The Hidden Risks of Big-Name Funds

ORC

Why ODD is Still Critical

Investing with large, well-established fund managers often provides allocators with a sense of security. Their track records, brand reputation and access to sophisticated investment strategies can make them appear like a safe bet. Plus, an underlying assumption that if the manager has other large investors, they must already have passed someone else's Operational Due Diligence ("ODD") exercise.

It is common to hear that ODD is more important on smaller, newer asset managers; however, history has repeatedly shown that even the most prominent investment firms can face operational failures, fraud or reputational damage. Thorough ODD therefore remains essential, not just for assessing the credibility of smaller, lesser-known managers but also for protecting investments with some of the industry's biggest names.

Maria Long
Partner

"Even the most established asset managers are not immune to operational risks. Robust ODD ensures transparency, accountability and resilience, safeguarding investors in an evolving landscape"

The Myth of Safety in Large Funds

Many investors assume that size and reputation equal security. The rationale is that a well-known manager with billions under management must have the necessary risk controls, compliance structures and ethical safeguards in place. While this may be true in many cases, the most high-profile financial scandals have often involved some of the world's most successful investment firms, firms that appeared robust and responsible until one day they weren't.

Lessons from High-Profile Failures

Despite their reputations and track records, some of the largest investment managers in history have suffered catastrophic failures. Many of these firms managed tens of billions in assets and had been in operation for decades before their downfalls. Bernie Madoff was one of the highest profile scandals of all time with clients defrauded of an estimated US$ 65 billon.

Madoff – Wall Street's Greatest Deception

Once a titan of Wall Street, Bernie Madoff built a reputation as a financial genius, managing billions through his firm, Bernard L. Madoff Investment Securities. For decades, investors, including hedge funds, charities and celebrities, poured money into what seemed like a consistently high-return strategy. However, in 2008, the facade crumbled when it was revealed that Madoff had orchestrated the largest Ponzi scheme in history, defrauding clients of an estimated US$ 65 billion. His empire collapsed, leaving thousands of victims devastated and reshaping financial regulations worldwide.

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The Abraaj Group, once managing US$ 14 billion, collapsed due to an alleged fraud. SAC Capital, US$ 14 billion in assets under management, was forced to shut down due to insider trading. Long-Term Capital Management, despite being run by Nobel laureates, lost nearly all of its US$ 126 billion portfolio due to excessive leverage. The Galleon Group, Woodford Equity Income Fund and Allianz Global Investors also faced their own crises, leading to billions in investor losses. These cases illustrate that no firm is too big to fail and that neglecting to conduct proper ODD can result in devastating financial consequences.

The Rise and Fall of Abraaj

Once the pride of emerging market private equity, Abraaj Group managed an impressive US$ 14 billion and operated for over 16 years. However, its meteoric rise came crashing down in 2018 when it was revealed that investor funds—including those from the Bill & Melinda Gates Foundation—had been allegedly misused. The firm collapsed under the weight of fraud allegations, leaving billions lost and investors reeling.

SAC Capital: A Billion-Dollar Scandal

For over two decades, SAC Capital was a dominant force in hedge funds, managing US$ 14 billion at its peak. But in 2013, the firm faced one of the largest insider trading crackdowns in history. A web of illicit trades led to US$ 1.8 billion in fines, and while founder Steven Cohen escaped personal criminal charges, the fund was forced to close, marking a stunning fall from grace.

Allianz Global Investors: A Costly Market Misstep

Allianz Global Investors, a subsidiary of the financial giant Allianz, faced disaster in 2020 when a high-risk options strategy imploded, wiping out US$ 7 billion in investor capital. Regulatory investigations followed, culminating in a massive US$ 6 billion settlement. The case served as a stark reminder that even industry stalwarts are vulnerable to operational and risk mismanagement.

Understanding Risk Even When Influence Is Limited

One of the common challenges faced by smaller Limited Partners ("LPs") investing in large funds is the perception that they have little leverage to influence decision-making or improve risk controls. Unlike cornerstone investors who can negotiate more robust side letters to meet their needs, smaller LPs may feel they have to accept the fund's structure and the manager's control environment as it is. This does; however, not diminish the need for understanding the operational, regulatory or reputational risk profile of an investment by conducting not only thorough ODD but also regular ongoing monitoring of the manager.

Even if an LP cannot demand changes, having a clear grasp of potential operational weaknesses allows them to make well-informed investment decisions: Is the risk worth the reward? Knowing where a fund's vulnerabilities lie can help investors appropriately size their allocations, set expectations and mitigate risk through diversification or additional oversight.

ODD is not just about checking boxes, it is about understanding how a fund truly operates and assessing whether its operational practices align with an investor's risk tolerance. A lack of visibility into key operational processes such as fund governance, risk management, trading policies and third-party oversight, can expose investors to risks they may not have anticipated.

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The Challenge of Being a Small LP in a Large Fund

Large fund managers often cater to their biggest clients, leaving smaller LPs with limited access to information and fewer opportunities to negotiate terms. Many investors hesitate to push for better transparency, believing their input carries little weight. There is also a common sentiment that well-established managers are unwilling to implement meaningful changes based on requests from smaller investors.

Solving the Influence Problem with ORC's Multi-Allocator Model

ORC's **Multi-Allocator Model** is designed to address the challenge of limited influence by smaller LPs. We achieve this by conducting ODD on behalf of a group of investors who collectively represent a larger percentage of the fund's capital.

Galleon Group: Trading on the Inside

At its peak, Galleon Group controlled US$ 7 billion and was a leader in technology and healthcare investments. That all changed in 2009 when its founder, Raj Rajaratnam, was caught orchestrating one of the largest insider trading networks in history. His conviction and 11-year prison sentence signalled the end of Galleon and shook Wall Street's hedge fund industry.

By aggregating smaller LPs, we help our clients to:

- **Enhance negotiation power** – A group of investors together can exert greater influence over fund governance, risk controls and transparency.
- **Drive better risk assessment** – Pooling resources allows for deeper, more thorough ODD, identifying potential red flags that individual LPs may miss.
- **Improve fund access for smaller LPs** – By representing a larger allocation collectively, smaller LPs can gain access to information and terms usually reserved for the biggest investors.

Not to mention that our Multi-Allocator Model provides significant cost benefits to our clients as they not only share the influence and results, but also the cost of conducting the ODD exercise.

Long-Term Capital Management: Billion-Dollar Losses

With US$ 126 billion in assets and a leadership team that included Nobel Prize winners, Long-Term Capital Management seemed untouchable. But in 1998, excessive leverage and risky bets on the bond market led to near-total collapse. A Federal Reserve-organized bailout was required to prevent financial contagion, proving that even the most sophisticated minds can miscalculate risk.

Woodford's Liquidity Nightmare

Neil Woodford was once hailed as one of Britain's top fund managers, but in 2019, his Woodford Equity Income Fund—managing over US$ 10 billion—suddenly suspended withdrawals. Poor liquidity management and overexposure to unlisted stocks led to its collapse, leaving thousands of investors locked out of their funds and damaging trust in active management.

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ODD is Not Only Best Practice, It Is a Necessity

The assumption that well-established fund managers are immune to operational failures or misconduct is a dangerous one. History has repeatedly shown that even the biggest and most respected firms can face significant challenges, whether through fraud, poor risk management or reputational crises. While smaller LPs may have less direct leverage over these managers, understanding the risk is still vital to making informed investment decisions.

By leveraging ORC's Multi-Allocator Model, investors can collectively improve their influence, drive better transparency and ensure that their capital is deployed in well-managed, operationally sound funds. In today's complex investment landscape, ODD is not just a best practice, it's a necessity.

About ORC:
Our firm, as a leading due diligence provider, excels in navigating the complexities of ODD across asset classes and the manager maturity spectrum. 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 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.

"Scale and reputation do not replace the need for rigorous due diligence. A thorough ODD process remains critical to identifying risks that could impact performance and integrity"

Nigel Morriss
CEO

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