# Trust, Transparency, and Financial Intelligence

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I recently led a session on "Trust, Transparency, and Financial Intelligence" at the Investment Management Institute's **Endowments and Foundations Forum**. The discussion, which took place on July 22-25, 2012 at the Equinox Hotel in Manchester, VT, offered important themes and takeaways for risk assessment and due diligence.

## Trust and Transparency

The discussion opened with the story of how CFS was created to build market trust, foster transparency, and offer intelligence on financial markets.

From the perspective of endowment and foundation professionals, trust and transparency were sorely lacking during the financial crisis.

## Implications and Suggestions

However, endowments and foundations can strengthen their due diligence process. Some examples include:

1. Evaluate if a hedge fund should have an administrator. An administrator would help in terms of validate account values and provide additional oversight.
2. Have a consultant validate performance of a fund, which is particularly important for hedge fund and private equity investments. Performance numbers are often taken for granted, yet need to be evaluated with care.
3. For actively managed funds, one must verify that managers are staying true to the investment style and goals advertised. Underperformance is not necessarily a reason to let go of a manager but style drift should never be acceptable.
4. For any fund manager, 100% of their energy should be on the fund. If managers have other interests, these should be disclosed.
5. If the chief investment officer function is outsourced, look for the basis upon which such firms can make good tactical asset allocation decisions. Many firms do not have a track record in this regard.
6. Monitor a fund before investing, whenever possible. This is the best way to know if the fund does what it states it will do.
7. For a private equity fund that goes off track, though your investment is locked in, that does not mean that you cannot express concerns to management. Word of mouth and reputation are very important for a private equity fund.
8. Fund fees do not bear enough risk for managers. A fund can have average performance and still do okay.
9. Do not accept best efforts reporting. Reporting for all funds, including fund of funds and feeder funds, should be within a reasonable time frame.

Strong due diligence and risk assessment cannot be emphasized enough. Transparency, though improving, cannot be relied upon and one must take extra steps to properly ascertain risk. To the greatest extent possible, foundation and endowment investors must use all tools available, such as financial intelligence and outside data, to properly evaluate risk and performance.