A new era for manager due diligence

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Adapting to a new virtual world

The 2007-2008 global financial crisis had a lasting impact on public and private pension funds, as the collapse of Lehman Brothers and massive fraud committed by Wall Street money manager Bernie Madoff placed greater emphasis on fiduciary obligations and manager due diligence. During the decade that followed, plan sponsors* continued to hone their manager research and screening processes until a new wave of disruption sent ripples across the institutional investment landscape.

This time, the black swan event took the shape of a global health pandemic fraught with lockdown orders that forced asset owners and asset managers to work remotely from the confines of their home offices. As the transition to work from home took hold, site visits, a long-time staple in manager due diligence, were replaced with Zoom meetings and investment managers and plan sponsors were forced to adapt to a brave new virtual world.

Initially, plan sponsors and asset owners were reluctant to conduct new searches virtually, and many elected to postpone new manager engagements, hoping the storm would be short-lived. Others decided to invest only in the managers they were currently engaged with. Clearly, favouring the incumbent or existing manager that they are using elsewhere in the portfolio is not a sustainable approach for meeting fiduciary responsibilities. As the world starts to reopen with the rollout of vaccination programs and some countries preparing to live with COVID-19 as an endemic, we anticipate that the manager due diligence process will continue to evolve.

Videoconferencing will remain core to the process by which organisations evaluate the investment and operational strengths, weaknesses, characteristics, and biases of managers. And while the purpose of this process remains unchanged, the virtual means by which plan sponsors assess an investment manager's culture, acumen, operational effectiveness, and corporate policies will continue to create new challenges and opportunities.

Navigating challenges of the new normal

Providing the opportunity to have real-time, face-to-face conversations with colleagues and professionals from across the globe, video conferencing has proven to be an invaluable tool during these unprecedented times. But the technology is not without some limitations.

For plan sponsors conducting manager due diligence entirely via virtual means, a common challenge is trying to assess the team dynamics and cultural fit of an asset manager through a computer screen.

Despite the best efforts of all parties, virtual meetings don't have the same level of spontaneity as in-person meetings for a host of reasons, and as a result, soft sensory perception is reduced along with the interpretation of

* A company or employer that sets up a healthcare or retirement plan for its employees.

non-verbal cues that can be invaluable to shaping in-person meetings and assessing team dynamics and culture. Reduced spontaneity can also hinder an organisation's understanding of the thought process and thinking of an investment team and firm, as some follow-up questions go unasked and discussions become harder to steer.

Assessing the operational effectiveness of an investment manager without the ability to lay eyes on a firm's infrastructure, trading floor or physical footprint can also prove to be challenging, particularly if managers are reluctant to share hard or soft copies of key documents for confidentiality reasons.

Fortunately, with time, investment managers are growing more willing to share this proprietary data and information as the use of non-disclosure agreements expands.

New due diligence tactics and techniques emerging

The sudden and unexpected transition from on-site visits to virtual meetings forced organisations to re-examine nearly every stage of their manager selection process—a development that has led to enhancements designed to foster better decision making and results.

First and foremost, both investment managers and plan sponsors are spending more time on planning and preparing for upcoming due diligence meetings. Not surprisingly, the elimination of travel has created more time for better information gathering. Increasingly, organisations are conducting their own qualitative and quantitative analysis of data and information provided prior to the meeting—a higher level of analysis that has unquestionably generated better questions and meeting agendas.

Before the pandemic, a plan sponsor might only be in town for a single day and it was standard practice to schedule one long in-person meeting. With the added flexibility of virtual meetings, these marathon sessions can be broken up into a series of shorter, smaller sessions scheduled across several days. This format has proven to enhance engagement, facilitate more discussions between the organisation and the investment manager, and allow professionals from different offices the opportunity to participate in targeted discussions.

Virtual meetings also provide plan sponsors and investment managers the ability to communicate internally in parallel in real time as a meeting is taking place. Often, this communication helps to guide discussions toward what matters most for all parties.

Finally, the unprecedented events created by COVID-19 provide plan sponsors with a rare opportunity to compare how managers are responding to a common challenge, particularly as it relates to the effectiveness of their business continuity plans. While no one could have predicted the events of 2020, the pandemic has created similar challenges for every asset management firm. Evaluating how firms have responded can offer valuable new insights into their governance, leadership, culture, research capabilities, and ultimately, investment processes.

While the recent trajectory of COVID-19 cases in the US and Europe suggest plan sponsors will continue to conduct manager due diligence virtually well into 2021, the amazing journey during the past 16 months will undoubtedly leave a lasting mark on how manager research and screening is conducted for years to come. Given the pace at which new challenges have been overcome and tactics and techniques have been developed to navigate the current environment, due diligence in a post-pandemic working environment will likely look like a hybrid of past and present approaches.

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