

## DUE DILIGENCE MATTERS - MARCH 2022

Our flexible **Allocator On-Demand ODD**, **Investment Manager ODD Therapy**, and **Service Provider ODD** work continues, with an ongoing bias towards private equity, credit and crypto operational due diligence.

Please note we can now include comprehensive background checks, at individual and/or entity level, in our ODD reviews - please contact me for more information and pricing, thank you.

### INSIGHTS, THOUGHTS AND OBSERVATIONS

#### The Impact of Russian Sanctions on ODD Reviews

Following the Russian invasion of Ukraine on 24 February, the resulting economic sanctions that have been applied to the Russian economy and financial sector, by the US, EU, UK and other G7 economies, have been wide-ranging and severe. While this is very much a developing situation, we have summarised some of the impacts on ODD.

#### Sanctions and Fund Investors

Investment managers need to ensure that their investor lists are compliant with the new sanctions regime. There are challenges in that sanctioned parties may have gone to great lengths to obfuscate their beneficial ownership or source of wealth/funds. In addition, any entity that is more than 50% owned by a sanctioned party is also itself considered as sanctioned and must be identified. Furthermore, the sanctions lists are changing as the situation unfolds.

Therefore, strong initial and ongoing AML KYC processes are needed. This includes regular sanctions screening of clients and transactions using adequate tools and expertise, including processes to deal with positive hits, such as exiting relationships or freezing assets. In many cases fund managers delegate AML KYC to fund administrators, which should have the relevant infrastructure, people, and processes in place. That said, investment managers need to perform adequate due diligence on their providers' AML KYC control framework and maintain regular communication. Investment managers which do not delegate these activities (e.g., those that self-administer their funds) may struggle with resources and expertise required to do this properly. Getting it wrong could not only undermine the effectiveness of the sanctions but also could also result in stiff

financial, regulatory and even criminal penalties on those found to be in violation.

Funds catering mainly to institutional investors, such as pension funds, are likely to be less impacted by sanctioned investors than those whose investor base is mainly high net worth individuals, family offices or private banks.

perform, as part of its standard ODD process, always seeks to understand the AML KYC controls in place at the fund administrator and investment manager. Recently we have been asking about what funds' exposures are to sanctioned parties, following the Ukraine invasion, and how the exposure is being managed.

#### Suspension of Fund Redemptions, and Valuations

With the Russian stock markets closed since the invasion, we understand several Russia-exposed funds have gated redemptions indefinitely until the underlying assets can be traded. Many Russia-focused ETFs have also suspended trading on US and European exchanges.

Although Russian assets account for a relatively small overall share of impacted portfolios (1.9% based on pre-war valuations, according to [Morningstar](#)), this is a complex and fluid situation for investment managers, administrators and valuation committees to navigate, and there is little visibility on how this may play out. In many cases, valuations have simply been marked down to zero by investment managers, and fees to investors have been waived or reduced. Additionally, in recent weeks the main index providers have been deleting Russian constituents from their emerging markets and international indices at a zero value.

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One recent development is that the UK's FCA on 16 March announced they were consulting with stakeholders on introducing side pockets to retail funds holding Russian assets to allow these funds to lift their dealing suspensions. By side pocketing Russian assets, the fund will be able to accept subscriptions while the investors redeeming at a loss will maintain any rights to benefit if the valuation of side-pocketed Russian assets recover.

In the current environment we recommend fund investors understand how Russian assets are being valued, and how these valuation decisions have been reached if the assets are not marked to zero.

### Operational Impacts

Ukraine is a notable location for technology staff and outsourcing, thanks to its large talent pool, and certain investment firms, suppliers and service providers will have teams of developers operating in what is now a warzone. Belarus and Russia may also be locations where firms have staff or outsourced providers, and the sanctions will seriously restrict the ability of firms to maintain operations or work with suppliers in these jurisdictions.

In current reviews of firms with staff in these locations, perFORM notes that, while no significant business interruptions have been observed, there are complexities around staff

welfare and moving staff to safer or better locations. Firms need adequate business continuity arrangements to minimise disruption, protect assets and ensure staff safety in these types of extreme situations. Given the possibility of escalation, firms which outsource to, or have operations in, Ukraine's neighbouring countries should have contingency plans in place.

We are all deeply concerned by the unfolding humanitarian crisis in Ukraine and our thoughts are with the millions of people who are affected by this war. Our parent company JTC Group has donated £25,000 to be allocated to two aid organisations in direct support of their humanitarian work in and around Ukraine.

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## DUE DILIGENCE SERVICES

perFORM Due Diligence Services Limited is an award-winning provider of operational due diligence services for a diverse base of UK and international Allocators and Investment Managers.

Launched in 2019 as the only London-based and technology-led ODD service of its kind, perFORM is a growing team of highly experienced ODD practitioners

with a laser-like focus on client service which ensures high levels of client satisfaction, trust and partnership. In October 2021, perFORM announced it had been formed as a subsidiary company of JTC Group PLC, an award-winning provider of fund, corporate and private client services.