



Are institutional investors the new masters of the universe? asks KPMG

- *New report finds that demands from institutional investors are transforming the alternative investment industry*

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A dramatic shift in the balance of power has given institutional investors the upper hand in the alternative investment industry concludes KPMG's recent report "*Transformation: The Future of Alternative Investments*". Their demands for institutional grade controls, increased transparency, liquidity and flexible product strategies are driving fundamental changes in the very fibre of the industry – business models, fee arrangements, servicing agreements, for example – and are affecting all players.

Tanis McDonald, Director at KPMG (BVI) Limited and member of the editorial board of the report says: "Historically, anyone considering an investment in alternatives had to invest on the manager's terms. Today, the picture of the industry has been turned on its head; it's now one in which investors are firmly in the driving seat and, fundamentally, investors want to see managers interests more closely aligned with their own."

And this picture is not likely to change anytime soon; over 50 percent of institutional investors surveyed said they intend to increase their allocations to alternatives in the next three years; some anticipate an allocation of over 10 percent of total assets. And managers, for their part, are not blind to this change in dynamic with 70 percent attesting that client service is their top priority after performance.

Impact of regulation

Surprisingly, while regulation has been widely promoted as a way to protect investors, the report finds that the majority are against it. Reasons cited include the belief that regulation will not produce any tangible benefits, it will add costs and bureaucratic burden, it will stall the industry's engine of creativity and it will limit choice. In addition, and of particular note, 81 percent of

institutional investors indicated that domiciliation makes little difference with regard to allocation decisions.

“There’s an interesting distinction here and an important observation for the British Virgin Islands,” says Tanis McDonald. “While investors are clearly looking for products with increased transparency and liquidity, they do not seem to be demanding regulated products. Nor are they particularly concerned with the question of domicile, which runs counter to how much attention the onshore/offshore debate has attracted lately.”

A New Breed of Manager

Tanis McDonald notes that there is also an emergence of a new breed of manager. “Recently, we’ve seen the rise of the entrepreneurial-institutional (EI) manager; one that’s more formalized and offers clients multiple products (including complementary services like financing, private placements and proprietary trading, for example) through multiple distribution channels. Despite their size, though, they seem to have managed the balance between the needs of a creative environment and the rigidity of the institutional infrastructure that investors are demanding.”

Allocation model changes and consolidation

Investor allocation decisions are also shaping the alternatives landscape. Fund of funds did not have a good market crisis, say their investors. As a result, larger institutional investors are moving to an allocation model with a clear trend in favor of direct investment and managed account platforms, the latter for reasons of security, liquidity and transparency. At the same time, allocations to fund of funds are falling. Larger fund of funds managers with the resources to expand into managed accounts, diversify their offerings in other ways, and use their brand name to attract investment will survive. Many smaller players, however, are unlikely to be able to compete and the result may be a wave of M&A activity.

Affecting administrators

Administrators are not even immune from investor influence as demands for reporting transparency and liquidity requirements rise and force greater standardization. Data demands from fund managers and regulators are also expected to swell exponentially, so administrators will need robust and flexible technology platforms that are capable of high-volume transaction processing and customized ‘real-time’ reporting. In this environment, the challenge of capacity comes to the fore. The research shows that nearly three in four administrators are currently operating at between 71-

100 percent. If alternative inflows develop as forecast, or anywhere near to it, administrators will face serious infrastructural issues.

McDonald says: “Led by demands from institutional investors, the alternatives sector is going through a period of transformational adjustment and while the industry is no stranger to change, this time around it will be profound.”

-Ends-

To download a full copy of “*Transformation: The Future of Alternative Investments*” go to www.kpmg.com.

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About the report

Obtained through surveys and structured interviews conducted globally between February and June 2010, this report compiles perspective from 200 respondents across 26 countries. Respondents include alternative investment managers with US\$515 billion under management; administrators with US\$4.2 trillion under administration; and institutional investors with US\$884 billion under management. The report also includes perspective from lawyers and independent directors. While the main focus has been on managers who invest in hedge funds, views from managers who also

invest in either, or a combination of, the following: private equity, real estate, infrastructure and structured products, have also been incorporated.

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