

# Operational Due Diligence and Independent Fund Directors: Collaborating for Success



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In the complex world of investment management, the relationship between Operational Due Diligence (ODD) professionals and independent fund directors has often been perceived as an adversarial dynamic rather than a collaborative partnership.

In this article, Julianne Recine – an independent fund director at Waystone and ODD professional – explores the evolving landscape where both parties, despite their distinct roles, share a common goal: ensuring robust risk management and safeguarding both the investors’ and fund’s interests. As we delve deeper, we will find that there is more alignment and collaboration between ODD professionals and independent directors that ultimately leads to developing and encouraging industry best practices.

## Introduction

Over the years, there has been somewhat of an “us versus them” stance between ODD professionals and independent fund directors. In certain circles, ODD professionals often sought to find fault with fund directors: that they were either not truly independent or were acting solely in the best interest of the Investment Manager (IM) or General Partner (GP) and hence not considering the best interest of investors. There’s been scrutiny and debate on this topic, leading to fund directors being viewed as service providers on the ODD professional’s due diligence list. ODD professionals hold fund directors accountable for the risk management, investment oversight and compliance of a fund vehicle and may criticize any shortcomings that arise.

ODD primarily focuses on evaluating the sustainability of the IM or GPs operations and identifying those potential risks beyond investment risk. In addition to evaluating the firm, ODD professionals will assess risks associated with the investment vehicles they invest in and, in some cases, those they may not invest in but are managed by the firm. Essentially, during a risk assessment, ODD professionals review all the moving parts at an IM/GP.

Independent fund directors on the other hand, particularly in the context of Cayman Islands registered mutual funds, are predominantly focused on ensuring governance and oversight of investment funds. To appropriately provide this level of oversight to the fund and its investors, the director also needs to oversee the operations, compliance, risk management and investment strategy of the fund. Through this process they are essentially evaluating the IM or GP and other key delegates to the Fund.

As an Operations and ODD professional for over 27 years, I have encountered various industry disruptors and initiatives that ensure best practices in a space that has historically been lightly regulated. ODD professionals pride themselves on turning every stone over to mitigate operational risks that could lead to financial risks. Ultimately, both ODD professionals and independent fund directors strive for similar outcomes. This article explores how both parties can align their efforts and, more importantly, work in partnership to achieve their goals: proper oversight and risk management while establishing industry best practices.

## How do ODD and fund directors work in partnership?

ODD professionals and independent fund directors both conduct a thorough due diligence before establishing a relationship with a fund, IM or GP. An essential part of this due diligence would include reviewing available firm and fund documentation along with meetings and discussions. A natural starting point often involves reviewing the fund's offering materials to determine the obligations of the IM/GP. Both groups put great emphasis on understanding service party relationships and gaining familiarity with the services sought by the fund or IM/GP.

Both ODD professionals and directors carefully review and understand the IM's/GP's rights. Although both roles expect that the IM/GP would have certain flexibility over the management of their strategy, they would expect the IM/GP to notify directors, and under certain circumstances, investors of certain updates or changes that would alter the strategy or adversely impact the investment fund and the investors. They essentially want to be sure that the IM/GP is not able to make changes to the fund's investment strategy, fees and expenses and redemption terms without oversight or consent, where relevant.

Independent fund directors are expected to act prudently and within the best interest of the vehicle or entity they represent, which ultimately is in the best interest of the investors in the fund. Similarly to ODD professionals who are focused on safeguarding their investments, within an equitable playing field, part of a director's role is to ensure investors are treated fairly and are made aware of key changes and updates.

Although a director is primarily responsible for overseeing the fund, their interests extend beyond the investment vehicle itself to include the responsibilities of the core providers. Directors are also concerned with how the IM/GP conducts its day-to-day business, oversees risk management, handles compliance and legal matters, communicates to shareholders, values the funds' investments, resolves conflicts and staffs itself accordingly with experienced and capable individuals.

Independent Fund Directors typically conduct diligence of the IM/GP before accepting an appointment. Not only does the IM/GP interview the director to assess their experience and capabilities, independent fund directors also conduct their own level of due diligence to ensure the IM/GP is someone they can confidently work with. Similarly, ODD professionals conduct a review/interview as part of their process. These interviews are critical for assessing whether the funds/firms are appropriate to engage with.

Both directors and ODD professionals expect to see consistency in the IM's/GP's messaging across all documentation for correspondence with investors and board members. Both roles want to see legal language in the documents that favors investors and is not overly protective or beneficial to the IM/GP. Quality offerings and marketing materials are also a priority.

At the heart of it, both ODD and fund directors seek collaboration. To that end, both parties often go outside of scope, providing valuable insights into best practice and identifying areas requiring improvement. They also engage with the fund's/firm's service providers, getting to know them better during the due diligence and board meeting processes.

## What other parties and activities are ODD professionals and independent fund directors involved with throughout the due diligence process?

An independent director's relationship with the fund/firm goes beyond the board meeting and they often collaborate with the IM/GP on ad hoc matters. There is a great deal of contact with the IMs' /GP's team during audit season to ensure timely and accurate audits. Directors frequently assist with certain audit filings and are involved in discussions regarding valuations, establishing new counterparty relationships, and addressing unique investor requests.

Likewise, ODD professionals often collaborate with funds by conducting periodic reviews after the initial due diligence, touching on updates or more material matters that may have arisen.

Both ODD professionals and independent directors may be in situations where they use a four eyes approach and work with other professionals on their teams to ensure an extra level of oversight and coverage when the key contact is unavailable. This process creates operational redundancies and fosters a more intuitive approach by incorporating diverse viewpoints. Also, engaging less-senior staff in this process is an effective way to develop internal talent to service future engagements.

While one might argue that independent fund directors primarily focus on governance and overall fund management, and ODD specifically focuses on operational/non-investment risk, both play crucial roles in investor protection and fund/firm success. By collaborating, they can enhance their effectiveness in achieving common objectives.

In this next article series, Julianne will address ways that both ODD professionals and directors work together to educate themselves and the industry.

## About Waystone

Waystone offers high-quality fund governance through experienced, independent fund directors, supported by advanced governance technology. We also provide ODD consultancy services, including the complete design of due diligence questionnaires (DDQs), reviewing completed DDQs, and responding to DDQs.

If you have any questions on the areas discussed in this article or would like to find out more about how our [Fund Director](#) and [ODD services](#) could help you ensure robust risk management and safeguard your investors' interests, please contact your usual Waystone representative directly or reach us via the button below.

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