

TRENDS IN OPERATIONAL DUE DILIGENCE

ODD BRIEF #121 – MARCH 12, 2020



Coronavirus (COVID-19) and its Operational Considerations

Coronavirus ODD “To Do List”:

1. Investors should obtain and review manager Coronavirus Response Letters in order to assess each manager’s current operational environment.
2. Investors should call and talk to their managers to obtain color on their Coronavirus view and risk. Verbal discussions can sometimes more easily expose comfort or stress.
3. As February NAVs are due out in early to mid March, investors should monitor and track late NAVs; which could be caused by lean staff at the manager or administrator. Late NAVs could also be a sign of valuation challenges.
4. Valuations should be reviewed at March 31 quarter end to evaluate the manager’s fair value reporting for level 2 and level 3 assets. This can be done by reviewing Transparency Reports, annual audits, manager letters; and most importantly holding a call with the manager’s CFO to discuss changes in the valuation of investments that are not exchange traded.

Operational risk increases with strain and stress during a period of global crisis, which we are experiencing right now with the current Coronavirus pandemic. Investment managers lead through these short term rare tests only with sound leadership from the top of their organizations. Investors and ODD professionals work all year long to ensure that they select and opine on managers with sound judgment. Preparedness therefore is the key to long term sustainability, and business continuity planning and testing are critical to the success of the actual live alternate work arrangements that are in play today.

One of the best measures investment managers can take is to borrow from the West Coast play book: supply all employees with secure laptops and phones and adopt periodic and/or routine remote working environments. While up until now, a global pandemic was not expected, without proper office equipment, staff are left communicating from their houses and apartments on maybe old, poorly configured, slow, or cyber exposed personal home computers and cell phones. Over the last few years, many managers and investment firms have taken the path of providing staff with a VPN instead of purchasing business continuity laptops for their

staff. This is “the current industry norm”. With overseas factories shut down for several weeks at this point, purchasing equipment has been on a several month delay for many technology hardware vendors since January 2020. With that said, the nominal investment of \$1000–\$2000 per employee is a best practice turned into an asset for those managers who made this investment prior to 2020. Currently many fund managers, or more realistically most fund managers, are working from home and have moved to video meetings for the near term. Today, Zoom has become an even more valuable tool in global asset management. Technology in general will become more and more essential.

Volatility in the markets this month is resulting in liquidity and valuation risk. The ODD already completed on counterparty risk management and valuation risk management should serve investors and managers well in this current market environment. The industry best practices of dual prime brokers, separate cash custodians, notice periods on margin, third party valuation agents for level 3 assets, formal valuation committees, back office verification of all pricing, and fund administrator oversight on all level 1 and 2 assets; are proving their importance now more than ever.

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