The ability to extract value from data has emerged as a powerful competitive differentiator for alternative asset managers. Leading companies are investing in advanced data and analytics capabilities to help boost performance, manage risk, and satisfy the growing demands of institutional clients and industry regulators.
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State Street commissioned the Economist Intelligence Unit (EIU) to survey more than 400 asset owners and asset managers — collectively termed institutional investors in this report — to gather insights into how they are using investment data and analytics. The survey, which was conducted from August to September 2013, included 81 alternative asset managers.

Among all respondents, roughly one-third were based in North America, one-third in Asia Pacific and one-third in Europe. All data featured in this report is derived from the State Street 2013 Data and Analytics Survey conducted by the Economist Intelligence Unit, unless otherwise noted. The survey results were supported by in-depth interviews with industry executives.
The greater focus on the importance of data is driven by several connected trends. First, institutional investors are increasing their allocations to alternatives in a bid to drive up returns and diversify risk. But these investors are becoming highly selective. If alternative asset managers are to continue to attract capital in this environment, they must demonstrate exceptional performance based on industry-leading capabilities. “Increasingly, investors want to see real, differentiated skill and performance that can be reliably tracked back to alpha,” says Scott Carpenter, senior vice president and global head of State Street’s Alternative Investment Solutions client relationship and strategy group. “Alternative asset managers need to produce the detailed analysis and information that shows their clients are getting exceptional value.”

These higher demands from clients come at a time of greater scrutiny from industry regulators. In the European Union alone, there are almost 60 regulatory initiatives that affect alternative asset managers either directly or indirectly.¹ Most of these regulations impose exacting demands on fund managers to collect and report on a wide range of data.

Faced with these challenges, alternative asset managers increasingly view their investment data as a competitive asset. In our survey, 7 out of 10 (71 percent) alternative asset managers agree that leading-edge data and analytics capabilities will be among their most important competitive advantages in the future. Yet only a minority of alternative asset managers — 31 percent — believe they obtain a competitive advantage from their data today. This gap

¹ Risk Management for Asset Management Survey, Ernst & Young, 2012.
between future aspirations and current capability helps explain why 94 percent of alternative asset managers have increased spending on data and analytics over the past three years.

Key Conclusions

• **Transparent and flexible reporting can help alternative asset managers attract capital.** Only 28 percent of institutional asset owners in the survey currently feel very confident that they can accurately assess the performance of alternative asset managers. Better reporting is key to building stronger relationships with institutional investors — and ultimately should help alternative asset managers attract more capital from this increasingly important group of clients.

• **Front-office tools are a key investment priority for alternative asset managers.** One way new technology can deliver a competitive edge is by empowering portfolio managers to act rapidly on new investment opportunities. Over the next three years, almost four out of five alternative asset managers (79 percent) expect to increase their investment in order management and execution management systems (OMS/EMS).

• **Technology will help improve risk management.** Managers that can blend exceptional performance with strong risk management are in high demand, but the survey suggests that alternative asset managers’ tools for analyzing risk need improvement. Almost half (46 percent) of alternative asset managers cited more stringent risk management standards as an important reason to change the way they manage data over the next three years.

• **Alternative asset managers need new regulatory reporting platforms.** A global wave of regulations is forcing alternative asset managers to rethink the way they collect and report on data. Two out of five alternative asset managers say that tools to manage regulation in multiple jurisdictions will be a key priority for their data strategy over the next three years.

• **To succeed tomorrow, alternative asset managers need data excellence today.** Seven out of 10 alternative asset managers in our survey agree that advanced data and analytics capabilities will be among their most important competitive advantages in the future. But only a minority is confident that they are deriving competitive advantage from these capabilities today.
Meeting the New Stakeholder Demands

A challenging investment climate characterized by historically low interest rates has encouraged many institutional investors to embrace alternative assets. This trend is driven by a search for yield, but also by a range of other considerations such as the desire to diversify portfolios, reduce volatility and construct portfolios that match longer-term investment objectives.

<table>
<thead>
<tr>
<th>Five Drivers of Data Management Change for Alternative Asset Managers</th>
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<tbody>
<tr>
<td><strong>Strategic Impact</strong></td>
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<tr>
<td>The search for alpha</td>
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<tr>
<td>Investors demand more transparency</td>
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<tr>
<td>New emphasis on risk management</td>
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<tr>
<td>Real-time focus</td>
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<tr>
<td>Regulatory complexity</td>
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Institutional investors’ increased allocation to alternatives creates both challenges and opportunities for the industry. To compete, alternative asset managers need to deliver exceptional performance. At the same time, institutional investors are looking for more transparency about where that performance comes from — for example, through data tools that support comprehensive performance attribution.

Investor demands for more insight are partly driven by the desire to find top-performing managers. This is important in an industry where performance can vary substantially (for example see Figure 1, which shows how performance compared between top quartile and bottom quartile private equity funds in the years 1999 to 2009). It is also about helping investors understand how a manager’s investment strategy fits with their own investment philosophy and objectives. Today, however, investors struggle to achieve the level of oversight they need when dealing with alternative asset managers. In our research, fewer than 3 out of 10 asset owners surveyed are very confident when it comes to assessing the performance of alternative asset managers accurately and objectively.

“Alternative asset managers are seeking ways to continue to tell their story better, and they need to use data to develop and support their argument,” says Scott Carpenter. This is reflected by the survey results: almost one-third (31 percent) of alternative asset managers say increased demands from clients are the most likely trigger of change in how they manage investment data in the next three years.

In this context, alternative asset managers that have the right data tools to provide comprehensive, relevant and detailed information to their clients already have a strong advantage. When this is combined with a demonstrably strong investment performance, alternative asset managers can capitalize on the growth opportunities that the influx of institutional money provides.
Intense Regulatory Focus

The alternative asset management industry faces an increasingly complex, multifaceted and rapidly changing regulatory environment. “Today, we are increasingly seeing regulators push for more transparency into a company’s activities and positions than ever before. They are evaluating a broader and more diverse set of information — moving beyond traditional transaction information within a company’s four walls to industry risk models, reference data and trading algorithms, as well as a company’s systemic risk analytics related to trading controls and governance. The ability to demonstrate strong data governance and data quality will become increasingly important,” says Jeannie Johnson of KPMG’s Advisory Practice.

Measures such as the Alternative Investment Fund Managers Directive, the Markets in Financial Instruments Directive II and Basel III, as well as US regulations including the Foreign Account Tax Compliance Act and the Dodd-Frank Act are putting immense pressure on managers’ data management and handling capabilities. Collecting, analyzing and reporting the required data for all these regulations is a daunting challenge. “Regulation has probably been the biggest driver of increased demands for improved data capabilities for alternative asset managers,” says Scott Carpenter. “Funds need to make sure they get the right data submitted to the right regulators at the right time.”

PwC partner and asset management leader Julien Courbe’s experiences illustrate how challenging compliance can be: “Form PF is one area where we spent quite a bit of time...
working with hedge funds, since they have to actually report a new set of data to the regulators. This is a space where they are investing in new reporting tools."

Given these pressures, it is no surprise that one-quarter of alternative asset managers view regulation as the most likely driver of change in how they manage investment data over the next three years. Meanwhile, 40 percent of respondents cite better tools to manage regulation in multiple jurisdictions as their most important data and analytics priority, and nearly 9 out of 10 anticipate that regulatory change will drive major technology investments (see Figure 2).

**Figure 2: Which of the following are most likely to require changes to the way your firm manages investment data over the next three years? Please select up to three.**

- Better tools to manage regulation in multiple jurisdictions — 40%
- Better integrated electronic trading platforms — 37%
- Improved risk tools with multi-asset class capabilities — 35%
- More flexible or modular tools that will grow with the business — 31%
- Improved ability to manage and extract insight from multiple data sources — 31%
- More intuitive user tools/interfaces — 25%

Source: State Street 2013 Data and Analytics Survey conducted by the Economist Intelligence Unit

**A Renewed Focus on Risk Management**

Increased scrutiny from both investors and regulators is also forcing alternative asset managers to rethink the way they manage and report on risk. In addition to demonstrating their ability to deliver exceptional performance, alternative asset managers are investing in data systems that will help them meet more demanding risk requirements. Nearly half of alternative asset manager respondents (46 percent) cited more stringent risk management standards as the biggest driver of how their firm will manage investment data over the next three years. This is a higher proportion than any of the other investor types — including asset owners, traditional asset managers and insurers — that we surveyed.
Institutional investors are increasingly analyzing the risk profile of their fund strategies, and in particular how those funds might perform under market stress. In this context, they will invest only with managers who can demonstrate best practice in risk management and reporting. A recent survey featured on Risk.net, for example, suggests four out of five hedge funds believe risk management will become more central to raising capital from investors in 2013.²

Advancing Liquidity

The growing emergence of liquid alternatives is another development within the alternatives industry that creates specific data challenges. These products, which mirror some of the characteristics of alternatives products but with greater liquidity, have gained in popularity following the financial crisis amid investors’ desire for more liquidity and highly regulated products. Today, more investors are looking to these products for access to yield. The manufacture and packaging of “synthetic liquidity” is, however, a data-intensive process, involving multiple models, methodologies and indices — which puts pressure on existing operating models and enhances the due diligence needs of the end-investor.

Data That Delivers a Better Return

While most alternative asset managers in our survey see data and analytics as a key source of competitive advantage, many of them have yet to exploit its full power.

Analysis of our full survey of more than 400 institutional investors reveals a growing divide between “data leaders” in the industry — companies who are already harnessing data for competitive advantage — and the “data laggards” who struggle to derive benefits from their data. This divide is evident among alternative asset managers — 31 percent emerge as data leaders, while 17 percent fall into the category of data laggards. Interestingly, alternative asset managers are more likely to be gaining a competitive advantage from their data than traditional asset managers (those that focus on fixed income and equities). In the overall survey, only 23 percent of the latter group emerged as data leaders.

This split between leaders and laggards will have major ramifications for alternative asset managers in the coming years. Our research shows that data leaders benefit from a powerful competitive advantage across many aspects of their businesses (see Figure 3). They have

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an enhanced ability to generate forward-looking insights from their data and manage risk and performance more effectively across complex investment portfolios. (For more detail on how data leaders achieve a competitive edge, see State Street’s recent report, “Leader or Laggard: How Data Drives Competitive Advantage in the Investment Community,” at www.statestreet.com/vision.)

**Figure 3: Measuring Up: Data Leaders Versus Data Laggards**

**DATA LEADERS ARE BETTER AT...**

<table>
<thead>
<tr>
<th>Extracting Insight from Data</th>
<th>Managing Risk &amp; Performance</th>
<th>Electronic Trading</th>
<th>Preparing for Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>% confident in capability</td>
<td>% confident in capability</td>
<td>% confident in capability</td>
<td>% agree with statement</td>
</tr>
<tr>
<td>50%</td>
<td>75%</td>
<td>72%</td>
<td>92%</td>
</tr>
<tr>
<td>Extracting investable insights from a large volume of data</td>
<td>Integrating our performance analytics with our risk analytics</td>
<td>Optimizing our electronic trading strategies</td>
<td>Investment data &amp; analytics are keeping pace with the growth of the business</td>
</tr>
<tr>
<td>43%</td>
<td>64%</td>
<td>33%</td>
<td>7%</td>
</tr>
<tr>
<td>Generating forward-looking insights from our data</td>
<td>Evaluating risk &amp; performance in relative and absolute terms</td>
<td>Conducting scenario &amp; stress testing on the investment portfolio</td>
<td>The complexity of managing our data issues distracts employees from core focus</td>
</tr>
<tr>
<td>70%</td>
<td>83%</td>
<td>96%</td>
<td></td>
</tr>
<tr>
<td>Source: State Street 2013 Data and Analytics Survey conducted by the Economist Intelligence Unit</td>
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By contrast, the majority of alternative asset managers find that their data systems are not meeting the demands of a rapidly changing business environment. For example, only 16 percent of alternative asset managers in the survey strongly agree that their data and analytics capabilities are keeping pace with the growth of the business.

Many alternative asset managers will need to overhaul their existing data infrastructures. One of the key priorities will be improved decision-support tools for the front office, particularly solutions that help alternative asset managers to execute on investment decisions faster and more effectively. Over the next three years, almost 9 out of 10 alternative asset managers plan to increase investment in order management/execution management systems (see Figure 4).

Figure 4: Over the next three years, what changes do you expect to the level of investment your institution makes in the following types of technology or data?

![Graph showing investment changes over three years for various technologies, with order management/execution systems at 51% significant increase and 38% slight increase.]

Source: State Street 2013 Data and Analytics Survey conducted by the Economist Intelligence Unit
Some of the regulatory changes outlined earlier in this report also place a greater focus on more advanced order execution tools. For example, the Private Fund Investment Advisers Registration Act, part of the Dodd-Frank Act, requires hedge fund advisors to register with — and disclose detailed information to — the SEC. As more hedge funds become registered investment advisors, they’ll need to be able to capture and report on a full audit history on each trade — a development that will require more advanced order execution technology.

In addition to these specific areas and tools, modular solutions that grow with the business are increasingly important, allowing alternative asset managers to adapt their investment strategies and reporting tools as market conditions require. “Scalability is absolutely essential to us and how we’ve built our technology infrastructure — to handle any investment size, whether it’s small, medium or large. We really put the thought and capital into selecting the right service providers,” says Andrew Cohan, founder of Macoma Capital Group, a private investment vehicle funded by family offices.

Finally, alternative asset managers will also need to focus on their relationships with external providers of data services. This is particularly important because they are more likely to rely on external providers for performance and risk analytics than any other sector covered by the survey. For example, 31 percent of alternative asset managers rely mostly or exclusively on external providers for performance and risk analytics, while a further 20 percent rely on a combination of external and in-house services in this area. In this context, selecting the right data partners and integrating their insights into a broader data strategy will be a key requirement as alternative asset managers seek to extract more value from their data.

**Data Leadership: The Way Forward**

Data leaders will need to continue to invest in technologies and talent to help them remain at the forefront of the industry. As part of this process, they will need to decide what core competencies they want to resource in-house, and where it makes more sense to outsource data requirements to specialist providers. Our research suggests there are five steps that alternative asset managers need to focus on to become a data leader.
The Five Building Blocks of the Data-Driven Business

1. **Integrate data to extract insight from multiple data sources.** Leading alternative asset managers are investing in enterprise data warehouses to make information more accessible and easier to analyze across the enterprise. They also need technology and good data governance to help them integrate data streams from a range of external data providers.

2. **Deliver flexible reporting tools.** Investor demands for greater transparency need to be met by more powerful and customizable reporting tools. These systems should be designed to help alternative asset managers capture granular data on performance and risk, and present it in ways that best serve the needs of each client.

3. **Use data systems to manage regulation in multiple jurisdictions.** Alternative asset managers need systems that incorporate compliance rules into investment, risk and trading platforms, plus reporting tools that support a complex and growing array of regulatory requirements.

4. **Speed up investment decisions.** In a fast-changing environment, the ability to act rapidly on investment strategies and insights is an important consideration for the overall IT architecture. In particular, for some hedge funds, achieving zero latency is a priority.

5. **Develop a scalable data strategy that will grow with the business.** Alternative asset managers need flexible systems that can support new asset classes, complex mandates and offshore assets. They also need to make sure that their outsourced data providers are managed as part of a coherent data strategy.
Conclusion: Power to Perform

In today’s world of fast-changing technology, real-time information, increasing stakeholder scrutiny and ever-deepening financial regulation, data and analytics capabilities have become essential to alternative asset managers’ success.

Investing in better data analytics capabilities now will enable alternative asset managers to extract the investment insights they need to drive returns and develop new products, as well as provide investors with the transparency they increasingly require.

While investor demands are becoming more onerous, alternative asset managers must also deal with unprecedented regulatory complexity. If they are to fully satisfy these regulators’ comprehensive information demands, they must adopt more flexible data tools. Our survey has shown that data leaders are already harnessing the power of large volumes of data to extract insight, make better and faster investment decisions, and build enduring relationships with investors.

The alternatives industry is becoming increasingly competitive, and only the managers that deliver in line with investors’ expectations can expect to thrive in the coming years. A mastery of data will give alternative asset managers the insights they need to outperform their peers, while satisfying an ever-growing list of requirements from their clients and other stakeholders.
Contact Information

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