BACKSTOP SOLUTIONS®

WHITE PAPER

THESE 6 INVESTMENT RESEARCH SILOS ARE CRIPPLING INSTITUTIONAL INVESTMENT FIRMS

IS THIS HAPPENING TO YOUR ORGANIZATION?

SILOED DATA

Institutional investors, as LPs, are demanding — and getting — exponentially more data now than ever before, thanks to the financial upheavals in 2008. Endowments, foundations, pensions, funds of funds, family offices, and similar entities recognize that they must put potential and current investments under the microscope to protect the interests of their stakeholders.

INSTEAD OF FLOWING FREELY ACROSS AN ORGANIZATION, DATA IS RESTRICTED WITHIN SILOS. THIS RESULTS IN VITAL FACTS BEING BURIED AND IMPORTANT CONNECTIONS BEING MISSED.

But, while more data is available than ever before, it is often not used to its fullest advantage due to the silos that exist within institutional investment organizations. Instead of flowing freely across an organization, data is restricted within silos. This results in vital facts being buried and important connections being missed. In the end, decisions are made that would never have been made if all the data was aggregated and prioritized properly.

All the research necessary to make wise fiduciary decisions is being performed by institutional investors today. But because this research is not being properly leveraged and remains stuck in silos, institutional asset owners — and their constituents — are suffering.

SIX RESEARCH SILOS

There are six main silos that exist across institutional investment organizations. Each is responsible for performing a specific type of research.

Accounting/Back Office

The accounting area and the back office have always collected net asset value (NAV) statements, but the amount of transparency contained within those statements has increased dramatically over the past decade. Consequently, accounting and the back office are taking special care to calculate fees: management fees, performance fees, capped research fees, etc. A full understanding of all fees is critical to ensure that the institutional investment firm is being run in a lean, cost-effective manner.

Operations

As a result of the Madoff revelations, the activities of the operations due diligence team have expanded drastically with regard to how investment firms and managers are assessed. The team gathers information about key personnel as well as internal policies, processes, and controls, and goes through that data with a fine-toothed comb. The team also examines service providers and confirms audits. Positions and valuations are reviewed to determine if they have been properly arrived at. The goal of operational due diligence is to ensure the existence of prudently supervised processes to prevent unwelcome surprises down the road.

Legal

The legal team analyzes transactions, offering documents, and other official matters. But their focus has turned to the nuances within those materials. For example, legal experts want to understand the level of transparency an investment firm is providing, the potential of being gated or of having a suspended NAV (which would result in an illiquid investment), and how the investment firm treats other investors. They are on the lookout for any possibility that the institutional allocator could be left “holding the bag” if an investment goes south.

Compliance

Compliance reviews investment materials and structure documents to ensure compliance with stated policies and procedures. They ensure prudent fiduciary processes are being followed on behalf of clients and in accordance with regulatory authorities.

Analysts

Analysts gather qualitative and quantitative information to properly assess the talents of the investment manager, the opportunity set within the particular strategy, and whether that investment manager is the best fit to deliver on expectations.

Risk

Managing risk is much more than simply tracking performance on a monthly basis and running regressions. Risk analysts assess positions, gross and net exposures, the intercorrelation of underlying investments, scenarios and simulations in order to best assess risks/factors present in the portfolio — real or potential — that an institutional asset owner may have.

All of the research done by these six silos is needed by the investment committee and the board of directors so that these bodies can make and approve investment decisions for the institutional investor. The investment committee requires detailed data, including both quantitative and qualitative inputs, to make recommendations about current and potential investments. The board of directors views the data from a higher level to verify that the institutional allocator is adhering to its investment strategy, policy, and goals.

THE IMPACT OF SILOED RESEARCH

It sounds simple, doesn’t it? If each silo shared its information across the organization and directed it to the investment committee and the board of directors, everything would be coordinated and cohesive.

It would be ideal — if it happened. But the reality is, the silos exist and they have unintended walls that impede knowledge transfer. Investment committees find themselves severely hampered in their efforts to make wise fiduciary decisions because:

- Information is not shared across silos so that important connections are missed
- Crucial data is not highlighted for the investment committee
- Seemingly immaterial data at the silo level is not bubbled up; thus inhibiting the potential to create a material mosaic in conjunction with information in other silos

This is no small matter. If the investment committee doesn't have the information they need presented in a way that can be readily assessed, they can make an inappropriate recommendation. That recommendation is then passed up to the board of directors, who, working on the same data, approves it. Once approved, the decision has potential negative ramifications for all investors, and for the institutional asset owner organization itself. Though the asset owner worked to be a prudent fiduciary at each step within the due diligence process, that comes apart if that aggregate information is not effectively channeled at the point of decision.

ILLIQUIDITY IGNORANCE

As an example of the dangers of keeping investment research in siloes, consider this situation. An investment analyst is looking at a fund with an event-driven strategy, monthly liquidity, and the requirement of 15 days' notice for redemption. He notes that the fund appears to be fairly liquid. However, the back office team, in studying prior audits, realizes that the fund has an outsized proportion of level-three assets — assets which are deemed not readily liquid. The legal team, meanwhile, notes that a very specific gate can occur if a certain number of shareholders redeem. So, while there is no individual gate, per se, a redemption of 50% of the funds could result in the entire fund being gated. And, given the illiquidity in this fund, it most likely would result in a herd mentality out the door during a performance drawdown which only compounds the problem.

If information is not being shared across these siloes, the analyst will not realize that the fund, which seems acceptable from his vantage point, has a potential illiquidity problem. The legal team, similarly, is not aware of the level-three assets, which would make their concerns about being gated much stronger.

The information from these three areas travels up to the investment committee, but the necessary connections have not been made and highlighted. The investment committee does not connect the dots, and approves the fund. Eight months later, the majority of investors in the fund request redemption. The gate is raised, and the institutional investor is stuck in a fund that is spiraling into disaster.

ESTABLISHING THE ESSENTIAL CONNECTION

It must be stated emphatically that all the silos are doing the required research and are doing it well. There is no attempt to "hide" information from other areas in the organization or from the investment committee or board of directors. The problem is that there is too much information for everyone to absorb. It is too easy to miss a vital connection. It is too simple for an important fact to be overlooked.

It does not have to be this way, however. The answer is to implement a holistic system that combines research management and portfolio monitoring capabilities in a single, integrated suite. Choosing the right research and portfolio management technology can provide the essential connection between all investment research silos, the investment committee, and the board of directors. With the right research management and portfolio monitoring system in place, critical information is dynamically pushed to stakeholders for consideration and analysis. The "noise" is eliminated so that the investment committee can focus their attention on matters of key interest.

A robust research management and portfolio monitoring technology will boost productivity and business agility by:

- Combining qualitative, quantitative, and subjective data tracking so that the investment committee has all the information they require in one place
- Storing documents, e-mails, meetings, calls, and other activities in one location to facilitate searching, sharing, and collaboration
- Centralizing information, eliminate redundancies, and fuel comparative reporting
- Monitoring and reporting on qualitative and quantitative data points over time for monthly, quarterly, or annual due diligence
- Turning qualitative data and proprietary subjective analysis into quantitative measures for “apples-to-apples” comparisons and rankings
- Containing powerful performance analytics to assist with evaluating and monitoring managers from a quantitative perspective
- Running up-to-date analyses on fund and holding performance

The data is available. The analysts and the operational due diligence teams are doing their jobs, as are the experts in the accounting, back office, legal, compliance, and risk departments. The investment committee and board of directors are striving to act in the best interest of investors.

All that is needed is a strong productivity platform integrating research and portfolio management to break down the silos and bring the information together.

IN SUMMARY:

Making wise fiduciary decisions depends on data, analysis, and insight. All of this research is present today in institutional investment organizations, but it is contained within siloes. This hampers investment committees because they may miss crucial data and critical connections. A Research Management System that combines Portfolio Management and Monitoring capabilities is essential to help institutional allocators leverage the available information to make the best recommendations about current and prospective investments.

ABOUT BACKSTOP SOLUTIONS

Because every minute matters, Backstop's mission is to help the institutional investment industry use time to its fullest potential. We develop technology to simplify and streamline otherwise time-consuming tasks and processes, enabling our clients to quickly and easily access, share, and manage the knowledge that's critical to their day-to-day business success. Backstop provides its industry-leading cloud-based productivity suite to investment consultants, pensions, funds of funds, family offices, endowments, foundations, private equity, hedge funds, and real estate investment firms.

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