SPOTLIGHT ON OPERATIONAL DUE DILIGENCE
What's top of mind heading into 2020?

New Year, New Priorities? Year-end is always a time of reflection, as well as an opportunity to set strategic objectives for the year ahead. On the non-investment side of the business, our clients are looking at where it makes sense to make enhancements, re-invest, or re-evaluate existing practices. To get a pulse on what is most relevant to the allocator community, the Jefferies Capital Intelligence team spoke with Operational Due Diligence professionals across the industry about what is top of mind for them.

ESG

"What do you do about ESG?'"
And we're not just talking about socially responsible investing.

Headline Focus:
- Allocator Demand
- Product Creation
- Generational Drivers
- Carbon Trading

What's *NOT* in the Headlines?
Large, institutional allocators are now starting to ask managers to evaluate their own organizations through an ESG lens – essentially a parallel to how a fundamental investor may assess the companies in their portfolios

Where to Start? Evaluating your own Organization through an ESG lens
- **Corporate Governance** – concentration, diversity of board, employment practices
- **Effectiveness of policies and procedures** – have there been any consistent lapses in policies and procedures? Beyond having them, how are you evaluating whether they are working?
- **Diversity**
- **Environmental footprint** – impact of travel, internal initiatives around recycling, etc.

Who can help? Firms like Sustainalytics and MSCI

Strategic Outsourcing

Growth of Strategic Outsourcing
While the concept of **outsourcing or co-sourcing** isn't new to the industry, the model itself has continued to evolve, and has experienced tremendous growth over the past few years.

Key Growth Areas: Accounting | Operations | Compliance | Trading | IT

Outsourcing Solutions Across the Lifecycle

Emerging
Remain "lean and mean," grow strategically

Maturing
Operational Continuity, additional expertise

Institutional
Identifying efficiencies, special projects

What is the value proposition?
- Access to expertise
- Flexibility – to scale either up or down, as needed
- Operational Continuity and process efficiency
- Cost – human capital, technology, etc.
- Enable internal talent to focus on core competencies

How do you make it work?
- Strong oversight maintained by a senior control person
- Full accountability retained internally
- Strong team relationships and defined escalation points
- Leverage industry insights and consultative aspect

Another impact of this model? Evolution of the COO role …

People

Diving into the Talent Pool…

Hiring decisions continue to be one of the most important things a manager needs to make and get right. What are some of the other human capital considerations that should be top of mind?

- **Employee training -** as a small to mid-sized organization, do you have the ability/willingness to provide proper training?
- **Performance Management** – it doesn't stop at training. Once your team is on board, it is important to institute a formalized and consistent employee performance review. And, allocators will be focused on how (outside of compensation), you think about retaining your best talent.
- **Background checks** "Whatever level of background check you think you need, do one layer more…" Ideal to conduct on all employees pre-hire, and then update regularly for all key decision-makers across the organization.
- **The "culture build"** – for early stage managers, the notion of having to teach people how to work in an environment driven by process typically needs to be proactive. Are you evaluating potential hires in some way by their ability to adopt this aspect of the firm's culture?

Compliance

In the Interest of Full Disclosure…

In 2019, firms like Facebook, Nissan, and Hertz had actions brought against them by the SEC for various issues around **disclosure – whether of data, liability, or income..** With these large public companies facing scrutiny, it is a good time to re-evaluate current disclosures and ensure compliance policies are up to date.

What else to look out for?

- Proposed changes to the Advertising Rule and Solicitation Rule
- Continued evolution of the compliance framework around alternative data

Trade Allocation

Are changes in order allocations consistent with your fiduciary relationship with clients, code of ethics, and disclosures? – Securities and Exchange Commission

In a market where we continue to see **product diversification across the board** (SMAs, Fund of Ones, Carveouts), allocators are focused on ensuring proper trade allocation policies are in place.

What does this mean?

- Written policies in place
- All trades allocated pro-rata
- No post-trade intervention
- No favorable treatment
- Best Execution

Be Prepared to:

- ❑ Dig into examples
- ❑ For any situation where there may have been a post-trade allocation, articulate the justification

Product Diversification

Still on the rise…

The continued rise of product diversification is a trend that has more clients thinking about what might make sense for them. See below for key considerations when exploring this option.

- Is the goal to provide existing investors with another opportunity, attract new investors, or both?
- Are you leveraging this as an exercise to re-market your original product/products?
- What additional resources will be required? Headcount, legal, consultants/specialists?
- What structure makes the most sense? Distinct SPVs?