Navigating ODD Challenges - Emerging Managers

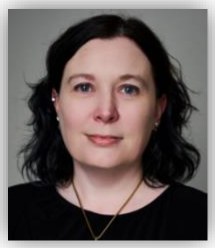
Striking the Balance: Identifying Risks Without Over-burdening the Managers

Allocators invest in Emerging Managers for various reasons. They might seek more nimble alpha, pursue developmental mandates or aim to ensure the industry supports new entrants and increased diversity.

Whether allocators seed these managers or invest after specific criteria is met, they inevitably take on additional operational risk. Identifying, mitigating and managing this risk is critical, and that's where Operational Due Diligence ("ODD") plays a pivotal role.

ODD should go beyond a one-size-fits-all, checkbox approach. Emerging Managers face unique risks and cannot be held to the same standards as larger, more established managers. Addressing these differences requires tailored mitigation strategies. In this thought piece, we explore how ORC tackles the challenges of ODD for Emerging Managers while upholding a robust institutional ODD framework, including:

1. **Mitigating Risk:** Giving phased and proportionate recommendations to address identified risks;
2. **Monitoring and Managing Risk:** Ongoing monitoring of key Milestones;
3. **Public vs Private Markets**; and
4. **Reducing ODD Burden** – Making use of multi-allocator ODD.



Maria Long
Partner

"Maximizing the impact of ODD on Emerging Managers doesn't have to overwhelm. ORC ensures robust results while minimizing the burden on managers."

Mitigating Risk

Operational risk increases when investing in Emerging Managers. These managers are often in the earlier stages of their development, operate with fewer resources and need time to establish a fully institutional operating model.

Despite this, allocators must actively mitigate these operational risks and ensure that Emerging Managers take appropriate steps to address them within reasonable timeframes.

At ORC, we believe it is vitally important to an institutional ODD process that managers receive informative feedback on risks or issues identified during the ODD process. This feedback should be delivered in real-time during the ODD meeting and again after the final report is prepared. Sharing portions of the ODD report with the manager offers valuable context, helping them understand why specific risks have been flagged.

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Simply highlighting risks to the manager is not a complete solution. Ending the ODD process at this stage merely transfers the problem to a manager who likely already has limited resources, potentially increasing operational risk rather than reducing it. Emerging managers need clear guidance on how and when to effectively address these risks.

At ORC, we go beyond identifying risks by providing tailored recommendations on key controls, governance and frameworks needed to resolve flagged issues. We ensure these recommendations are phased and aligned with the manager's maturity, strategy, and jurisdiction.

These recommendations serve as a roadmap, prioritizing actions to enable risk-controlled progress. Time-bound guidance offers a clear path forward, spanning critical issues that require immediate attention before investment, to best-practice frameworks the manager can implement over a two-year horizon.

Delivering feedback and recommendations in a phased and proportionate manner avoids overwhelming the manager and increases the likelihood of receptiveness and implementation. This approach directly supports the mitigation of operational risks for allocators.

Monitoring and Managing Risk

While recommendations provide a roadmap for Emerging Managers, actively managing operational risk is essential to ensure these recommendations are implemented and to identify new risks as the manager matures.

Ongoing monitoring is a critical component of an institutional ODD process. ODD should never be a one-time assessment, even for established managers, and it becomes even more vital when investing in Emerging Managers.

At ORC, our Ongoing Monitoring Solution enables us to track these managers' evolving risks, helping allocators effectively manage their exposure. This ongoing monitoring focuses on two key areas:

1. Identifying key changes at the manager and fund level; and
2. Tracking progress on the implementation of recommendations from the initial ODD.

Operational risk is dynamic, especially for Emerging Managers. For example, as Assets Under Management ("AUM") grows, the manager may face increased complexity and new challenges not present during the initial ODD. Conversely, if performance falters or AUM remains stagnant, existing risks—such as staff retention or financial stability—could intensify. By conducting regular ongoing monitoring, allocators can understand these risks as they occur, alongside other key events that may pose risk such as regulatory fines, key person events or litigation on the firm or fund.

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Monitoring an Emerging Manager's progress in implementing the recommendations from the initial ODD serves two key purposes for allocators.

First, it enables allocators to assess whether the identified risks are being effectively mitigated. As recommendations are implemented, the level of operational risk—absent new risks—should progressively decrease.

Second, it provides valuable insights into the manager's culture. A refusal to implement proportionate recommendations may indicate that the manager is unwilling to operate institutionally or does not prioritize the interests of its investors.

These insights are essential for allocators to manage operational risk effectively, offering a clearer understanding of both the manager's risk profile and their commitment to institutional best practices.

Public vs Private Markets

While issuing phased and proportionate recommendations and conducting ongoing manager monitoring is critical for Emerging Managers across all strategies, certain nuances must be taken into account depending on whether the manager operates an open-ended public markets fund or a closed-ended private markets fund.

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Reducing ODD Burden

Institutional ODD is a time- and resource-intensive process, especially for Emerging Managers, who may need to undergo this exercise multiple times during the early stages of a fund's lifecycle.

At ORC, we provide a solution that ensures a thorough and robust ODD while reducing the burden on managers through our Multi-Allocator ODD and Ongoing Manager Monitoring Solutions.

Allocators joining together in a single ODD exercise provides a multitude of benefits including an amplified voice with the manager, consistency of messaging and, of course, cost efficiencies. Read more about the benefits of this model in a prior ODD Thought Piece:

Multi-Allocator ODD is the Way Forward

About ORC:
Our firm, as a leading due diligence provider, excels in navigating the complexities of emerging markets and nascent asset classes. We specialize in investment, operational and ESG due diligence. We offer deep insights into evolving risk trends and support asset owners in managing these risks effectively. By raising institutional investment standards, we aim to drive positive change in local investment ecosystems.

Reach out to find out more.

About the author:
Maria Long is a Partner and Head of ODD at ORC and a leading expert in investment operations. With over 20 years of experience, she provides strategic advisory services to institutional investors, helping them manage operational risks and implement best practice standards.

"ODD on Emerging Managers is essential but complex. ORC simplifies the process, helping clients navigate challenges and effectively manage operational risk"

Nigel Morriss
CEO

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