perfORM

DUE DILIGENCE SERVICES

DUE DILIGENCE MATTERS - JUNE 2022

Our flexible Operational Due Diligence (“ODD”) work continues cross asset class, from long only, hedge, crypto, private equity and credit. We are pleased to be introducing timely and unique ODD services for Investment Managers and Service Providers.

perfORM’s clients are global and diverse including: Investment Managers, Family Offices / Multi-family Offices, Private Banks, Wealth Managers, Fund of Funds, Asset Managers, Pensions, Endowments, Service Providers / VASPs and Sports Teams.

Please contact us to discuss our extensive Investment Manager / Fund coverage and accessing our ODD Reports

In this issue, we cover Five Reasons You Should perform Investment Manager ODD and Wrong on Rat Poison, Right on Reputation…

"As part of accepting a new sponsorship partner, we engaged perfORM for their timely and unique crypto due diligence services”

F1 Team – Head of Business Affairs

[click here for timely FT article quoting perfORM]

INSIGHTS, THOUGHTS AND OBSERVATIONS

ODD Blog #3 – Five Reasons You Should perform Investment Manager ODD

The most obvious consequence of an investor failing to perform robust operational Due Diligence (“ODD”) is direct financial loss, but there are other situations that could prove equally problematic.

ODD, in-house or using a third party, helps to avoid potential operational errors or fraud by focusing on the operational controls of an Investment Manager (“IM”) and the investment entity (the “Fund”).

ODD allows you to invest with operational conviction and stay invested. It identifies and assesses the IM and Fund specific non-investment (operational) risks including people, organisation and governance, operational process, regulation, compliance, IT/cyber and service provider dependencies.

Here are five areas that could cause potential loss without appropriate ODD:

1. Operational Efficiency

Systems failures, such as outages or website crashes, may not lead to an immediate decline in an organisation’s profitability, but they are likely to damage a reputation, particularly if repeated. To defend against these issues, ODD reviews confirm the durability and security of an IM’s systems and ensure that the operational model is robust, with sufficient processes and procedures in place. Checks should also be performed on providers of outsourced services.

2. Cyber-attacks

A fake Zoom invite forced a hedge fund to close after cybercriminals found a way into their emails. The fraudulent invite planted malicious software on the Investment Manager’s network, allowing the hackers to take control of email systems and send off fraudulent invoices.

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In late March, a hacker stole roughly $600m in digital currencies by exploiting a weakness in the 'digital bridge' built to help users and companies transfer assets from one blockchain to another.

It has subsequently been revealed that across the asset class "more than $1 billion in crypto currency has been stolen by exploiting flaws in such bridges in little over a year." This incident demonstrates that there is no digital infrastructure, even blockchain, for which security should be accepted at face value without regular checks and tests.

3. Crypto Currencies

As well as being a popular target for cyber-attacks, the new world of crypto currency investment and trading requires regular ODD reviews if investors want to have confidence around the safety of investments.

One important issue is the custodianship and security of digital assets, particularly given the continuing debate questioning around whether crypto currencies are assets or currencies, which alters their legal status. The requirement for ODD examination here is underlined by the fact that unlike their colleagues running hedge funds, for example, many crypto IMs have an array of custody options to choose from, including self-custody, a decision which requires case-by-case examination.

4. Environmental, Social and Governance (ESG)

Being associated, as an investor, shareholder or an employee, with an organisation that has a poor or declining ESG score can damage your reputation.

Today in the investment management sector, as across most of financial services, the moral considerations of ESG are important. Typically, perfORM will review ESG issues at the IM level. These include checking an organisation's transition to carbon neutrality, confirming appropriate remuneration, diversity and whistleblowing policies, as well as examining issues such as employee related litigation and staff turnover.

5. Reputation and Liability

Go into any supermarket and you will immediately be confronted by a range of products, edible or otherwise, which promote themselves as be vegan, sugar-free, better for the environment, and so on. Impressive claims but are they true? Has anyone checked?

Promoters of investments often make equivalently impressive claims, and regular ODD reviews can provide re-assurance that these claims are true.

Again, this is not necessarily about money but about reputation and sometimes legal liability. Those entrusted with the care and disposition of other people's assets, be they consultants to family offices or pension fund managers, do not want to be found to have committed capital without due care and attention, for example to "greenwashed" rather than green funds, or with management groups with a notable lack of diversification at senior level. There is personal career risk here, and furthermore risk of possible legal action for failures in governance should a selected portfolio be found, for example, to contain sanctioned assets.

Enabling fact-based decisions

ODD is not the alchemist's stone for the investment industry, but it does play a key role in underpinning responsible decision-making. As Sherlock Holmes once commented, "It is a capital mistake to theorise before one has data."

Guest comment: Wrong on Rat Poison, Right on Reputation

Warren Buffett needs little introduction. His multi-decade success as an investor has rightly earned him exalted status. But both Buffett and Berkshire Hathaway vice chairman Charlie Munger are no fans of crypto.

Commenting recently at the Berkshire Hathaway annual shareholders meeting Buffett claimed he'd "not buy all the bitcoin in the world for $25", and in 2018 said "bitcoin is probably rat poison squared". And Munger went a step further to compare crypto to a venereal disease. How charming.

No doubt the last few months of steep declines in crypto markets, and more recently the spectacular implosion of UST, will have done nothing to endear the likes of Buffett & Co to crypto.

I happen to think that Buffett is spectacularly wrong on crypto, but as someone who has read every single one of his letters to shareholders dating back to 1965 I find his acerbic and total dismissal of crypto hard to digest (albeit unsurprising).

But Buffett's views on reputation remain as pertinent today as ever, and all those busy building crypto projects and businesses today should at least heed his advice here.

"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently" he once said.

100% correct.

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Building a sound reputation in the crypto sector should be seen as a deliberate, long-term and painstaking process. And if crypto is going to truly achieve its wide-reaching and extraordinary potential, then we all have a responsibility to articulate the sector's long-term relevance and value in a way that is truly accessible and understandable. This is even more important as crypto winter sets in.

Not only that, there needs to be a much more active focus on managing reputational risks. The reality is that for most crypto companies today there is a massive imbalance of promotion over protection. Far too little tends to be done to guard against that five minutes that can destroy reputation and an entity's long-term chance of success.

People will be forgiven for ignoring Buffett on crypto, but ignore his advice on reputation at your peril.

By George Godsal, Founder, REKT Partners - a specialist crypto reputation, issues and crisis communications consultancy

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DUE DILIGENCE SERVICES

perfORM Due Diligence Services Limited ("perfORM") is an award-winning provider of ODD services for a diverse base of UK and international Allocators, Investment Managers and Service Providers.

Launched in 2019 as the only London-based and technology enabled ODD service of its kind, we are 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 we announced that perfORM had been formed as a subsidiary company of JTC Group PLC, an award-winning provider of fund, corporate and private client services.