

The AIFM data challenge

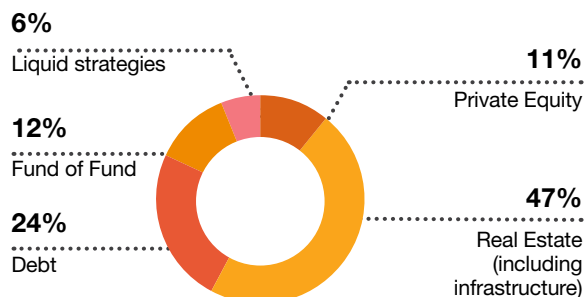
Successfully tackling regulatory and operational challenges in 2021

More than two years into Circular 18/698, and just having gone live on the recent SFDR journey, PwC's Alternatives Advisory team hosted an event aimed at understanding how Alternative Investment Fund Managers (AIFMs) coped with these two additional requirements, in the context of strong growth both in terms of new funds as well as overall assets under management (AuM). Main topics of discussion turned around how equipped AIFMs are for further regulation, the potential CSSF on-site visits, and whether the recent developments impacted their operational setup and approach to data management. This year, the event was split into two sessions. PwC held one session with third-party AIFMs on 16 March and another one with Group AIFMs on 23 March with an overall participation of just above 25 managers.

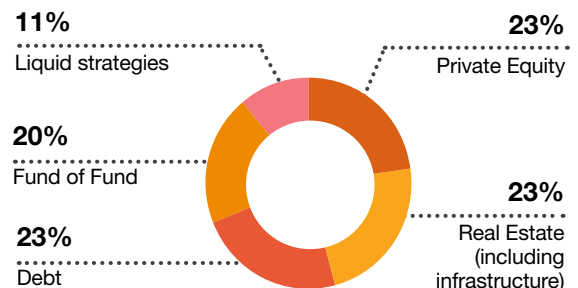
The audience was generally more Real-Estate-focused on the Group AIFM side and offered the full range of illiquid strategies on the third-party AIFM side. In terms of AuM, participants were mostly players from mid-sized businesses with a total AuM ranging typically between EUR 5bn and EUR 15bn amongst both groups. Regarding employees, the number of FTEs was slightly higher for third-party AIFMs than for Group AIFMs.

Which of the following asset classes do you service?

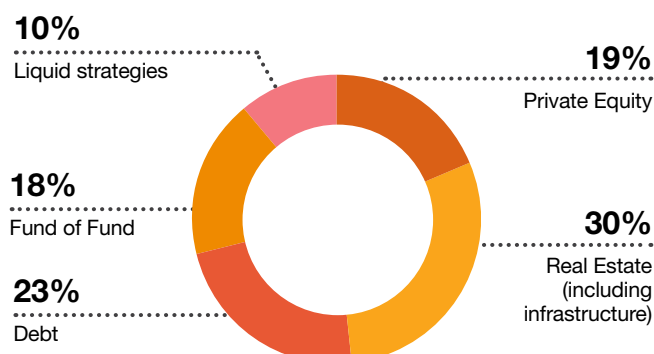
Group AIFM



3rd Party AIFM

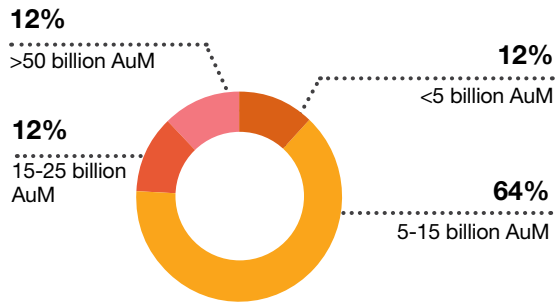


Overall

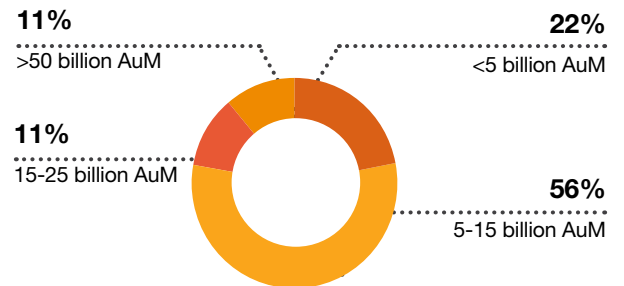


What is the range of AuM that you currently manage?

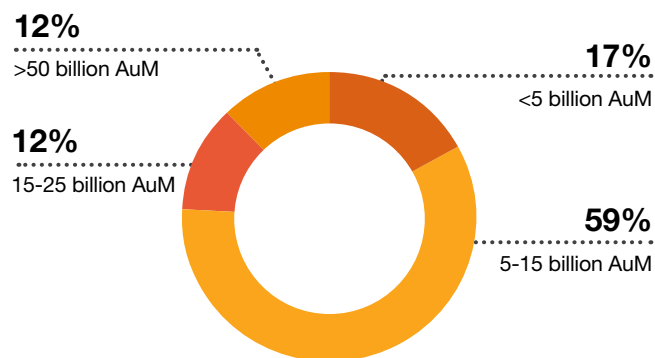
Group AIFM



3rd Party AIFM

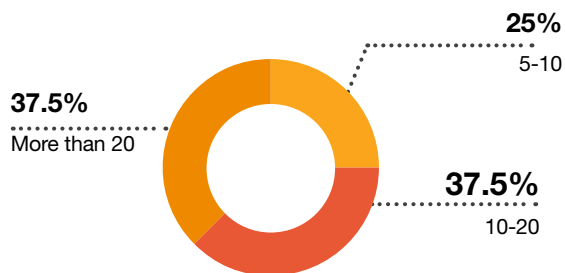


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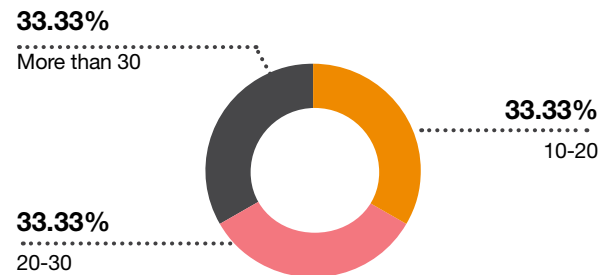


How many full-time employees do you have in your AIFM?

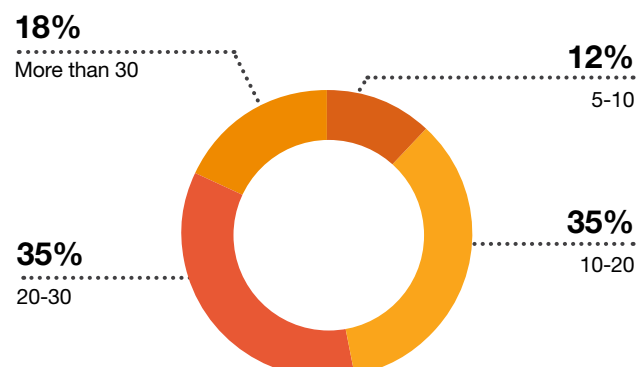
Group AIFM



3rd Party AIFM



Overall



The following topics were discussed at the roundtable event:

1. CSSF on-site visits on Circular 18/698 compliance
2. Improving operational efficiencies through efficient data management
3. SFDR implementation: lessons learnt and preparedness
4. Outlook of third-party AIFM landscape*

* For the third-party event only

Impact of Circular 18/698 on operating models and CSSF on-site visits

While the audience agreed that regulatory pressure on delegation and outsourcing has grown over the past few years and the requirements for oversight have become stricter, there was consensus around the table that delegation is definitely still a factor the market relies on, typically for portfolio management as well as for low value-adding or administrative tasks.

Intra-group delegations still bear uncertainty around local oversight obligations and the consequences this might have on local operations and policies. In practice, an intra-group delegation is often considered as low risk and, at times, does not trigger sufficient control over the delegate. According to the regulations and oversight duties, this risk classification cannot be “automatic”, it should rather be an outcome of a proper assessment which does not free the delegating party from performing appropriate oversight.

Is delegation of low to medium value-adding tasks a key driver of your operational strategy, and if not, what are the key factors holding you back from outsourcing?

78%

Yes, delegation of low to medium value-adding tasks is part of our operational strategy

22%

We prefer to perform tasks in-house and are willing to invest into in-house tools/buy software to be used in-house

0%

We can never be sure that our service provider's level of knowledge is sufficient

0%

Collecting data and preparing it for the third-party provider takes so much time that we see little value add and therefore prefer to keep the task in-house

0%

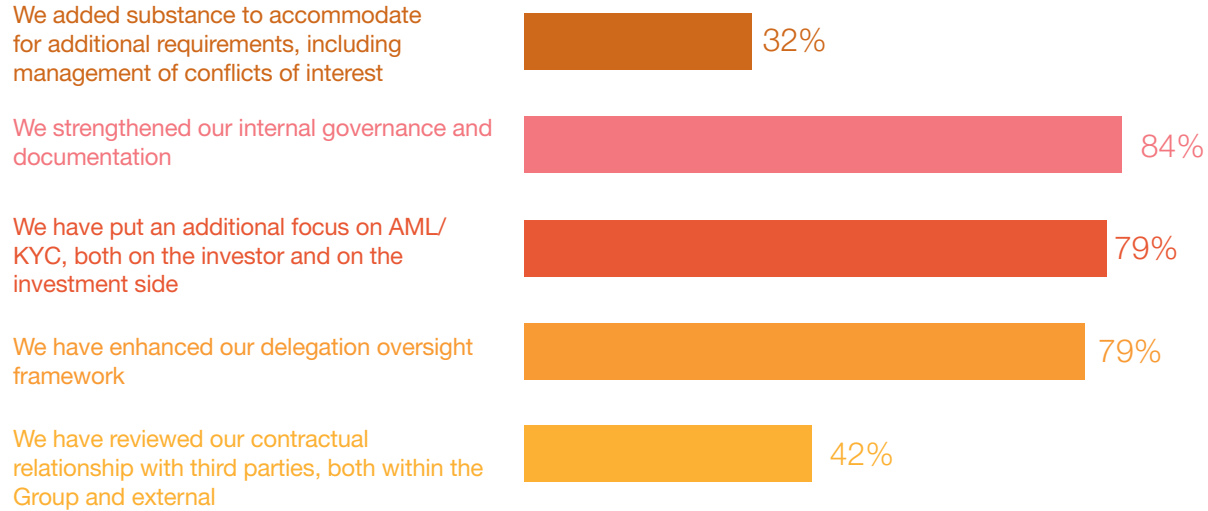
We do not want to hand our data to third party providers

0%

Performing supervision on the work performed by the service provider takes just as long as performing the actual task in-house

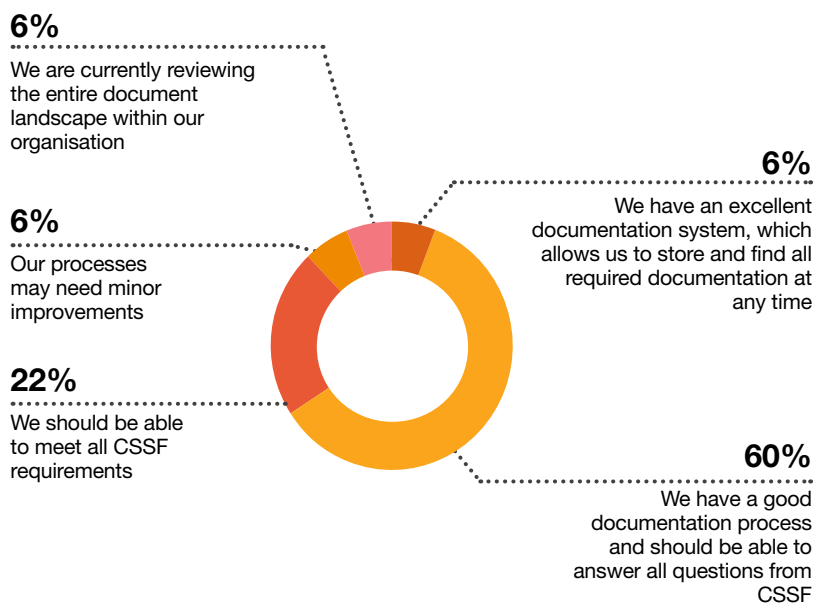
Circular 18/698 did, without a doubt, have a significant impact on operating models:

Which were the main impacts that CSSF Circular 18/698 had on your organisation?



While more than one vote was possible for this answer, the entire audience confirmed to have strengthened their internal governance and documentation, and the majority stated they are comfortable enough to show the CSSF all documents they may request within the usual 10-day deadline:

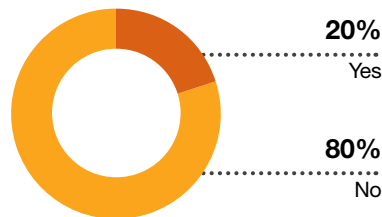
How comfortable are you with meeting the 10-business-day notice to provide this list of documents to the CSSF?



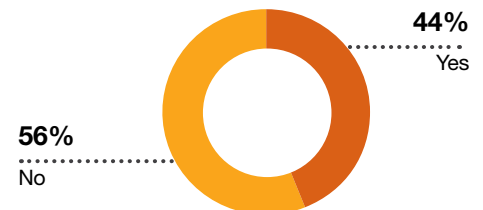
The fact that the CSSF has grown their on-site visit teams significantly over the past few years is starting to reflect in the number of on-site visits they are conducting on the application of Circular 18/698:

Has the CSSF already announced/performed a visit?

Group AIFM



3rd Party AIFM



Overall



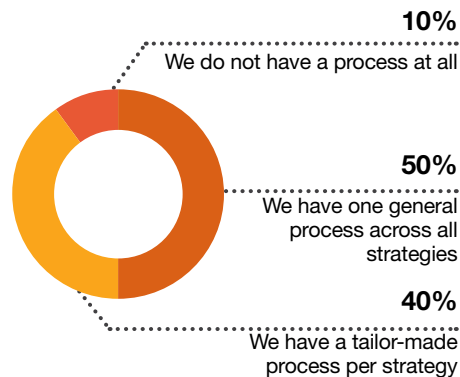
It became apparent from the discussion that AIFMs, who demonstrate proactive communication flows with the CSSF, where any changes in the organisation are reported immediately, periodic updates are established and feedback from the regulator is considered prior to any major decisions locally, are potentially seen as “lower risk” and hence have not yet received a request for an onsite-visit. This needs to be seen in the context of the overall internal review of all AIFMs done by the CSSF to establish the timings of the different visits.

The organisations that reported having received a request for an on-site visit or even had received the CSSF already to assess their Circular 18/698 compliance confirmed that the regulator had a very stringent approach with zero tolerance for Covid-related excuses and that there was absolutely no difference in terms of quality or thoroughness of the assessment, although reviews were conducted virtually. The follow-ups are described as being sharp and precise, with the the CSSF looked at portfolios and transactions from up to a couple of years prior to their visit, reviewing the entire process.

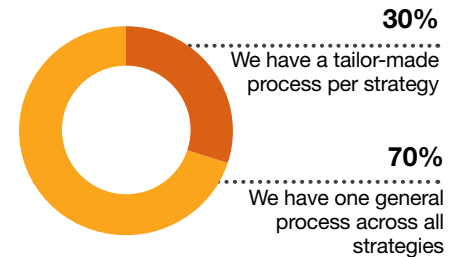
Delegation oversight was a strong focus at various visits, looking at long-term service provider relationships, as those bear the risk of relying on said relationship rather than conducting appropriate periodic due diligence and ongoing monitoring, which is not acceptable from a regulatory perspective. The majority of representatives from both Group and third-party AIFMs, reported to have KPI reporting schemes in place with their service providers.

Do you have formalised ongoing monitoring (KPI) processes in place with all your service providers?

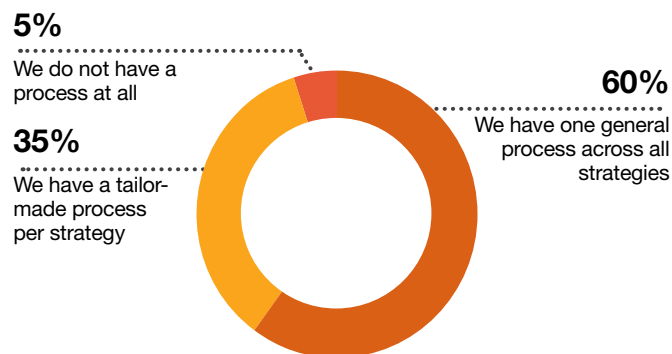
Group AIFM



3rd Party AIFM



Overall



While the monitoring of delegates is an important obligation which is not only dictated by the regulator but also makes common sense, KPI reporting activities are often considered a time consuming exercise that may add little value to either party, depending on how the required reporting matches the reports received and on the level of manual intervention required. A possible but seldomly applied solution for this could be the use of data mining tools, which allow the extraction of reports on the usage of systems such as Yardi, Efront, Investran and alike. The reports can also provide insights on elements such as the application of four-eye-principles as well as processing statistics. This, however, requires a high degree of end-to-end system usage by the delegate or service provider which is not (yet) always the case in the Alternatives Investment space.

This is also confirmed when looking at the digitalisation level within service providers. Most managers considered that asset servicers generally operate at what was assessed as below satisfaction across the board. They argue that it sometimes feels like digitalisation has not yet fully arrived at the service provider landscape, but also acknowledge that the situation is improving gradually, especially on the TA side.

In the context of increased oversight required by the CSSF on your service providers, how satisfied are you with the level of digitalisation provided by your service providers overall (FA, TA, depositary, auditor, tax consultants, etc.)?

22%

Satisfied

56%

Rather satisfied

11%

Dissatisfied

11%

Very dissatisfied

Improving operational efficiencies through efficient data management

When looking at the level of digitalisation and digitisation within AIFMs, there is a clear trend amongst most managers to move towards more digital operating models with none of the Group participants and only 10% of third-party AIFMs voting themselves into the category of “Heavily reliant on manual processes and Excel”:

How digital are your current operations overall?

16%

Largely digital, with a strong focus on improving current solutions and interfaces (incl. with group systems) over the next years

11%

Largely digital, but with a fragmented IT architecture (e.g. differences by asset classes, lacking integrations...)

5%

Heavily reliant on manual processes and Excel

68%

Somewhat digital for specific parts of the organisation / processes but remain very manual for others

The overall AIFM community shows a clear willingness to uplift their operations, move away from Excel spreadsheets and heavy reliance on manual processes. They not only bear risks of operational errors but also a certain amount of key-man risk, which is clearly to be avoided in the back-and middle-office. Surprisingly, during PwC’s last AIFM event held not more than a year ago, one-third of the audience reported that they still relied heavily on manual processes and Excel.

Level of digitalisation of our attendees’ operations (Group and third-party AIFMs mixed) in February 2020: :

20%

Largely digital, with a strong focus on improving current solutions and interfaces (incl. with group systems) over the next years

27%

Heavily reliant on manual processes and Excel

53%

Somewhat digital for specific parts of the organisation/ processes but remain very manual for others

This direct comparison re-emphasises the trend and the focus area mentioned in the introduction: The entire financial market has put “Data & Digi” on their agenda, as they know that without software and system support, (i) it will become more and more difficult to manage and service structures that constantly increase in scale and complexity, (ii) they will become too expensive and prone to (human) error compared to their peers, (iii) they will not be able to keep up meeting their clients’ needs and (iv) most likely attract less talent on the labour market in the long run, as the majority of “digital natives” are most likely not interested in manual processing of repetitive, low value-adding tasks.

Lastly, the systems’ landscape has evolved significantly: While there are still a handful of IT vendors sharing the largest portion of the market for the respective asset class they specialise in from an ERP perspective, smaller tech firms and start-ups are on the rise and continue to gain relevance in the market. The fact that “*tools are like Lego – very easy to combine*” helps new tech companies enter the market, and also promotes the setup of in-house tool developments capable of connecting certain bits and pieces between systems acquired from external vendors:

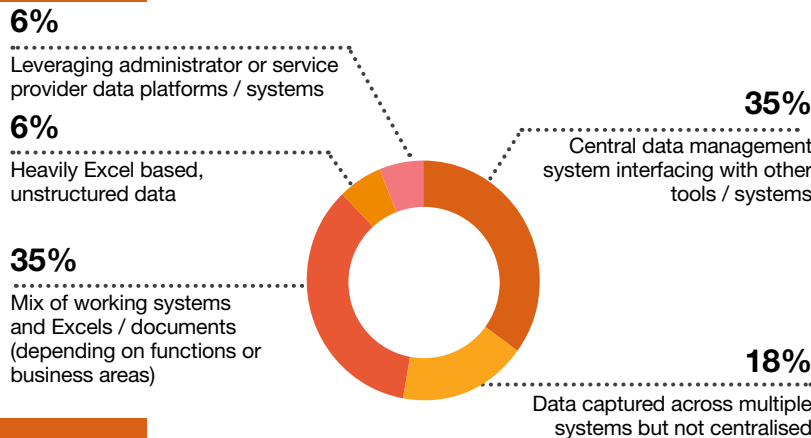
Which digital tools are you using in your day to day operations?



There was consensus around the table that the key is not to implement as many tools as possible but to really use and combine a selection of dedicated and fit-for-purpose systems and applications in the smartest way possible, and using internal IT and data experts to develop their full potential. Most participants “*are convinced that they need to have a digital strategy, which shall determine the tools that you are using*” and not the other way around.

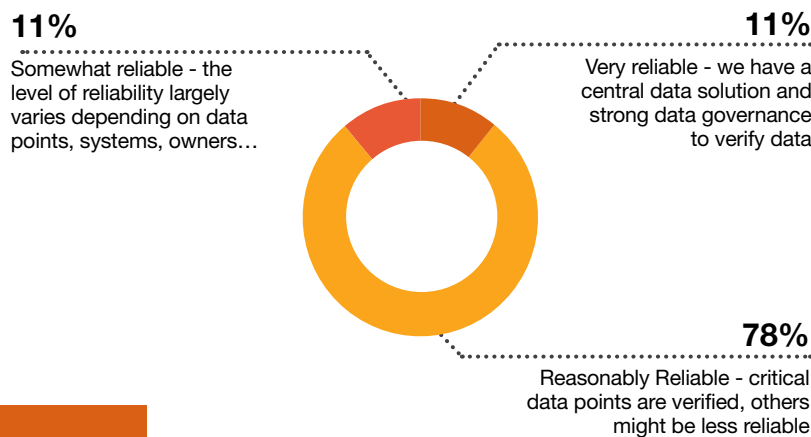
One of the key challenges lies in the data management within the organisation. The final objective is to establish a golden source of truth through central data management systems that ideally interface with other tools and applications within an appropriate control framework. In such a set-up, all systems are seamlessly integrated into daily operations.

How do you manage data within your organisation?



While there is still some way to go for most third-party AIFMs and at least half of the Group AIFMs PwC interviewed in March 2021 to achieve fully supported data warehousing systems that ensure accuracy at all times, a clear trend is emerging, one that set towards a more thorough data management. The vast majority is already confident or very confident when it comes to the quality of their data:

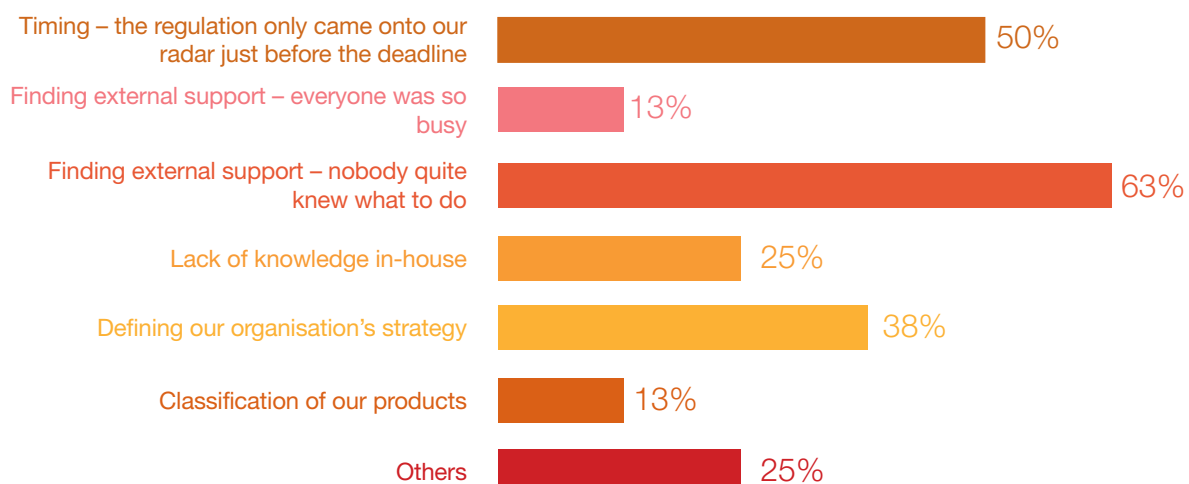
How would you rate the quality of your data?



As data becomes more complex and continuously increases in volume, this is a meaningful development and the only way to stay on top of information. Regulatory developments such as SFDR and the application of level II, increases even further the need for data collection, management and storage and raises the expectations for a high level of accuracy for periodic reviews and reporting.

SFDR implementation: Fund documentation is updated – what's next?

What were the main challenges you faced when trying to achieve SFDR level I compliance?



When it comes to SFDR, all potential challenges applied to our panel of AIFMs, which did not come as a surprise. This regulation was once called “*the most forgotten regulation of the century*”.

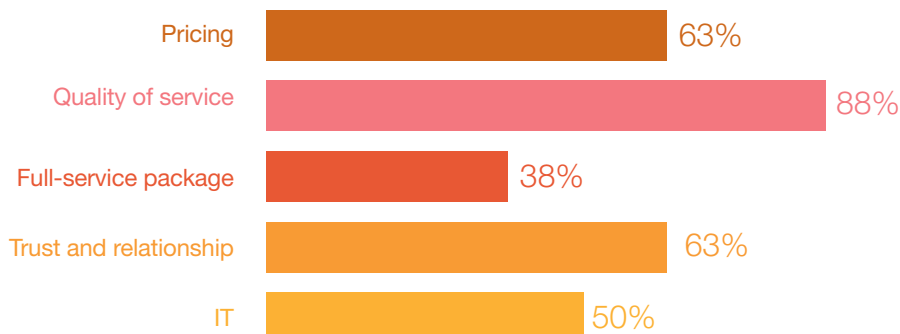
From the experience PwC has gained in the topic so far, the participants were expecting more difficulties with defining the company’s strategy. They stated that the confinement did not help with finding resources and getting the “company’s head around the topic”, while learning how to deal with a global pandemic and slowly adapting to the “new normal”. Just after having achieved Level I compliance, the Level II is approaching already, with its deadline in January 2022. This is providing an opportunity for the wider Alternatives industry as it will structurally reshape the capital flows and investment sphere and entice investors to allocate more capital towards long-term sustainable investments especially in the private markets. There was consensus around the table that ESG clearly matters when looking to keep existing and attract new investors, considering that more and more organisations are moving towards a more sustainable investment approach.

Outlook of third-party AIFM landscape

While it’s still an open question whether third-party AIFMs are going to sustain their current relevance in the market going forward, participants show little concern about their business, arguing that third-party ManCo/AIFM services are not the only business stream they have to offer. They can also provide other services such as directorships, depositary and central administration services. In addition, one-stop-solutions, including AIFM services, are still going to be requested, especially from non-European fund managers.

In terms of competitiveness amongst third-party AIFMs, for market participants, technology is not seen as a main differentiating factor given it is increasingly considered a must-have:

What do you expect to be the main drivers of your business growth over the next three years?



Instead, pricing, trust and relationships and quality of service are seen as parameters where the wheat is separated from the chaff. This also shows that despite all technological advancements, the human aspect of client services still matters and it’s expected to continue being a key differentiator in the future.

Conclusion

While regulatory waters are currently slightly calmer after the implementation of circular 18/698 and the publication of SFDR Level I, AIFMs are currently putting a major focus on operational efficiency in order to cope with and prepare for strong business growth. A crucial driver in that exercise is data and the way it is being collected, treated and reported. Having their middle- back- and front-office operations in order will allow market participants not only to make better business decisions and remain relevant in the market, but it will also facilitate the regulatory aspects of their organisation. Examples of this include providing documents and answer questions during on-site visits from the CSSF or preparing for the practical application and data collection exercise under SFDR Level II as from next year. The one key take-away from both sessions is that, no matter which category of business model you fall into (Group or third-party AIFM) and regardless of regulatory burdens, digitalisation and data management are key to continue succeeding in the future, scaling operations and staying competitive.

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