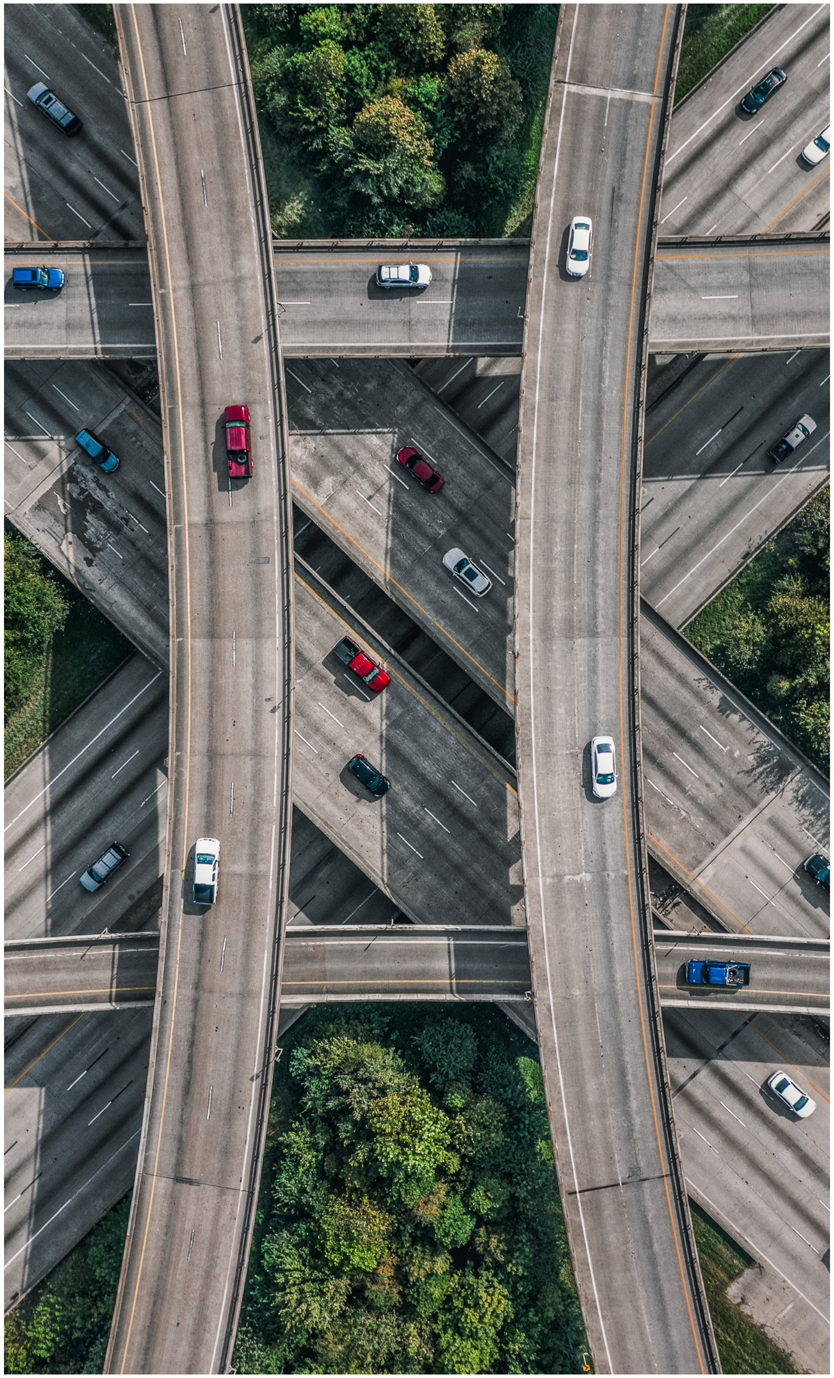
By adapting our approach to a digital platform, we could achieve the client interactivity and relationship building that we previously only thought possible with in-person meetings,” Finnegan says.

Looking ahead

Pre-pandemic, many alternative investment managers recognized the need to invest in technology across the board to make investment decisions, fund reporting, compliance, legal and many other processes more efficient. Many other firms just hadn't yet acted on that recognition.

It's highly likely that the pandemic will lead to a more rapid adoption among alternative asset managers of digital technologies, such as data analytics, automation, blockchain and AI. For some firms, that will mean a significant investment in in-house and potentially bespoke systems. For others, the answer will likely lie in outsourcing a range of activities.

The second part of this report will explore the challenges and opportunities that transformation can bring. We also examine what the future may look like for the industry and how the environment could change post COVID-19.



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