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Alternative Administration Survey

The evolving relationship between alternative managers and third-party administrators

pwc

We are pleased to present the findings and insights from our Alternative Administration Survey.

The results of our analysis show that third-party administrators play a key role in the back-office administration activities for most of the managers in our survey. Additionally, survey respondents indicated that these relationships may expand to include other administrator-led services, such as regulatory compliance and reporting support.

We expect that the working dynamic between alternative managers and third-party administrators will continue to evolve over time, particularly as managers adjust their product mix in response to changing investor preferences and expanded market opportunities.

Key Contacts

Mike Greenstein, Partner
U.S. Alternative Investments Leader - *Assurance*
michael.s.greenstein@us.pwc.com
+1 646 471 3070

Timothy Mueller, Principal
U.S. Alternative Investments Leader - *Advisory*
timothy.mueller@us.pwc.com
+1 646 471 5516

Erich Butters, Director
Asset Management Advisory
erich.butters@us.pwc.com
+1 646 471 0074

Gary Meltzer, Partner
Global Asset Management Leader - *Advisory*
gary.c.meltzer@us.pwc.com
+1 646 471 8763

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Executive Summary & Respondent Profiles

84 alternative managers participated in our Alternative Administration Survey.

Managers were segmented into three categories:

- Hedge fund managers (52% of respondents) – firms that focus on hedge fund strategies such as long/short equity, global macro, credit, etc.
- Private equity / real estate managers (32% of respondents) – firms that focus on private equity strategies, such as leveraged buyout, venture capital, real estate, infrastructure, etc.
- Hybrid managers (16% of respondents) – firms that manage at least one hedge and one private equity/real estate strategy.

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Executive Summary (1 of 4)

General Outsourcing Trends (Section 2)

Rate of Outsourcing

The rate of outsourcing by alternative managers participating in our survey was strong, with 75% of all respondents outsourcing at least one back-office function to a third-party administrator (TPA). This suggests that broad adoption for back-office outsourcing has occurred across the alternative asset management industry. However, different rates of outsourcing were found across hedge fund managers, hybrid managers, and private equity / real estate (PE/RE) managers.

- Approximately, **90% of hedge fund** and **85% of hybrid manager** respondents outsource at least one back-office function to a TPA. By comparison, only **52% of PE/RE** manager respondents outsource at least one back-office function. However, based on outside research conducted by PwC, we estimate that the PE/RE asset class is only 30% outsourced when measuring on the basis of invested capital**.**
  - The differential between the two outsourcing rates reflects a PE/RE segment that is bifurcated in its adoption of outsourcing, as non-US and smaller PE/RE managers have outsourced more often than large US managers. This trend results in a higher industry outsourcing rate when measuring based on the number of managers, and a lower rate when measuring on the basis of invested capital, since large US managers represent a sizeable percentage of the industry's AUM.
- **Hedge fund and hybrid managers outsource 1.7 times more often than PE/RE manager respondents**. The higher rates occurred because these managers were largely pushed to TPA models by institutional investors after the credit crisis.
- There is evidence suggesting that there is growing interest in TPA models among PE/RE managers, since these models provide opportunities to transfer these costs to the funds and to avoid sizeable capital investments in non-core functions such as regulatory reporting.
- Our survey generated consistent findings, as 25% of the PE/RE managers currently using an insource model indicated they are planning to outsource at least one back-office in the next 12-24 months.

Types of Administrator Relationships

We found that managers differed in the type of administrators and the number of administrators they used.

Administrator Types: In general, we observed managers used three types of administrators, (i.e., bank-owned, large non-bank, and small non-bank), with each segment using a different administrator most often. For example, PE/RE managers used small non-bank administrators most frequently, which is a reflection of a PE/RE administration industry that is currently fragmented and comprised of smaller firms predominantly. Conversely, hybrid managers used bank-owned administrators most often, suggesting banks may be in a better position to meet the more diverse and complex needs of these managers.

Executive Summary (2 of 4)

Types of Administrator Relationships

Number of Administrator Relationships: Managers also leveraged different numbers of administrator relationships. The majority of manager respondents (64%) used a single administrator, while 36% of respondents indicated that they use a multiple administrator servicing model, with 25% using two administrators and 11% using three or more administrators.

We found that larger managers used multiple administrators **twice as often** as the smaller managers on average. While there was a relationship between a manager's size and the number of administrator relationships they maintained, we found that larger managers also had more geographies and strategies on average. Higher numbers of locations and strategies per manager, which we considered a proxy for operational complexity, are the most significant drivers behind the use of multiple administrators.

- On average, larger managers had **1.4 times** the geographic footprint and **2.2 times** the strategy coverage of smaller managers.

Manager / Administrator Interaction Models

86% of hedge fund and hybrid manager respondents reported their preference for a decentralized interaction model (over a single point of contact) when working with their administrator(s). This suggests that managers prefer the option to directly contact the most appropriate resource for a particular situation. PE/RE managers showed no preference for either model.

95% of managers indicated that they have a vendor governance process in place with their administrator; however, **only 72% of these firms** review pricing as part of this process. As managers focus more on cost efficiency in an attempt to offset margin compression, we expect to see an increase in the percentage of managers that review pricing as part of their normal governance process.

Administrator Selection Trends (Section 3)

We examined the factors that managers cited as being most critical in their decision for selecting an administrator. We found that managers select administrators based on service levels, capabilities, and pricing most often. Other factors, such as cultural fit, technology, reputation, stability, and ability to scale, were considered secondary in their overall importance to the decision-making process.

- **78% of manager respondents** listed service levels (high quality and ability to customize) in their top 5 factors for evaluating and selecting an administrator. **39%** of managers also cited service levels when specifying the factor most important to their decision making process.
- **~57% of manager respondents listed capabilities** (financial reporting, tax preparation, regulatory reporting, etc.) **and price** in their top 5 factors for evaluating and selecting an administrator. However, when specifying the factor most important to the decision making process, **26% of manager**s cited price (2nd highest overall) and **11% cited capabilities** (3rd highest).

We also found that there were differences in the factors driving selection by manager segment. See pages 22 – 24 for this detail.

Executive Summary (3 of 4)

Back-Office Outsourcing and Shadow Accounting (Section 4)

Of the managers that outsource at least one back-office function to a TPA, we found that **69% of these managers outsourced fund accounting**. The rate of outsourcing across other back-office functions was lower, as firms appear to perform many of these functions in house presently.

- **82% of hedge fund** and **85% of hybrid managers reported outsourcing** fund accounting and administration**.** By comparison, only **41% of PE/RE managers** outsource fund accounting. This differential is primarily due to institutional investors pushing managers of hedge fund strategies to TPA models after the credit crisis.
- **57% of hedge fund managers** indicated that they outsourced investor servicing to a TPA. This rate is nearly double that of hybrid managers, which reported outsourcing investor services at a rate of 31%.
- Outsourcing rates for other back-office services were lower, ranging from 11% to 45% across the three manager segments. See pages 27 – 29 for more detail.

The use of shadow accounting functions by managers is a pervasive trend in the industry, as over 80% of respondents reported maintaining a set of shadow books and records at some level. This suggests that most respondents believe administrator quality and transparency must improve before shadow accounting functions can be phased out or that managers feel some level of shadowing is required to their fiduciary responsibilities. There was some variance by manager segment; however, the trend was generally consistent. See page 30 for more detail.

Manager Satisfaction (Section 5)

Managers reported higher levels of satisfaction with their administrator's back-office offering, suggesting the administration industry has improved substantially, in terms of quality and efficiency, over the last five years. **73% of managers** indicated they were satisfied with their current administrator's level of service. While satisfaction was consistent across manager segments, there was some variation among the size cohorts. See pages 32 and 33 for more detail.

- Current satisfaction levels are likely tied to the fact that **70%** of respondents believe their administrator is consistently meeting service levels.
- **Only 6% of managers** indicated they **are actively looking to switch** administrators. The remaining 94% cited: 1) current satisfaction with service levels, and 2) high switching costs, as the factors most preventing them from making a change.

Executive Summary (4 of 4)

Regulatory Services (Section 6)

Managers overwhelmingly indicated that regulatory services are an important component of an administrator's offering. Managers also reported being generally satisfied with their administrator's regulatory reporting capabilities.

- 76% of managers reported using a TPA for at least one regulatory reporting or regulatory compliance service.
- 72% of managers indicated it was important for their administrator to provide a regulatory reporting capability.
- Approximately 70% of managers indicated they were satisfied with their administrator's regulatory reporting capability.

Middle-Office Outsourcing (Section 7)

The rate of middle-office outsourcing was low among manager respondents; however, participants consider some middle-office outsourcing services to be value-added, indicating that manager demand for these services may grow in the future.

The functions outsourced most often were portfolio accounting (16%) and P&L reporting (16%).

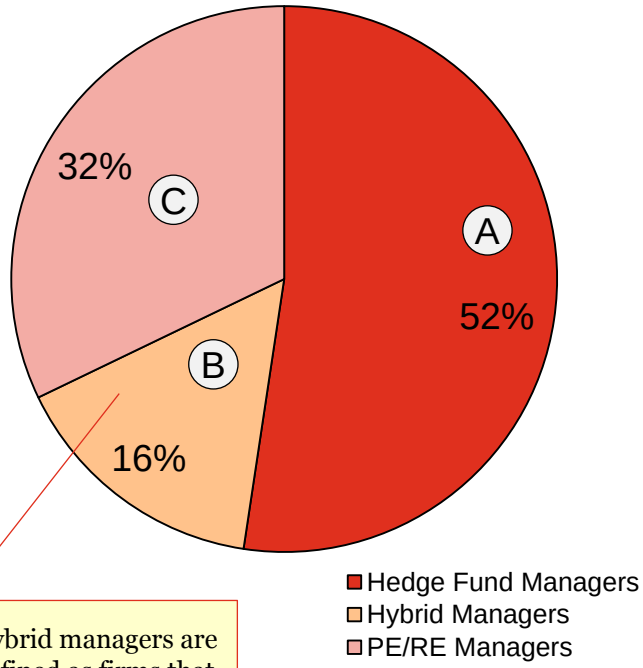
Other Services (Section 8)

Hedge fund and hybrid managers with bank-owned administrators were 2.3 times more interested in using "expanded banking services," (e.g., cash management, collateral management, etc.) from an administrator.

Over 80% of hybrid managers expressed an interest in an integrated administration offering, while interest from other manager segments was limited to respondents with more AUM and/or more strategies on average.

Our 2013 Alternative Administration Survey is based on responses from 84 alternative managers…

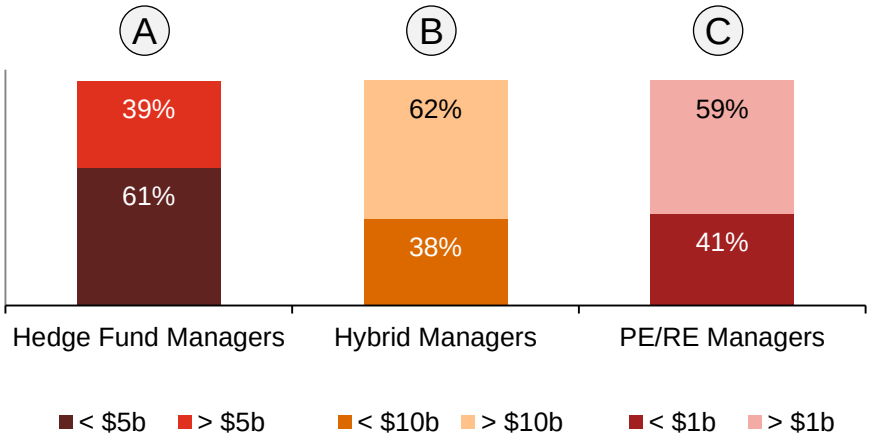
Respondent Mix (84 managers by type)



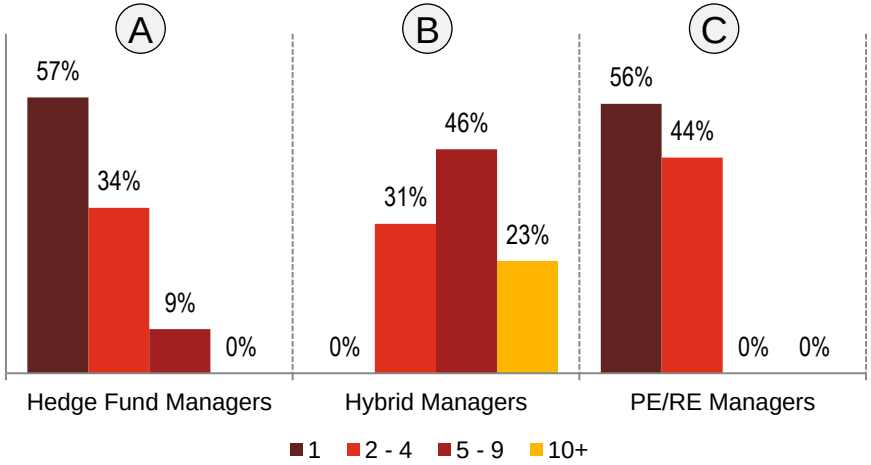
Hybrid managers are defined as firms that manage at least one hedge fund and one PE/RE strategy.

Number of Respondents: 84

Manager Segments by Size

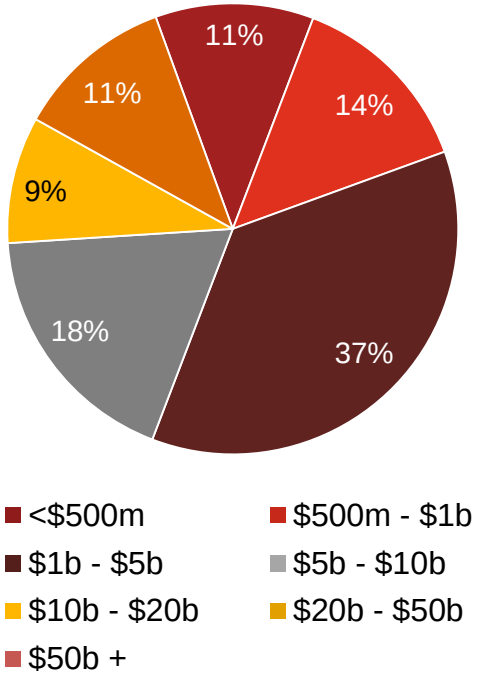


Number of Strategies (by manager segment)



A Hedge Fund Manager Profiles

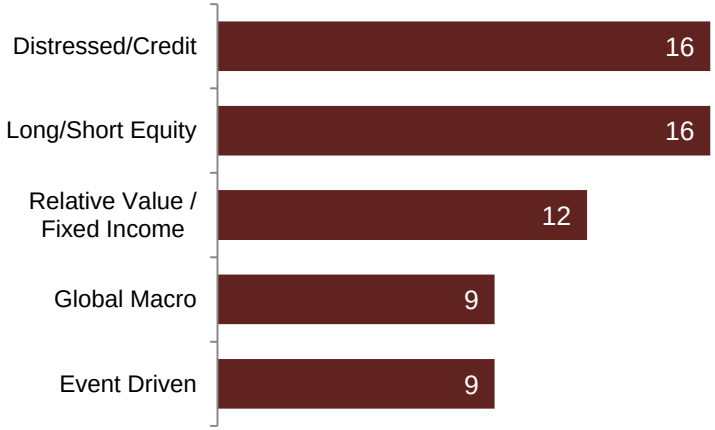
Hedge Fund Managers by Size



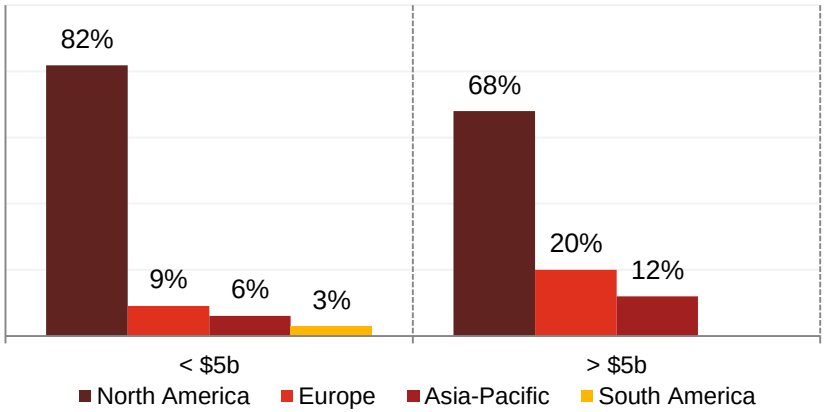
Number of Respondents: 44

NOTE: The hedge fund manager segment includes both single manager hedge funds and fund of hedge fund managers. There were 38 hedge fund manager respondents and 6 fund of hedge fund manager respondents.

Most Common Strategies

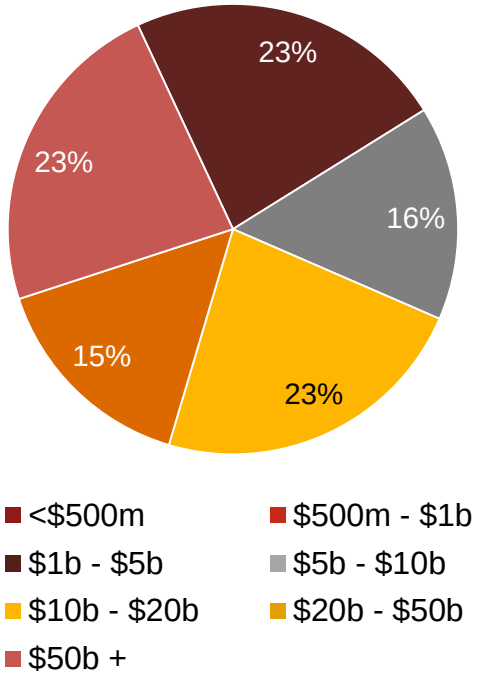


Front-Office Geographic Footprint



B Hybrid Manager Profiles

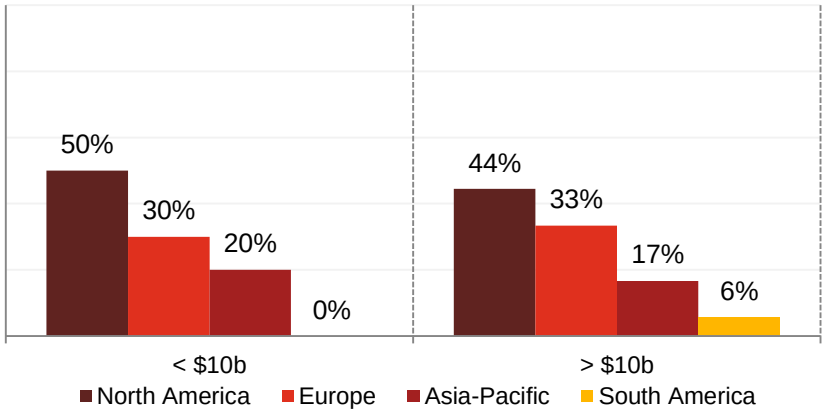
Hybrid Managers by Size



Number of Respondents: 13

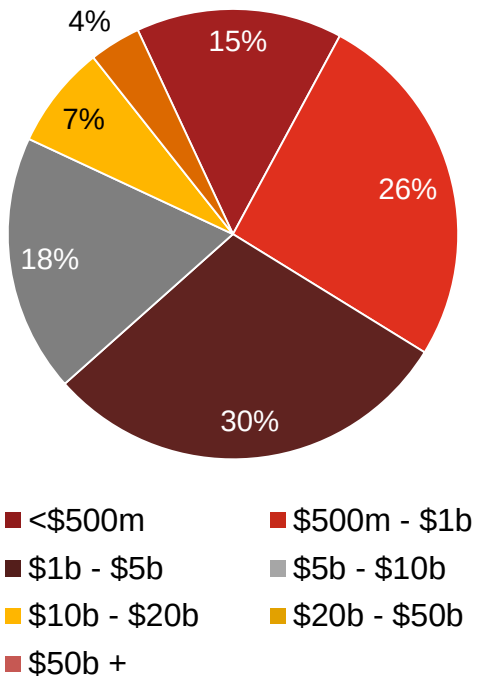
Most Common Strategies

Front-Office Geographic Footprint

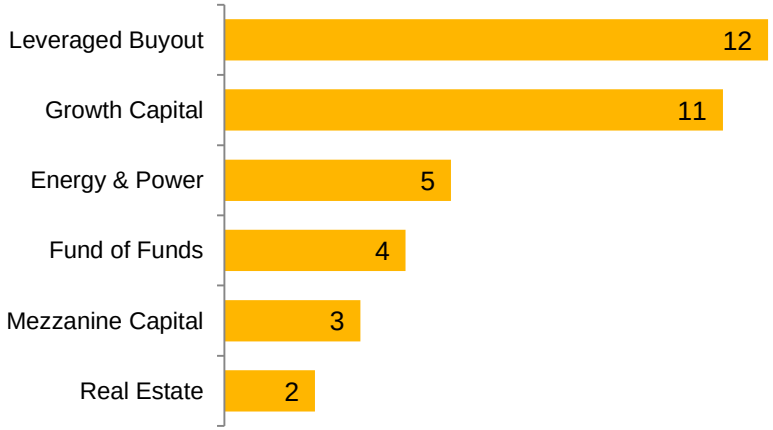


C Private Equity / Real Estate (PE/RE) Manager Profiles

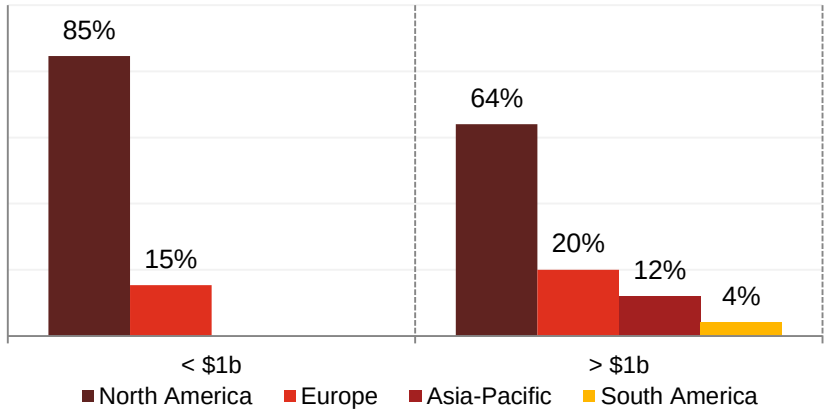
PE/RE Managers by Size



Most Common Strategies



Front-Office Geographic Footprint



Number of Respondents: 27

General Outsourcing Trends

Over 75% of manager respondents indicated they outsource at least one back-office function to a third-party administrator (TPA).

Hedge fund and hybrid manager respondents outsourced ~1.7 times more often than private equity / real estate managers.

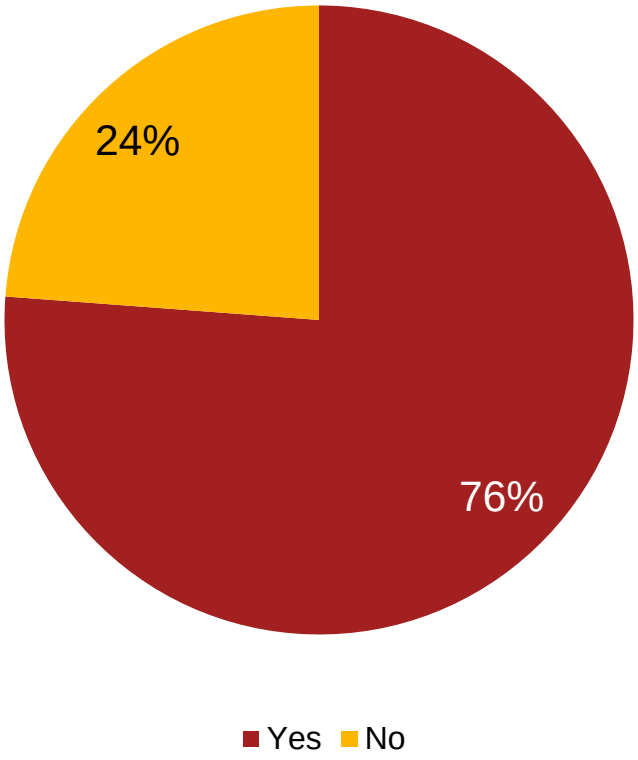
Managers with higher levels of AUM used multiple administrators at twice the rate of other managers in their segment.

Managers with higher levels of AUM had ~1.4 times the geographic footprint and ~2.2 times the strategy coverage of managers with lower levels of AUM.

Higher numbers of locations and strategies per manager, which is considered a proxy for operational complexity, are the biggest drivers behind the use of multiple administrators.

2

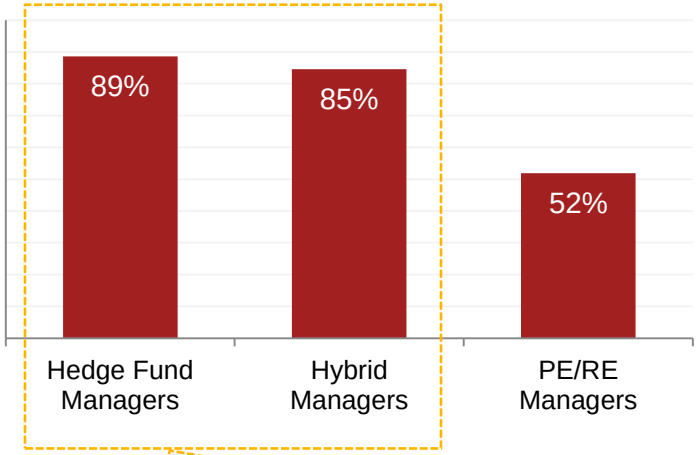
Over 75% of respondents indicated they use at least one third-party administrator



Number of Respondents: 84

However, the degree to which managers have adopted third-party administration varies by asset class

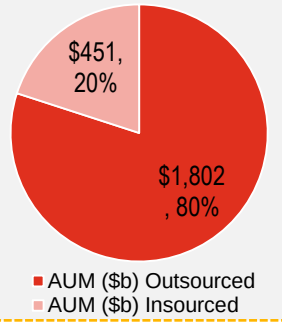
Percentage of respondents using a third-party administrator (by manager segment)



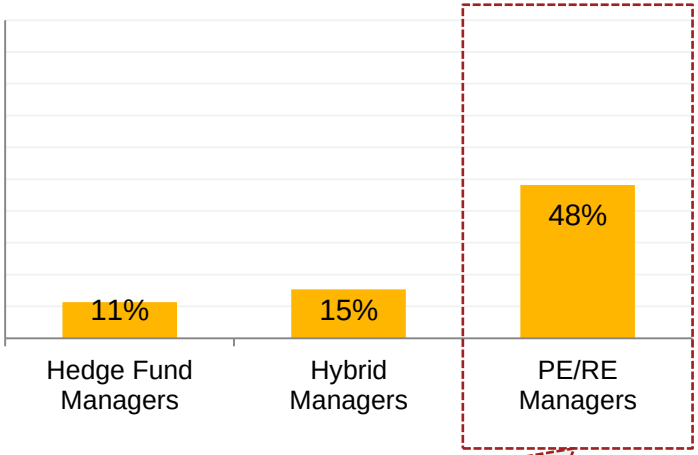
Over 85% of hedge fund and hybrid manager respondents reported using at least one third-party administrator (TPA) for a back-office function.

This rate is generally consistent with our industry-level view for AUM managed in hedge fund strategies. We estimate at least one back-office function is managed by a TPA for 80% of this AUM.

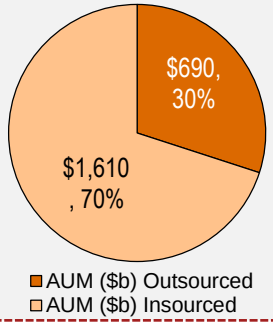
% of HF AUM administered by a TPA



Percentage of respondents using in-house administration only (by manager segment)



% of PE/RE invested capital administered by a TPA



Approximately 50% of private equity / real estate (PE/RE) respondents reported using at least one third-party administrator (TPA) for a back-office function.

This reporting at the manager level is higher than our industry-level view for invested capital. We estimate only 30% of PE/RE invested capital is outsourced to a TPA, because larger managers remain insourced.

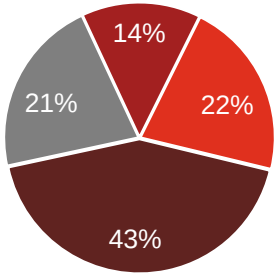
Number of Respondents: 84. PwC industry outsourcing estimates (in pie charts) are based on an analysis of ADV filings, discussions with hedge fund managers, and review of industry publications, press releases, and analyst reports. Total hedge fund AUM from HFR and total PE/RE invested capital from Preqin.

Managers of all sizes appear to have adopted outsourcing

Hedge fund and hybrid managers outsource at higher rates primarily because of the strong push from institutional investors for more transparent books and records. Private equity and real estate managers do not appear to face the same level of investor pressure as those managing hedge fund strategies. However, additional benefits, such as those in the list below, are causing some PE/RE managers to reconsider outsourcing.

- Cost avoidance: eliminating the need to invest capital in non-core functions
- Regulatory complexity: increased sophistication of regulatory reporting
- Transference of operational risk: transitioning the financial cost of operational errors
- Pass-through benefits: benefitting from ongoing capital investments made by TPAs
- Cost transference: transferring back-office costs from the manager to the funds

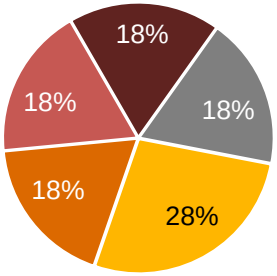
Size breakdown of PE/RE managers with at least one TPA relationship



<$500m ■ $500m - $1b ■ $1b - $5b ■ $5b - $10b

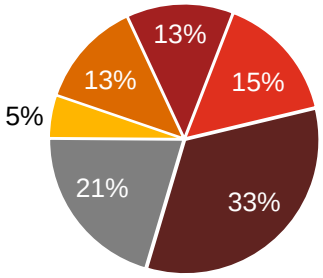
Number of Respondents: 64

Size breakdown of hybrid managers with at least one TPA relationship



$1b - $5b ■ $5b - $10b ■ $10b - $20b ■ $20b - $50b ■ $50b +

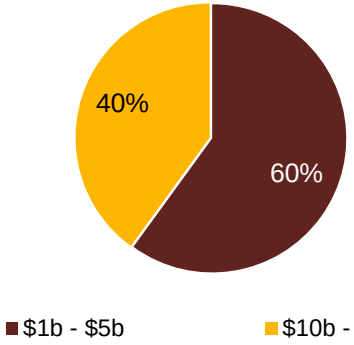
Size breakdown of hedge fund managers with at least one TPA relationship



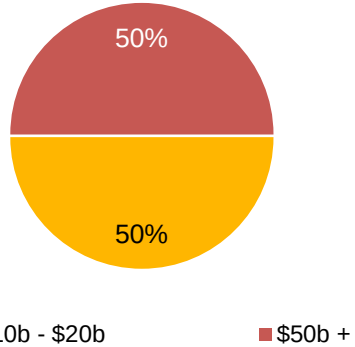
<$500m ■ $500m - $1b ■ $1b - $5b ■ $5b - $10b ■ $10b - $20b ■ $20b - $50b

PE/RE managers across all size cohorts continue to use insource models, while surprisingly, some of the larger hedge fund and hybrid managers also utilize an insource model

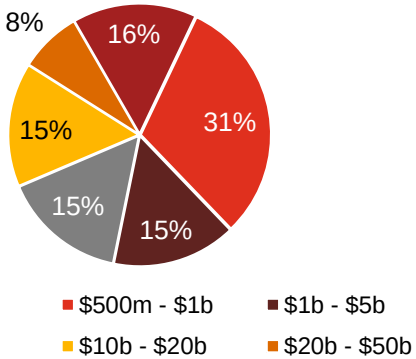
Size breakdown of hedge fund managers with insource models



Size breakdown of hybrid managers using insource models



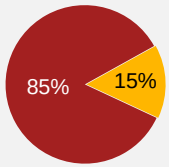
Size breakdown of PE/RE managers using insource models

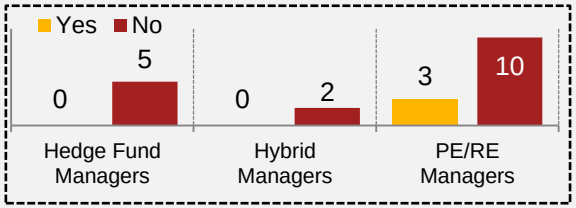


Because hedge fund and hybrid managers were driven to TPA models, the mix of the remaining firms with in-house models is less heterogeneous than PE/RE managers.

Our survey indicates that there are still large hedge fund and hybrid managers that operate using a fully insourced administration model.

Respondents planning to outsource their back-office for the first time in the next 24 months





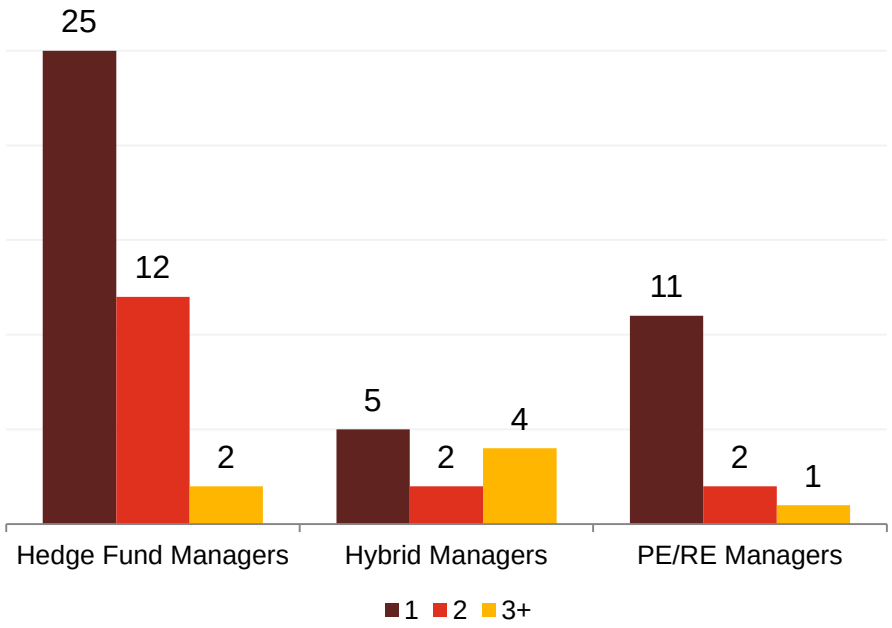
Of the 20 insource firms, three (3) indicated they plan to outsource in the next 12-24 months. All three (3) of these firms were PE/RE managers, suggesting the interest in TPAs may be on the rise in this manager segment.

Growth in PE/RE outsourcing may lead to added complexity for managers and administrators in the near-term. PE/RE LP agreements (LPAs) are custom by design, and can make the operating model for supporting these processes more labor intensive and less scalable than other asset classes. The result for administrators is a limitation on the degree of operating leverage that can be achieved for PE/RE admin currently.

Number of Respondents: 20

The majority of manager respondents reported having a single administrator relationship; however, the hybrid and hedge fund manager segments indicated a greater propensity to use multiple administrators

Number of managers with 1, 2, or 3+ administrator relationships

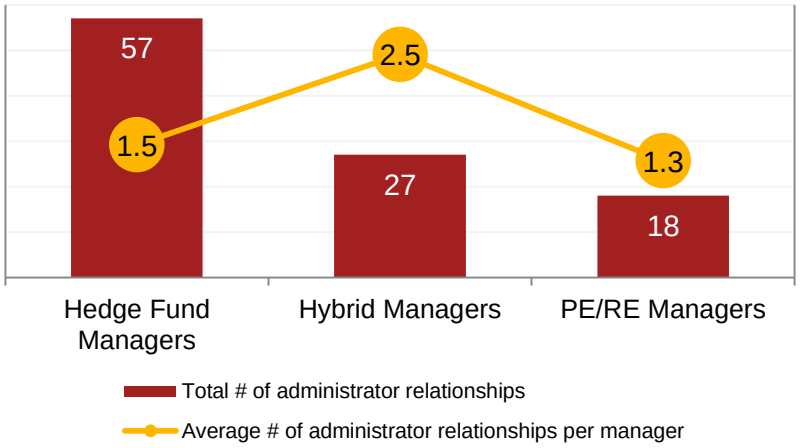


Why multiple administrator relationships?

In separate discussions with alternative managers, we found the most common reasons cited for maintaining multiple administrator relationships for back-office outsourcing are:

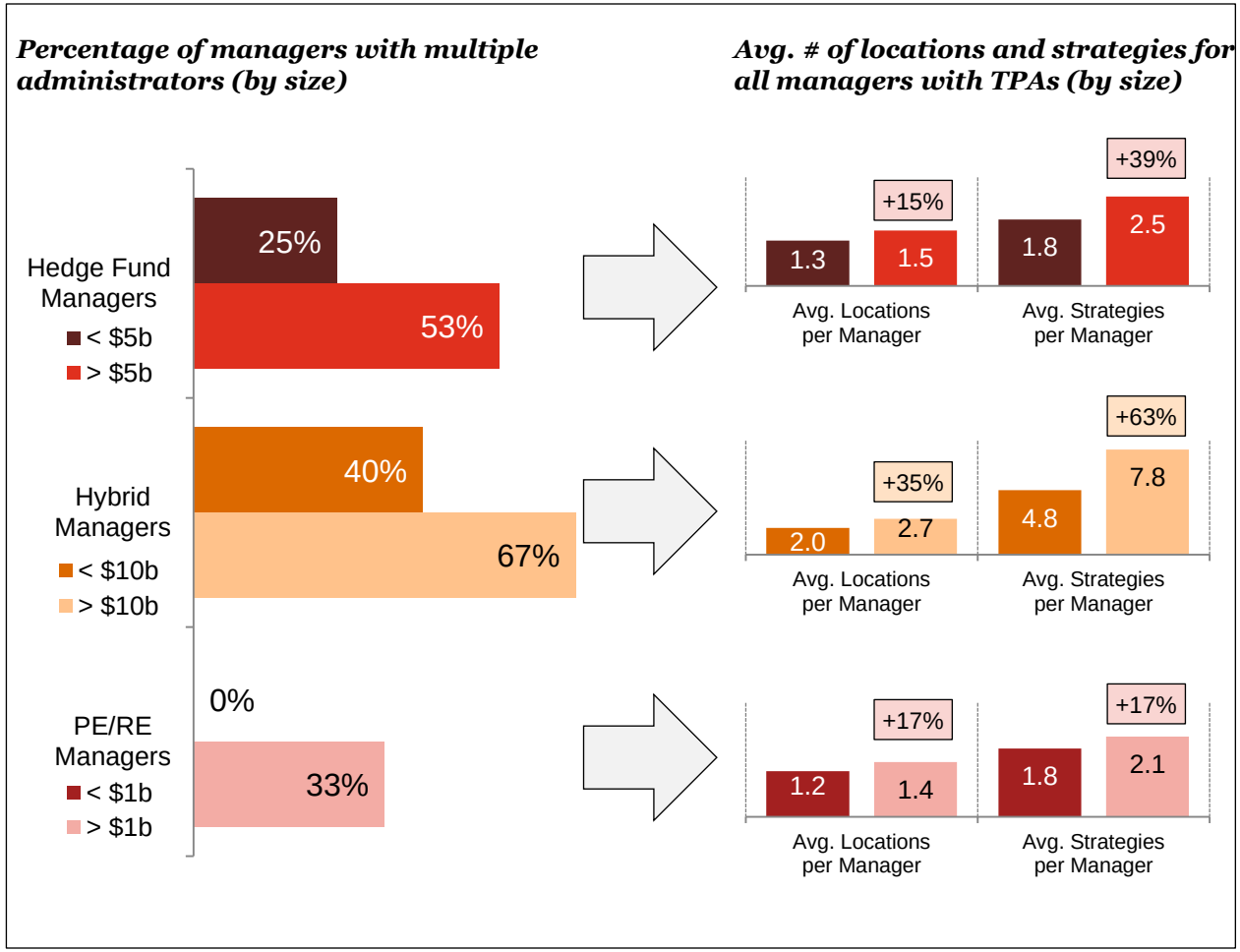
1. New fund strategy for which the incumbent provider lacked the knowledge, skills, and/or capabilities to service
2. New geography where the incumbent provider's footprint is nascent
3. Manager has grown to a size where the administrator has difficulty scaling to meet the manager's changing needs
4. Diversification of vendor risk
5. Change in the COO/CFO is prompting a reevaluation of both existing and future administrator relationships

Total and average number of administrator relationships by manager segment



Number of Respondents: 64

The biggest driver behind the use of multiple third-party administrators (TPAs) appears to be size, which is a likely proxy for higher complexity

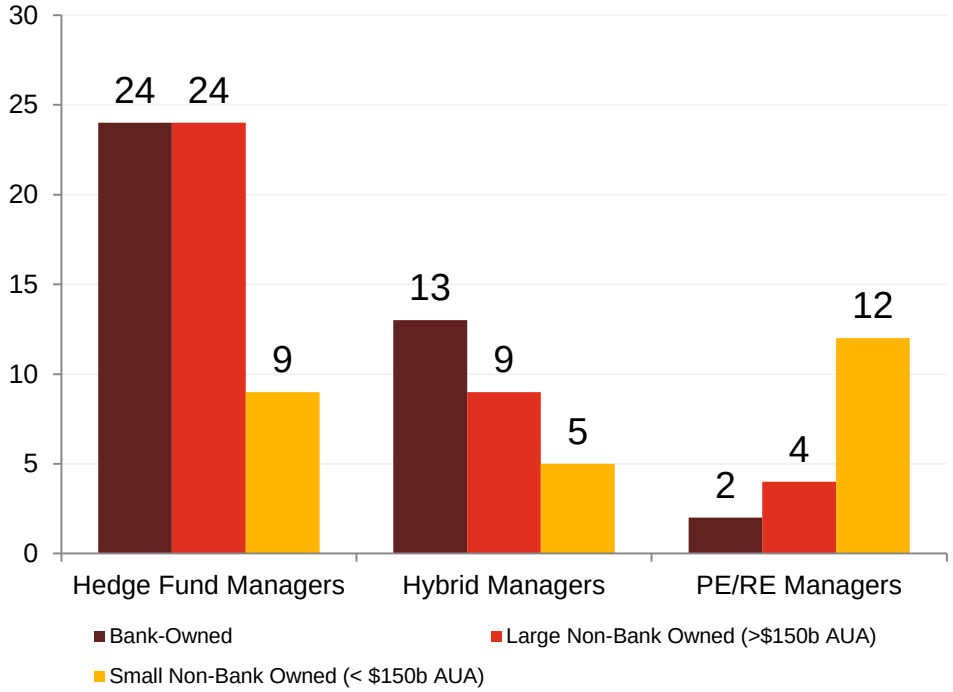


- There is a clear delineation in the use of a single versus multiple administrators when evaluating manager respondents on the dimension of size. In fact, manager respondents with higher levels of AUM used multiple administrators at twice the rate of those with lower levels of AUM.
- Two of the common drivers for multiple administrator relationships were new strategies and new geographies (see previous page).
- In examining the survey data, we found that larger respondents had more strategies and locations on average, when compared to the smaller respondents in their asset class.
- Higher numbers of locations and strategies per manager is a proxy for operational complexity, which is likely the biggest driver behind the use of multiple administrators by larger managers.

Number of Respondents: 64
NOTE: Locations included: North America, Europe, Asia-Pacific, and South America.

Hedge fund and hybrid manager respondents used bank and large non-bank administrators most often, while PE/RE manager respondents used small non-bank owned administrators predominantly

Total number of administrator relationships by manager segment

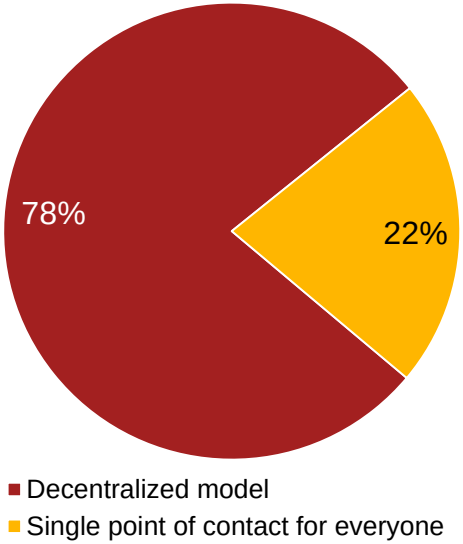


- Hedge fund manager respondents used the same number of bank-owned and large non-bank owned administrators, indicating that the opportunity to bundle other services with a bank-owned administrator is not perceived as a key differentiator by all managers within the segment.
- Hybrid manager respondents used bank-owned administrators most often, which may be driven by the fact that they have a more diverse set of needs that bank-owned administrators are considered to be in a better positioned to fulfill.
- The use of small non-bank owned administrators by PE/RE manager respondents is reflective of the fact that the PE and RE administration market is less mature and more fragmented than the hedge fund administration market. As such, much of the PE/RE administration industry is currently comprised of smaller players.

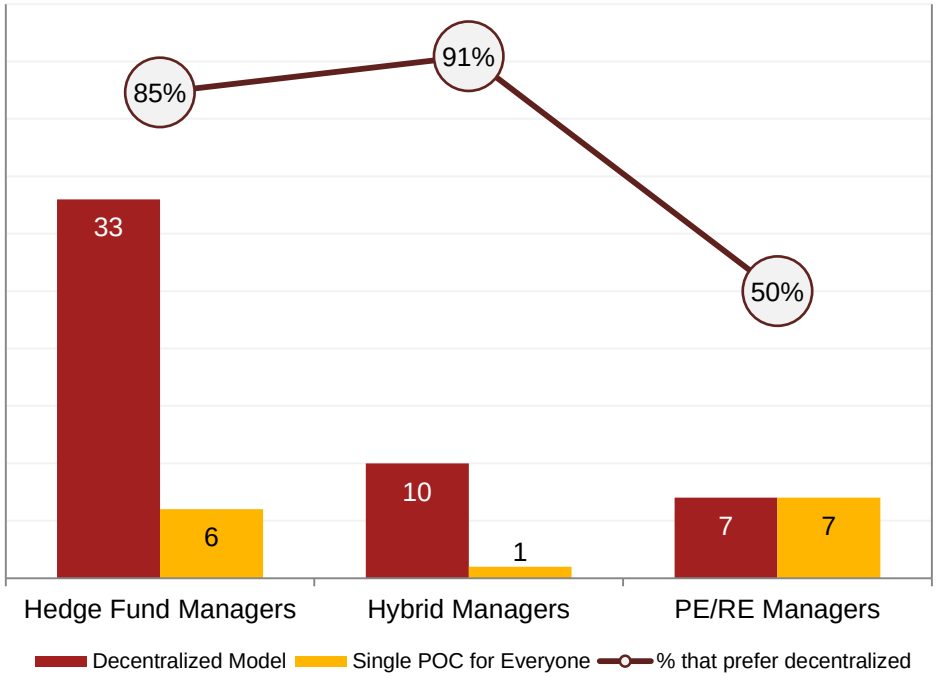
Number of Respondents: 64
NOTE: AUA = Assets Under Administration

Hedge fund and hybrid manager respondents preferred a decentralized interaction model when working with their administrator(s), while PE/RE manager respondents showed no preference

Preferred administrator interaction model (all segments)



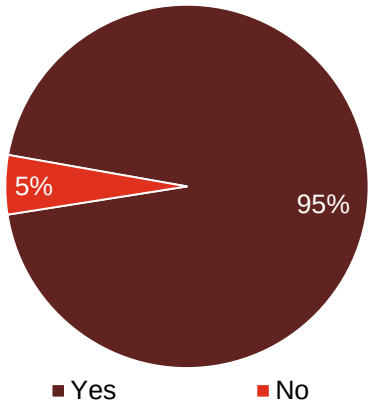
Preferred administrator interaction model (by manager segment)

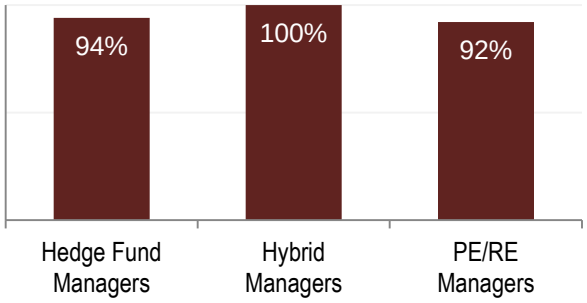


Number of Respondents: 64

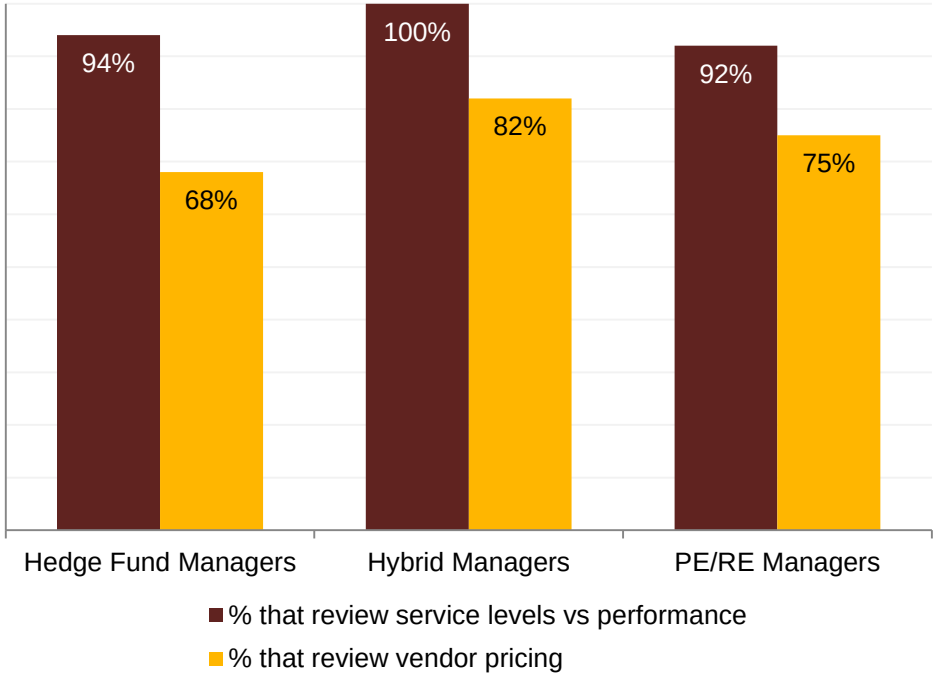
95% of manager respondents indicated they have a vendor governance process in place with their administrator; however, only 72% of these firms review pricing as part of this process

Percentage of manager respondents with a formal vendor governance process in place





Percentage of manager respondents that review service levels versus performance and/or pricing as part of their vendor review process



Number of Respondents: 57. Question was optional.

Administrator Selection Trends

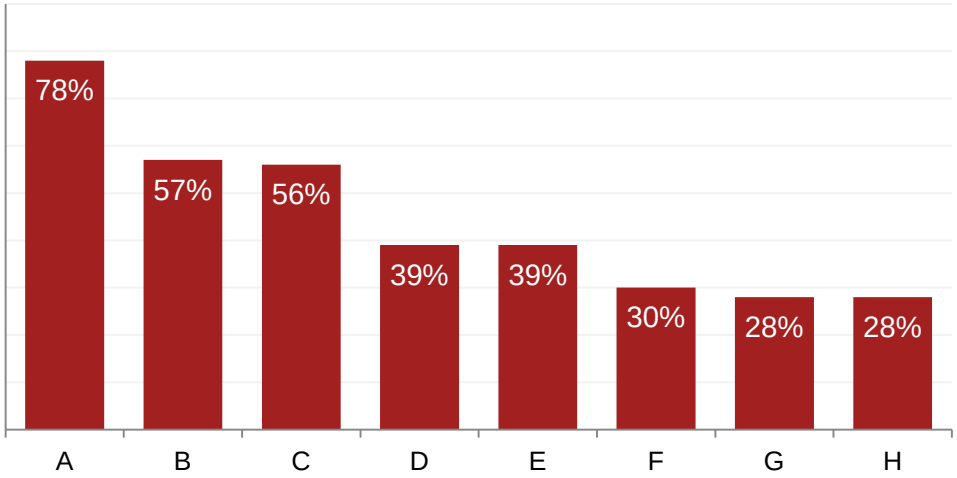
Manager respondents reported selecting administrators based on service levels, capabilities, and pricing most often, with other factors, such as cultural fit, technology, reputation, stability, and ability to scale cited less often. Key highlights include:

- 78% of manager respondents indicated service levels were an important factor in administrator selection.
- Similarly, 39% of manager respondents indicated service levels were the most important factor in their decision-making process (more than any other factor).
- Capabilities (57%) and price (56%) were also listed as important factors in administrator selection; however, when citing the factor that was most important, managers indicated price (26%) more often than capabilities (11%).

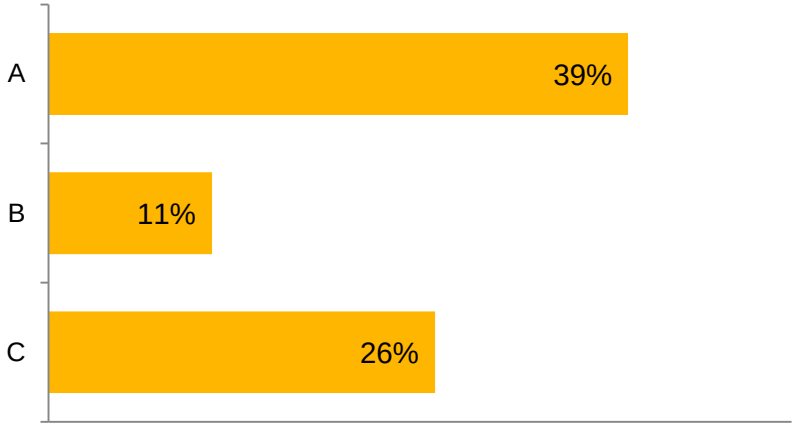
3

When selecting an administrator, respondents indicated that service levels, capabilities, and pricing were the factors most heavily weighted in their decision-making process

Percentage of respondents citing a particular factor as a top five reason for selecting an administrator



Percentage of respondents citing a particular factor as the most important reason for selecting an administrator



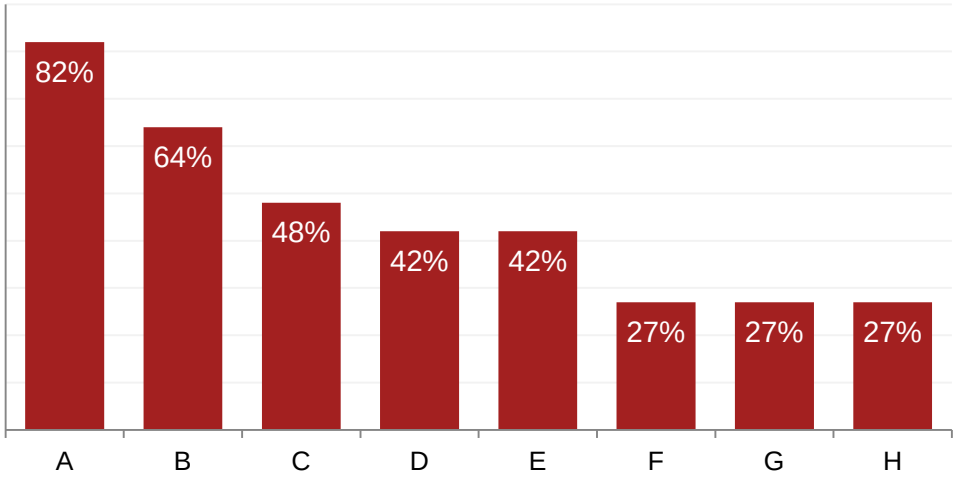
Letter	Selection Factor
A	Service Levels (quality, ability to customize)
B	Capabilities (tax, financial reporting, middle-office outsourcing, regulatory, etc.)
C	Price
D	Reputation of Administrator
E	Existence of Leading Edge Technology
F	Cultural Fit
G	Stability
H	Ability to Scale with Manager

Number of Respondents: 54. Question was optional. Responses by size were consistent generally.

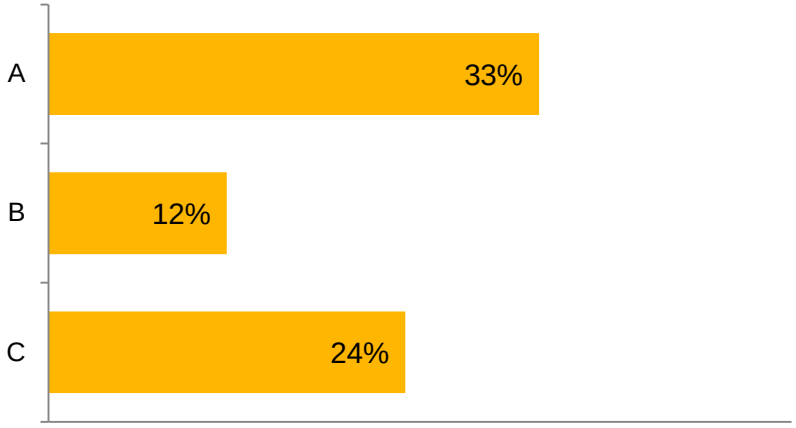
NOTE: Managers were asked to rank in order of importance the top 5 reasons for selecting an administrator. The graph on the left depicts the percentage of respondents that listed the factor as one of their top 5 reasons. The graph to the right depicts the percentage of respondents that ranked the factor first (or most important) in their decision-making process.

Hedge fund manager respondents reported that service levels and pricing were the most important factors in their decision for selecting an administrator

Percentage of respondents citing a particular factor as a top five reason for selecting an administrator



Percentage of respondents citing a particular factor as the most important reason for selecting an administrator



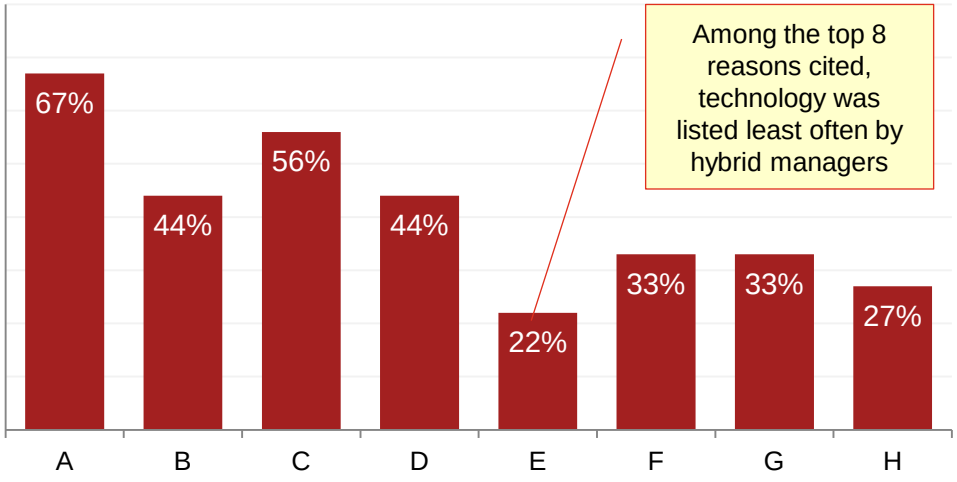
Letter	Selection Factor
A	Service Levels (quality, ability to customize)
B	Capabilities (tax, financial reporting, middle-office outsourcing, regulatory, etc.)
C	Price
D	Reputation of Administrator
E	Existence of Leading Edge Technology
F	Cultural Fit
G	Stability
H	Ability to Scale with Manager

Number of Respondents: 33. Question was optional. See footnote on page 21 for additional explanation on graphs. Responses by size were consistent generally.

- Service levels and pricing were listed most often among the top five factors that hedge fund manager respondents utilized to select an administrator.
- 82% of hedge fund managers chose service levels as one of their top 5 factors for selecting an administrator, indicating that the need for quality and flexibility is consistent across the segment.
- **33%** of hedge fund manager respondents **cited service levels** as the most important factor, while another **24%** of hedge fund manager respondents **indicated pricing** was the most important factor in a selection.
- We found that **pricing was more important to hedge fund manager respondents with less than $5 billion in AUM**, as **29% indicated it was the most important selection factor**, while only 17% of hedge fund managers with more than $5 billion responded in similar fashion. This appears to confirm that smaller hedge fund managers are more price-sensitive.

44% of hybrid manager respondents cited pricing as the most important factor in their administrator selection process, suggesting that hybrid managers may be more price-sensitive, despite having higher levels of AUM

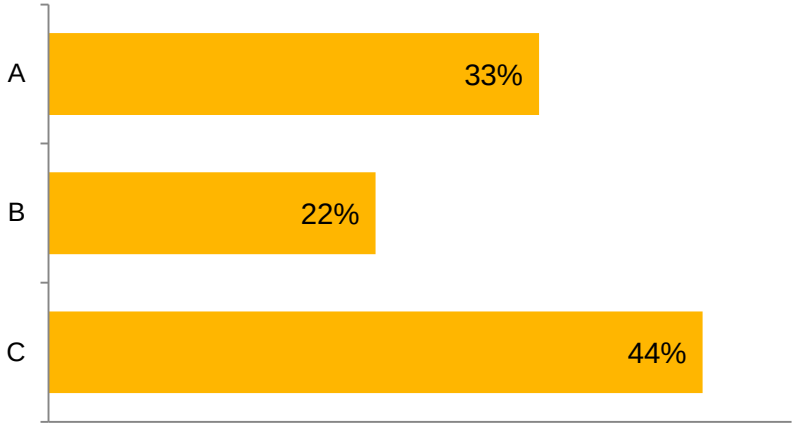
Percentage of respondents citing a particular factor as a top five reason for selecting an administrator



Letter	Selection Factor
A	Service Levels (quality, ability to customize)
B	Capabilities (tax, financial reporting, middle-office outsourcing, regulatory, etc.)
C	Price
D	Reputation of Administrator
E	Existence of Leading Edge Technology
F	Cultural Fit
G	Stability
H	Ability to Scale with Manager

Number of Respondents: 9. Question was optional. See footnote on page 21 for additional explanation on graphs. Responses by size were consistent generally.

Percentage of respondents citing a particular factor as the most important reason for selecting an administrator

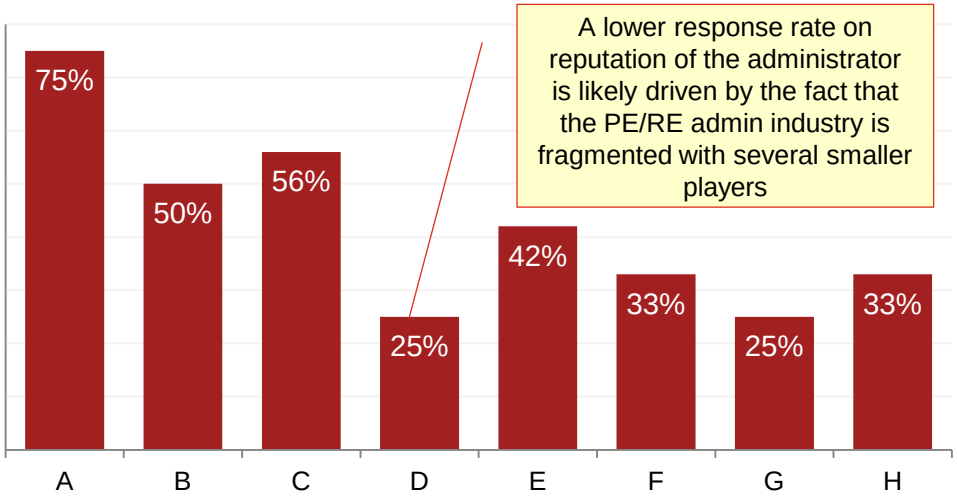


- Service levels and pricing were listed most often among the top five factors that hybrid manager respondents utilized to select an administrator.
- 44% of hybrid manager respondents cited pricing as the most important factor when selecting an administrator, suggesting that hybrid managers are more price-sensitive, despite having higher levels of AUM.
- Another 33% of hybrid manager respondents cited service levels as the most important factor in administrator selection, suggesting that administrators need a high quality / price efficient offering in order to compete for managers in this segment.

NOTE: The hybrid manager segment had the smallest number of respondents in our survey. As such, there is a higher margin of error associated with the results for this segment.

When selecting an administrator, over 50% of PE/RE manager respondents cited service levels as the most important factor in their decision-making process

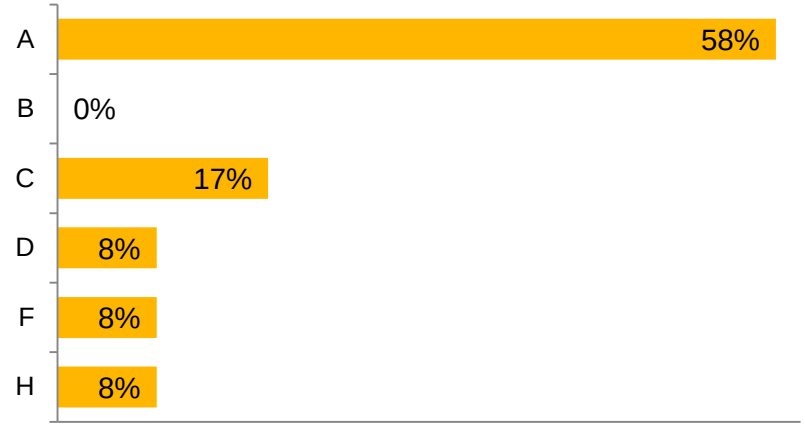
Percentage of respondents citing a particular factor as a top five reason for selecting an administrator



Letter	Selection Factor
A	Service Levels (quality, ability to customize)
B	Capabilities (tax, financial reporting, middle-office outsourcing, regulatory, etc.)
C	Price
D	Reputation of Administrator
E	Existence of Leading Edge Technology
F	Cultural Fit
G	Stability
H	Ability to Scale with Manager

Number of Respondents: 12. Question was optional. See footnote on page 21 for additional explanation on graphs. Responses by size were consistent generally.

Percentage of respondents citing a particular factor as the most important reason for selecting an administrator



- Service levels, pricing, capabilities, and reputation were listed most often by PE/RE manager respondents. These participants also cited service levels (58%) as the most important selection factor.
- Only 17% of PE/RE respondents listed price as the most important factor. These respondents may have deprioritized price since many have preferred pricing in place with their administrator currently (see page 35 for data).
- The higher rate of preferred pricing among PE/RE manager respondents (relative to hedge and hybrids) is likely an outcome of low outsourcing levels by the segment.
- When administrators lack the capabilities to service an emerging segment, such as PE/RE administration, they will look for opportunities to "lift-out" the people, process, and technology from managers in the segment. This approach gives the administrator a more cost-effective way of accessing needed capabilities. In exchange, the managers in these scenarios may receive preferred pricing for a specified term.

Back-Office Outsourcing and Shadow Accounting

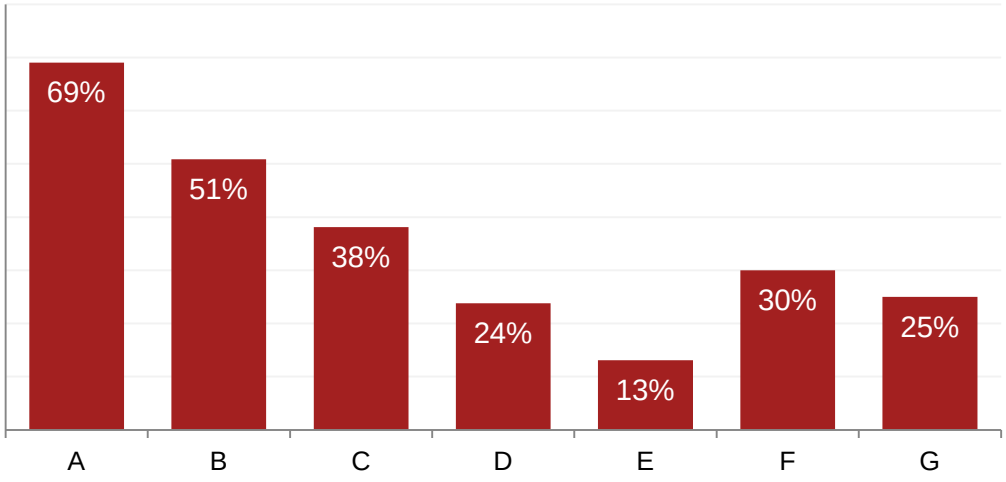
Manager respondents outsource fund accounting and investor servicing predominantly, with other back-office functions being performed using insource models most often. In-house shadow accounting functions continue to be a pervasive trend in the industry, suggesting that manager respondents believe administrator quality and transparency must improve before they can reduce their reliance on these functions. Key highlights include:

- 69% of manager respondents outsource fund accounting to a TPA; however, the outsourcing rates are higher with hedge fund (82%) and hybrid managers (85%). Only 41% of PE/RE managers outsource fund accounting.
- 51% of hedge fund and hybrid manager respondents indicated they outsource investor servicing to a TPA.
- Over 80% of manager respondents maintain shadow books and records. The rates were even higher among hedge fund (86%) and hybrid (91%) manager respondents.

4

The rate of back-office outsourcing is highest for fund accounting, indicating that a majority of respondents perform their non-accounting functions in-house

Percentage using a third-party administrator (all manager segments)



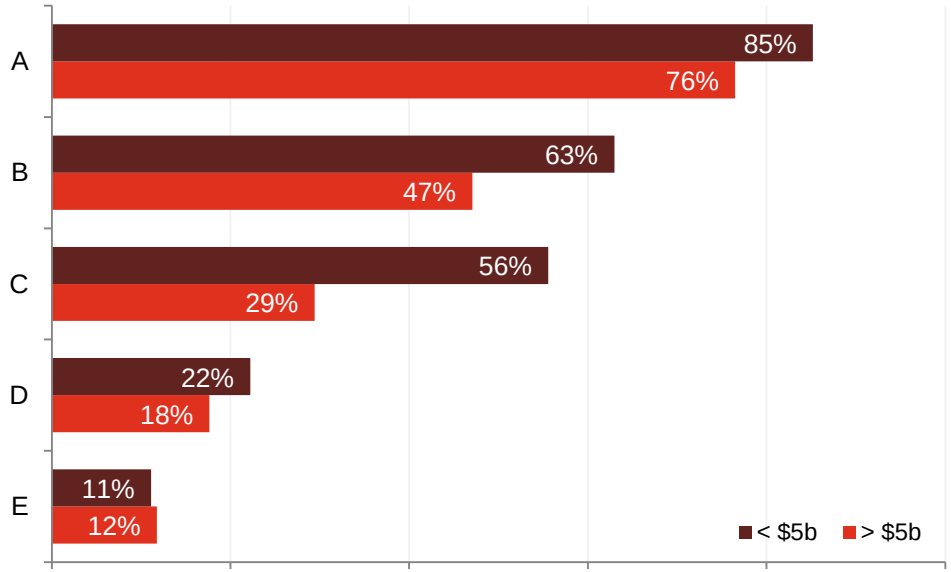
Letter	Function / Service
A	Fund Accounting
B	Investor Servicing (excludes PE/RE)
C	Financial Statement Preparation
D	Tax Form Preparation, Filing, and Income Distribution Calcs. & Forms
E	SPV Accounting
F	Capital Calls & Distribution (PE/RE & Hybrids only)
G	IRR & Waterfall Calculations (PE/RE & Hybrids only)

Number of Respondents: 64

- More then 50% of manager respondents outsourced fund accounting and investor servicing, while they outsourced other back-office services at lower rates.
- A push from institutional investors, who demanded hedge fund and hybrid managers transition their books and records to a TPA, is the main driver behind the higher rates of outsourcing in fund accounting.
- Lower levels of outsourcing across other back-office functions may be due to the fact that manager respondents have developed in-house capabilities to perform these services.

Hedge fund manager respondents with less than $5 billion in AUM outsourced at a higher rate than hedge fund managers with more than $5 billion in AUM

Percentage of hedge fund managers outsourcing (by size)

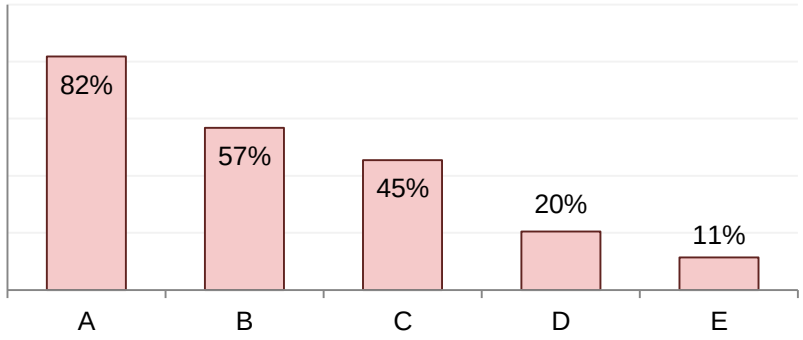


Letter	Function / Service
A	Fund Accounting
B	Investor Servicing
C	Financial Statement Preparation
D	Tax Form Preparation, Filing, and Income Distribution Calcs. & Forms
E	SPV Accounting

Number of Respondents: 44

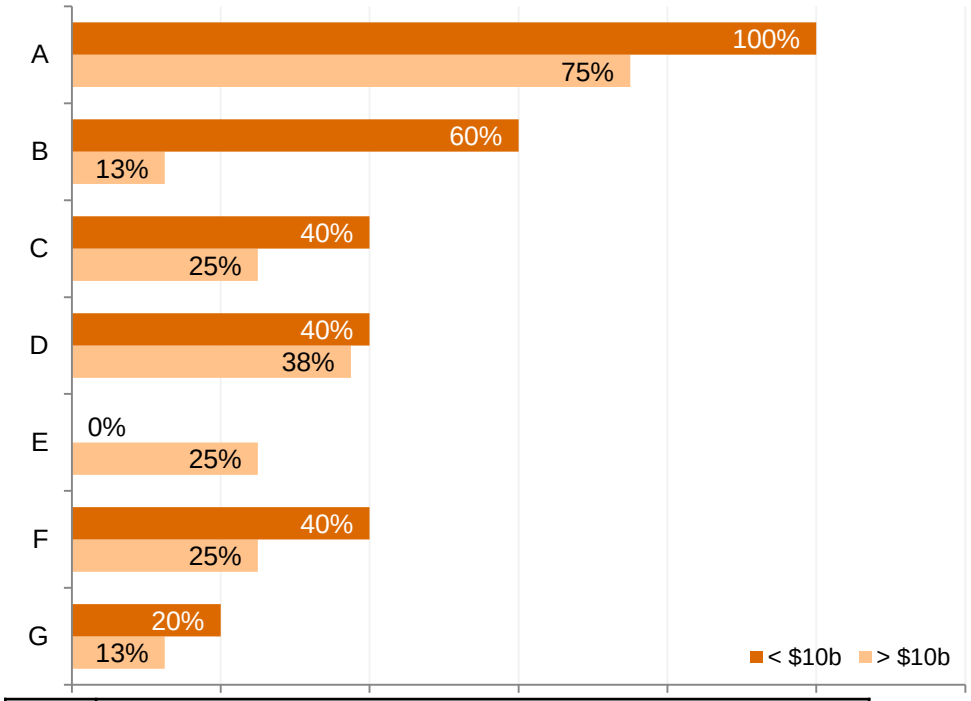
- The difference in outsourcing of fund accounting between the two size cohorts was not material, though we expected to see a similar or higher rate of outsourcing by hedge fund manager respondents with more than $5 billion in AUM.
- Hedge fund manager respondents with more than $5 billion in AUM keep back-office functions in-house more often, as they appear to have invested in the leading capabilities needed to perform these services.
- Across both size cohorts, tax preparation and SPV accounting are generally not outsourced to a third-party administrator, suggesting the complexity of these tasks warrants a different solution.

% of hedge fund managers outsourcing (total)



Similar to hedge funds, hybrid managers with less than $10 billion in AUM outsourced at higher rates than those with AUM greater than $10 billion

Percentage of hybrid managers outsourcing (by size)



Letter	Function / Service
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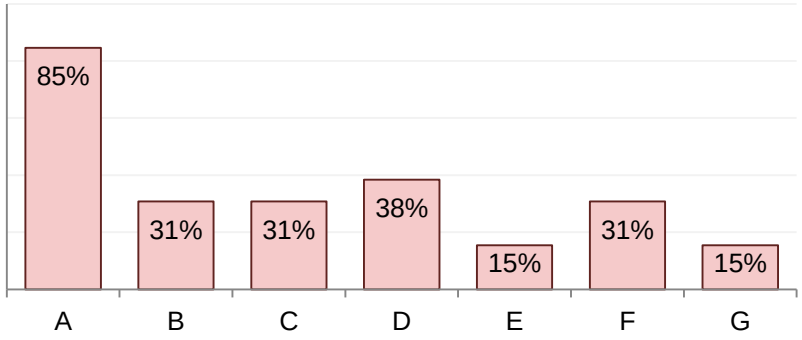
C	Financial Statement Preparation
D	Tax Form Preparation, Filing, and Income Distribution Calcs. & Forms
E	SPV Accounting
F	Capital Calls & Distribution (PE/RE & Hybrids only)
G	IRR & Waterfall Calculations (PE/RE & Hybrids only)

- All hybrid managers with less than $10 billion in AUM outsourced fund accounting, while only 75% of hybrid managers with more than $10 billion did so.
- The biggest outsourcing differential was in investor services. Hybrid managers with less than $10 billion outsourced at a much higher rate than hybrids with more than $10 billion. This difference may be driven by the fact that larger hybrid managers invested to develop in-house capabilities that presently support their needs.
- For the remaining services, the two size cohorts outsource at levels that are generally similar to one another.

NOTE: The hybrid manager segment had the smallest number of respondents in our survey. As such, there is a higher margin of error associated with the results for this segment.

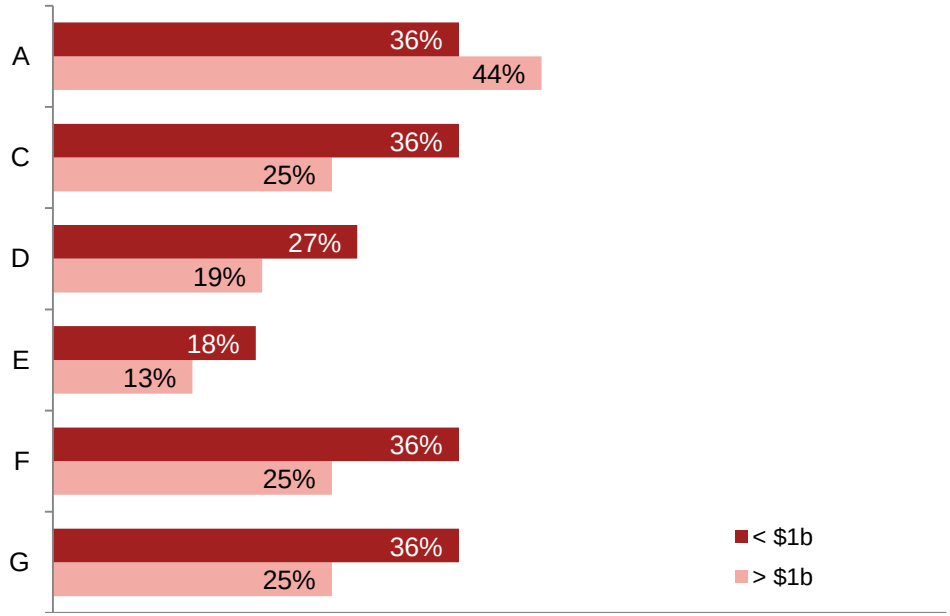
% of hybrid managers outsourcing (total)



Number of Respondents: 13

The rate of outsourcing by PE/RE manager respondents was lower than hedge fund and hybrid managers; however, the rate of outsourcing was consistent generally across the two PE/RE size cohorts

Percentage of PE/RE managers outsourcing (by size)

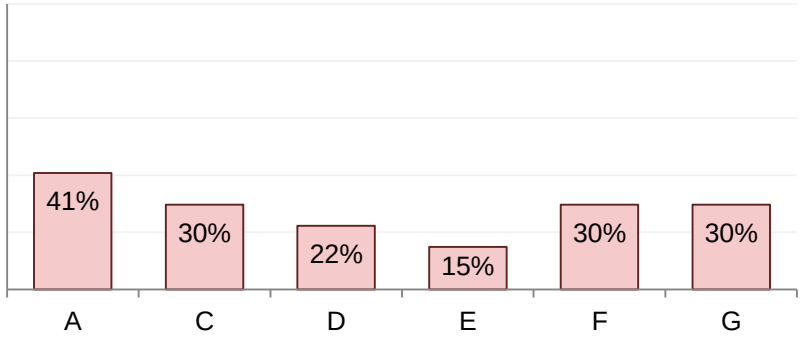


Letter	Function / Service
A	Fund Accounting
C	Financial Statement Preparation
D	Tax Form Preparation, Filing, and Income Distribution Calcs. & Forms
E	SPV Accounting
F	Capital Calls & Distribution (PE/RE & Hybrids only)
G	IRR & Waterfall Calculations (PE/RE & Hybrids only)

Number of Respondents: 27

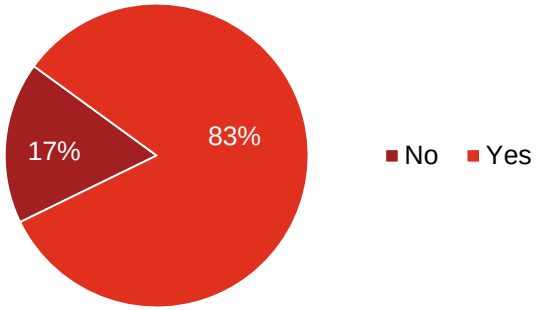
- Private equity and real estate (PE/RE) managers had the lowest rate of outsourcing fund accounting.
- There are several reasons for this segment differential; however, the largest driver is the absence of investor pressure on PE/RE managers to outsource books and records.
- The rates of outsourcing between the two PE/RE manager size cohorts were generally consistent.

% of PE/RE managers outsourcing (total)

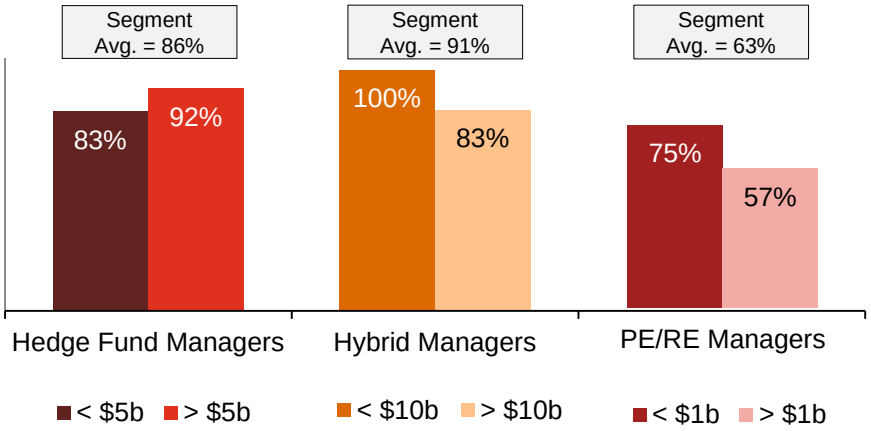


A high percentage of hybrid and hedge fund manager respondents maintain a shadow accounting function in-house

Percentage of respondents that maintain a shadow accounting function in-house (total)



Percentage of respondents that maintain a shadow accounting function in-house (by manager segment and size)



- The use of in-house shadow accounting functions by hedge fund (86%) and hybrid (91%) manager respondents is pervasive.
- The high use of shadow accounting functions is attributable to various factors and suggests that most respondents believe administrator quality and transparency must improve before shadow accounting functions can be phased out.
- If administrator-provided tools allow asset management staff to monitor fund accounting accuracy, without using a second set of books and records, then managers could improve their margins by reducing or eliminating the cost of operating an in-house shadow accounting function.
- The cost of maintaining a shadow accounting function has become more burdensome, particularly in the current environment, where increased negotiations by institutional investors has resulted in management fee compression for many alternative managers.
- To reduce the need for shadow accounting, managers and administrators should work collaboratively to design new tools and capabilities that offer managers improved transparency into the accounting book of record.

NOTE: Managers were not asked to indicate the degree to which they shadow their books and records. As such, differences may exist in the size and responsibilities of the in-house shadow function maintained by each manager.

Number of Respondents: 58. Percentages out of the number of participants that outsource fund accounting.

Manager Satisfaction

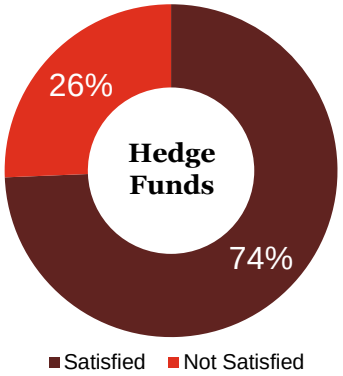
Manager respondents reported being generally satisfied with their administrator's back-office offering, suggesting the administration industry has improved substantially, in terms of quality and efficiency, over the last five years. Key highlights include:

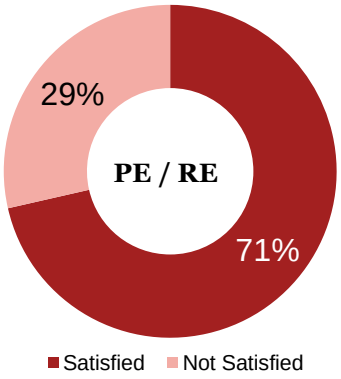
- 73% of respondents indicated they were satisfied with the level of service provided by their current administrator
- Current satisfaction levels are likely tied to the fact that 70% of respondents believe their administrator is consistently meeting service levels
- Only 6% of respondents were looking to switch administrators, while the remaining 94% cited general satisfaction and high switching costs as the most common reasons for their retention

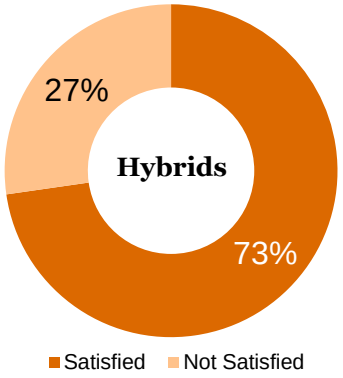
5

73% of respondents indicated they were satisfied with the level of service provided by their current administrator…

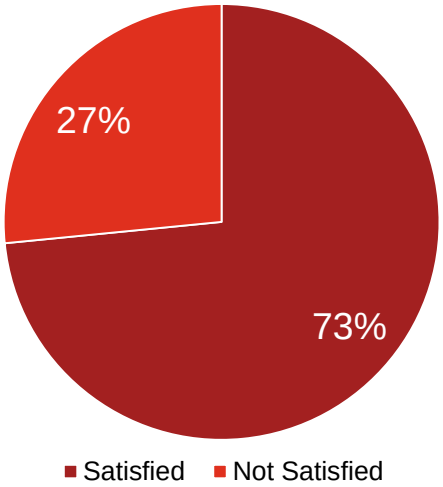
Administrator satisfaction by manager segment







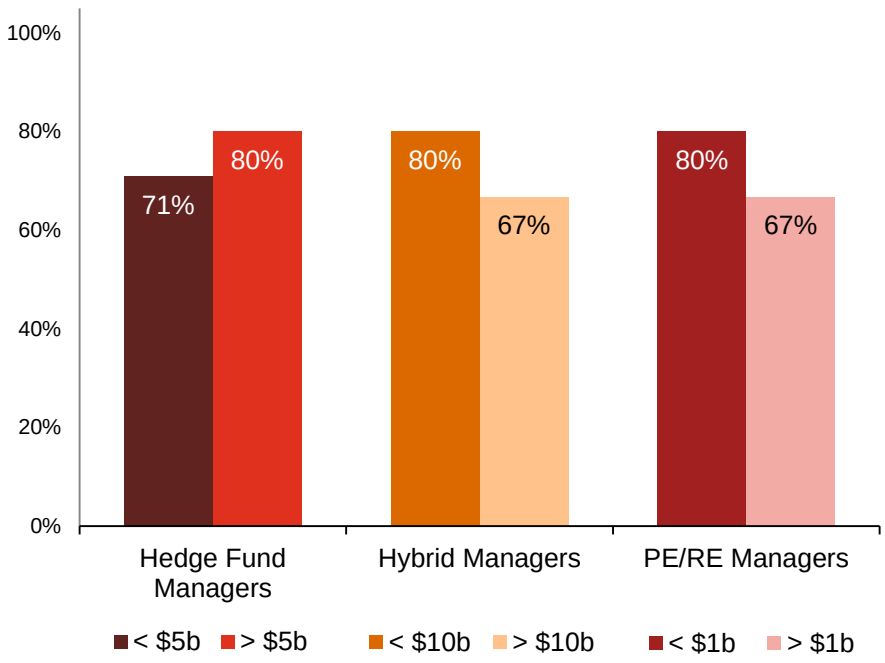
Overall level of administrator satisfaction across all respondents



Number of Respondents: 64

...however, there was some variation between respondent size cohorts, confirming there are differences in the factors that drive satisfaction within a manager segment

Manager satisfaction rates by size



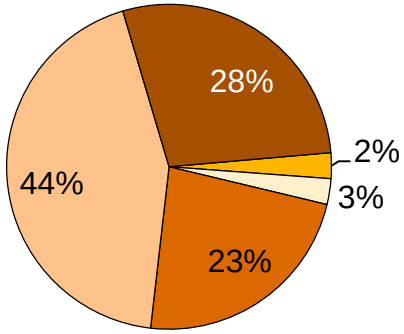
Number of Respondents: 64

- Hedge fund manager satisfaction was higher for respondents with more than $5 billion in AUM (80% versus 71% for hedge fund participants with less than $5 billion). This may be the result of larger hedge funds receiving higher levels of service and/or more opportunities for service level customization on average.
- Lower satisfaction levels by smaller hedge fund manager respondents could be the result of many factors, including, but not limited to:
  - Higher fee schedules from missing asset minimums or failing to pass all breakpoint tiers
  - Lower levels of service relative to hedge fund managers with less than $5 billion in AUM
- Hybrid manager satisfaction was lower for respondents with more than $10 billion in AUM (67% versus 80% for hybrid participants with less than $10 billion). Lower satisfaction may be the result of the administration industry's inability to consistently meet the diverse and complex needs of larger hybrid managers.
- PE/RE fund manager satisfaction was higher for respondents with more than $1 billion in AUM (67% versus 80% for PE/RE participants with less than $1 billion). The decline in satisfaction among large managers may stem from increases in the number of operational incidents caused by administrators. PE/RE operating models are more labor intensive and less scalable than hedge fund models. As such, these structural inefficiencies can result in an administrator generating more operational incidents when the number of funds and/or investors increase for a PE/RE manager.

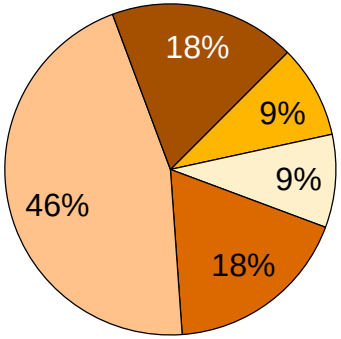
Current satisfaction levels are likely tied to the fact that 70% of respondents believe their administrator is consistently meeting service levels

Percentage of time administrators meet managers' service levels

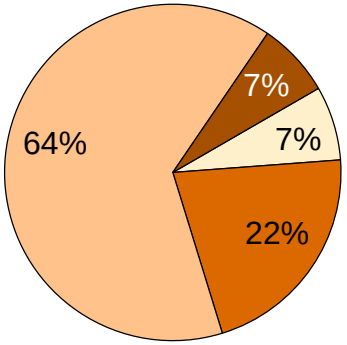
Hedge Fund Managers



Hybrid Managers

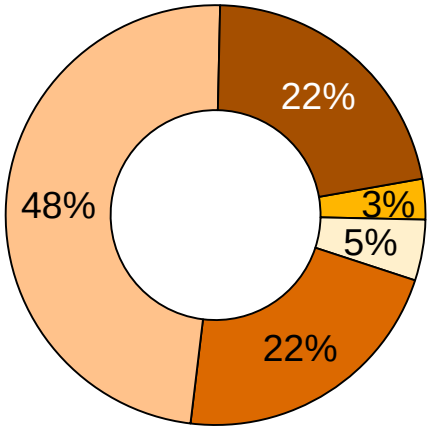


PE/RE Managers



Rarely
Sometimes
Always
Occassionally
Most of the Time

All Manager Segments



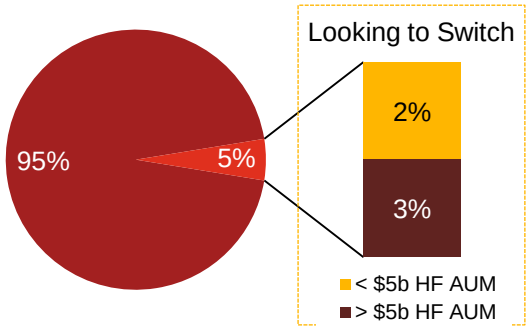
Rarely
Sometimes
Always
Occassionally
Most of the Time

Category	Level
Rarely	<=30%
Occasionally	<=59%
Sometimes	60% - 79%
Most of the Time	80% - 99%
Always	100%

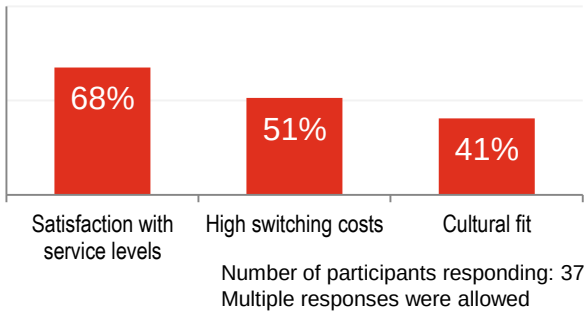
Number of Respondents: 64

Only 6% of respondents were looking to switch administrators, while the remaining 94% cited general satisfaction and high switching costs as the most common reasons for their retention

Hedge Fund Manager Segment

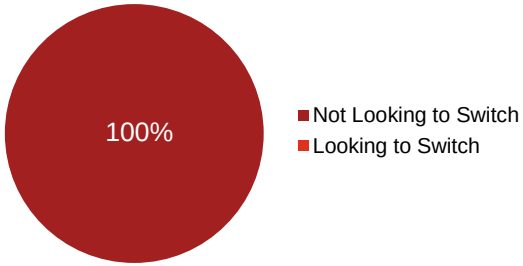


Top 3 reasons for staying with current admin(s)

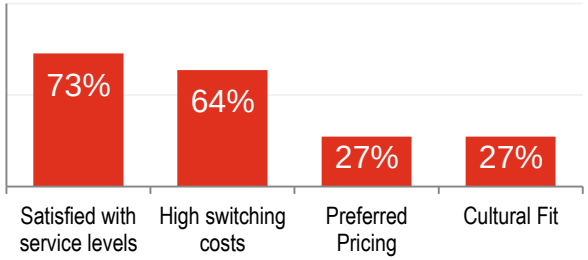


Number of participants responding: 37
Multiple responses were allowed

Hybrid Manager Segment

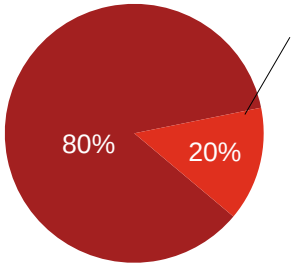


Top 3 reasons for staying with current admin(s)



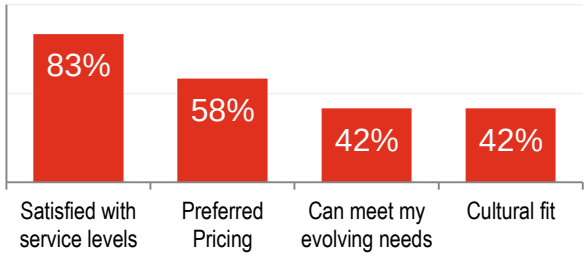
Number of participants responding: 11
Multiple responses were allowed

PE/RE Manager Segment



All PE / RE managers above $1b in AUM

Top 3 reasons for staying with current admin(s)



Number of participants responding: 12
Multiple responses were allowed

Number of Respondents: 64. There are 60 responses for graphs on right, as those actively looking to switch were not presented with this question.

Regulatory Reporting / Compliance Services

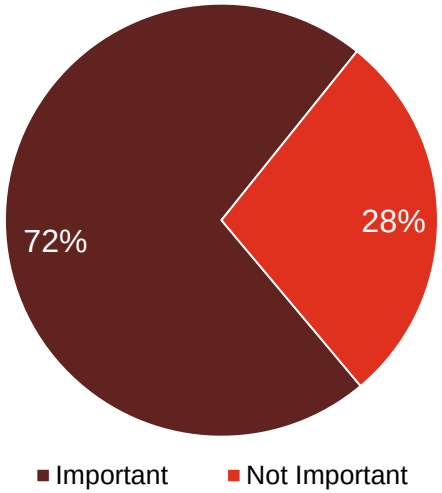
Manager respondents overwhelmingly indicated that regulatory services are an important component of an administration offering. These respondents also reported being generally satisfied with their administrator's regulatory reporting offering. Key highlights include:

- 72% of manager respondents indicated it was important for their administrator to provide a regulatory reporting capability.
- Approximately 70% of manager respondents indicated they were satisfied with their administrator's regulatory reporting capability.

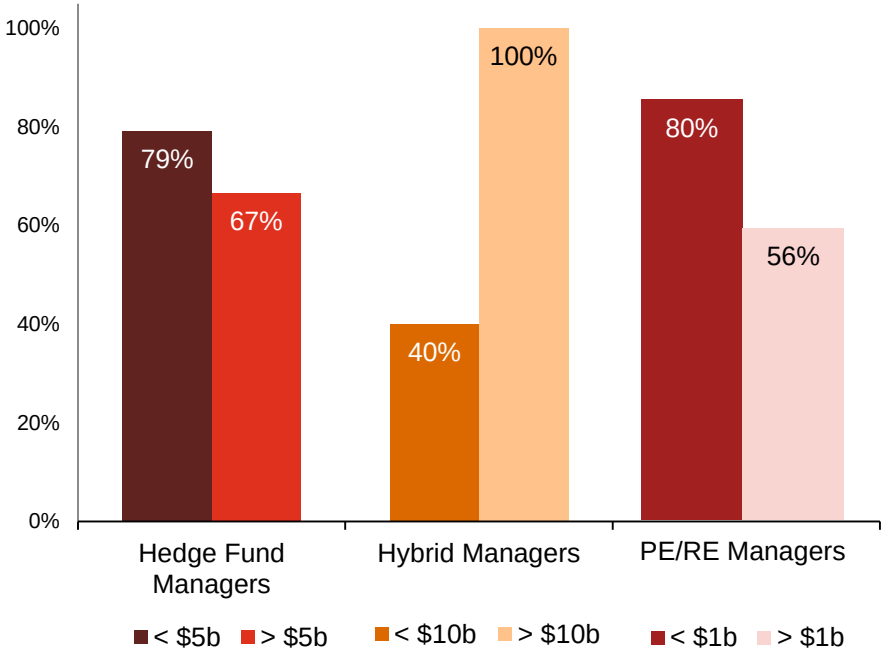
6

72% of manager respondents believe it's important for their administrator to provide a regulatory reporting capability

Percentage of manager respondents that believe an administrator-provided regulatory reporting offering is important (total)



Percentage of manager respondents that believe an administrator-provided regulatory reporting offering is important (by segment & size)

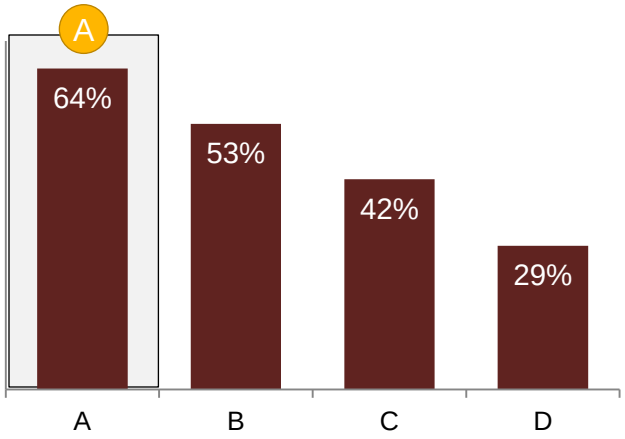


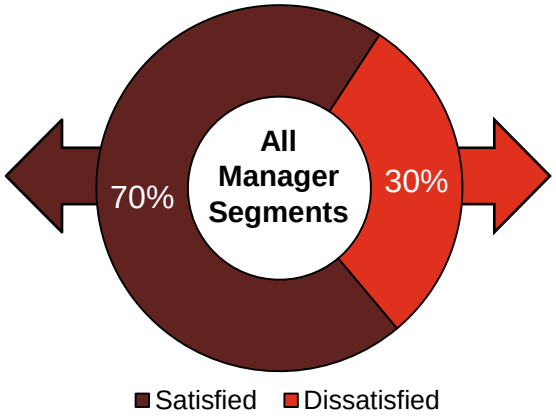
NOTE: The hybrid manager segment had the smallest number of respondents in our survey. As such, there is a higher margin of error associated with the results for this segment.

Number of Respondents: 64

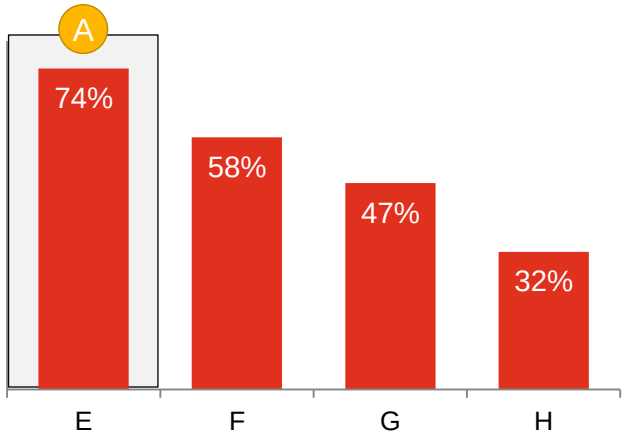
Approximately 70% of all respondents indicated they were satisfied with their administrator's regulatory reporting offering

Reasons for Satisfaction





Reasons for Dissatisfaction



Letter	Reason for Satisfaction
A	Admin provides regulatory reporting & industry insight (advice-oriented)
B	Admin's data model helps us meet requirements easily
C	Is proactive with regulatory reporting trends
D	Is able to submit my filings electronically

A

Letter	Reason for Dissatisfaction
E	Admin does not provide regulatory reporting or industry insight (advice-oriented)
F	Admin's data model is suboptimal
G	Responds to regulatory reporting trends reactively
H	Is not able to submit my filings electronically

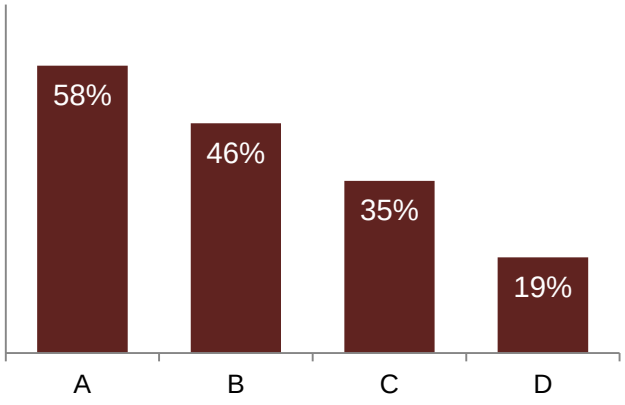
The factor most commonly driving satisfaction and dissatisfaction with administrator regulatory reporting capabilities was an advice-oriented solution.

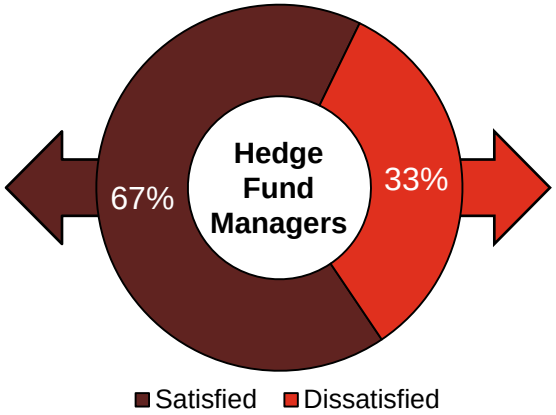
Based on our discussions with alternative managers, an advice-oriented solution involves the administrator advising managers on methods for efficiently meeting regulatory reporting deadlines. Managers are also looking to their administrators to convene recurring manager panel discussions where the industry can share leading practices for meeting regulatory reporting requirements, while minimizing operational burden. Overall, managers are showing that they value regulatory reporting advice significantly more than the ability to support report generation alone.

Number of Respondents: 64. Participants allowed to select more than one option.

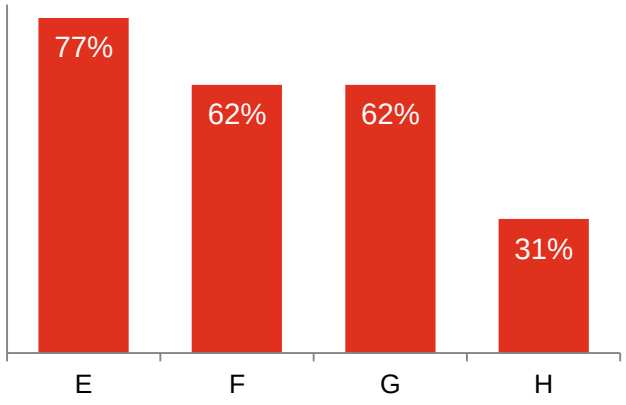
67% of hedge fund manager respondents indicated they are satisfied with their administrator's regulatory reporting capabilities

Reasons for hedge fund manager satisfaction





Reasons for hedge fund manager dissatisfaction



Letter	Reason for Satisfaction
A	Admin provides regulatory reporting & industry insight (advice-oriented)
B	Admin's data model helps us meet requirements easily
C	Is proactive with regulatory reporting trends
D	Is able to submit my filings electronically

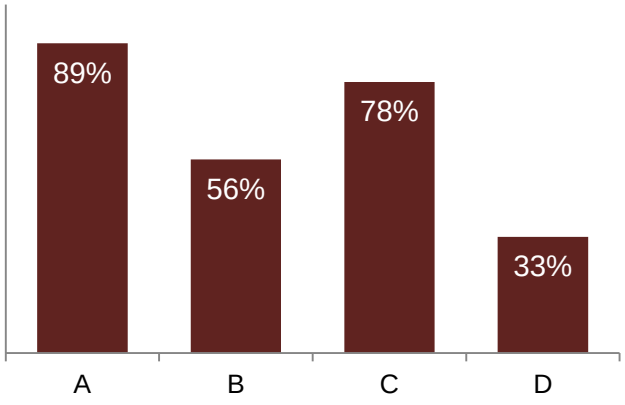
Letter	Reason for Dissatisfaction
E	Admin does not provide regulatory reporting or industry insight (advice-oriented)
F	Admin's data model is suboptimal
G	Responds to regulatory reporting trends reactively
H	Is not able to submit my filings electronically

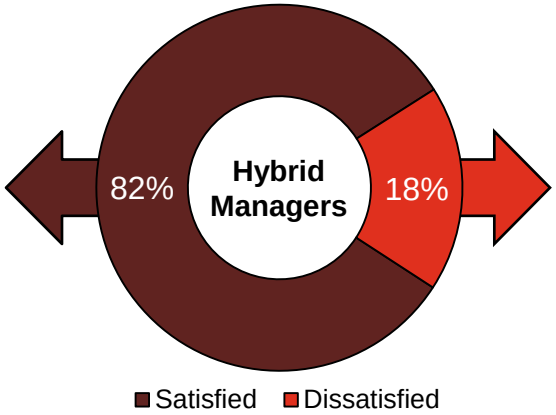
Number of Respondents: 39. Multiple responses allowed.

NOTE: Respondents indicating they were satisfied were presented with a question on "reasons for satisfaction," while manager respondents that were dissatisfied were presented with a question "reasons for dissatisfaction."

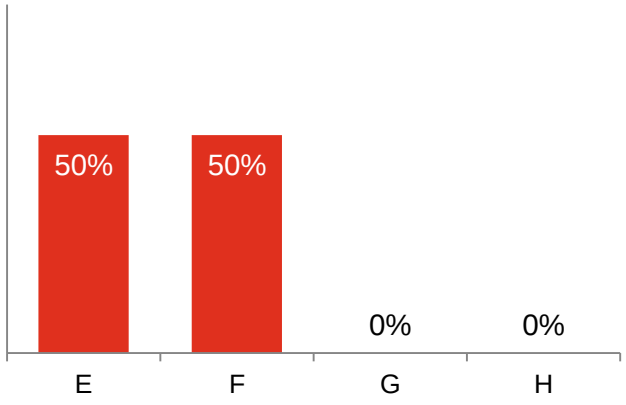
82% of hybrid manager respondents indicated they are satisfied with their administrator's regulatory reporting capabilities

Reasons for hybrid manager satisfaction





Reasons for hybrid manager dissatisfaction



Letter	Reason for Satisfaction
A	Admin provides regulatory reporting & industry insight (advice-oriented)
B	Admin's data model helps us meet requirements easily
C	Is proactive with regulatory reporting trends
D	Is able to submit my filings electronically

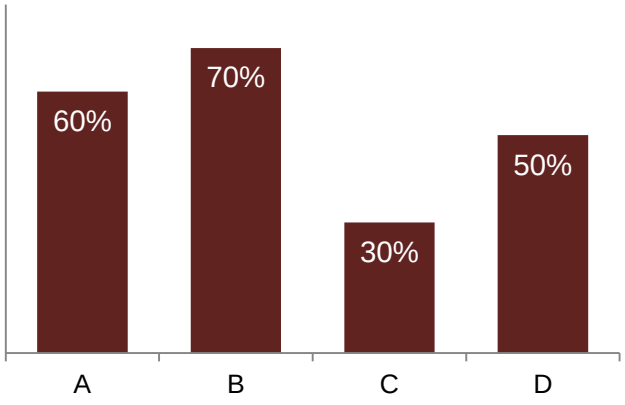
Letter	Reason for Dissatisfaction
E	Admin does not provide regulatory reporting or industry insight (advice-oriented)
F	Admin's data model is suboptimal
G	Responds to regulatory reporting trends reactively
H	Is not able to submit my filings electronically

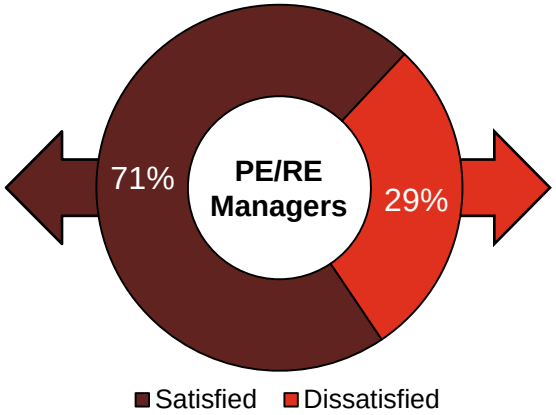
Number of Respondents: 11. Multiple responses allowed.

NOTE: Respondents indicating they were satisfied were presented with a question on "reasons for satisfaction," while manager respondents that were dissatisfied were presented with a question "reasons for dissatisfaction."

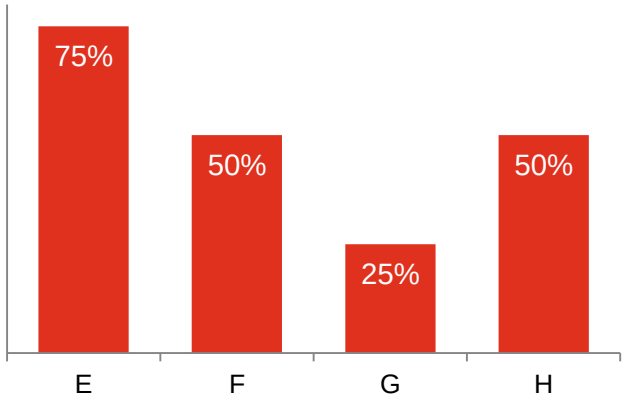
71% of PE/RE manager respondents indicated they are satisfied with their administrator's regulatory reporting capabilities

Reasons for PE/RE manager satisfaction





Reasons for PE/RE manager dissatisfaction



Letter	Reason for Satisfaction
A	Admin provides regulatory reporting & industry insight (advice-oriented)
B	Admin's data model helps us meet requirements easily
C	Is proactive with regulatory reporting trends
D	Is able to submit my filings electronically

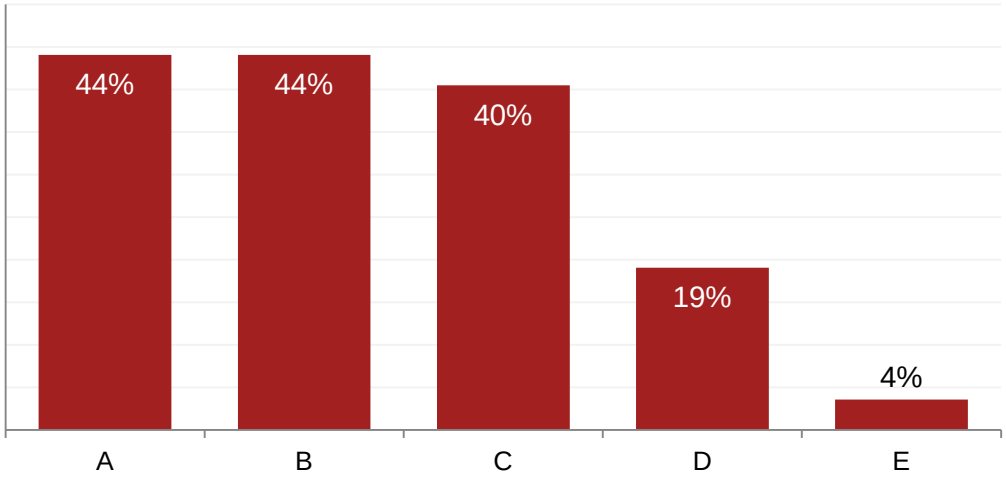
Letter	Reason for Dissatisfaction
E	Admin does not provide regulatory reporting or industry insight (advice-oriented)
F	Admin's data model is suboptimal
G	Responds to regulatory reporting trends reactively
H	Is not able to submit my filings electronically

Number of Respondents: 14. Multiple responses allowed.

NOTE: Respondents indicating they were satisfied were presented with a question on "reasons for satisfaction," while manager respondents that were dissatisfied were presented with a question "reasons for dissatisfaction."

44% of managers reported outsourcing regulatory compliance activities, such as AML/KYC/OFAC, while outsourcing rates for regulatory reporting were lower generally

Percentage of respondents using a third-party administrator for a compliance or regulatory reporting service (all segments)



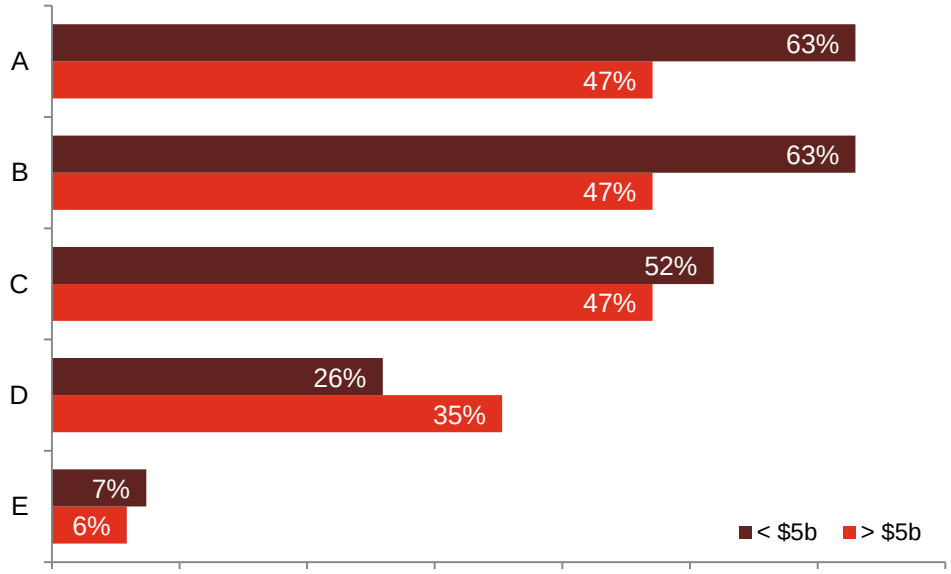
Letter	Regulatory Reporting / Compliance Function
A	AML / KYC
B	OFAC
C	Form PF
D	FATCA
E	Other Reporting (13F, ADV, etc.)

- Manager respondents reported outsourcing regulatory compliance activities such as AML/KYC/OFAC at a rate of approximately 44%. This rate was generally consistent with the rate at which respondents outsourced investor servicing (51%).
- 40% of participants indicated they outsource Form PF reporting to an administrator, suggesting that alternative managers perceive administrator-driven capabilities as adequate solutions to their regulatory reporting needs.
- The FATCA outsourcing rate was lower than Form PF; however, we expect this rate will increase as the deadlines for manager compliance near.
- Respondents indicated they use an administrator infrequently for other regulatory filings / reports.

Number of Respondents: 84. Percentages in chart above reflect the percentage of managers that reported outsourcing a particular regulatory / compliance function out of the total number of respondents

Hedge fund manager respondents with less than $5 billion in AUM outsourced compliance and regulatory reporting more often than hedge fund managers with greater than $5 billion in AUM

Percentage of hedge fund managers outsourcing (by size)

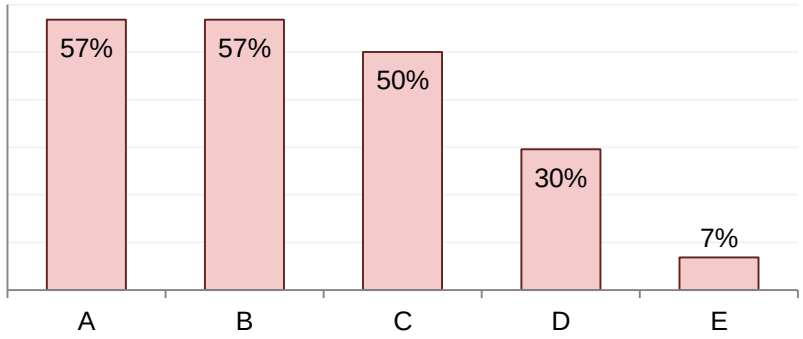


- The difference in outsourcing of regulatory compliance activities between the two size cohorts was not statistically significant, though we expected to see a similar or higher rate of outsourcing among hedge fund manager respondents with more than $5 billion in AUM.
- Approximately 50% of hedge fund manager respondents indicated they outsource Form PF to a third-party administrator, suggesting that these managers view administrator-driven Form PF offerings as viable solutions for meeting their needs.

Letter	Regulatory Reporting / Compliance Function
A	AML / KYC
B	OFAC
C	Form PF
D	FATCA
E	Other Reporting (13F, ADV, etc.)

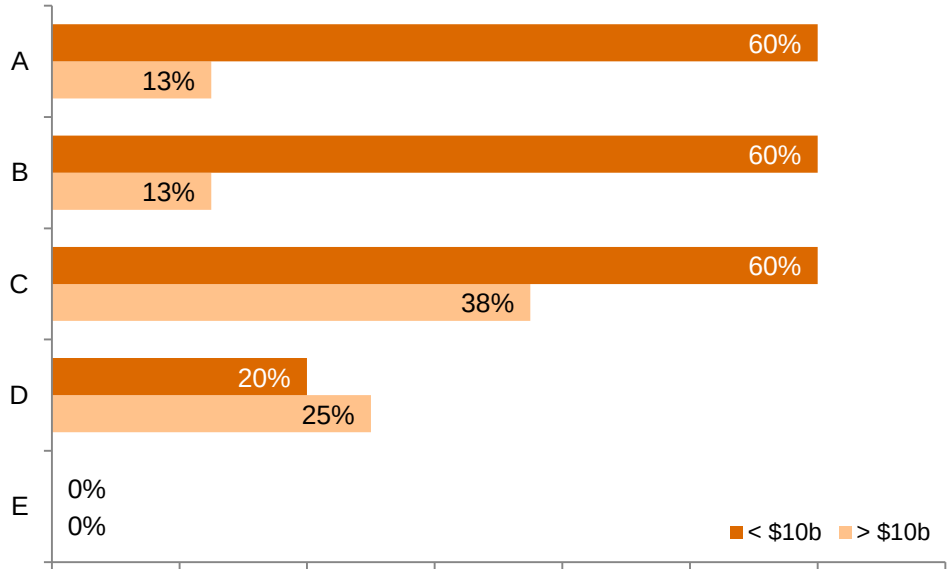
Number of Respondents: 44

% of hedge fund managers outsourcing (total)



The use of compliance and regulatory reporting services among hybrid manager respondents from each size cohort was inconsistent, though larger hybrid managers may have developed in-house capabilities to support these functions

Percentage of hybrid managers outsourcing (by size)



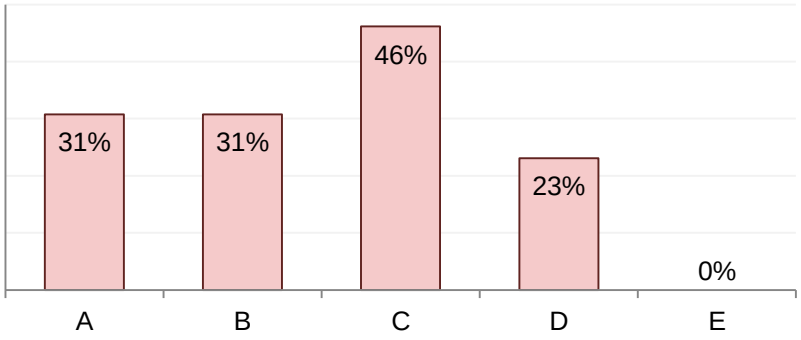
Letter	Regulatory Reporting / Compliance Function
A	AML / KYC
B	OFAC
C	Form PF
D	FATCA
E	Other Reporting (13F, ADV, etc.)

Number of Respondents: 13

- Hybrid manager respondents with less than $10 billion in AUM outsourced regulatory compliance (AML/KYC/OFAC) at a substantially higher rate than hybrid manager participants with more than $10 billion in AUM.
- Large hybrid managers may have invested in the compliance capabilities that enable them to perform these functions in-house.
- Both size cohorts used administrators for Form PF, though larger hybrid managers did so at a lower rate, suggesting that some of these respondents have chosen to build Form PF capabilities internally.

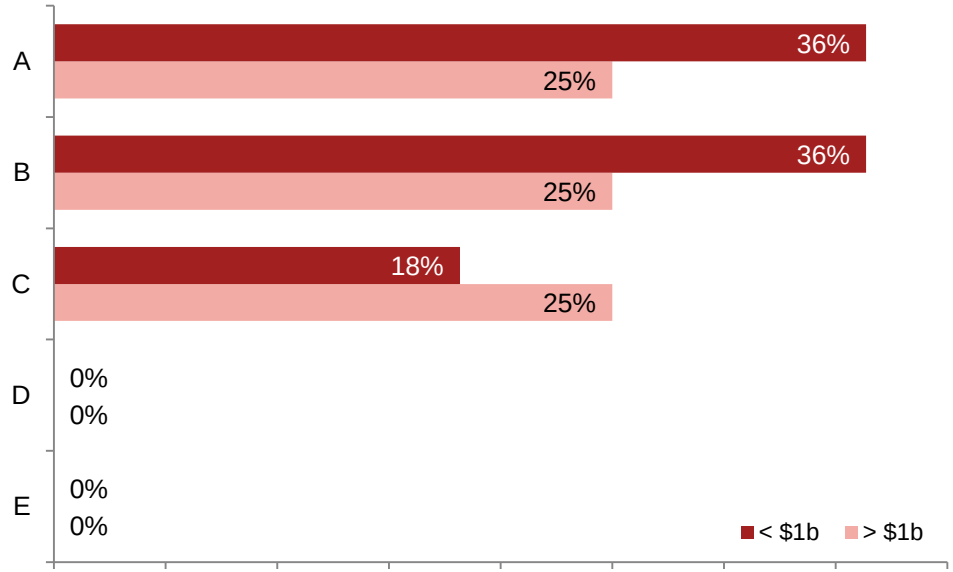
NOTE: The hybrid manager segment had the smallest number of respondents in our survey. As such, there is a higher margin of error associated with the results for this segment.

% of hybrid managers outsourcing (total)



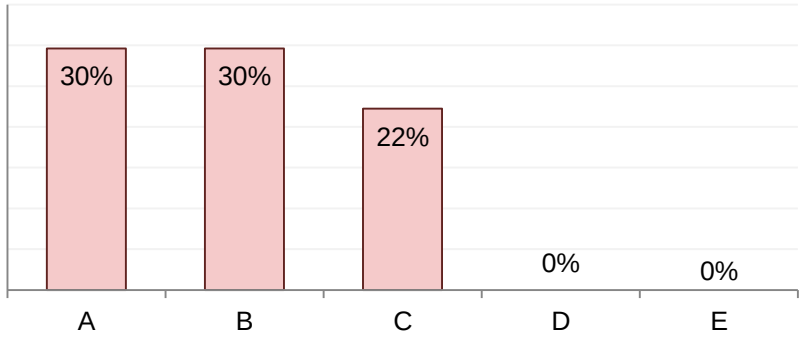
PE/RE manager respondents used regulatory compliance and Form PF reporting services from administrators only, though the use of services such as FATCA is expected to increase in the future

Percentage of PE/RE managers outsourcing (by size)



- Private equity and real estate (PE/RE) manager respondents outsourced regulatory compliance at the lowest rate.
- PE/RE manager respondents with more than $1 billion in AUM outsourced Form PF reporting at a rate of 25%.
- PE/RE manager respondents did not use a third-party administrator for FATCA; however, we expect this rate will increase in the future as the compliance deadlines near.

% of PE/RE managers outsourcing (total)



Letter	Regulatory Reporting / Compliance Function
A	AML / KYC
B	OFAC
C	Form PF
D	FATCA
E	Other Reporting (13F, ADV, etc.)

Number of Respondents: 27

Middle-Office Outsourcing Services

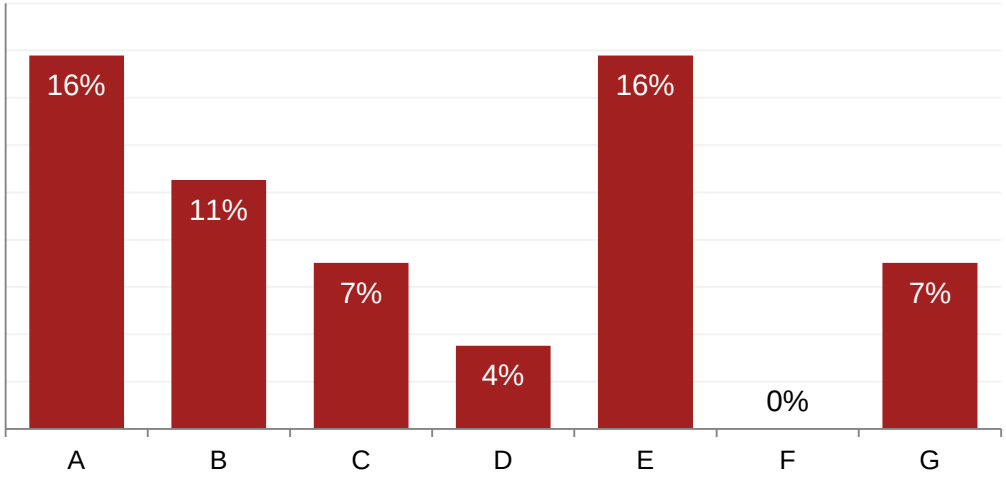
The rate of middle-office outsourcing was low among manager respondents; however, participants consider some middle-office outsourcing services to be value-added, indicating that manager demand for these services may grow in the future.

The functions outsourced most often were portfolio accounting (16%) and P&L reporting (16%).

7

The rate of middle-office outsourcing was low among respondents; however, participants consider some middle-office outsourcing services to be value-added, indicating that manager demand for these services may grow in the future

Percentage of respondents using a third-party administrator for a middle-office function (all segments)



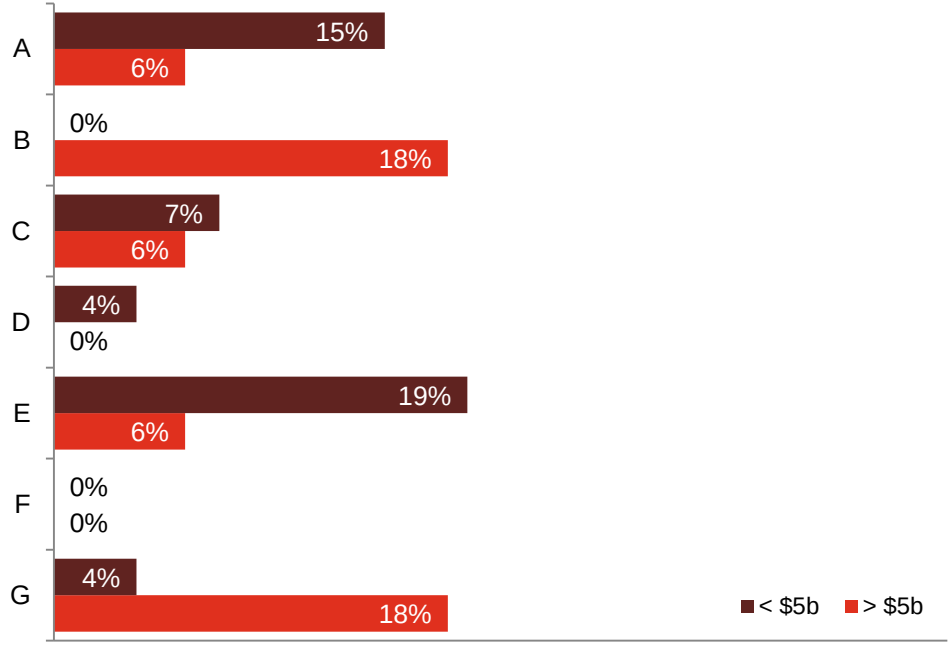
Letter	Function / Service
A	Portfolio Accounting
B	Trade Processing
C	Derivatives Processing
D	Collateral Management
E	P&L Reporting (T+0 or T+1)
F	Risk Attribution
G	Risk Reporting

- The highest rate of middle-office outsourcing was 16% among all participants for portfolio accounting and P&L reporting.
- The limited degree of middle-office outsourcing suggests that these functions can be more complex to outsource. Additionally, administrator-provided middle-office capabilities are generally perceived as being less mature than back-office solutions, which may be another contributing factor to the current rate of adoption.
- We asked managers to provide ratings on middle-office services across the dimensions of importance and value-add.
  - Middle-office services, such as P&L reporting, risk attribution and reporting, and collateral management, were considered value-added, but they were not perceived as important for an administrator to provide
  - Middle-office services, such as trade capture and portfolio accounting, were rated as important, but are expected of administrators by managers
- With manager respondents characterizing some middle-office services as value-added, this may suggest the potential for increases in future demand, provided that these services can demonstrate a compelling cost-to-benefit ratio.

Number of Respondents: 84. Percentages in chart above reflect the percentage of managers that reported outsourcing a particular middle-office function out of the total number of respondents

Hedge fund manager respondents used middle-office outsourcing on a limited basis, suggesting that in-house models adequately meet their needs currently

Percentage of hedge fund managers outsourcing (by size)

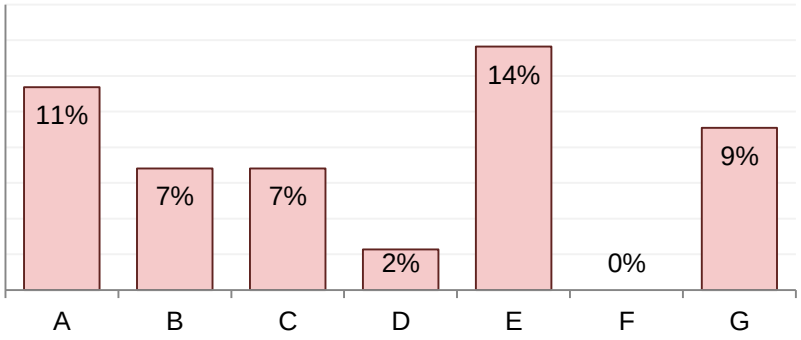


- Middle-office outsourcing rates by hedge fund manager respondents were low, as the rate of outsourcing was below 20% for all middle-office services.
- Differences in the outsourcing rates between size cohorts is not significant given the small number of respondents that comprise the results.

Letter	Function / Service
A	Portfolio Accounting
B	Trade Processing
C	Derivatives Processing
D	Collateral Management
E	P&L Reporting (T+0 or T+1)
F	Risk Attribution
G	Risk Reporting

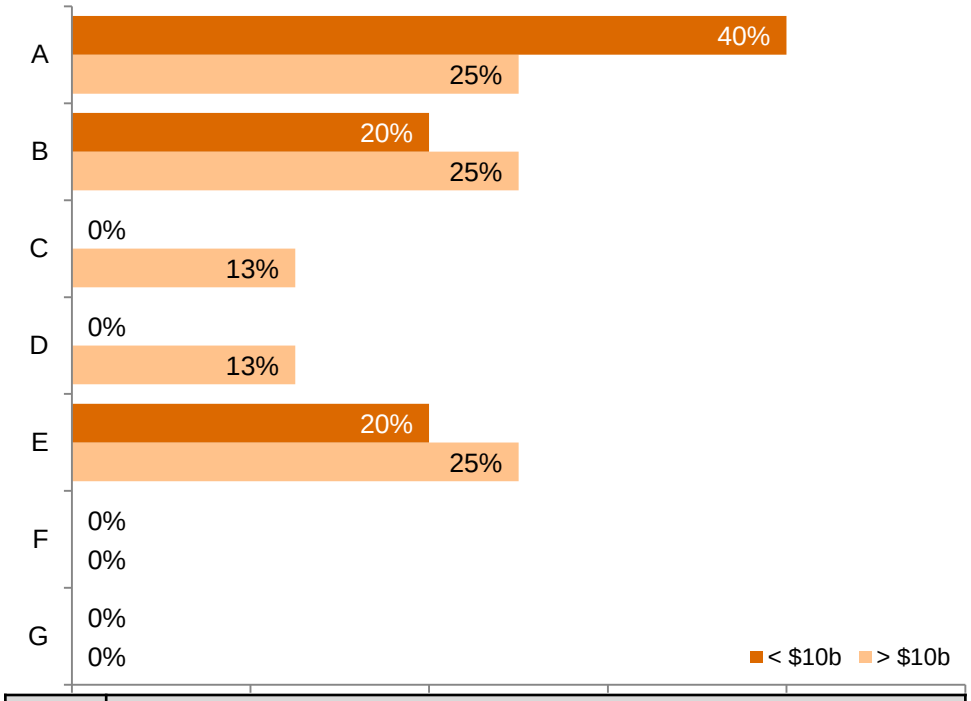
Number of Respondents: 44

% of hedge fund managers outsourcing (total)



Hybrid manager respondents reporting using middle-office outsourcing services at a higher rate than hedge fund managers

Percentage of hybrid managers outsourcing (by size)



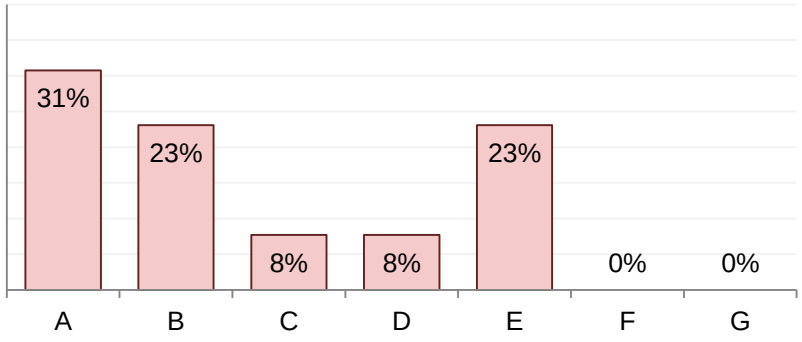
Letter	Function / Service
A	Portfolio Accounting
B	Trade Processing
C	Derivatives Processing
D	Collateral Management
E	P&L Reporting (T+0 or T+1)
F	Risk Attribution
G	Risk Reporting

Number of Respondents: 13

- Differences in the outsourcing rates between size cohorts is not significant given the small number of respondents that comprise the results.
- Hybrid manager respondents used middle-office outsourcing capabilities more often than any other manager segment, with the largest percentage of participants (31%) outsourcing portfolio accounting.
- Hybrid manager respondents may outsource middle-office functions more frequently because the cost-benefit ratio is more compelling when a manager reaches higher levels of AUM, (i.e., > $5 billion).
- However, other factors are likely contributing to this result, as the same relationship between size and the rate of middle-office outsourcing is not evident among the larger hedge fund managers from our survey.

NOTE: The hybrid manager segment had the smallest number of respondents in our survey. As such, there is a higher margin of error associated with the results for this segment.

% of hybrid managers outsourcing (total)



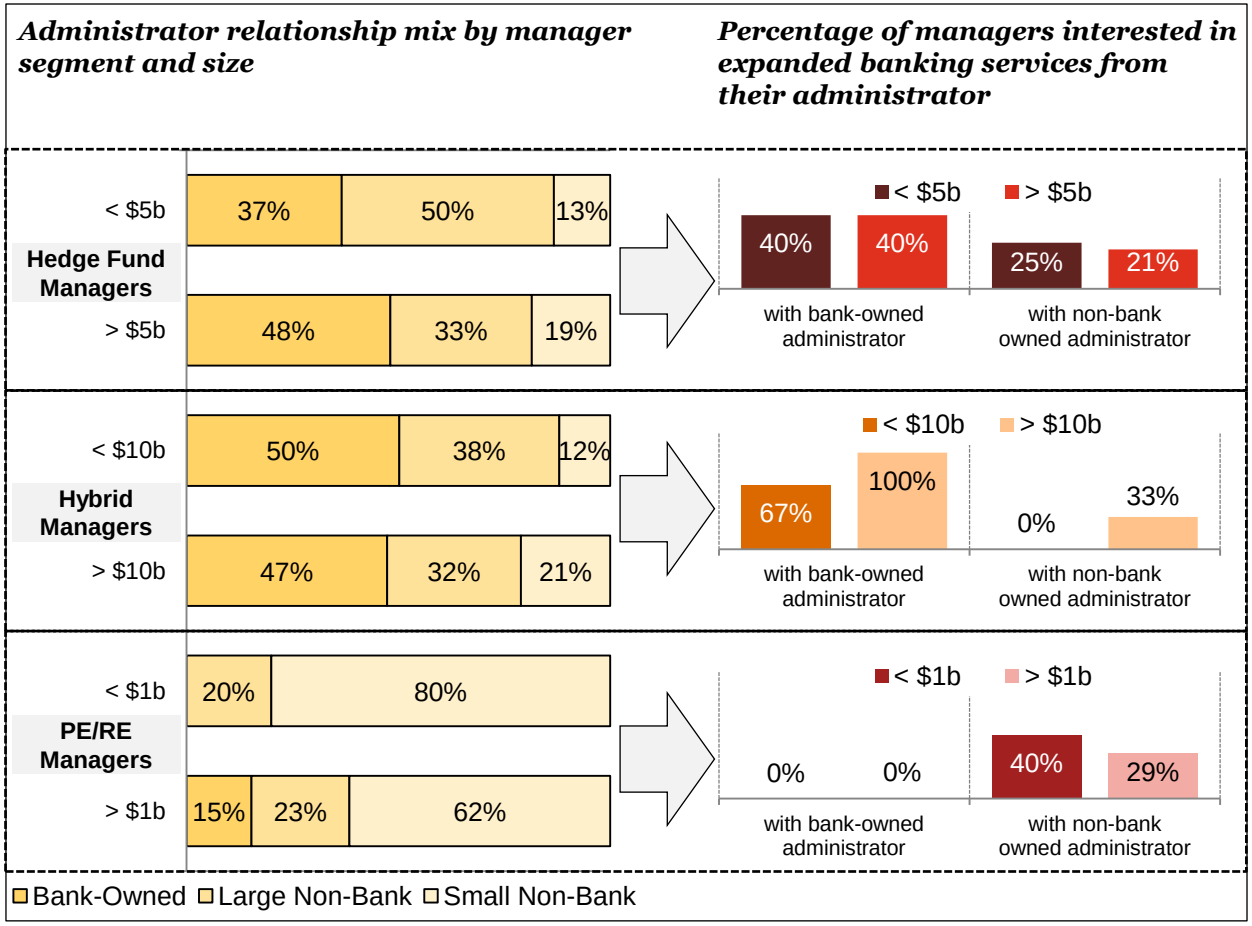
Other Services

Hedge fund and hybrid managers with bank-owned administrators were 2.3 times more interested in using “expanded banking services,” (e.g., cash management, collateral management, etc.) from an administrator.

Over 80% of hybrid managers expressed an interest in an integrated administration offering, while interest from other manager segments was limited to respondents with more AUM and/or more strategies on average.

8

Hedge fund and hybrid managers with bank-owned administrators were 2.3 times more interested in using banking services from an administrator



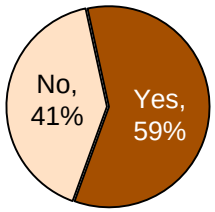
Number of Respondents: 64

- Hybrid and large hedge fund managers reported using bank-owned administrators most often.
- These managers were also 2.3 times more interested in using banking services from an administrator (when compared to hedge and hybrid managers using non-bank administrators).
- 83% of hybrid managers with bank-owned administrator relationships indicated an interest in "expanded banking services," which was four times greater than the level of interest reported by hybrid managers using non-bank administrators exclusively (20%).
- 40% of hedge fund managers with bank-owned administrator relationships indicated an interest in "expanded banking services," which was nearly two times greater than the level of interest reported by hedge fund managers using non-bank administrators exclusively (22%).
- The services of greatest interest to hedge fund and hybrid managers using bank-owned administrators were cash management and collateral management.
- PE/RE firms with less than $1 billion in AUM expressed an interest in "expanded banking services." However, the interest from these managers was restricted to deal/bridge financing, indicating that these responses were a product of the managers' desire to access financing, as opposed to an interest in utilizing banking services from an administrator.

Over 80% of hybrid managers expressed an interest in an integrated administration offering, while interest from other manager segments was limited to respondents with more AUM and/or more strategies on average

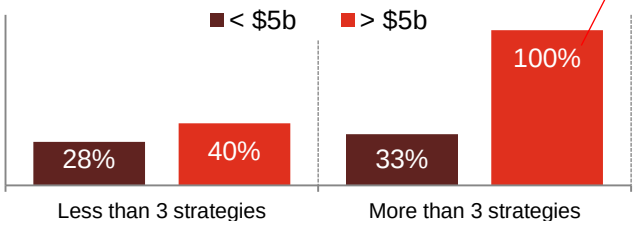
Percentage of hedge fund manager respondents interested in integrated admin

Hedge Fund Managers



Number of Respondents: 39

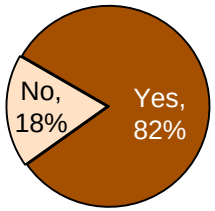
Hedge Fund Managers (by size and number of strategies)



Large hedge fund managers with more strategies on average showed strong interest.

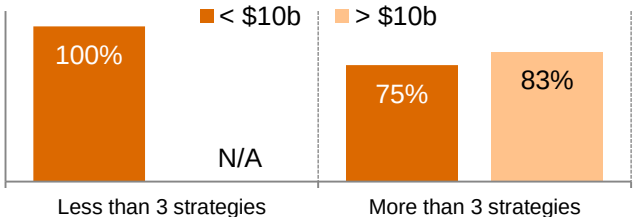
Percentage of hybrid manager respondents interested in integrated admin

Hybrid Managers



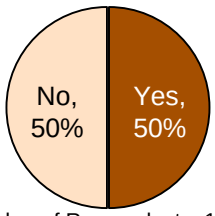
Number of Respondents: 11

Hybrid Managers (by size and number of strategies)



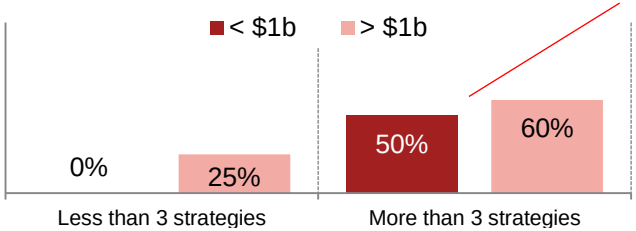
Percentage of PE/RE manager respondents interested in integrated admin

PE/RE Managers



Number of Respondents: 14

PE/RE Managers (by size and number of strategies)



PE/RE managers with more strategies on average showed some interest.

- Integrated administration represents the delivery of services and reporting to managers in a coordinated fashion at the relationship level.
- Examples of integrated admin services may include:
  - Consolidated reporting across all asset classes and strategies to general partners
  - Consolidated reporting to limited partners on behalf of the GP community
  - Integrated risk reporting and tools
  - Managing non-administration services (e.g., cash management) in a coordinated manner, across the client relationship, with an emphasis on improving service quality
- Hedge fund manager respondents showed mixed interest for integrated administration overall; however, large hedge fund participants managing more strategies than the average respondent (i.e., 3+ strategies) showed universal interest.
  - Interest from this sub-segment is logical as managers with more AUM and strategies use an administrator for more services on average.
- Hybrid managers showed strong interest across all size and strategy cohorts. The interest from these respondents is consistent with intuition, as hybrid managers are generally more complex and use more administrator services on average.
- PE/RE managers showed mixed interest in integrated administration overall; however, PE/RE participants managing with more strategies demonstrated a higher level of interest than those managing fewer than 3 strategies.

PwC Asset Management Advisory

Survey Authors

Michael Greenstein, Partner
U.S. Alternative Investments Leader - *Assurance*
+1 646 471 3070
michael.s.greenstein@us.pwc.com

Timothy Mueller, Principal
U.S. Alternative Investments Leader - *Advisory*
+1 646 471 5516
timothy.mueller@us.pwc.com

Erich Butters, Director
Asset Management Advisory
+1 646 471 0074
erich.butters@us.pwc.com

PwC Asset Management Leadership

Barry Benjamin, Partner
Global Asset Management Leader
+1 410 659 3400
barry.p.benjamin@us.pwc.com

Gary Meltzer, Partner
Global Asset Management Leader – *Advisory*
+1 646 471 8763
gary.c.meltzer@us.pwc.com

Mark Casella, Partner
Global Alternative Investments Leader
+1 646 471-2500
mark.j.casella@us.pwc.com

Julien Courbe, Principal
U.S. Asset Management Leader – *Advisory*
+1 646 471 4771
julien.courbe@us.pwc.com

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