

2020 Annual Institutional Investor

Operations Due Diligence Effectiveness - Survey Report

presented by Convergence, Inc.



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February 2021



Operations Due Diligence Effectiveness Survey

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Detail of Survey Questions and Responses

Operations Due Diligence Effectiveness Survey - 2020

Survey Introduction and Background

Convergence is pleased to present the annual results of our 2020 survey focused on Operations Due Diligence (ODD) practices and processes with respect to investment allocations by institutional investors to alternative assets. Survey participants include a cross section of institutional investors with respect to type of investor (e.g. funds of funds, pensions, endowments, etc.), amount and number of investment allocations to external managers and the amount of new annual allocations to external managers.

Convergence appreciates the participation from all respondents. Convergence also **appreciates the assistance of several industry practitioners who helped with the design and distribution** of this study. With the increasing regulatory focus and business complexity of alternative asset managers, investors have been allocating greater resources to ODD prior to making an investment allocation decision and then on an ongoing basis once that investment allocation has been made.

The report includes 1 - this introduction and background; 2 - an executive summary of highlights and findings compared to past year's survey and from each section of the 2020 survey, which includes key data points derived from the overall results; and 3 - observations and conclusions by Convergence based on survey results.

The appendix to this survey includes a more descriptive summary of highlights and findings from each section of the survey, along with the response results of each survey question.



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Operations Due Diligence Effectiveness Survey - 2020

About Convergence, Inc.

This 2020 survey was designed to identify relevant trends, best practices and a view on Operating Risk.

*Convergence has developed a data, analytics and surveillance platform that provides transparency and easily accessible information relating to the business operations and infrastructure of alternative asset managers. Convergence products include technology-based tools used to facilitate manager and industry research, analytics and surveillance across the universe of registered investment advisors, including assessment of their operating and business risk profile, comparisons to peers and competitors, and analyses of their service providers. **ALSO INCLUDED IS A WORKFLOW PRODUCT TO REMEDIATE RISKS IDENTIFIED AT THE ADVISORS YOU WORK WITH.** The Company's platform includes dynamic data and analytics on 40,000 + Advisors and over 350,000 funds. Also included is the industry's ecosystem of 6,000 service providers. The platform includes 4000 + data points from regulatory filings, news sources and a significant amount of derived analytics and proprietary original content – most notably Advisor operating model Risk Ratings and Complexity.*

*Institutional investors use the Company's products to research advisors and their business model with a focus on **OPERATIONAL, COMPLIANCE, VENDOR and REGULATORY EVENT RISK** prior to and throughout investment allocation. Convergence products benefit institutional investors focused on employing a dynamic, data-based on-going process of manager and advisor surveillance.*

Please visit us at www.convergenceinc.com, or contact George Evans at gevans@convergenceinc.com (215-704-7100) for additional inquiries or questions pertaining to Convergence, its products, or this ODD survey.



Operations Due Diligence Effectiveness Survey - 2020

Executive Summary of Findings – Comparison of Survey Results

The Executive Summary notes key trends in the 2020 survey – the detailed questions follow:

RESPONDENT PROFILE

- A good mix of Public-Private Pension Plans, Endowments, Foundations, FOF, and OCIO respondents.
- The number of Advisors with allocations in 2020 was 75% with more than 100 Advisors and in 2019 was 67% with more than 100 Advisors.
- Bulk of respondents allocate over 15B and add less than 5 new Advisors – 2019 was 6-10 Advisors a year.
- Managed Account investing topped all Asset Types in 2020.

ORGANIZATION AND INFRASTRUCTURE

- 60% of ODD teams continue to be in house and 40% a hybrid of in/outsourced. The inhouse number is slightly lower than 2019.
- The majority of current staffing levels in ODD were 0-3 fte in 2020 – the same as 2019.
- The primary skill sets of ODD professionals continue to be Investment Operations consistent with 2019.
- ODD staff time was primarily focused on Valuation Practices and Compliance. Very consistent with 2019.



Operations Due Diligence Effectiveness Survey - 2020

Executive Summary of Findings – Comparison of Survey Results

The Executive Summary notes key trends in the 2020 survey – the detailed questions follow:

THE ONBOARDING PROCESS

- Over 60% of ODD teams require an Advisor to complete an annual questionnaire – 10% higher than 2019 findings.
- Regulatory data, Media Market News, External 3rd party data and Advisor Peer Data led the pack of data sets collected independent of the Advisor in 2020, also very consistent with 2019 findings.
- Respondents were split 40/60 relative to benchmarking Advisors to their peers in 2019. This is down from 50/50 in 2019. When benchmarking, top areas included complexity of the manager's business model, manager service providers/vendors, the assessment of staff and their qualifications, technology and control policies.
- More than 50% of respondents had formal policies and procedures in place to standardize a view on Operating Risk – consistent with 2019.

ODD MONITORING PROCESS

- 75% of respondents noted that Workflow was an important tool in their ODD model in 2020 compared to 80% in 2019.
- Material change subject matter was highest with C Suite Changes, Qualified Audits, Vendor concentration/changes, Regulatory headline and Negative News.
- Daily notification of Advisor Material changes was the preferred frequency.
- Additional ODD monitoring services of respondents relied on Regulatory Filings and News Media and supported a Daily News page on Advisors for material changes and alerts.



Operations Due Diligence Effectiveness Survey - 2020

Executive Summary of Findings – Comparison of Survey Results

The Executive Summary notes key trends in the 2020 survey – the detailed questions follow:

ODD GOVERNANCE, DECISION MAKING AND COMPETITIVE ADVANTAGE

- All participants overwhelmingly report that their organization views ODD as a value adding activity; ODD helps improve returns and manage risk.
- Most respondents supported ‘scoring’ an Advisors regulatory filings as an additional input to a culture of compliance at the Advisor.
- Respondents noted that the 2 areas that have the highest impact on Advisor Operating Risk were the Investment Process and the Regulatory environment.
- There was significant upside amongst respondents to employ more technology and data analytics to oversee Risk at the Advisor. Prevalent considerations were cost, better monitoring of risk and the ability to rate the Advisor infrastructure.



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Observations and Conclusions

CONVERGENCE OBSERVATIONS

- ❑ *Given continued regulatory focus, and increasing manager operating complexity, investors should re-fresh their evaluation of the level of resources (staff and/or technology) dedicated to Operations Due Diligence, as well as their own current written policies and documentation requirements from managers. We note that current manager and new manager allocations remain steady versus 2019 and that dedicated resources (people and technology) remained steady during 2020 COVID. Toolsets provided by Convergence lend themselves to complimenting small to medium sized ODD teams challenged by capacity and bandwidth.*

- ❑ *Investors should consider reviewing their level of focus and current processes for evaluating NON-INVESTMENT RISK. Given the growth of Alternative managers, this will continue to stretch ODD teams. Service Provider 'best fit', the Filing accuracy/culture of Compliance and Regulatory Event Risk are also key considerations.*



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Observations and Conclusions

CONVERGENCE OBSERVATIONS

- ❑ *With the considerable increase in new products and new avenues for product distribution by managers, investors should re-evaluate those data points, metrics and sources of information for assessing manager operational complexity and Non – Investment risk. Consideration should be given to appropriate weighting of risk areas for “scoring” purposes, and scoring processes should be considered by those not presently doing such as part of their ODD process. Complexity and Risk profiling is paramount to active management of an Advisor.*

- ❑ *Although 100% of respondents indicate their organization views ODD as a “value adding” activity that can improve returns and manage portfolio risk, we are concerned that too many firms continue to focus on the basic ‘blocking and tackling’ – more sophisticated RISK DATA is available. Investors should consider a complete review of dedicated resources and toolsets in the marketplace for varied aspects of initial ODD and ODD monitoring, and make spending decisions consistent with their assessment of risk across their portfolio, recognizing that manager Non Investment risk profiles are in constant change.*

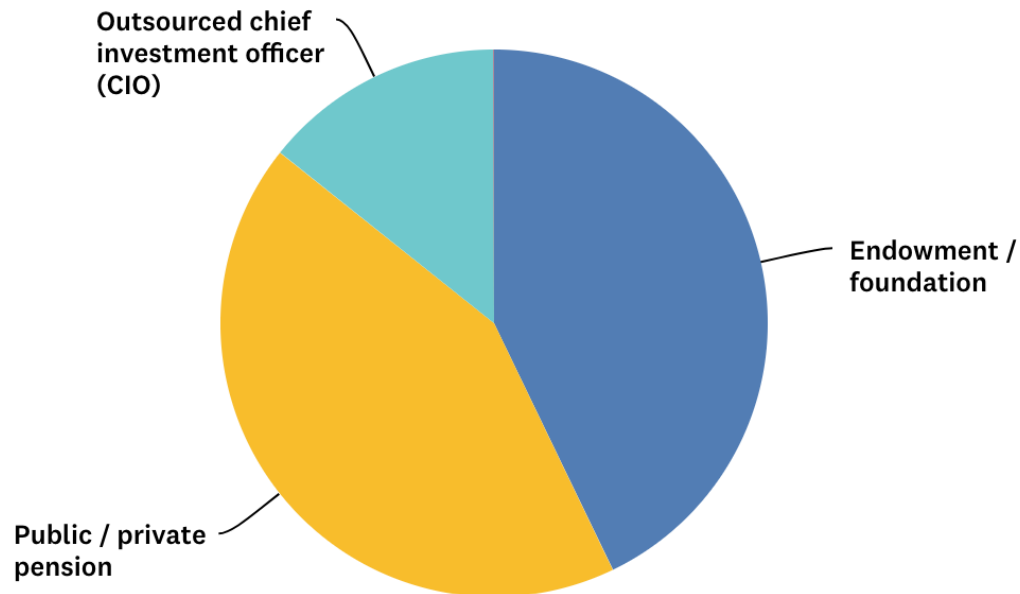
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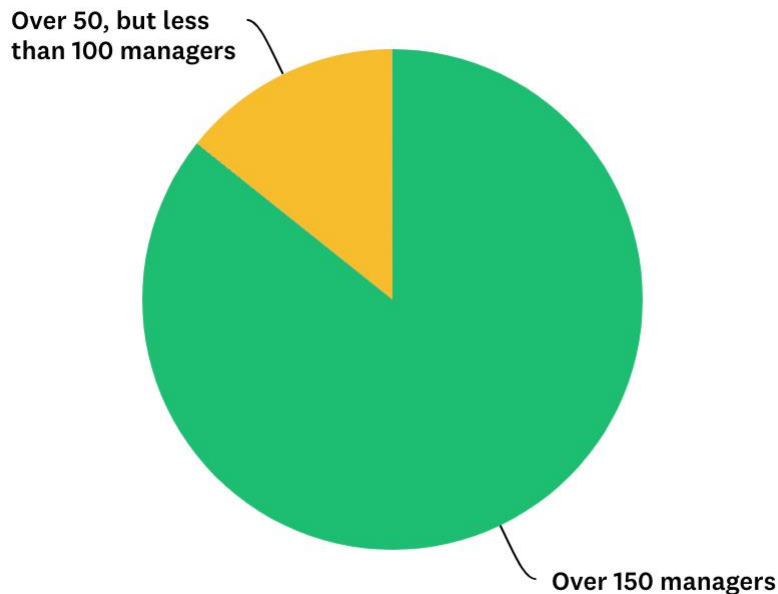
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Operations Due Diligence SURVEY QUESTIONS 1-33

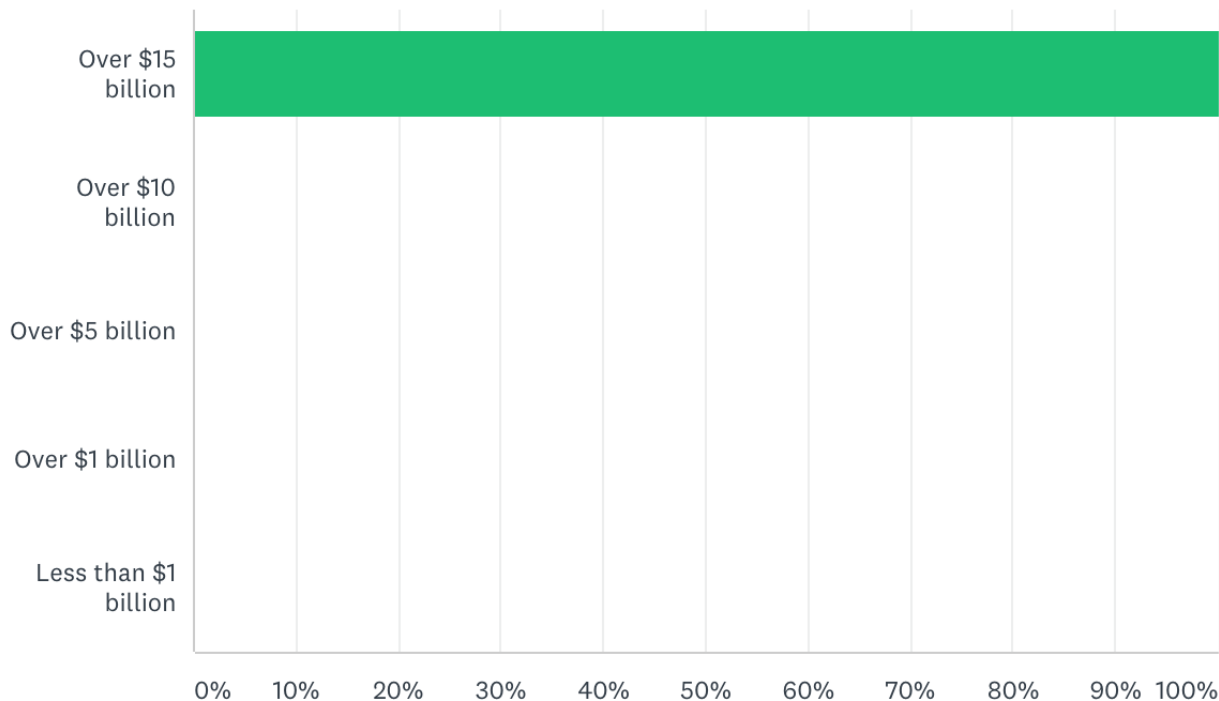
Q1: Please indicate the description below that best describes your institution or business.



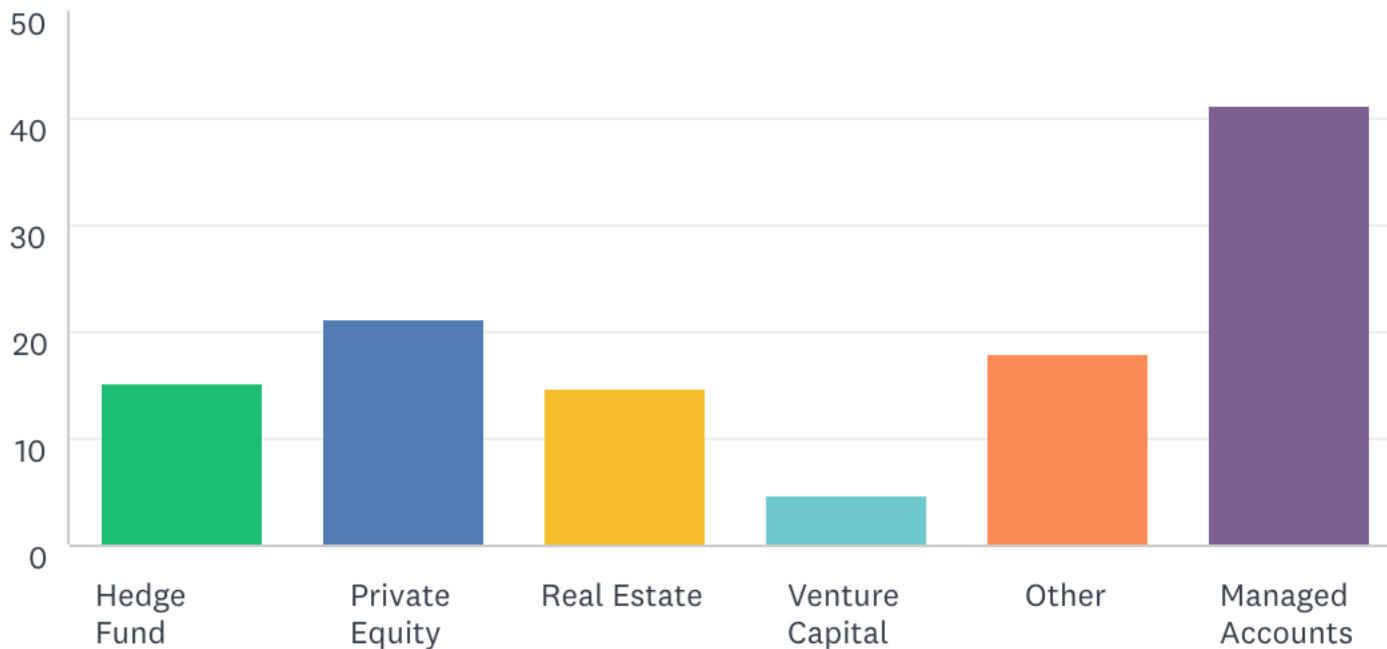
Q2: How many external managers do you follow in total, including those that are and are not currently managing AUM for your firm?



Q3: How much approximate AUM (in dollars) is allocated on a discretionary basis to external managers?



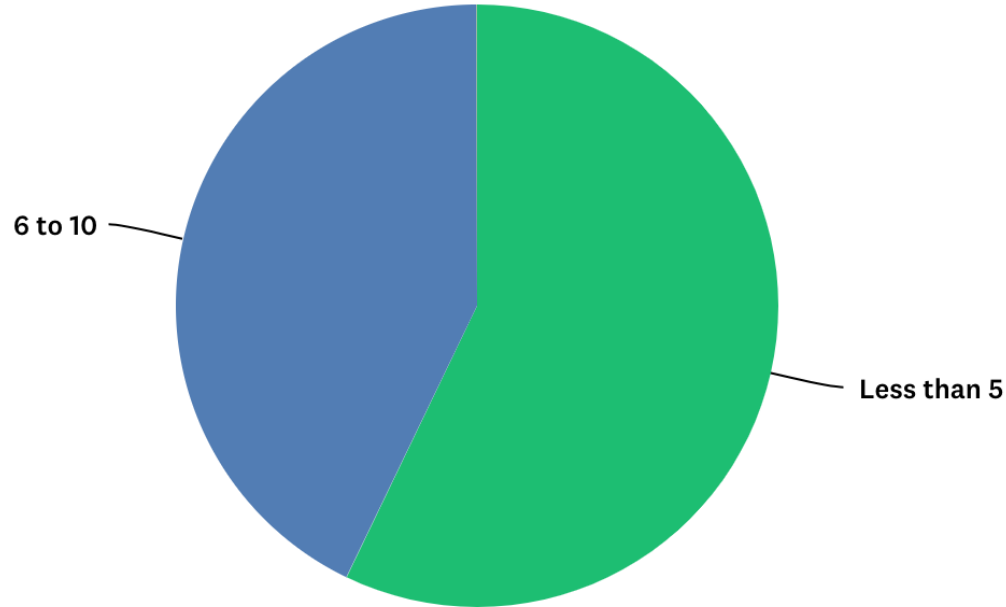
Q4: Please indicate the approximate % of your firm's external manager AUM allocations are to the following types of managers/funds.



Q5: What is the total number of NEW managers receiving allocations per year over the prior 3 years, on average?

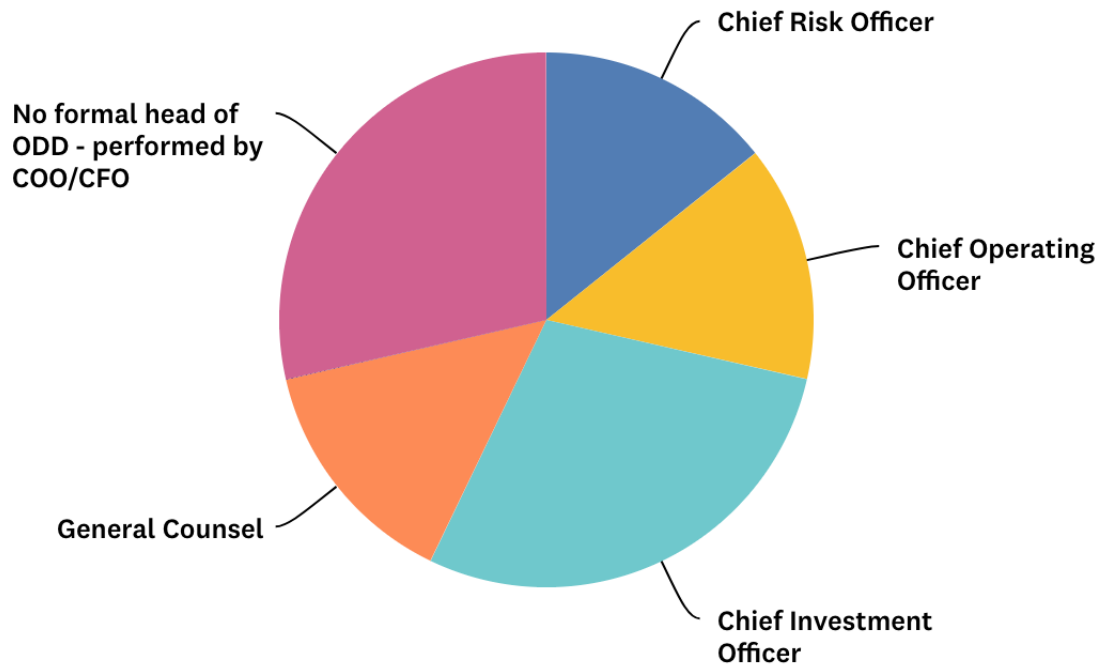


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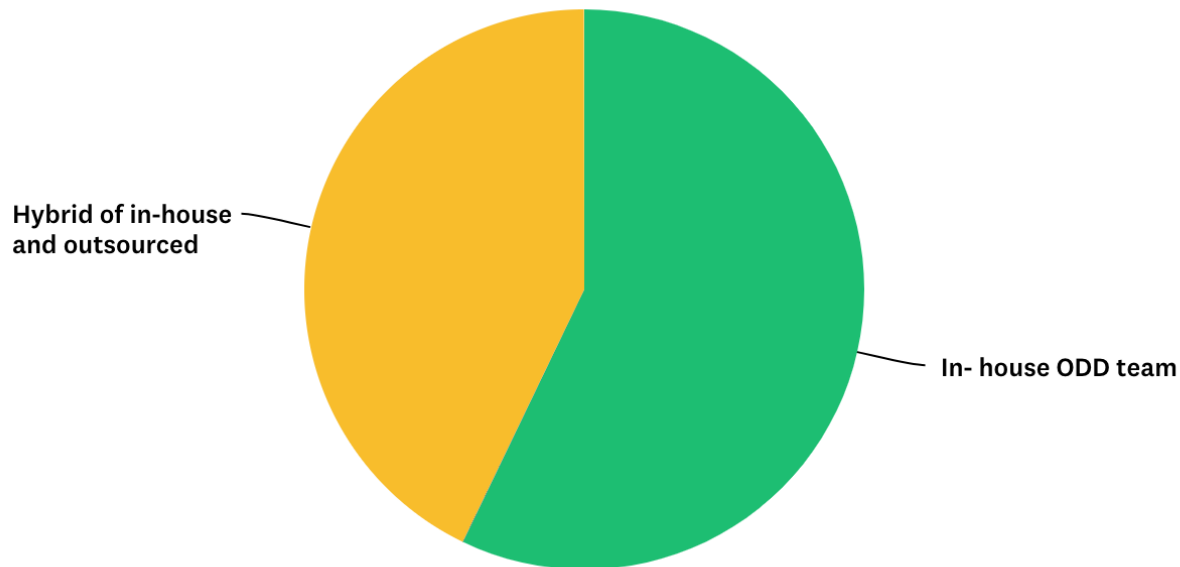


Q6: To whom does the Head of ODD Report?





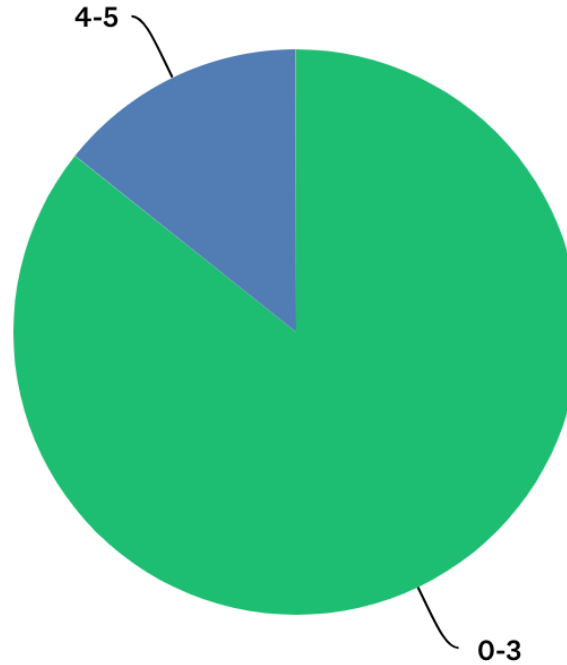
Q7: What ODD model best describes your firm's operation?



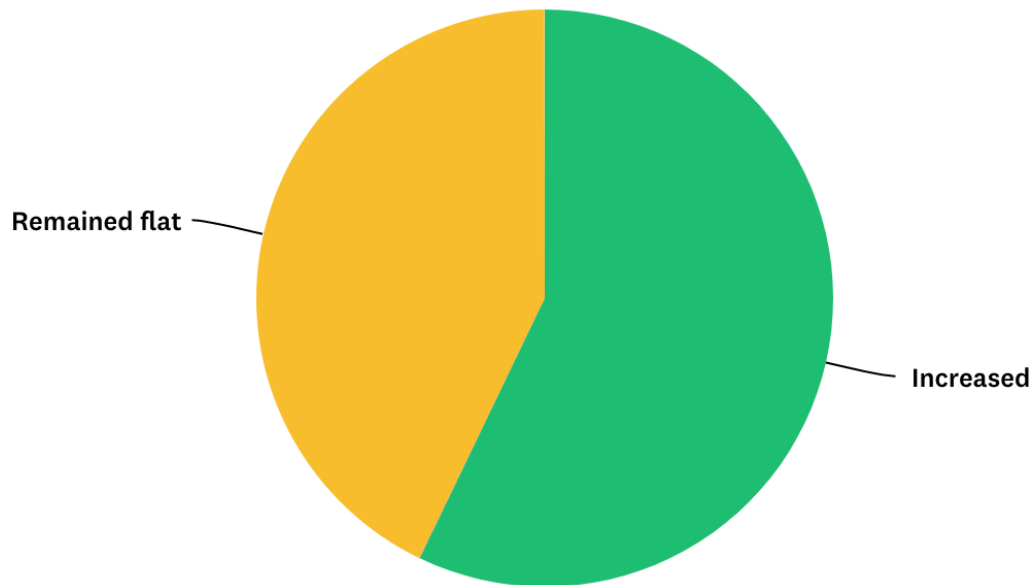
Q8: How many internal employees (full-time equivalents) are dedicated to ODD currently?



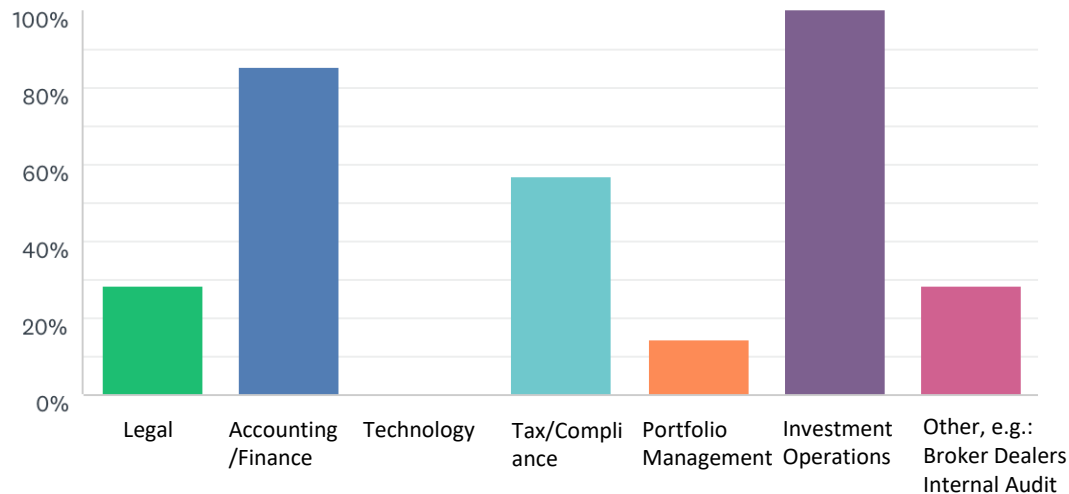
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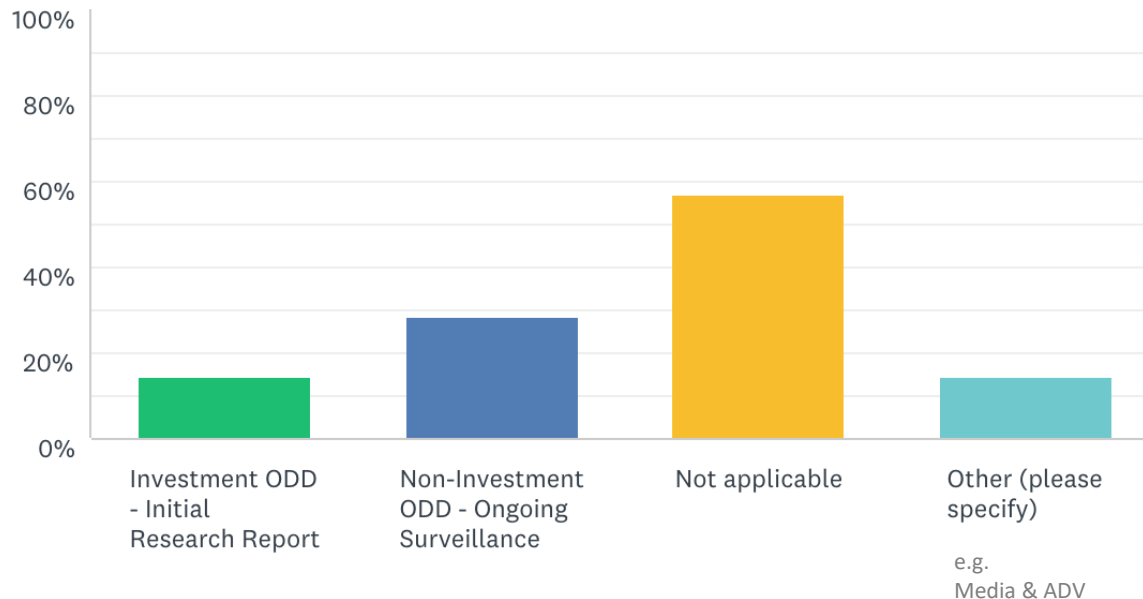
Q9: Over the last 3 years, has ODD - dedicated headcount increased, decreased or remained flat?



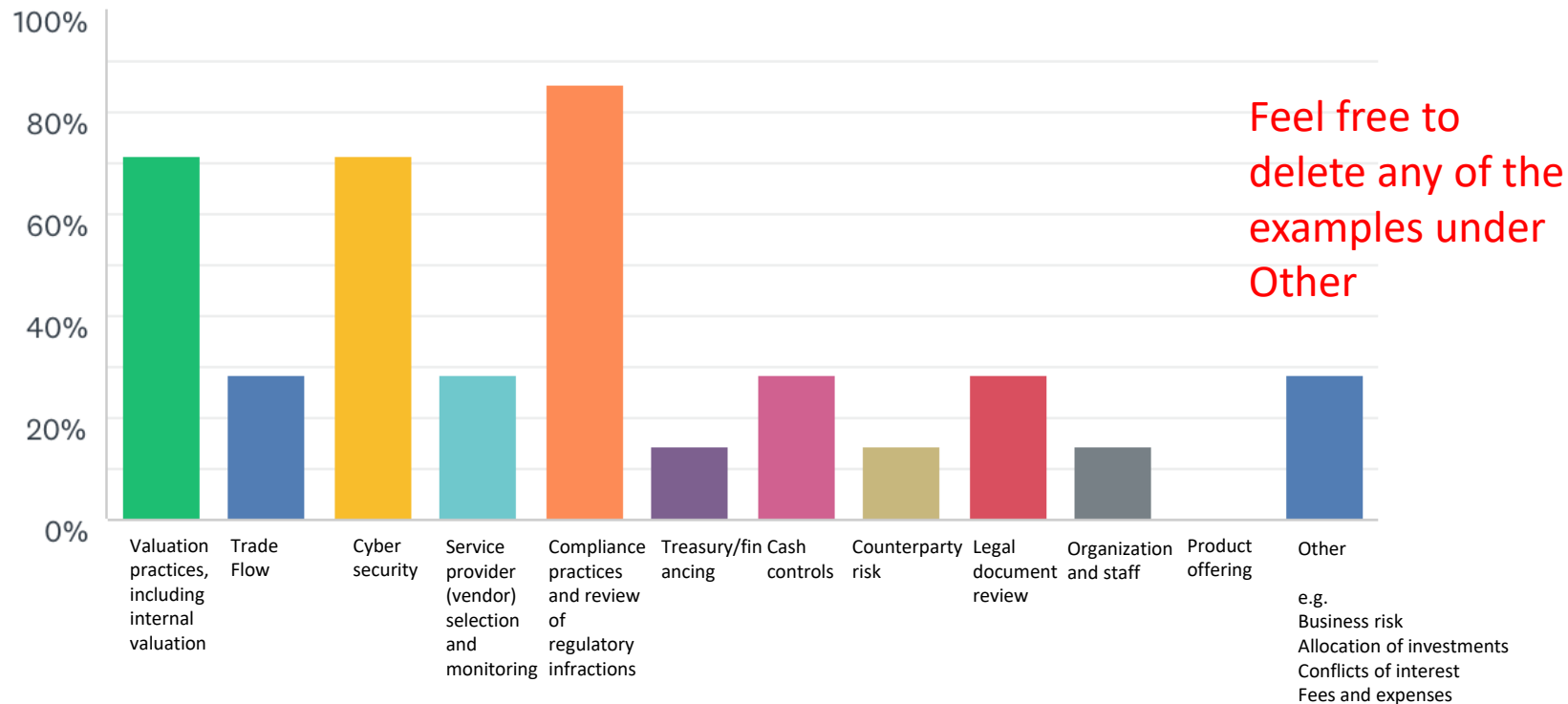
Q10: What are the primary professional areas of expertise of your firm's dedicated ODD employees? (select all that apply)



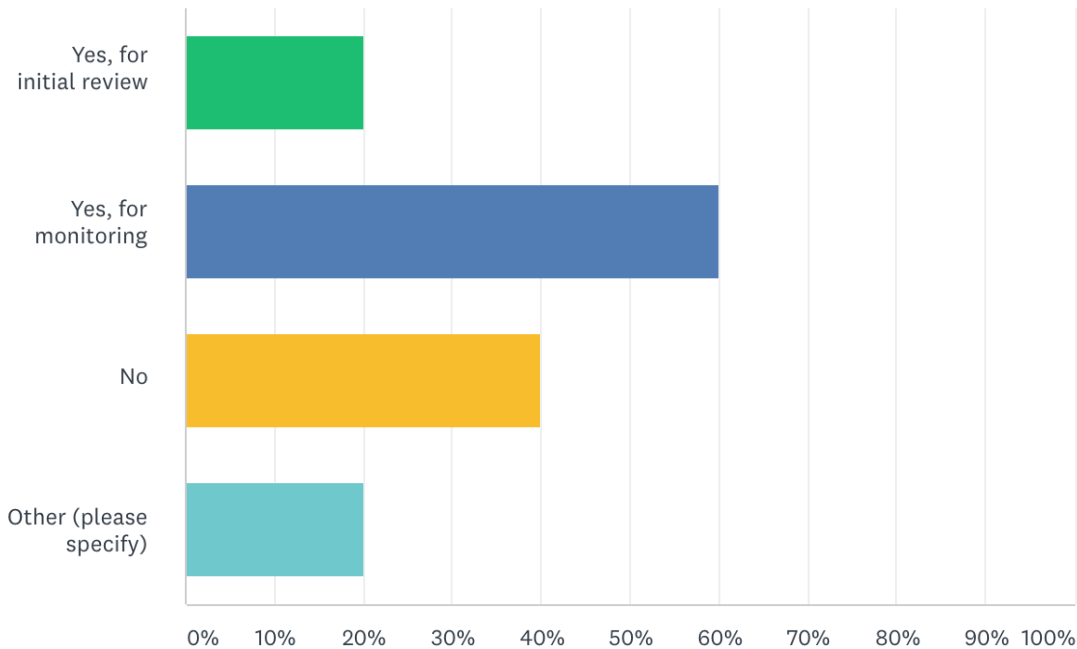
Q11: If your firm employs an external ODD consultant, for which activities are they employed, in full or in part? (select all that apply)



Q12: Which areas of focus does your firm allocate the highest % of ODD time? (select the top 5 areas)



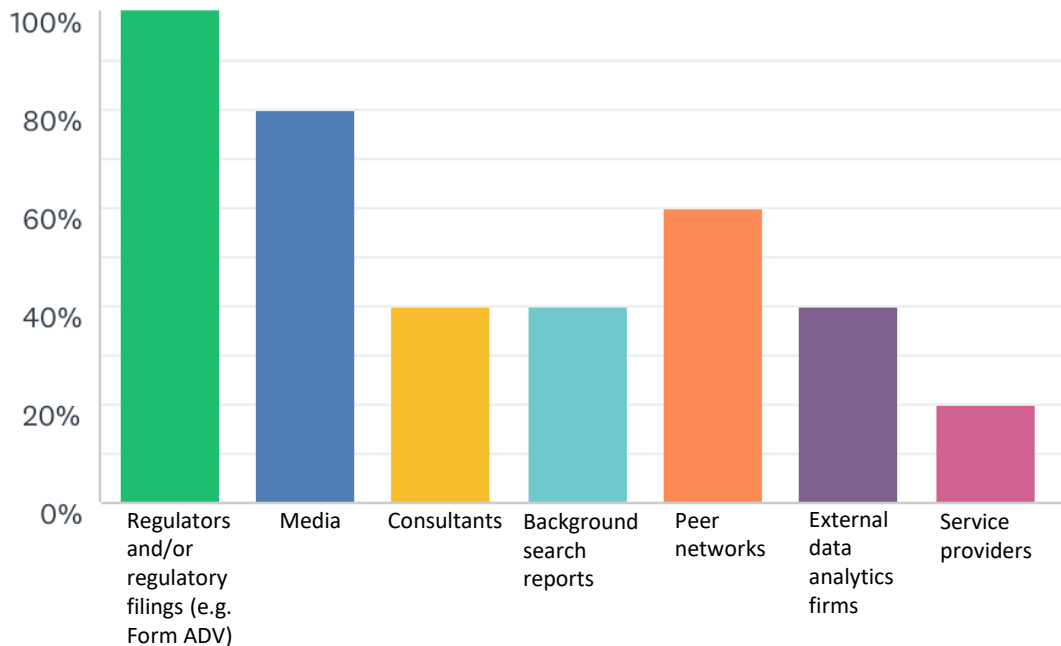
Q13: Do you have a proprietary ODD questionnaire that managers are required to complete? (select all that apply)



Q14: Besides managers themselves, where else do you source information prior to approving an investment with the manager? (select all that apply)

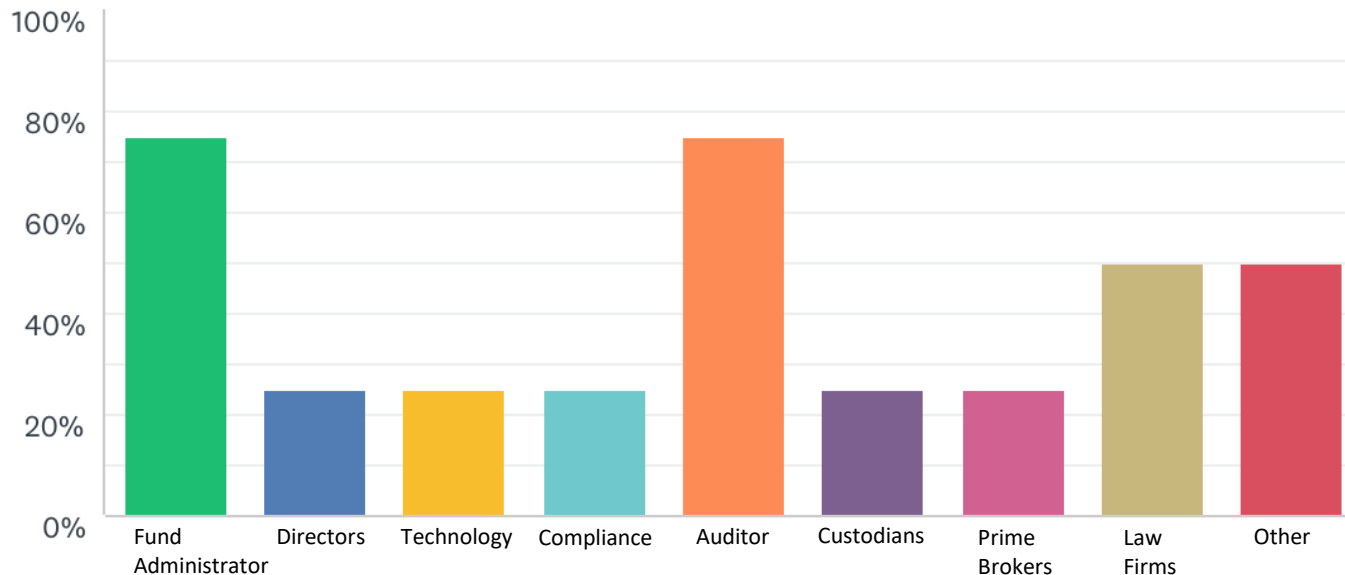


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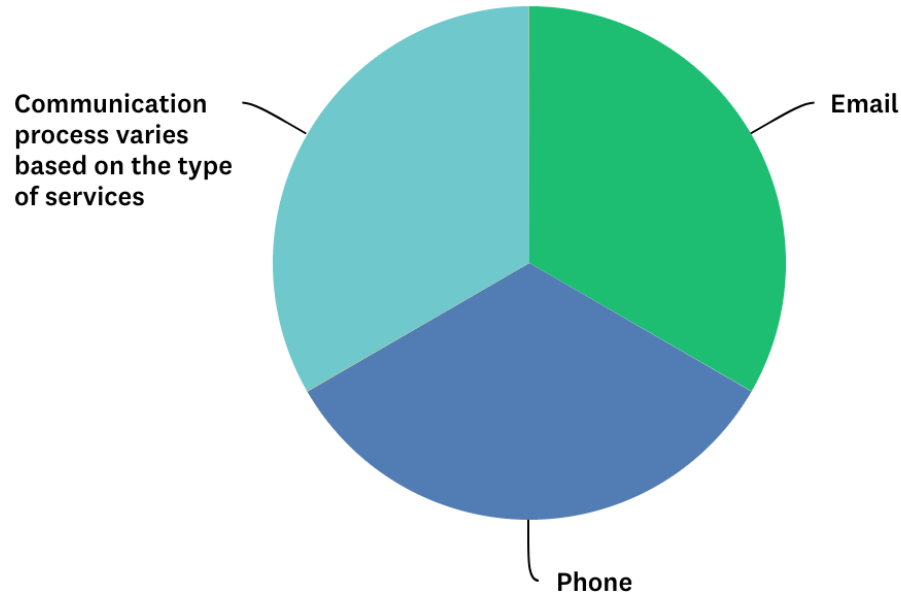


Q15: To which Service Providers do you verify managers/funds services? (select all that apply)

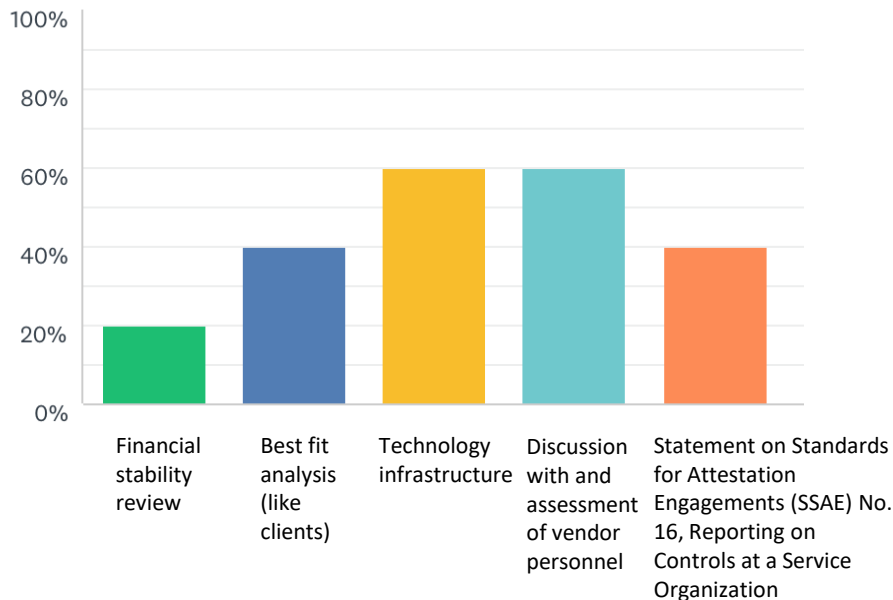




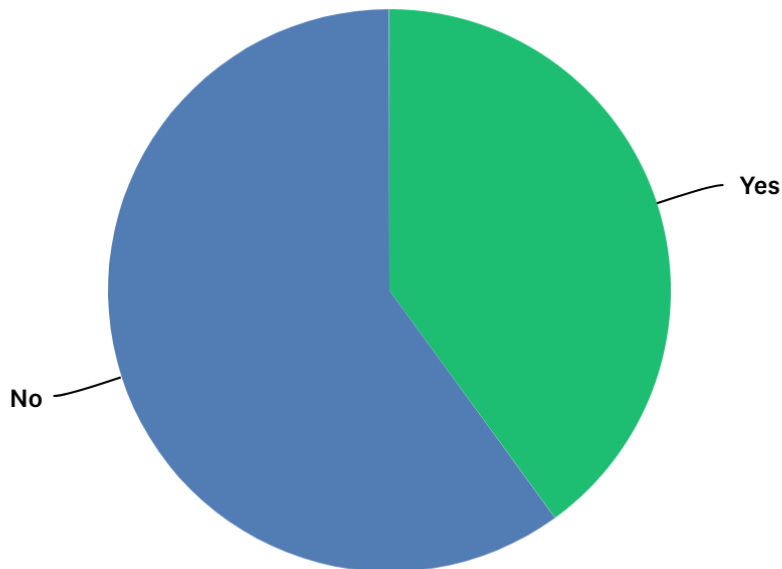
Q16: What primary medium is used to verify vendor services?



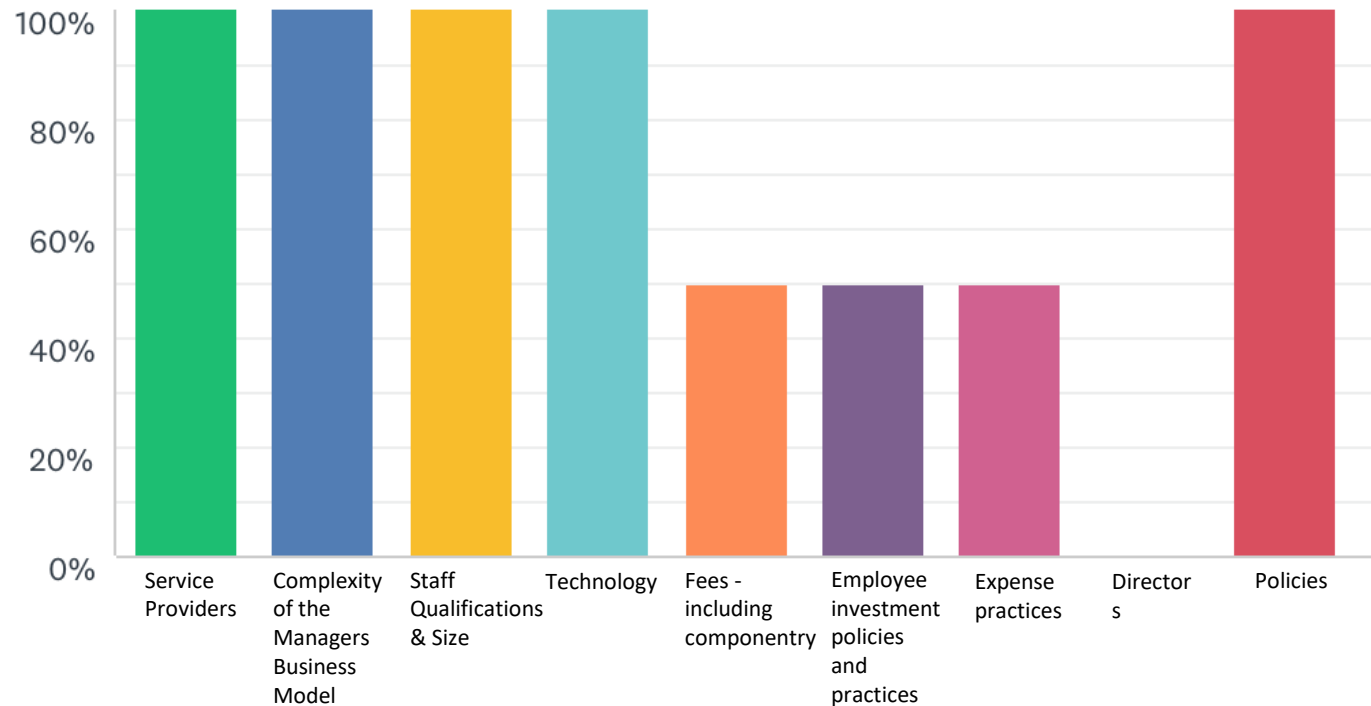
Q17: How do you evaluate the quality of the Service Providers used by the manager? (select all that apply)



Q18: Does your ODD research include benchmarking managers to their peers?



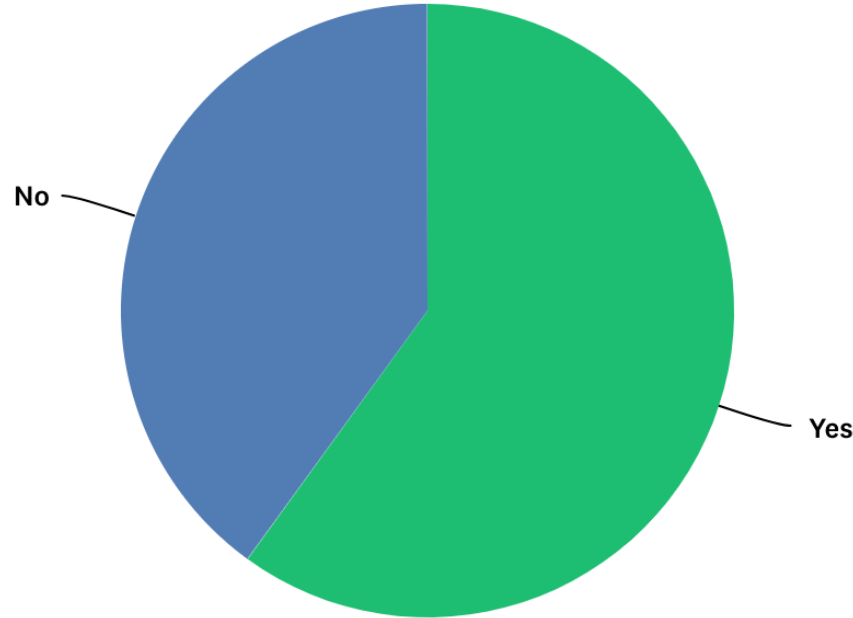
Q19: If your research includes peer benchmarking, what areas are benchmarked and documented in research reports? (select all that apply)



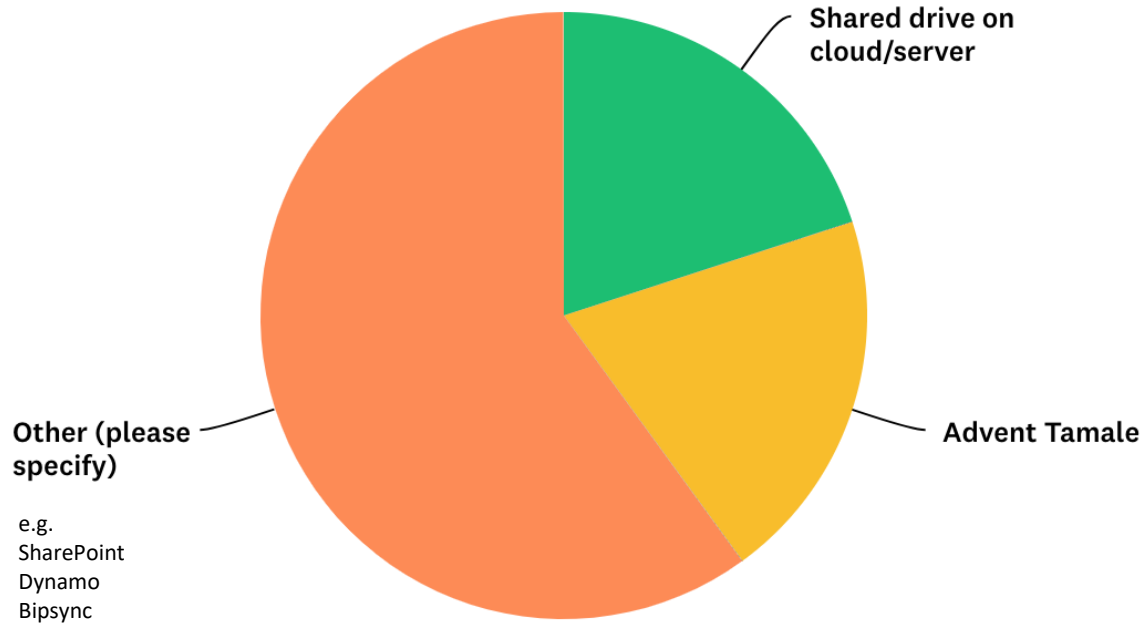
Q20: Do you have formal policies and procedures in place to measure and standardize Operational Risk?



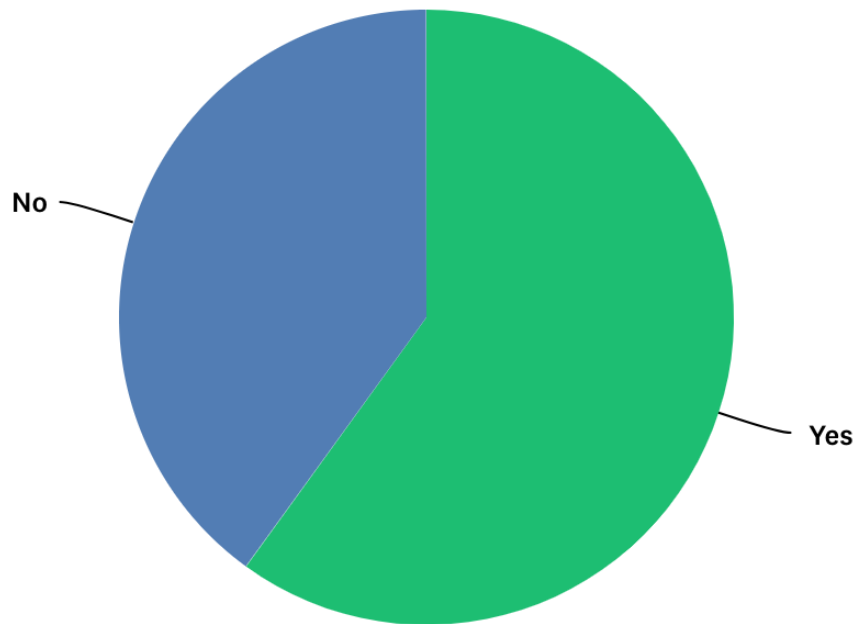
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Q21: Where are manager research and ODD documents saved and reported?



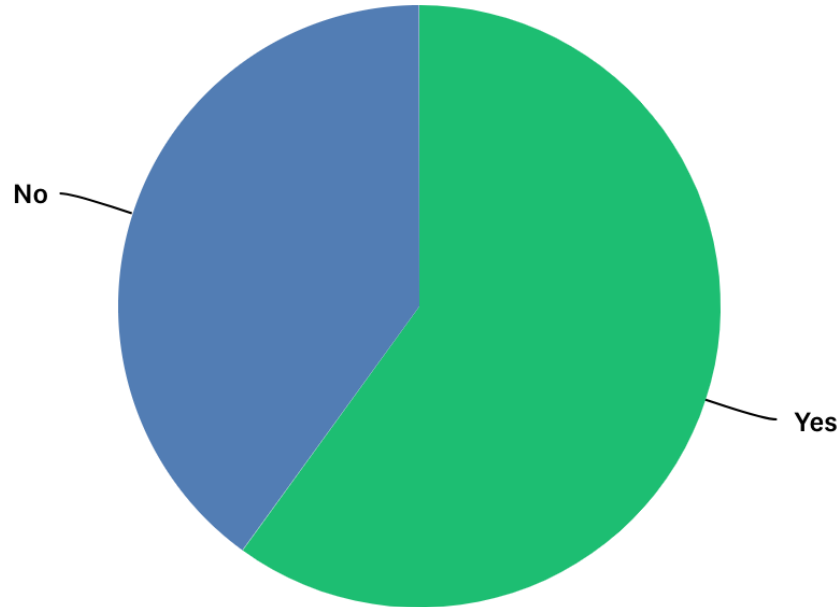
Q22: Is workflow an important consideration in your ODD model?



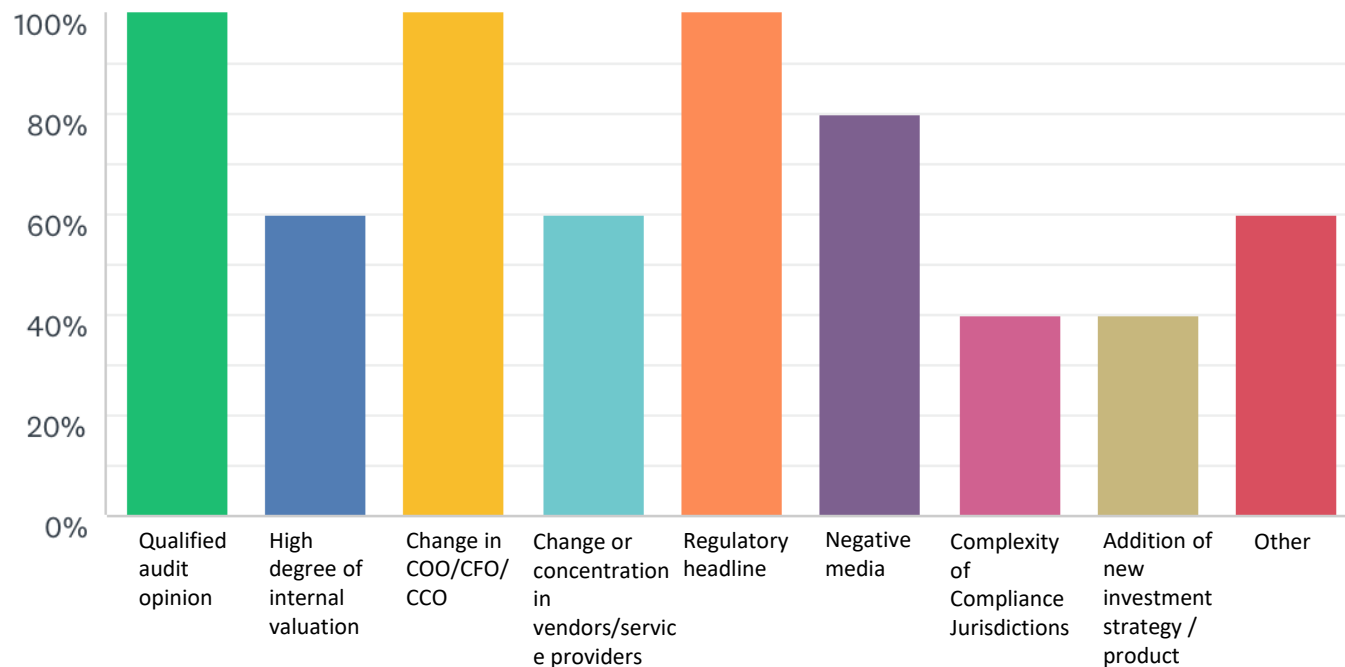
Q23: Do you run background checks as part of the initial review or onboarding process of a new manager?



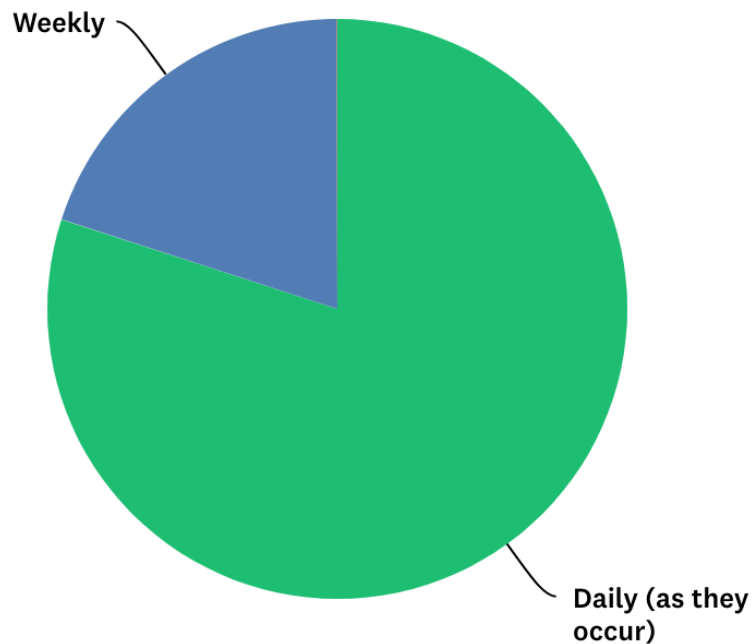
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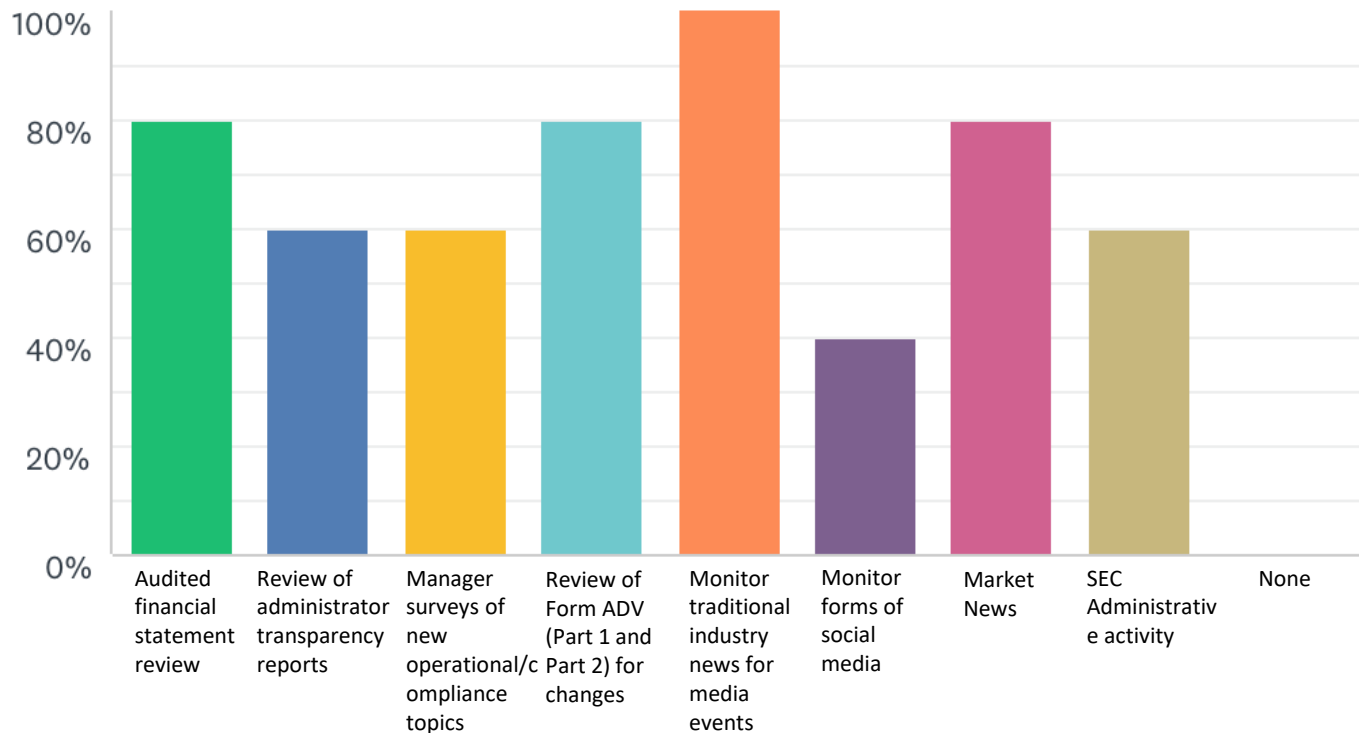
Q24: What changes in an Adviser's organization do you consider material events or red flags as they relate to your ongoing monitoring processes? (Select all that apply)



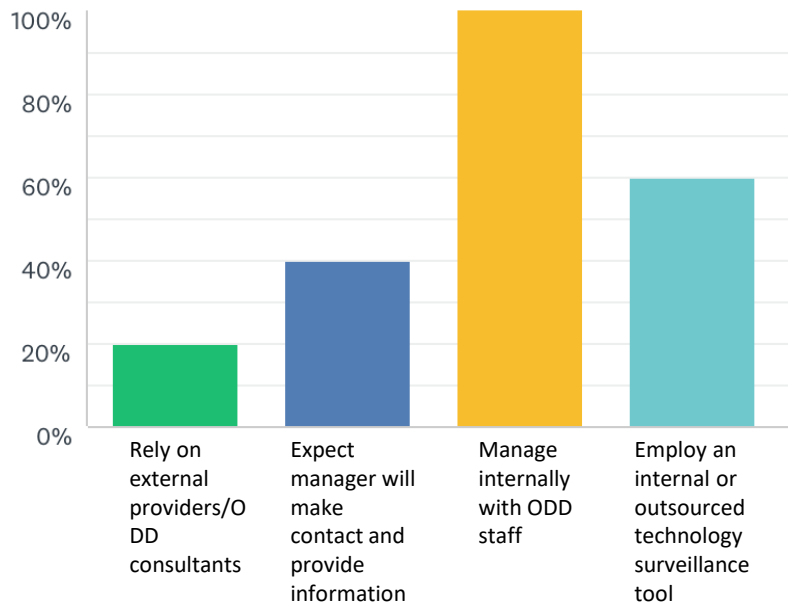
Q25: How frequently would you want to be notified of Material Events?



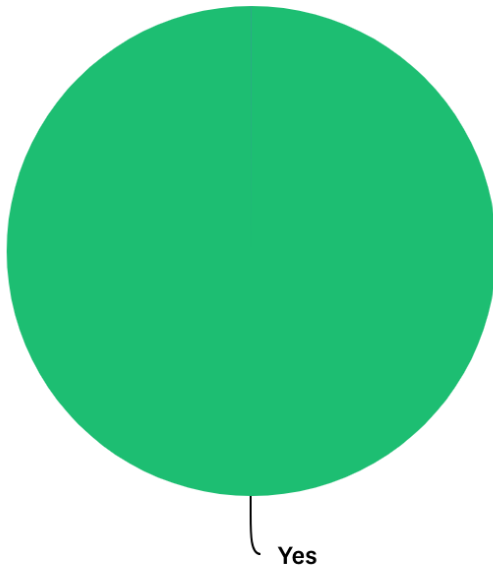
Q26: Outside of a formal periodic ODD review, what other ODD monitoring processes do you have in place on an ongoing basis (select all that apply)?



Q27: If you do engage in additional ODD monitoring (as per the previous question), how do you perform this ongoing monitoring activity (select all that apply)?



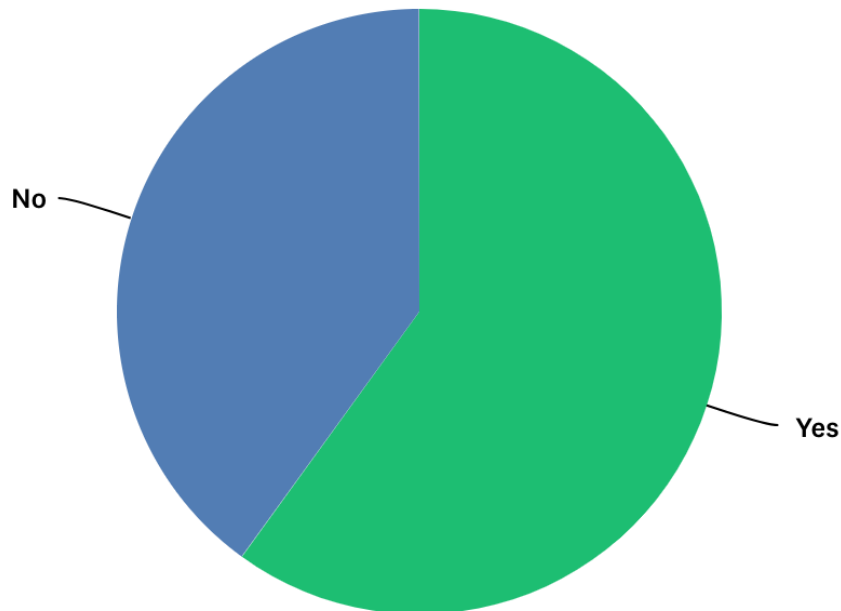
Q28: Would a Daily News page for external Managers (Market News, Material filing changes, SEC Administrative - Litigation - Suspension activity) be an important tool to monitor your Advisors?



Q29: Would scoring an Adviser's filing in terms of frequency - accuracy and best practice disclosures versus the market be of interest to you?



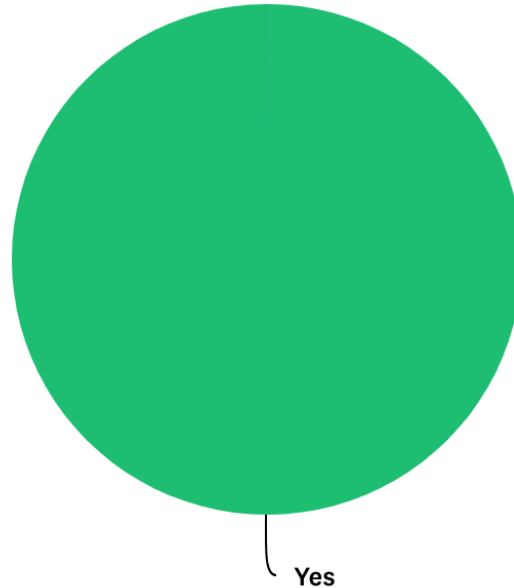
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Q30: Does your organization view ODD as a value adding activity that can help improve your returns and manage portfolio risk?



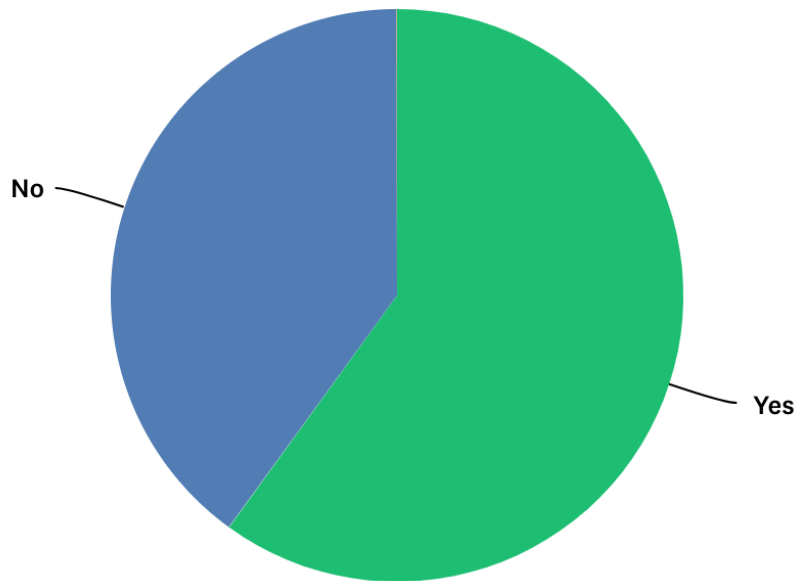
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Q31: Please rank the following list of factors that you believe have the most significant impact on a manager's operating risk (1= highest risk)?

| | 1 | 2 | 3 | 4 | 5 | Score |
|---|-----|-----|-----|-----|------|-------|
| The manager's investment process | 80% | 0% | 0% | 20% | 0% | 4.4 |
| The manager's regulatory environment | 0% | 0% | 40% | 60% | 0% | 2.4 |
| The manager's service providers | 0% | 20% | 60% | 20% | 0% | 3 |
| The manager's non-investment staff (quality and quantity) | 20% | 80% | 0% | 0% | 0% | 4.2 |
| Other | 0% | 0% | 0% | 0% | 100% | 1 |

Q32: Does your ODD process employ technology and/or data analytics to assess and to monitor trends in the operating risk profile of your manager allocations?



Q33: In your consideration of technology and/or data analytic tools to augment your ODD processes, what would be your highest priority areas of focus in making that decision? (please rank order by area of highest priority, 1 = highest priority)

| | 1 | 2 | 3 | 4 | 5 | Score |
|---|-----|-----|-----|-----|------|-------|
| Cost savings and/or the ability for additional capacity in your ODD operation | 0% | 0% | 20% | 80% | 0% | 2.2 |
| Ability to view and/or monitor trends and changes in the infrastructure and operating risk profile of managers | 60% | 20% | 20% | 0% | 0% | 4.4 |
| Ability to “score” or “rate” the infrastructure and operating risk profile of managers | 25% | 25% | 25% | 25% | 0% | 3.5 |
| Ability to compare and contrast the infrastructure and operating risk profile of manager allocations across our portfolio | 20% | 60% | 20% | 0% | 0% | 4 |
| Other | 0% | 0% | 0% | 0% | 100% | 1 |