

# In Brief

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Past performance is not necessarily indicative of future results. No assurance can be given that any investment will achieve its objectives or avoid losses. Risk management and due diligence processes seek to mitigate, but cannot eliminate risk, nor do they imply low risk. Unless apparent from context, all statements herein represent GCM Grosvenor's opinion.

## Effective Due Diligence in a Virtual World

Social distancing and remote workforces are the new normal. Many organizations around the world are managing their businesses, personnel, and client relationships without the benefit of in-office staffs. As companies consider how and when to re-open, it's increasingly apparent that the return to entirely onsite workforces won't happen any time soon, if ever.

Against this backdrop, asset managers and investors are evaluating the risks associated with performing diligence on managers, funds, and investments without the benefit of site visits or in-person meetings. These firms must in turn reassure their clients that they can still conduct a robust research process remotely.

In the following, we explore some of the challenges – and unforeseen benefits – of performing remote due diligence, and discuss what we believe makes a well-resourced, sophisticated investor properly positioned to conduct due diligence in this environment.

### DUE DILIGENCE IN A VIRTUAL WORLD

There are legitimate concerns among investors and their clients about the effect of social distancing on the due diligence process. Many investors fear that without the opportunity to meet a manager face-to-face, watch their body language, assess their culture, and tour their offices, the evaluation of that manager may be incomplete, and thus presents risks.

However, some interesting benefits of the new normal have emerged. Video meetings are easier to schedule and attend; they can be shorter and more frequent, are canceled less often, and more attendees can be in the "room." Meanwhile, limited travel has created cost savings for both investors and managers (particularly benefiting emerging managers), and senior staff members are generally more available for these calls.

This backdrop has created a scenario in which investors that are better equipped to navigate potential challenges may harness the potential benefits of conducting due diligence in the current environment. Here, we describe the particular traits of these well-positioned investors.

### CHARACTERISTICS OF THE WELL-POSITIONED INVESTOR

We believe that a well-prepared investor will be able to mitigate the challenges of a remote work environment and successfully capitalize on its advantages. We've identified some key characteristics of such investors:

- Breadth of manager relationships
- Experience and expertise
- Flexibility
- Market presence

### *Breadth of Manager Relationships*

Investors that maintained robust rosters of managers before the COVID-19 crisis are well-positioned for today's challenging environment. These investors can more easily capitalize on a quickly changing investment landscape by leveraging their manager relationships to efficiently evaluate deals and sponsors. Or, those seeking to invest with a manager that they know but have not yet invested capital can more successfully perform due diligence and allocate capital remotely because of their familiarity with the manager in question. For investors without these relationships, it can be difficult to confidently execute full due diligence on unfamiliar managers through virtual-only interactions. This applies to both established and small and emerging managers.

It is critical that an investor's roster includes small and emerging managers, complete with a database of critical information such as performance track records, as these managers can identify opportunistic investments and strategies that may not be captured by larger managers. Often, smaller managers are spin-offs from established firms, which again stresses the importance of a wide network of relationships. Investors with broad relationships, robust monitoring, and multiple touch-points at large firms will be more familiar with portfolio managers, and therefore, they have a first-mover advantage when those portfolio managers launch their own firms.

### *Experience and Expertise*

The current environment should not have a seismic impact on investors who have long been supplementing in-person investment due diligence meetings with a host of research activities and analytics. These investors already use remote technology, log countless hours on audio and video conferences with managers around the world, and use digital solutions to exchange sensitive data and reports. They also have robust screening mechanisms and monitoring platforms and are highly adept at performing reference checks.

From an operational perspective, we believe that social distancing restrictions have highlighted the importance of a robust operational due diligence (ODD) program. Among the key objectives of ODD is to *confirm and corroborate* a manager's investment operations and internal control environment by evaluating its operational systems, processes, and team. But certain aspects of these confirmation procedures may be challenging when in-person meetings or site visits are not allowed.

Therefore, a full ODD "toolkit" is critical to thoroughly evaluate managers from an operational risk perspective, in a remote setting. This toolkit includes, but is not limited to, extensive experience performing background checks, strategic interviewing techniques, strong negotiation skills, competence in making detailed reference calls with key service providers, and various technology solutions to mimic the in-person experience. While these activities can be completed remotely, without applying the full toolkit and ample resources, there is potential for increased risk. (See "A closer look" section for more.)

### *Flexibility*

While the above due diligence activities are rigorous and extensive, we believe they must also be flexible and adaptive, particularly in today's environment. For example, refusing to acknowledge or permit comprehensive remote due diligence as a suitable alternative for in-person or onsite visits(s) may unnecessarily delay or prohibit an investment. Instead, flexible investors will think differently about what constitutes an "onsite" visit and how to achieve its objectives within an overall due diligence process remotely.

Specific to the ODD process, virtual tours, pre-prepared videos, office floorplans, electronic access to sensitive information, system demos, or other activities may together suffice, assuming the ODD professionals are experienced and prepared to thoroughly evaluate the results of these alternate procedures. In these cases, an investor must have the confidence to move forward with an investment (or reject it) based on the entirety of the due diligence (investment, risk, and operational) completed, inclusive of the supplemental remote work performed.

## Market Presence

Finally, we believe large investors with sizeable amounts of capital in the market and strong reputations will benefit in the current situation. Managers are more apt to give these investors time, attention, and access because of their position in the market and familiar name. While this is a common view in any environment, today it is a different side of the same coin – in an environment of heightened risk and uncertainty, managers that cannot meet investors face-to-face may take comfort in knowing they chose a high-quality partner.

## A closer look: 3 required competencies for effective operational reviews in a remote environment

| Strategic interviewing techniques   | Determined approach to negotiating access and transparency  | Experienced, multi-disciplined, and independent team  |
|---|---|---|
| <i>There is an elevated need for staff trained in techniques that identify deceptive verbal and written behavior.</i>   | <i>Investors must gain access to information typically reserved for onsite review and evaluate specific risks, often “drilling down” on a particular situation or process.</i>  | <i>Diagnosing and mitigating operational risks, particularly in a remote setting, requires judgment by professionals with industry experience and credentials.</i>  |
| <ul style="list-style-type: none"> <li>+ Identify misleading or deceptive responses in written disclosures (selective disclosures, unnecessary qualifiers, narrowly worded answers, failure to specifically deny, etc.)</li> <li>+ Assess the integrity, competency, and demeanor of manager personnel integral to the operational control environment</li> </ul> | <ul style="list-style-type: none"> <li>+ Ensure organizational buy-in and support of the ODD function, thus establishing heightened importance for the access to internal documentation, regulatory correspondence, sensitive meeting minutes, etc.</li> <li>+ Assess risk through cross-corroboration: making similar or identical inquiries to multiple manager personnel, service providers, independent directors, external counsel, etc., and reviewing documentation</li> <li>+ Perform ongoing due diligence, which may require contractual provisions for future inspections, enhanced investor reporting, or specific notification rights</li> </ul> | <ul style="list-style-type: none"> <li>+ Create operational diligence team or function independent of the investment diligence process and empower it with veto rights or separate approval requirements</li> <li>+ Routinely influence managers to implement enhancements to internal controls or legal terms of the investment to lower its risk profile and improve its terms</li> </ul> |

## GCM GROSVENOR'S POSITIONING

Despite the potential challenges presented by the current environment, we believe that we are well-suited to flexibly adapt and, potentially, capitalize on the opportunities presented. Our \$55 billion global investment platform and robust roster of more than 600 manager relationships allow us to quickly and effectively identify and capitalize on opportunities on behalf of our clients. We believe our size and scale combined with our 50-year history, established track record, and institutional client base position us well to effectively deploy capital in the current environment.

Remote due diligence procedures have been integral to our overall due diligence efforts for years, so this new normal is not so new to us. Our Investment Committee has reviewed and confidently approved many investments without the investment team going on site.

In addition, our operational due diligence toolkit is comprehensive. We have a dedicated, independent, and experienced team of 15 professionals that are adept performing ODD. The team is trained by former CIA, FBI, and law enforcement professionals in strategic interview techniques and behavioral assessment tactics. We evaluate investment opportunities on a case-by-case basis since each presents a unique set of considerations – including whether to incorporate a site visit into the process.

In the current environment, we continue to perform a tailored risk assessment to thoroughly evaluate operational risk.

While we believe that remote due diligence will be sufficient in many cases, should a material issue arise during our due diligence process that we cannot fully diligence or sufficiently mitigate, we would not invest. Said another way, our due diligence underwriting standards and views towards investment and operational risk remain the same regardless of how or where we perform the work.

Finally, we have an extensive roster of, and over \$19 billion invested with, small and emerging managers who represent an important source of differentiated deal flow that we may access quickly. We continue to keep the emerging manager industry connected and build relationships with this community – even virtually – by participating in and hosting conferences such as the recent Consortium, which brought together over 500 managers, LPs, and consultants in a virtual setting.

While the current environment has many challenges, we believe that we have adapted a nimble approach that will allow us to continue our investment activities on behalf of our clients.

## ABOUT GCM GROSVENOR

GCM Grosvenor is a global alternative investment firm with \$55 billion in assets under management in hedge fund strategies, private equity, infrastructure, real estate, credit, and multi-asset class opportunistic investments. The firm has specialized in alternatives since 1971 and is dedicated to unlocking value for clients by leveraging its cross-asset class and flexible investment platform.

GCM Grosvenor's experienced team of approximately 500 professionals from diverse backgrounds serves a global client base of institutional and high net worth investors. The firm is headquartered in Chicago, with offices in New York, Los Angeles, London, Tokyo, Hong Kong, and Seoul.

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