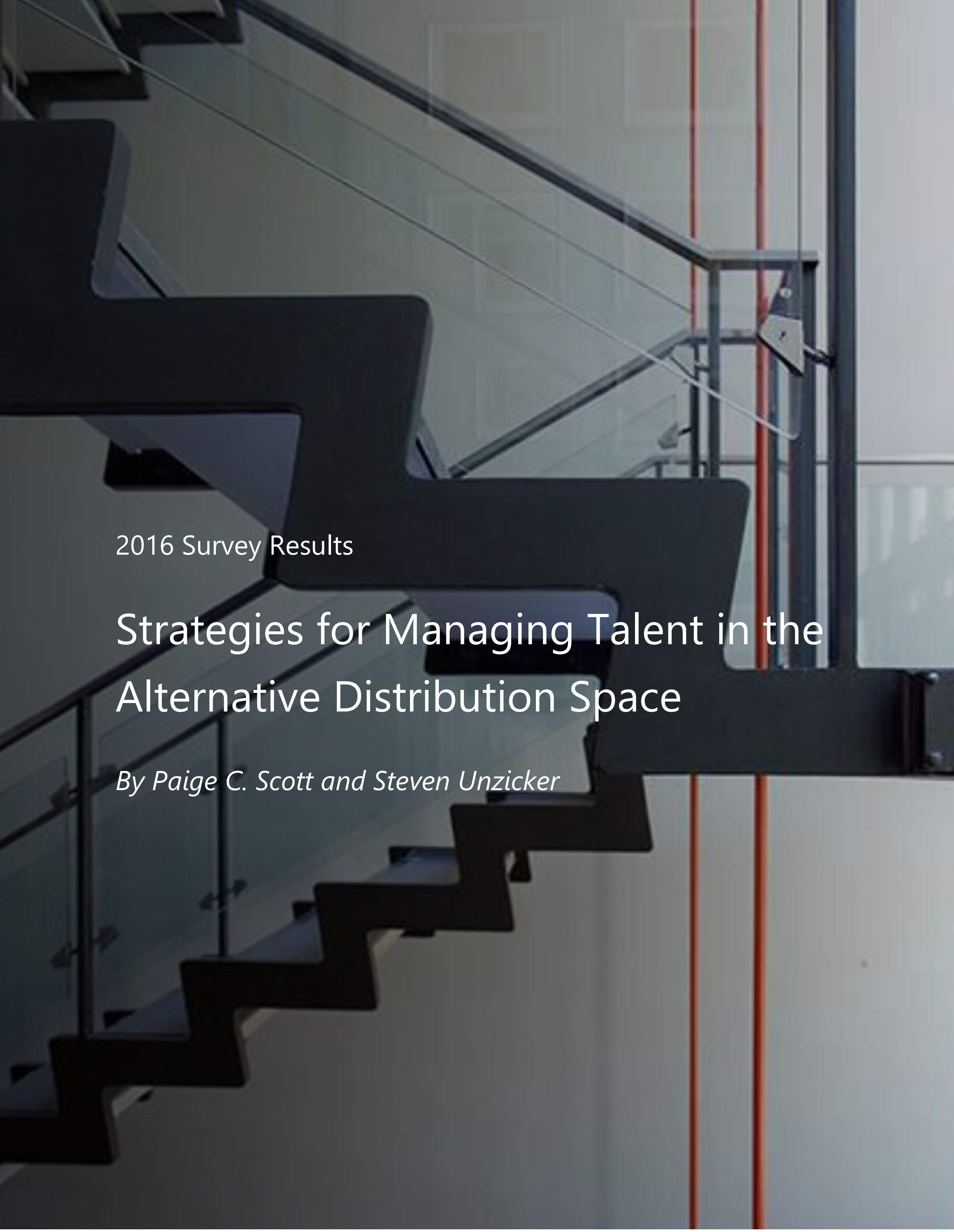

2016 Survey Results

Strategies for Managing Talent in the Alternative Distribution Space

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ALTERNATIVE INVESTMENTS INSTITUTE
FOCUS ON PRIVATE MARKETS AND ALTERNATIVES

Kingsley Gate Partners

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MARKET OVERVIEW

Compensation plans can be quite diverse, particularly among alternative asset management firms that are often more likely than more traditional asset management organizations to march to the beat of their own drummers. While approaches to remuneration may vary substantially from firm to firm, there can also be considerable commonality when it comes to describing changes and challenges in the business environment.

Performance, for example, is as important as ever, but fees are clearly playing an outsized role in the decision-making process of institutional investors when allocating to managers. Many people interviewed for the purposes of this paper remarked on growing fee pressure and its impact on asset flows. Some types of clients are more fee sensitive than others, with pension plans among the most vocal.

One reason fees are such a hot button issue? Competition is much more diverse than it used to be. Replication strategies and smart beta products are not only pressuring fees, but also making it more critical than ever before to keep up with or ahead of the competition with a differentiated strategy that demonstrably adds value to a portfolio—particularly if hoping to attract new assets.

The ever-evolving regulatory environment continues to make it more challenging to do business throughout Europe. This is particularly problematic for local firms whose fate is mostly tied to European markets, but it is also forcing some overseas firms to carefully consider their options when it comes to staffing locations and their business development objectives. Some firms are limiting outbound marketing to markets (like Switzerland and the U.K.) and only taking inbound queries elsewhere on the continent.

There are numerous challenges facing alternative managers in the European market, but more significant among them is the view that appetite for alternative strategies from asset owners across Europe has languished—forcing firms to question future growth from asset managers and sales professionals. Sovereign wealth funds, private banks and top-tier family offices were all singled out as particularly attractive segments of the market for raising new assets. All investors are becoming more demanding, however. Among other things, this means having clear visibility when it comes to all facets of fund infrastructure and operations. Overseas firms may have some staffing flexibility, but the distance to the rest of their operations can be a competitive disadvantage in the eyes of some European asset owners.

Given the relatively benign financial markets, the business development environment is surprisingly challenging. Compensation levels have also been languishing at some firms, making it more challenging to recruit candidates. As the European alternatives market continues to evolve, and hopefully grow, look for managers to become increasingly creative as they strive to create work environments and strategies that can attract the best talent in addition to evolving competitive compensation and benefit plans to retain them.

We want to thank everyone who spent the time to complete this year's inaugural survey as well as those who agreed to be interviewed. Our objective is to provide a management tool that allows for an objective comparison of approaches in recruiting, motivating and compensating institutional sales professionals in the alternatives space. We hope you will find the information and analysis contained in the following pages to be useful as you plan and prepare for your firm to compete effectively as the business climate evolves.

SURVEY METHODOLOGY

The EAII Institutional Sales Compensation Survey was launched in 2016 in conjunction with the new EAII organization. The survey was built on the foundation laid by several similar surveys conducted annually with members of other Institutional Investor Institutes (e.g. EIII, GFII and EI) over the past decade. This survey was launched to directly address the questions and concerns of those responsible for leading distribution (sales) professionals at alternative asset management firms based in Europe.

We are aware there is a plethora of compensation surveys on the market. We sought to differentiate this survey from others by focusing on compensation strategy rather than regurgitating raw compensation data. A conscious decision was made to focus on providing context, including:

- Macro business themes impacting fee revenue, bonus pools and sales activity
- Recruiting and retention opportunities, trends and challenges
- Impact of the changing regulatory environment on compensation structures and levels
- Compensation plan design, including team structure and key performance indicators

In short, our goal is to provide you with a strategic management tool that looks beyond compensation data to provide market intelligence and insights that enable effective talent management.

In-depth interviews and surveys completed by a dozen alternative managers between October and November of 2016. Heads of sales and marketing, human resources, strategy, as well as managing directors and other senior executives provided data. All participation was on a strictly confidential basis and results are only shown in aggregated form. In an effort to maximise utility and data anonymity, a minimum of three data points is required to produce a result.

FINDINGS

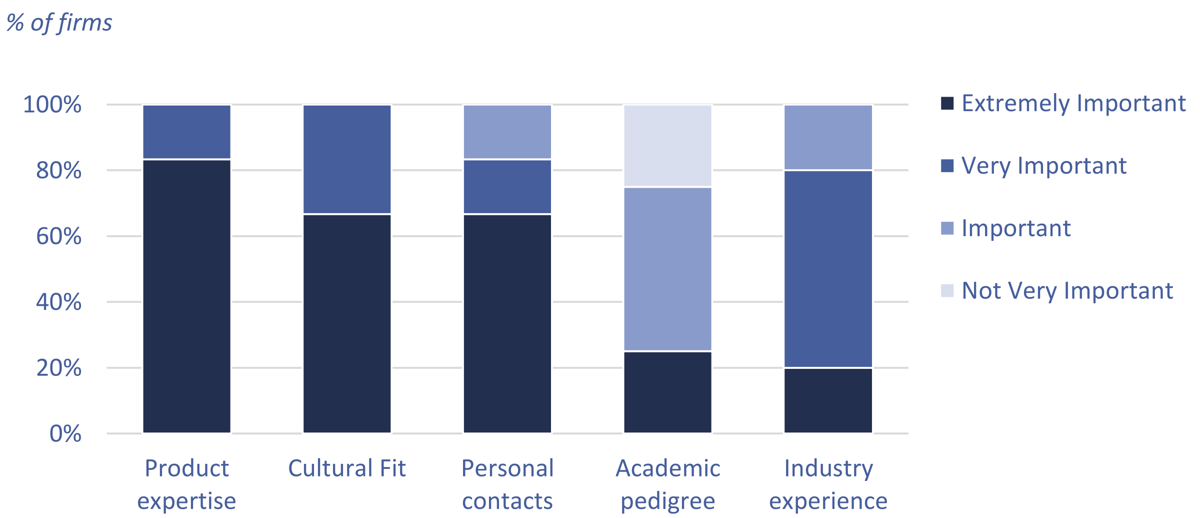
Recruiting

European headcount for many of the alternatives firms is quite lean, but half plan to add resources in the form of additional institutional sales professionals over the coming year. Priorities vary, but most firms agree that alternatives product expertise is a critically important factor to consider when recruiting new distribution professionals (Figure 1). Investment capabilities at alternatives firms tend to be much more complex and niche than capabilities at traditional firms. It is natural to be more concerned with sales people being able to communicate a convincing level of knowledge about a particular fund's strategy. This is particularly critical when working with limited local staff or investment talent in the region. It is therefore incumbent on sales professionals to carry a greater proportion of the investment selling proposition without support from local investment teams.

Personal contacts (or what we once quaintly referred to as a person's rolodex) are also vitally important (although this is starting to change in favor of grooming earlier stage talent when complimented in the region with a veteran sales professional), but cultural fit is something that many people addressed at length during interviews. It is widely acknowledged that it is not only important that distribution professionals represent the firm in a certain way, but also that they fit seamlessly into what are often very small teams with distinct cultural expectations.

One striking difference is the relative lack of emphasis on academic backgrounds. While valuable to some alternatives firms, the concept of the "right" school is far less common than it is among traditional long-only firms in the European market.

Figure 1. Factors rated by importance when hiring institutional sales professionals



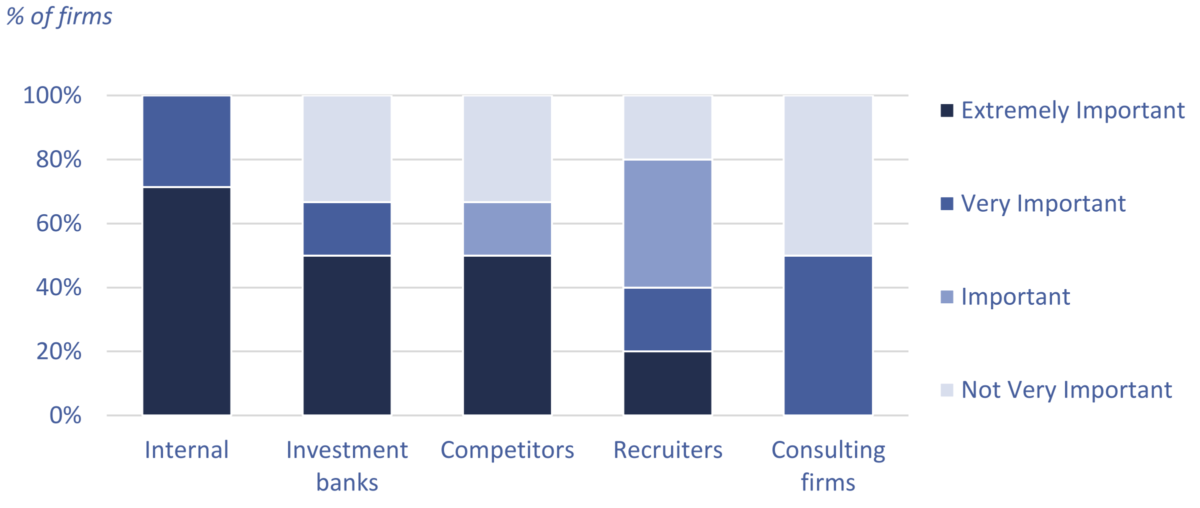
Talent Pools

Most firms looking to expand or fill gaps in their sales teams turn inward first to identify talent. All firms in the survey consider internal recruitment to be either "extremely" or "very" important (Figure 2). In light of the recruiting priorities discussed in the previous section, internal hires make sense on multiple levels. They are likely to already be intimately familiar with the firm's culture, people, products and processes. This greatly reduces the risk of "organ rejection" when considering culture fit, consistency and retention. They can, in other words, hit the ground running.

Nevertheless, it often becomes necessary to look outside to find the right talent. In these cases, the first stop is often investment banks. More than one respondent went so far as to say that virtually everyone on their team had come from a single global bank, pointing out that this facilitated acclimatization but also raised longer-term concerns about the lack of diversity.

Competitors are also an important source of talent for two out of three firms. Recruits from other alternative asset management firms may not be familiar with specific strategies, but they almost certainly know their way around the marketplace and have demonstrated that they can effectively sell to and service clients.

Figure 2. Sources of talent ranked by importance

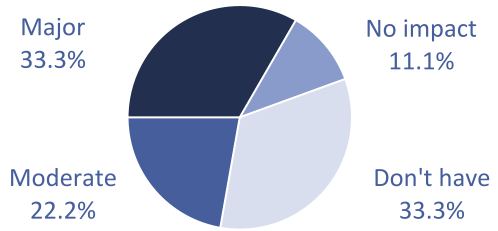


Product Specialists

Product specialists have taken on a more visible role at alternative asset management firms of all types over the past decade, and two out of three survey respondents report that their firms now employ dedicated product specialists (Figure 3). This is understandable, as prospective investors have become increasingly vocal about wanting to hear directly from investment teams. Direct participation in business development efforts is not always realistic for portfolio managers with limited time or bandwidth, and whose accessibility may also be hindered even further if they are located in New York or elsewhere. Product specialists are tasked with bridging this gap, and often produce excellent results: Half of the firms employing them say product specialists have a "major" impact on their ability to generate sales.

Figure 3. How much impact do product specialists have on institutional sales at your firm?

% of firms



Diversity

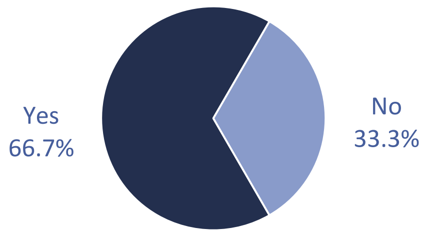
The asset management industry as a whole is notoriously lacking in talent diversity. Long-only and alternatives firms alike are not only dominated by white males, but their workforces often reflect extremely narrow recruitment efforts focused on a handful of business schools and firms. Moving away from this status quo will take a concerted effort, which is exactly what two out of three firms in the survey say they are actively pursuing (Figure 4).

Diversity can of course mean many things. Given their relatively homogenous starting point, it comes as no surprise that simply hiring more women would constitute a major increase in diversity at many firms. Nevertheless, even baby steps can be meaningful for firms that are aiming for more diverse workforces. This is because diversity is seldom (if ever) the ultimate objective. Instead, more diverse business development teams are seen as benefiting the firm with more creative ideas and better connections with an increasingly heterogeneous investor base and moving away from "group think".

Change will not come quickly. Heads of human resources point out it is difficult to change course, and their firms continue to hire the same kind of people from the same schools and firms anyway despite aspiring to genuine diversity.

Figure 4. Is your firm actively aiming to become more diverse through hiring?

% of firms



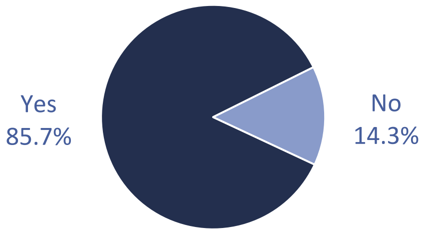
Fee pressure

One topic that emerged frequently during our interviews with survey participants this year was the growing pressure felt by alternatives firms to lower fees. Fee pressure has become more acute since the financial crisis, after which many institutional investors pushed for greater transparency and more regulation. Pressure has only grown with increasing availability of lower cost options like replication strategies and smart beta funds—this is particularly acute at firms that have lagged in fund performance or manage strategies with limited appetite by asset owners in Europe.

Fee pressure affects more than the bottom line. The vast majority of survey respondents said fee pressure actually makes it more difficult to recruit and hire talent (Figure 5). Fee pressure makes the sales process more complicated, less certain and a lot less comfortable. Despite the natural volatility inherent in alternatives strategies, sales talent today is seeking to avoid areas of volatility they can't control (e.g. strategy performance results or asset allocation away from specific strategies). The fee pressure trend has undeniably resulted in smaller bonus pools overall for both investment and sales professionals. It is not surprising that sales professionals would prefer to avoid joining firms where there are product and/or fee pressure issues if at all possible.

Figure 5. Is fee pressure having a negative impact on your ability to recruit and hire talent?

% of firms

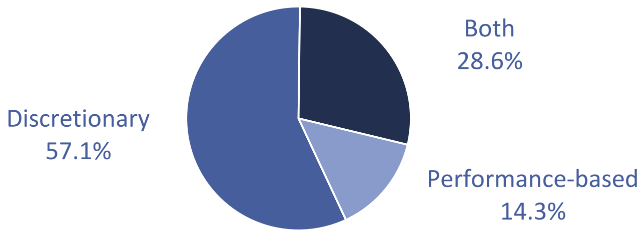


Bonus Methodology

Discretionary approaches to incentive compensation comprise the most common structure employed by alternative asset managers. This comes as no surprise, as alternative managers have been somewhat restricted in using formulaic compensation models than their long-only cousins due to regulations applying specifically to alternative managers. More than half of the firms surveyed use purely discretionary approaches. Methodologies are sometimes opaque, while others achieve greater transparency by incorporating the use of concrete metrics (Figure 6). A small minority of firms uses entirely performance-based plans, but more are likely to implement them in conjunction with discretionary plans.

Figure 6. How does your firm determine bonuses for its institutional sales professionals?

% of firms



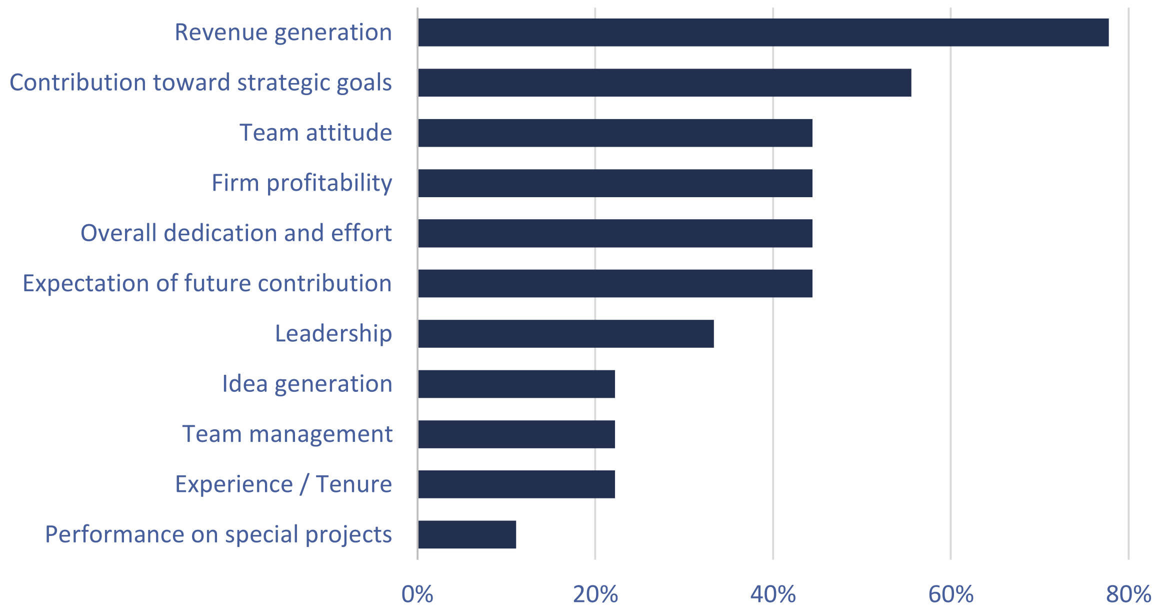
Key Performance Indicators (KPIs)

Most firms reward sales professionals with a blend of individual, team, and firm performance measures. Key performance indicators (KPIs) vary widely. Some easily tracked metrics, like firm profitability and revenue generated by a given individual, are widely used (Figure 7). Less quantifiable behavior is also tracked and considered by many firms. These factors include working as part of a team and contributing to longer term goals such as product development.

Other KPIs relied on to inform bonus awards range from highly specific ones that can be pulled directly from CRM systems (e.g. the number of calls made or meetings attended) to qualitative feedback from investment teams. More abstract concepts like asset quality or client/product diversification were also mentioned by some participants as being important goals that were being measured and tied to incentive compensation.

Figure 7. Factors considered when awarding discretionary bonuses

% of firms



Long-Term Incentive Plans (LTIPs)

Incentive compensation accounts for only part of the compensation of sales professionals at 60% of the alternatives firms in the survey. Long-term incentive plans (LTIPs) also play a role in compensating sales teams (Figure 8). The specific type of incentive used often comes down to corporate or GP structure. Private companies may use profit sharing or ownership units, for example, while publicly traded firms can grant restricted stock units. Independently operated firms also behave differently from subsidiaries of larger organizations (Figure 9).

Some LTIPs, like shares or GP ownership units, operate at the firm level. Others operate at the fund level. In some cases, the two are for all intents and purposes the same thing, since the vast majority of assets are tied up in a single fund.

Vesting schedules are idiosyncratic, with both cliff and graduated schedules used. Most vesting occurs over a three-year period.

Figure 8. Are long-term incentives included in compensation plans for sales professionals?

% of firms

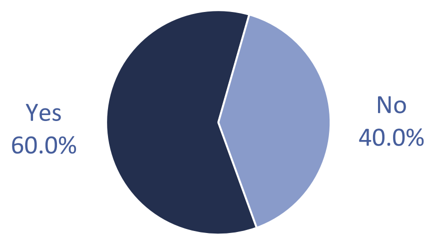
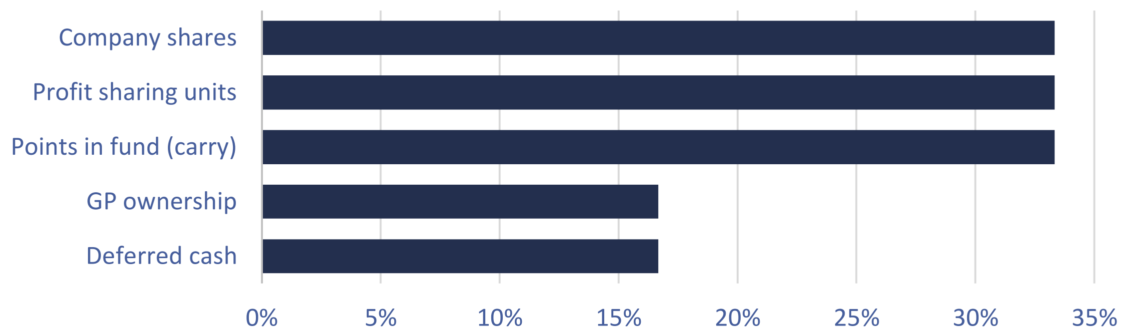


Figure 9. If yes, for which of the following are your sales professionals eligible?

% of firms



CONCLUSIONS

Despite pressure from regulators and clients on fees and transparency, discretionary and relatively opaque compensation approaches still dominate compensation plans at alternative managers based or doing business in Europe. Non-transactional metrics are nevertheless seen as increasingly important in an environment where new asset gathering is significantly challenged—meaning revenue metrics can't be the primary driver of sales skill and evaluation. Investment teams are even being tapped for their perspectives on the efficacy of sales professionals, signifying an approach that we have not seen much of before to date.

What may surprise managers most of all is the lack of appetite among sales professionals today for the volatility seen at alternative managers in this market environment. Gone are the days when talent would jump at the chance to join a hedge fund (PE and RE asset management firms still have far more appeal) in an effort to benefit from overall higher compensation incentives. Sales talent is now scrutinising the stability of product performance, GP pedigree, asset volatility and operational excellence than ever before—making recruiting top sales people a major competitive challenge. The ability to create a desirable culture (e.g. flexible schedules, geographic home base/commute options, modern work spaces, etc.) and environment where people want to work can pay significant dividends in talent retention initiatives.

We are also hearing more about the quality of assets, where assets are valued more or less depending on the type of client who has invested. With pension plans squeezing managers on fees—managers are now executing sales strategies focused on asset owner diversification whether to penetrate the HNW private banks, family offices or SWF's—all of whom are bright areas in an otherwise dismal fundraising environment. It will be interesting to see if this approach takes root and, if so, how it is measured and applied—and whether this spills across to other alternative asset managers as a significant KPI.

In an increasingly competitive market characterized by growing fee pressure, it should come as no surprise that there is a growing emphasis on asset retention. This is particularly true at more mature firms. If the business climate continues to be as challenging as it has been for alternative firms, it will be interesting to see if client servicing and asset retention play an even bigger role in the job descriptions and compensation plans of distribution professionals. Alternatively, these responsibilities could be seen as "lesser" skills in comparison to fundraising, negatively impacting compensation. In any event, attracting, recruiting and retaining institutional sales professionals in Europe (or EMEA) will continue to be an even more challenging enterprise in light of these headwinds in the coming years.

ABOUT THE SPONSORS

European Alternative Investments Institute

The European Alternative Investments Institute (EAII) is a private membership organisation for alternative investment management executives responsible for overseeing institutional business development.

Launched on 1 January 2016, members of the Institute come together with asset owners interested in alternative strategies in four private regional summits per year. With alternatives and private markets at the top of European asset owners' agendas, the Institute serves as an exclusive platform to exchange ideas in a collegial and collaborative environment.

Kingsley Gate Partners

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At Kingsley Gate Partners, we understand that although positions may have similar sounding titles, they mean different things in different parts of the globe. That's why we have assembled a team of experienced partners who have lived and worked in the specific areas of the world. They understand the local languages, the local culture and most importantly, the local nuances of the executive talent market in which they operate. We think globally but we act locally.

ABOUT THE AUTHORS

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Paige Scott is a Senior Partner and leads the Kingsley Gate Partners' asset management practice. With over 20 years of asset management search experience, Paige has led and completed "front office" searches across the globe for Global Heads of Institutional Sales & Marketing, Business Development, Consultant Relations, Product Specialists; to Heads of Active and Passive Strategies including team "lift outs" within fixed income, equities and alternative asset classes. Paige is actively involved in advising asset managers on global expansion activities and has developed specialized knowledge within Pension Risk Transfer (de-risking) build outs.

Paige started her retained search career with Pearson, Caldwell & Farnsworth (San Francisco) in 1998. The firm was acquired by Korn/Ferry International a year later. Paige became Senior Client Partner at Korn/Ferry (Boston) before leaving in 2005 to join Sextant Search Partners, a specialty boutique financial services search firm dedicated to alternative asset classes. In 2009, Paige joined Sheffield Haworth and subsequently opened both the firm's Boston and San Francisco offices while leading the North American Asset Management Practice and serving as a member of the U.S. Executive Committee.

Paige is a member of the Advisory Board of 100 Women in Hedge Funds. Paige currently leads the publication/production of compensation/"Best Practices" white papers for the Global Fixed Income Institute (GFII); the European Institutional Investor Institute (EIII) and the European Institute (EI) and is a regular speaker at all three annual senior delegate conferences for EIII, EI and GFII. She earned a Bachelor of Arts in French and Russian Literature from Wheaton College in Norton, Massachusetts. Paige is based in San Francisco. She can be contacted by phone at (628)-333-2319 or by email at pscott@kingsleygate.com

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