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An Ocorian Company

The importance of Investment Due Diligence in making investment decisions

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AIMA

Speakers

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Partner

As well as looking after traditional asset managers on an ongoing basis, Abi and her team cover alternatives such as private equity, real estate, venture capital, and impact funds.

Contents

- Regulatory context
- Financial Crime obligations
- Risks to be considered
- Risk Management Framework and process
- Q&A

Regulatory context

- The increasing trend towards investment in private assets requires commensurate risk management to tackle financial crime risks related to complex ownership structures.
- Firms should be alert to the risk they could be used to facilitate financial crime, including fraud, money laundering, terrorist financing and bribery and corruption.
- Appropriate and proportionate systems and controls are key mitigants to this risk, and effective oversight is crucial where controls are outsourced. Proportionate and risk-based due diligence on investments and robust Know Your Client (KYC) checks are particularly important to identify ultimate beneficial owners.
- **Asset Management & Alternatives - Supervisory Strategy Dear CEO Letter February 2025**



Regulatory context

- Asset managers act as agents for their customers, making investment decisions in financial markets on their behalf.
- Confidence that asset managers will conduct themselves in accordance with regulatory requirements when acting on behalf of customers is central to the relationship of trust between the industry and its customers.
- When making investment decisions on behalf of the funds they manage, asset managers are expected to ensure a high level of due diligence in deciding which assets such funds invest in and have in place written policies, procedures and effective arrangements to assess and manage risks associated with their investment decisions.
- Asset managers are also required to identify and manage effectively any conflicts of interest to ensure they do not interfere with their obligations to customers.

- **H2O AM LLP Final Notice August 2024**

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Financial Crime obligations

- Sanctions
- Money Laundering/Terrorist Financing
- Bribery and Corruption
- Fraud
- Tax Evasion
- Individual Investment risk assessment

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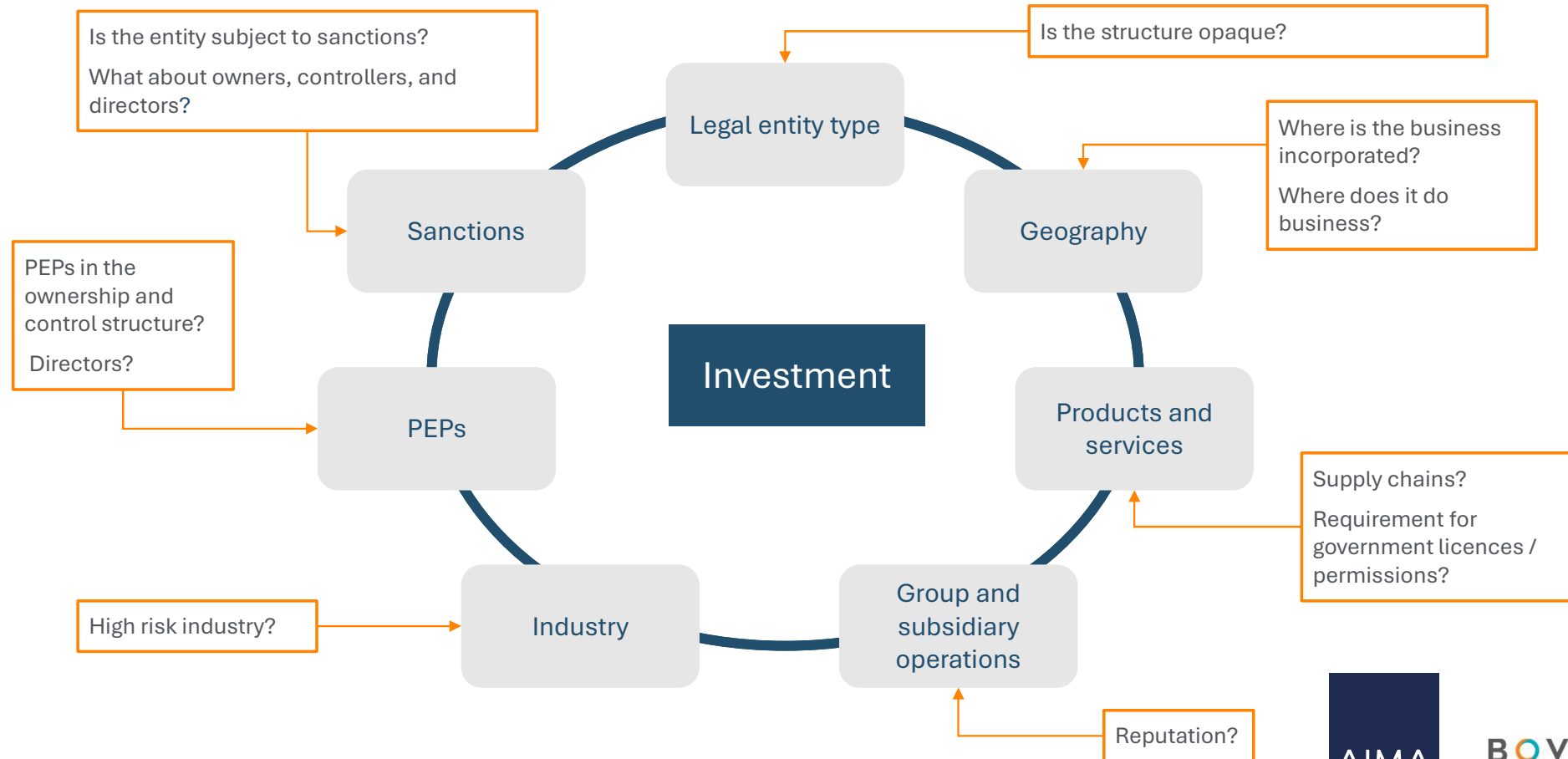


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Assessing financial crime risk for investments

The below diagram conveys what you should be considering when risk assessing investments



Investment Due Diligence: Financial Crime

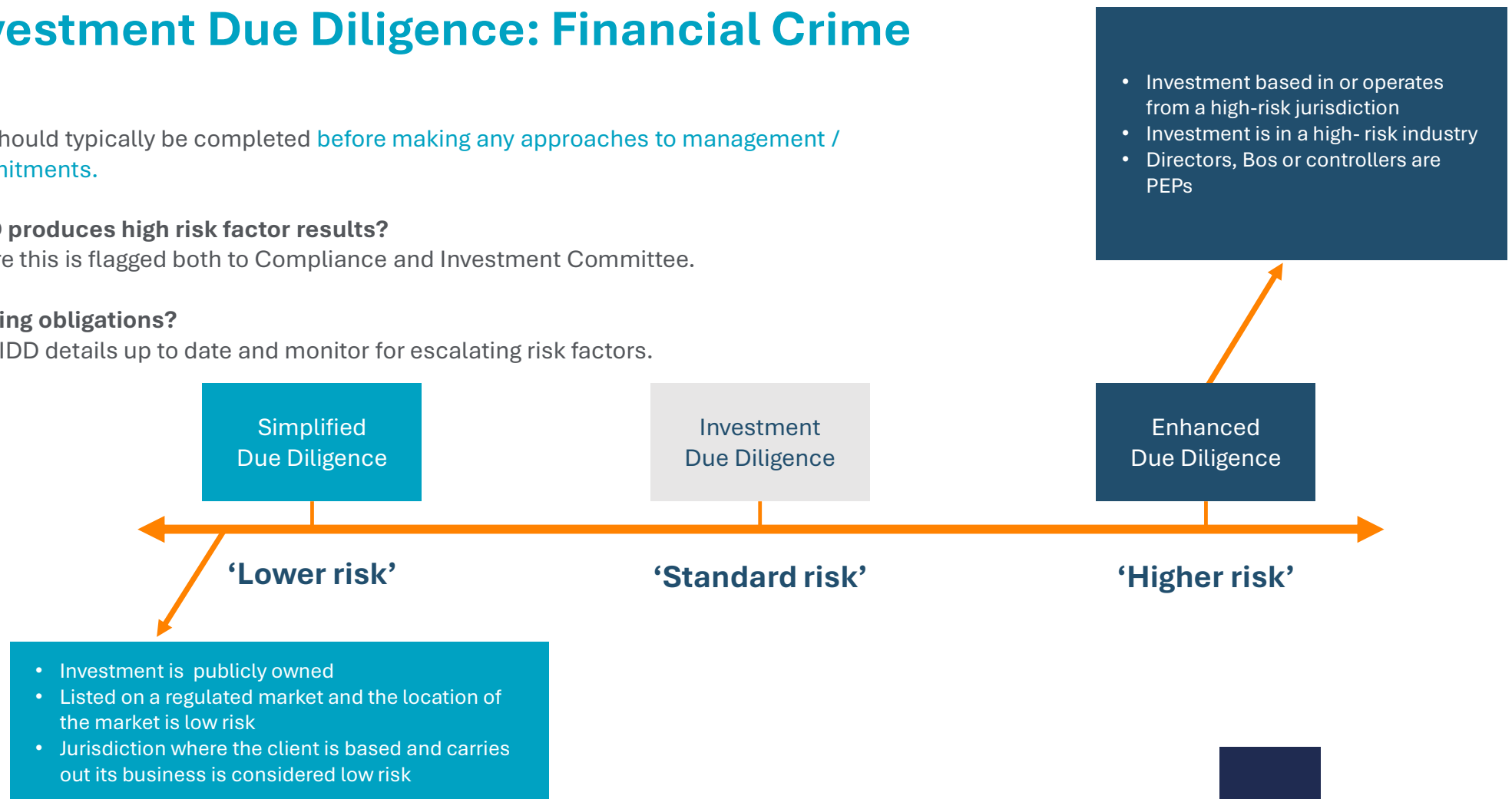
IDD should typically be completed **before making any approaches to management / commitments.**

If IDD produces high risk factor results?

Ensure this is flagged both to Compliance and Investment Committee.

Ongoing obligations?

Keep IDD details up to date and monitor for escalating risk factors.



Investment Due Diligence: Risk factors to be considered

- **Credit risk**
 - Capital position
 - Liquidity
- **Market risk**
 - Valuation
 - Volatility of cashflow/ business model
 - Macro / geo-political factors (include supply chains)
- **Operational risk**
 - Conflicts
 - Operational resilience/cyber threat
 - Human resources dependencies including key person risk



Investment Due Diligence: Esoteric risks and ESG

- **Esoteric risk**
 - Legal / required licences
 - Science and Technology including AI factors
 - Other unique contingencies
- **Environmental risk**
 - TCFD, SFDR, SDR , Greenwashing *requirements*
 - Sustainability *risk*
- **Social and governance risk**
 - Impact *requirements*
 - Impact *risk*
 - Diversity and Inclusion

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Risk Management Framework

- **Financial Crime investment DD**

- Individual investment financial crime risk assessment done by 1LOD, confirmed by 2LOD
- Documentation collection done by 1LOD, signed off by 1LOD senior manager, tested and monitored by 2LOD
- Outsourcing?
- External regulatory consultant/ law firm for advice, not decisions
- Escalation process....refer to Audit, Risk and Compliance Committee or other senior risk body
- Full disclosure to Investment Committee
- Capture escalated financial crime risk in ongoing Investment Committee monitoring



Risk Management Framework

- **Investment Committee**

- Composition: voting and non- voting members
- Balance of PMs and others
- Terms of Reference
- Challenge and expertise
- Specialist input: external co-optees, NEDs
- Frequency: quarterly, ad hoc?
- Documentation: a templated risk checklist for proposals?
- Conflicts declared
- Minuted with contingencies tracked
- KRIs and metrics
- Role of 2LOD / compliance
- Escalation?



Q&A

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Get in touch



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