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BDO FINANCIAL SERVICES

A Q&A WITH JOANN ARWEILER AND NISHA CORALLO, OF BDO CONSULTING'S INVESTIGATIVE DUE DILIGENCE PRACTICE

Traditionally, due diligence has been conducted on a pre-investment basis and then once every 18-24 months. What has dictated this norm, and is that evolving?

Joann: Ultimately, risk tolerance dictates an investor's approach to due diligence. For some, this means conducting investigations every 18-24 months. For others, it means supplementing those investigations with refresher checks as needed.

The 2008 financial crisis is not yet out of our rearview mirrors, and over the course of the past nine years we've seen a fairly significant cultural shift toward more frequent due diligence checks. A growing number of investors are electing to conduct ongoing due diligence on investment managers as they work to proactively mitigate their risk exposure. The number of clients using eConnaissance®—our proprietary due diligence tool that conducts ongoing, real-time monitoring of fund managers has grown substantially since we launched it last year. That growth is absolutely a function of the increasing demand among investors for this type of service.

What risks might investors be exposed to if they only conduct due diligence checks every 18-24 months?

Joann: When it comes to portfolio risk, a lack of transparency can be lethal. The sooner investment risk is discovered and addressed, the better. By allowing more than a year to pass between investigations, investors—both institutional and high-net-worth individuals—expose themselves to risks that may have been identified and mitigated had they been discovered sooner.

Investors who use eConnaissance do so primarily because they want greater visibility into the potential and emerging risks that fund managers may or may not be exposing them to on an ongoing basis, rather than waiting the standard two years between checks. The risk appetite for that type of void is dropping quickly across the industry. Investors are overwhelmingly seeking a clearer, more holistic picture of who is managing their money in order to understand any potential adverse effects that fund manager could have on their investment portfolio.

When did investors start pushing back on the due diligence every-two-years model?

Nisha: Even as recently as five years ago, when choosing who to entrust with their money, investors placed the greatest emphasis on previous professional relationships forgoing any form of due diligence. Those days are long gone. Today, our clients are not only keenly aware of the need for due diligence, but in many cases, it drives their investment decisions. An investor cannot uncover red flags just by having a relationship with a money manager—that requires methodical due diligence.



"The 2008 financial crisis is not yet out of our rearview mirrors, and over the course of the past nine years we've seen a fairly significant cultural shift toward more frequent due diligence checks," said Joann Arweiler, BDO Consulting managing director and Investigative Due Diligence practice leader. "A growing number of investors are electing to conduct ongoing due diligence on investment managers as they work to proactively mitigate their risk exposure."

How does eConnaissance work, and what types of information does it provide to investors? How has it evolved since launching in early 2016?

Nisha: eConnaissance mines various public databases on a daily basis, performing targeted searches on the fund managers of interest and combining the results into an investor alert report. The tool provides a single, timely summary of all information on a fund manager that is available in the public domain, oftentimes ahead of when managers themselves would be required to disclose such information through direct filings. When an investor wants to further explore an item in an alert, we can provide them with additional detail upon request. We have also recently added the ability to monitor changes to Form ADV filings. This new capability allows our clients to see the old form and the new form simultaneously—something they could not do on their own as old forms are not available through traditional online searches.

eConnaissance growth since February 2016 launch:

255%

Increase in subscriber companies

582%

Increase in individual users

11,000+

Alerts sent to investors

Major client alerts delivered since February 2016:

Adverse alerts **809**

New docketed **540**

New judgments/liens **150**

New lawsuits **97**

New criminal records **22**

*Figures as of March 23, 2017

Why do a growing number of investors want to continuously monitor the fund managers they work with?

Nisha: Continuous monitoring of fund managers empowers investors in three ways. First, it is an effective way to avoid headline risk by identifying and addressing red flags early, allowing for proactive rather than reactive risk mitigation—a key priority for our clients. Second, the tool takes a hybrid, "people+" approach, using both technology and human intelligence to not only produce a comprehensive report, but more importantly, to provide thoughtful human interpretation and critical analysis of the results. We decode the results to ensure they are aligned with the investor's primary interests. Finally, the tool cuts down on the overall costs of risk management, monitoring key issues of interest on a daily, cost-effective basis.

Without continuous monitoring, which flags developments like bankruptcy filings and multi-million-dollar purchases, investors potentially put their entire investment portfolio at risk by remaining in the dark about the behavior of their fund managers. The ability to identify risks at the outset rather than after the damage is underway is key to an effective due diligence process.

How can BDO help?

Joann: We leverage BDO's global network and technological resources to provide reports tailored to each client's individual risk profile and preferences. eConnaissance, in conjunction with traditional due diligence reports and updates, enhances risk management safeguards for both investors and stakeholders.

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