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DUE DILIGENCE

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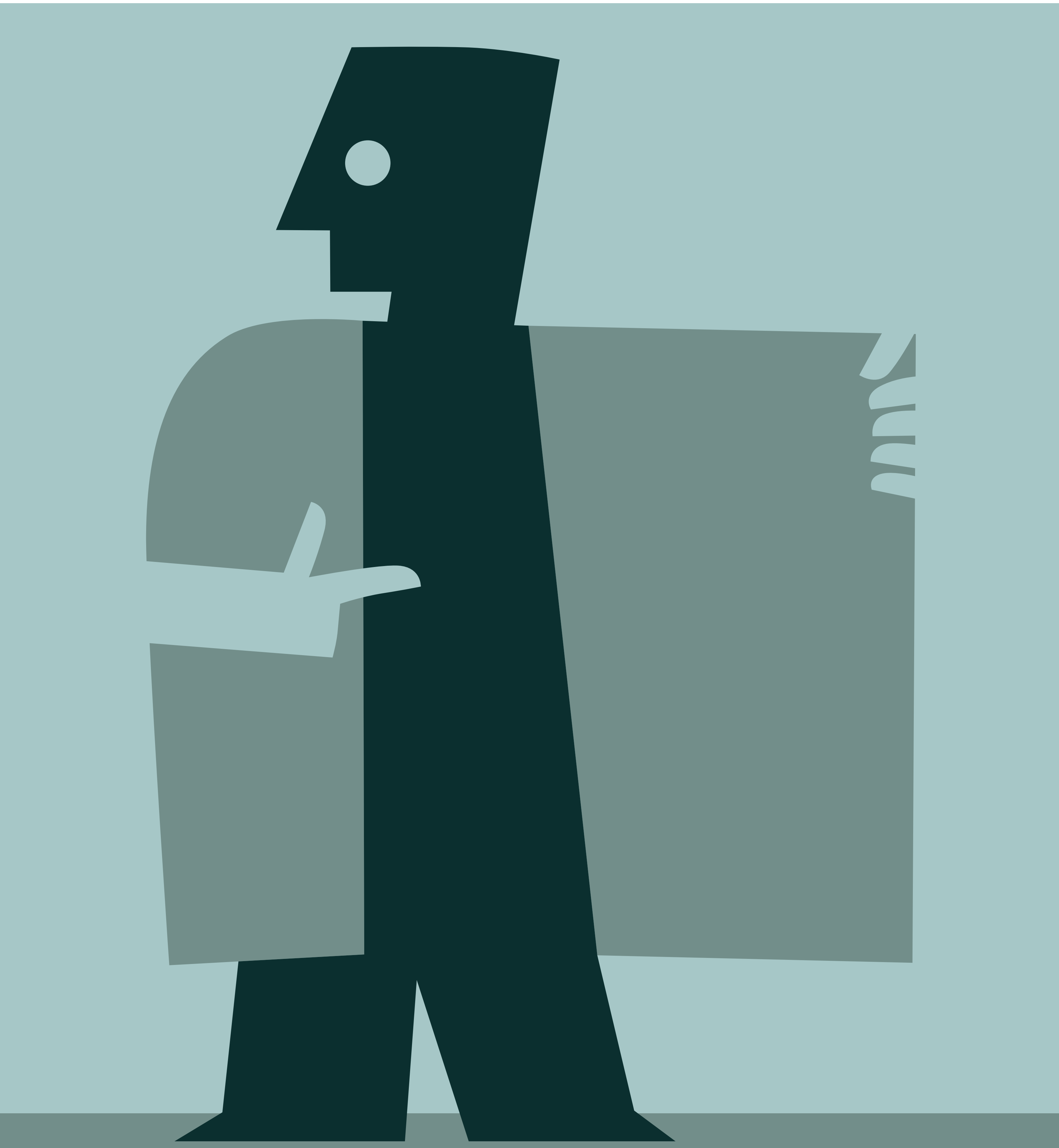

Inhoud

CALL FOR PAPERS

Kunstmatige intellegentie en ChatGPT in de Nederlandse beleggingssector: recente ontwikkelingen en impact op de praktijk

In de dynamische en steeds veranderende wereld van beleggen, staan Kunstmatige Intelligentie (AI) en geavanceerde *large language models* zoals ChatGPT van OpenAI, niet langer aan de zijlijn. Zullen deze technologieën de maatschappij transformeren? Leidt dit tot innovatieve beleggingsstrategieën of nieuwe operationele efficiëntie? En wat gebeurt er op dit moment in de praktijk?.

Wat eens futuristisch leek, wordt nu realiteit: met massieve data-analyse lijkt nowcasting mogelijk te worden, waardoor trends en patronen worden onthuld die traditioneel verborgen bleven.
De performance analysis wordt aanzienlijk verfijnd, met AI en ChatGPT die ons helpen de details te begrijpen die anders ongrijpbaar zouden zijn. Manager selectie wordt ook gestroomlijnd, waarbij AI en ChatGPT in staat zijn om de enorme hoeveelheid informatie te verwerken die nodig is voor grondige en noodzakelijke evaluaties.

Dit betekent een transformatie in hoe we denken over beleggen, handelen, werving en selectie, en de next-generation medewerkers. Hoe wordt AI, ChatGPT, en *Machine Learning* nu al toegepast door Quants/data science beleggers? Zijn de implicaties diepgaand, zowel op micro- als op macro-economisch niveau? Verandert deze technologie de grondbeginselen van de sector en de rol van de individuele analist, portefeuille manager en zelfs de beleggingsinstelling zelf?

Naast algemene bijdragen, nodigen wij bijdragen uit op onderwerpen zoals:

- De relevantie van AI en ChatGPT voor beleggingsbeslissingen, werving, handel en de quant van de volgende generatie
- De toepassing van AI in risico management zoals *early warning systems* bij krediet analyse.
- Recentelijk ontwikkelde toepassingen van AI en ChatGPT in de Nederlandse beleggingssector, met bijzondere aandacht voor nowcasting door big data-analyse, performance analysis en manager selectie. Praktische case-studies van partijen die in Nederland actief zijn en AI en ChatGPT hebben toegepast in hun beleggingsstrategieën en -processen
- De ethische, auditability en transparantie-uitdagingen bij het gebruik van AI en ChatGPT in de beleggingssector
- Aanvullend: wat zijn de risico's voor het gebruik van deze modellen die worden gevoegd door historische data ten behoeve van beleggingsbeslissingen, manager selectie etc? Hoe hou je balans tussen de toegevoegde waarde versus de risico's?
- De regulatoire ontwikkelingen, uitdagingen en kansen die AI en chatbots met zich meebrengen

Via deze call for papers roepen wij geïnteresseerde auteurs op voor 15 september 2023 een samenvatting van hun bijdrage te sturen naar de redactie (irma.willemsen@cfasociety.nl).
Het moet daarbij gaan om oorspronkelijk werk dat nog niet elders is gepubliceerd. Het artikel kan zowel in het Engels als Nederlands worden aangeboden.

Verdere informatie over bijvoorbeeld auteursinstructies en eerdere journaals staat op https://cfasociety.nl/en/vbajournaal.

Due Diligence

De zomereditie van het VBA Journaal staat in het teken van een thema dat voor het eerst de aandacht krijgt in het VBA Journaal: Due Diligence. En niet geheel onterecht, gezien het feit dat aanzienlijk deel van de beleggingen in Nederland is uitbesteed aan externe beheerders. Het beheersen van dit uitbestedingsrisico vormt een essentieel onderdeel van de activiteiten van veel vermogensbeheerders. Voordat een externe beheerder kan worden aangesteld moeten alle beleggings- en operationele risico's bij deze beheerder worden geïdentificeerd en zo goed mogelijk worden gemitigeerd of beheerst. In deze editie wordt Due Diligence vanuit meerdere invalshoeken belicht, waarbij wij een bijdrage willen leveren aan dit onderbelichte onderwerp.

We openen dit nummer met een bijdrage van Mark Geene, redacteur van het VBA Journaal, die zijn 25 jaar werkervaring op dit gebied benut om het belang van gedragskenmerken bij zowel manager selectie teams als externe beheerders te benadrukken. Hij betoogt dat de vereiste gedragskenmerken veel overeenkomsten vertonen met die van professionele sporters en biedt praktische handvatten om dit kwalitatieve aspect mee te nemen in het manager selectie proces.

In het volgende artikel pleiten Lisa Hayles en Martijn Huijnen voor de integratie van de rechten van de LGBTIQ+ gemeenschap in het investeringsproces. Ze onderstrepen in eerste instantie de voordelen van inclusie van deze gemeenschap voor bedrijven en bieden vervolgens praktische richtlijnen om de LGBTIQ+ rechten daadwerkelijk te implementeren in de beleggingspraktijk.

Het onderwerp van Due Diligence wordt onderbroken door een interview met emeritus hoogleraar Sylvester Eijffinger. Hij uit zijn bezorgdheid over het gebrek aan vertrouwen in de financiële wereld, de opkomst van de digitale euro als een aardverschuiving, het gebruik van de verkeerde rekenrente en zorgen over lagere pensioenen.

Sarita Gosrani, Kathryn Saklatvala en Frans Verhaar belichten de toegenomen integratie van ESG-factoren (Environmental, Social, and Governance) in veel beleggingsportefeuilles en de impact daarvan op het aanstellingsbeleid van externe managers. Aan de hand van vier uitdagingen brengen ze de geloofwaardigheid van externe beheerders op het gebied van ESG in kaart. Hierdoor wordt het onderscheid duidelijker tussen beheerders die ESG enkel in woorden belijden en diegenen die het ook daadwerkelijk in praktijk brengen.

Met trots kondigen we aan dat Anna Dijkman de nieuwe columnist van het VBA Journaal is. Zij is momenteel redacteur en columnist bij Het Financieele Dagblad en heeft in het verleden diverse rollen vervuld in de mediasector. Haar eerste column behandelt de valkuilen die kunnen optreden bij het uitbesteden van vermogen.

Bij uitbesteding is de kwaliteit van de operationele organisatie net zo belangrijk als de beleggingsinhoudelijke kwaliteiten van een beleggingsorganisatie. Michiel Vetkamp, Evelien Starren, Hylke Bijma en Matthijs Verspeek werpen hun licht op de gevolgen van de COVID lockdown voor het proces van Operational Due Diligence.

Peter Laaper bekijkt Due Diligence vanuit een juridisch perspectief als (AIFMD)-beheerder van een beleggingsportefeuille die een derde inschakelt voor een deel van het vermogensbeheer. Hij richt zich daarbij op onderwerpen die vaak onvoldoende aandacht krijgen in de praktijk, zoals onderuitbesteding en wijziging in de eisen als gevolg van nieuwe regelgeving of veranderde wensen bij de beheerder.

Naast de column van Anna Dijkman zal vanaf nu ook een redactielid van het VBA Journaal een column verzorgen. De hoofdredacteur, Gerben de Zwart, neemt de eerste column voor zijn rekening. Hij introduceert XP due diligence dat door verschillende generaties anders geïnterpreteerd kan worden.

De boekreview in dit nummer wordt verzorgd door Lodewijk van Kroft. Hij bespreekt het boek " The Intelligent Fund Investor" van Joe Wiggens. Dit is een van de weinige toegankelijk geschreven boeken over fonds- en managerselectie.

Tot slot rest ons alleen nog om u in deze zomer veel leesplezier toe te wensen met deze editie over Due Diligence.

Namens de redactie,

Manon Hosemann, Michel Wetser en Gerben de Zwart

Celebrating: the CFA Charter Award Ceremony, 5-Year Merger Party and RBA Graduation Ceremony June 2023

Een benchmark kun je uitbesteden, maar niet je eigen verantwoordelijkheid

Ton Schrijen en Hilde Veelaert

Inleiding

In lijn met de groei van duurzame beleggingen groeit ook de behoefte aan en het gebruik van duurzame indices.

In 2019 waren er wereldwijd al meer dan 37.000 duurzame benchmarks[1] van verschillende aanbieders en dit aantal is in de afgelopen jaren alleen maar sterk toegenomen. Door de grote verscheidenheid aan duurzaamheidsvoorkeuren hebben grote benchmarkproviders in de laatste jaren ook vele "off the shelf" duurzame benchmarks ontwikkeld voor verschillende duurzame thema's. Daarnaast zijn er in samenwerking met asset managers ook diverse "customised" (op maat) gemaakte benchmarks ontworpen. Er is een hoop te kiezen voor (institutionele) beleggers en asset owners. Maar hoe stel je nu een duurzame benchmark samen en welke overwegingen spelen hierbij een rol? En hoe kijkt de Nederlandse toezichthouder naar deze producten?

Als duurzaamheidscommissie wilden wij dan ook graag een event organiseren waarbij deze vragen centraal stonden. En daarnaast bewustwording creëren voor de verantwoordelijkheid die we als asset owners en -managers blijven houden. De sprekers op het event waren: Arian Borgers (Philips Pensioenfonds), Robbert Edwards (Morningstar) en Jurgen Veenker (AFM). Het event werd gemodereerd door Martijn Huijnen (SER).

Hoe maak je een duurzame of ESG-benchmark?

Bij het maken van een keuze uit de verschillende bestaande "off the shelf" duurzame benchmarks is het belangrijk om de achterliggende methodologie goed te doorgronden. Ondanks de vele mogelijkheden, kan het zijn dat een bestaande benchmark nog niet helemaal goed aansluit bij het eigen beleid of de visie van een asset owner. In die gevallen is het een goede oplossing om samen met een benchmarkprovider een "customised" (op maat) gemaakte benchmark te creëren, waarin alle voorkeuren en beleidskeuzes meegenomen kunnen worden.

Figuur 1 geeft een overzicht van de karakteristieken waarover een keuze gemaakt dient te worden. Een benchmark zal altijd 'rule-based' zijn met een duidelijk omschreven methodologie waarin toegelicht wordt wat het startuniversum (parent index) is en vervolgens hoe en op basis van welke data duurzame keuzes tot stand komen. Belangrijk is ook een toelichting op de wegingsmethodiek en hoe het onderhoud van de index plaatsvindt. Hoe vaak worden de gewichten van de individuele aandelen (of breder gezegd effecten) in lijn gebracht met de "parent index"? En hoe vaak wordt de ESG-data bijgewerkt? Belangrijke criteria waaraan een benchmark en de benchmark methodologie in iedere geval moet voldoen zijn: rule-based, belegbaar en representatief. Daarnaast is transparantie belangrijk zodat gebruikers van benchmarks de juiste informatie tot zich kunnen nemen en inzicht hebben in de gemaakte keuzes.

Bij de keuze van de ESG-data en betrokken aanbieder is het belangrijk om goed te begrijpen waarvoor de data staat, wat de kwaliteit van de data is en of deze past bij het ESG-beleid dat beoogd wordt. Het is belangrijk om niet over één nacht ijs te gaan bij de keuze voor de onderliggende ESG-data die ten grondslag ligt aan de index. Deze heeft een grote impact op de portefeuille (bijvoorbeeld: via uitsluitingen) alsook op de kwaliteit van de implementatie van het ESG-beleid en dus de representativiteit.

Een belangrijke opmerking over ESG-data op dit moment is dat ontwikkelingen zich snel opvolgen. Zo komt er steeds meer ESG-data beschikbaar, zijn er nieuwe inzichten en wordt er gewerkt aan meer wet- en regelgeving. Tezamen heeft dit een sterke invloed op de onderliggende ESG-data methodologieën waarmee de data tot stand komt, waardoor deze sterk verandert in de loop van de tijd. Hierdoor is het lastiger om

AGENDA

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Annual Dinner
PL 1 CREDIT

27 september 2023
Dutch Performance Measurement Round Table
PL 3 CREDITS

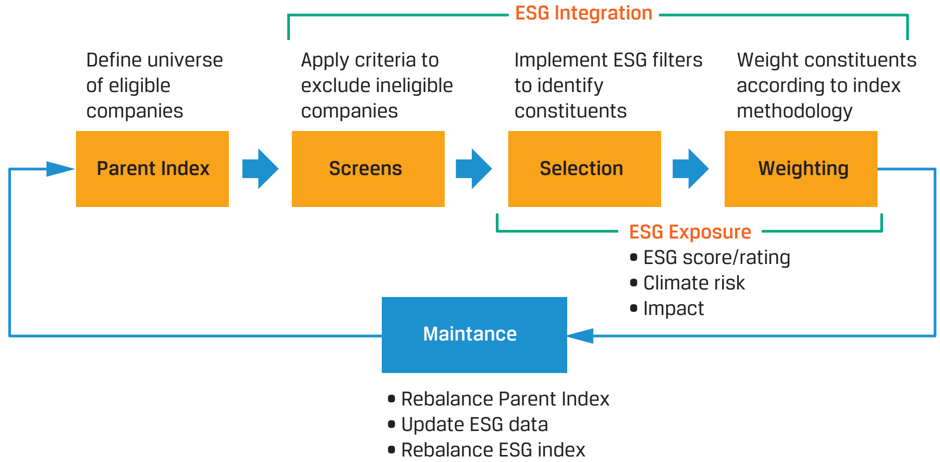
2 november 2023
ALM congres
PL 6 CREDITS

backtests uit te voeren op een nieuwe duurzame benchmark.

Ook de keuze van het wegingsmechanisme is belangrijk en kan een grote invloed hebben op het risicoprofiel van de ESG-benchmark versus de Parent Index. Veel voorkomende keuzes voor wegingen zijn market cap gewogen, gelijk gewogen en meer recent met overwegingen gebaseerd op bepaalde ESG-factoren.

Qua onderhoud wordt er vaak voor gekozen om 2 of 4 maal per jaar volgens de rule based vastgelegde methode de benchmark te updaten voor nieuwe ESG-data. Dit kan leiden tot een andere samenstelling van de benchmark. Er kunnen aandelen bijkomen of verdwijnen uit de benchmark of het gewicht van een individueel aandeel kan wijzigen.

Figuur 1
Karakteristieken en keuzes in samenstellen ESG index, bron Morningstar presentatie



Wat zijn de meest voorkomende categorieën ESG-benchmarks?

ESG-benchmarks zijn onder te verdelen in 4 grote categorieën (figuur 2):

1. Best in class benchmarks
2. Exclusionary
3. Optimized
4. Impact of thematisch

De Best-in-class benchmarks, die de beste duurzame bedrijven binnen een sector selecteren, hebben als voordeel dat sector afwijkingen versus de parent index beperkt blijven. In het geval van uitsluitingen op specifiek gericht op één thema: zoals fossiele brandstoffen, kunnen er sector afwijkingen ontstaan en kan de tracking error (TE) oplopen. Geoptimalizeerde ('optimised') indexen maximaliseren een bepaalde uitkomst, in het geval van duurzame benchmarks is dat vaak de implementatie van het ESG beleid in combinatie met het controleren van sector en stijlrisico's waardoor de TE laag kan blijven. Dit gaat wel enigszins ten koste van transparantie. Thematische indexen selecteren aandelen binnen een bepaald thema zoals biodiversiteit of de energietransitie. Zij hebben in regel een hogere TE versus de Parent Index. Op het vlak van duurzaam investeren is er geen one-size-fits-all aanpak, er is een spectrum dat loopt van 'negatieve duurzame uitkomsten voorkomen' tot 'positieve duurzame uitkomsten bevorderen' (en soms heel gericht op een thema). Hierbij is er altijd een afweging en wisselwerking tussen: market coverage, tracking error en duurzaamheidsverbetering. Het een gaat mogelijk ten koste van het andere.

Case study Philips Pensioenfonds

Tijdens het event gaf Arian Borgers een inkijk in het proces dat Philips Pensioenfonds recent heeft doorlopen bij het aanpassen van de aandelenstrategie om de beleggingen meer in lijn te brengen met een selectie van de SDGs (duurzame ontwikkelingsdoelen).

Philips Pensioenfonds heeft een beleid voor maatschappelijk verantwoord beleggen, omdat:

- deelnemers hebben aangegeven dit belangrijk te vinden;
- het Pensioenfonds als grote belegger een maatschappelijke verantwoordelijkheid heeft;
- en maatschappelijke aspecten van invloed zijn op het risico en rendement van de beleggingen.

Het beleid is onder andere gevormd door te kijken welke SDGs het meest in lijn zijn met het beleid van de aangesloten ondernemingen Philips en Signify.

Figuur 3

Vervolgens werd een uitgebreide uitvraag onder deelnemers gedaan naar onder meer:

- Kunnen de deelnemers zich vinden in de geselecteerde SDGs?

Figuur 2
Overzicht verschillende ESG categorieën met kenmerken, bron Morningstar presentatie.

Type of ESG Index	Tracking Error/ Turnover	Benefit	Downside	Example	Portfolio fit
Best-in-class/ Integration	Low/Medium	Simple to understand/ easy to implement	Less control over TE	Reduce ESG Risk and ±2% sector exposure	Core holding
Exclusionary	Low/Low	Easy to implement	Light touch/Blunt instrument	Ex-fossil fuel	Core holding
Optimized	Low/Low	Most control	"Blackbox"	Achieve Paris Aligned Benchmark Status	Either
Impact/Thematic	High/High	High Conviction	High Risk/ Concentration	Renewable Energy/ SDG	Satellite

- Op welke wijze kan het Pensioenfonds dit implementeren in de beleggingsportefeuille?
- En hoe ver moet het Pensioenfonds daarbij gaan?

Er was een hoge mate van response op het deelnemersonderzoek (circa 25%) waarbij de deelnemers overwegend aangaven een duidelijke voorkeur te hebben om duurzamer te beleggen en dat zij zich konden vinden in de keuze voor beleggingen die bijdragen aan SDG 3, 11, 12 en 13 (figuur 3).

Daarna ging de ontwikkeling van de beleggingsoplossing van start. Philips Pensioenfonds heeft de kennis en ervaring om dit proces samen met uitbestedingspartners te doorlopen. Er werd gekozen voor een passieve beleggingsstrategie tegen een benchmark op maat. Een geschikte oplossing voor het Pensioenfonds om diverse redenen waaronder voldoende verwacht rendement tegen lage kosten.

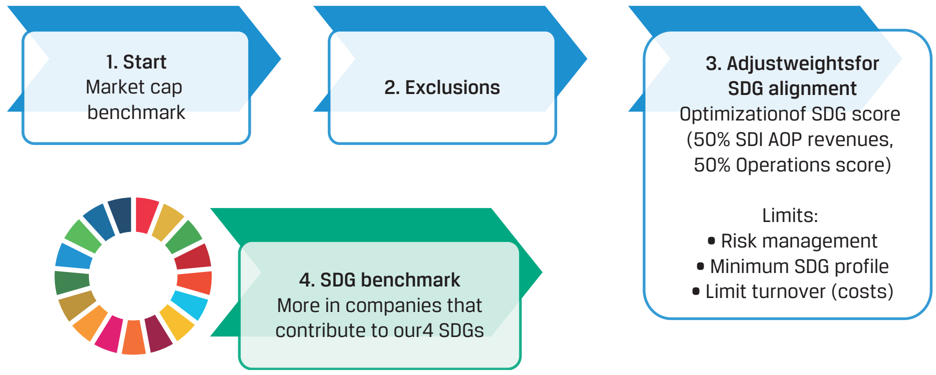
In een volgende stap werd de benchmark verder uitgewerkt. Waarbij de asset manager van Philips Pensioenfonds analyses heeft uitgevoerd die het Pensioenfonds kon gebruiken bij het maken van keuzes in de benchmarkconstructie. Het project heeft van initiatie tot en met implementatie van de benchmark een jaar in beslag genomen. Gedurende het project werden besluiten genomen over onder meer: de data bronnen, de benchmark provider, brede benchmark criteria, gedetailleerde benchmark criteria, implementatie en communicatie.

Het resultaat van het project was een SDG benchmark met de volgende kenmerken:
- Tracking error van ongeveer 85 bp
- 20%-punt meer blootstelling aan bedrijven die meetbaar bijdragen aan de SDGs met hun producten en diensten t.o.v. de standaard marktwaarde gewogen benchmark (van 15% naar 35%)
- Extra uitsluitingen van bedrijven die het behalen van de SDGs tegenwerken door hun bedrijfsvoering of met hun producten en diensten
- 30% lagere CO_2 intensiteit

Perspectief van de AFM

De AFM ziet steeds meer duurzame benchmarks en deed recent onderzoek naar de mate waarin benchmark statements en

Figuur 4
Process – Parent benchmark to SDG benchmark



benchmark methodologieën van benchmark providers voldoen aan de transparantie-eisen van hun benchmarks in relatie tot de openbaar te maken ESG factoren. Het belangrijkste doel van de AFM is het bewaken van de transparantie, zodat gebruikers van benchmarks de juiste informatie tot zich kunnen nemen.

Gezien het mandaat van de AFM richt zij zich op benchmark administrators in Nederland. Er zijn binnen de EU circa tachtig partijen actief, waarvan negen in Nederland.

De benchmark verordening[2] is met name tot stand gekomen in de periode na en als reactie op het LIBOR schandaal. Deze gebeurtenis maakte duidelijk dat er meer behoefte was aan regulering rond benchmarks. De benchmark verordening richt zich op het verhogen van transparantie, nauwkeurigheid en robuustheid. Een benchmark mag geen black box zijn: het moet duidelijk zijn voor de gebruiker hoe bepaalde indicatoren gekozen worden en tot stand komen, en of de daaraan gerelateerde uitlatingen juist zijn. Benchmark administrators moeten daarom van de wetgever verschillende informatie templates invullen. Voor duurzame benchmarks moet in deze templates extra data worden ingevuld zoals onder meer: carbon intensiteit, percentage beleggingen in tabak, percentage beleggingen in controversiële wapens.

In recent onderzoek heeft de AFM onderzocht of de vereiste transparantie over duurzame factoren ook daadwerkelijk gepubliceerd worden. De uitkomst is dat veel benchmark administrators de vereiste data publiceren en vaak zelfs nog meer. Dat is goed nieuws! De gebruikers van de benchmarks krijgen hierdoor meer informatie. De AFM stelde echter ook vast dat de informatie soms nog moeilijk te vinden was, doordat deze vaak over verschillende documenten verspreid was en niet altijd de juiste templates gebruikt werden. Dat maakt het voor de gebruikers moeilijk om alle informatie te vinden en te vergelijken.

Conclusie

Als asset owner is het inmiddels mogelijk om duurzaamheidsbeleid te implementeren in een benchmark. Het aantal beschikbare duurzame benchmarks is sterk gegroeid en er zijn ook diverse benchmark aanbieders waarmee gezamenlijk een benchmark op maat kan worden gemaakt. Bij de constructie van een duurzame benchmark moet een keuze gemaakt worden over het gebruik van ESG-data. Deze data zijn nog volop in ontwikkeling en hebben een grote invloed op de duurzame uitkomsten van de benchmark. Voor bestaande benchmarks wordt al informatie gepubliceerd over welke duurzame data gebruikt wordt en hoe dat gebeurt, alleen is deze informatie niet altijd goed terug te vinden.

Concluderend: via een duurzame (ESG) benchmark kun je de implementatie van je duurzaamheidsbeleid uitbesteden, maar je verantwoordelijkheid niet!

Noten

1 The Benchmark that Changed the World | S&P Global (spglobal.com)
2 Benchmark verordening: EUR-Lex – 32016R1011 – EN – EUR-Lex (europa.eu)

Reflections on the role of behavioral traits in the Due Diligence process

MINDSET MATTERS BOTH WAYS TO REDUCE THE ROLE AND IMPACT OF BIASES AND HEURISTICS

Mark Geene[1]

INTRODUCTION

Investing and financial markets are two components underpinning the science of Economics. Subsequently, Economics in itself, features in the wider group of social sciences. Whilst the use of models can add value in this space, information analysis and decision making are always propelled by human behavior. The behavior of economic actors is influenced by their characters, moods and emotions at the time of 'acting' and well-known behavioral biases and heurists. Behavioral characteristics, or so-called traits like attention to detail, curiosity, creativity, perseverance and drive are all important in investment management, but are also key ingredients to, for example, the career of the most successful professional athletes. In both professions, the stakes are high and performance is measured, transparent and compared by the entire (financial) world. These traits, combined with 'technical' financial knowledge were evidenced by individuals uncovering irregularities at firms like Enron, MBIA, Wirecard, Madoff-funds and even the underpricing of risks in subprime mortgages during the 2000s. In other words, these personality traits are very relevant as part of the due diligence (DD) process on investment managers to uncover both true alpha as well as risks. It also goes both ways. Not only is it about how traits and the character of persons matter when performing a DD, it is important to understand which traits of an investment team are important to assess during a DD. The secular shift towards ESG- and impact-investing and increased focus on engagement activities by asset owners and managers will further increase the role of these personal traits for the investment industry in general.

This article explores the traits of a DD-team and the traits of an investment manager to be assessed during a DD as just one part of an extensive set of activities performed throughout a comprehensive DD that can improve the quality of the DD-results. However, these traits are not just relevant for a DD, but these are in general important traits and skills for all investment professionals to pay attention to in our challenging and continuous evolving environment. Likewise these traits are relevant to embed in teams consisting of regulatory professionals, corporate finance experts and investment bankers as well as forensic accountants.

First, this article starts with describing where the assessment of traits fits in the DD-process and why it matters. Subsequentially, it describes the traits relevant for teams performing a DD. The next paragraph elaborates on the traits of the investment team to be assessed during the DD process. Lastly, this article concludes with the two key takeaways for CIO's or managers who are responsible for DD-activities, but these are similarly relevant for investment professionals in general.

BEHAVIORAL CHARACTERISTICS: WHY IT MATTERS AND WHERE IT FITS WITHIN THE DD-PROCESS

Assessing an investment manager as well as making continuous decisions on investments in a portfolio requires searching for and analyzing information succeeded by decision making. In the last

Mark Geene
Senior Investment Consultant PGGM

decades, numerous papers and books have shown that both of these processes (information processing and decision making) are prone to human biases and heuristics.[2] Therefore decision making in investing never recedes to rational decision making, nor is it entirely quantifiable like in Physics. Biases and heuristics are determined by, among other factors, behavioral traits of a person as well as his emotions and mood at specific moments in time. Paying attention to these traits, or otherwise stated the personality and character of people involved, is instrumental for all investment professionals. This article will show how this relates to DD.

REFLECTIONS ON EXPERIENCE WITH DD AND THE ROLE OF TRAITS WITH BOTH INVESTMENT PROFESSIONALS AS ACADEMICS

The assessment, observations and statements in this article on the role of traits in the DD-process are based upon combining 25+ years of DD-experience and investment decision making with being a lifelong student of behavioral finance.
The observations on DD's include DD's on a wide range of investment strategies and asset classes, but also assessing how other investment managers and/or teams perform DD's. That experience informed me about the universal role of traits for a broad set of investment strategies. The traits listed below are also informed by the traits acknowledged as important for investigative journalists, forensic accountants and intelligence agents. These professions, like DD- and investment activities, entail deep dive research in a wide range of information sources, overcoming hurdles and obstacles along the way and subsequently derive conclusions. The assessments and observations in this article are of my own, but during my entire career I have reflected upon these matters with both colleagues as well as academics. In other words these are based upon abductive reasoning.

> PROFESSIONAL SPORTS AND INVESTING SHARE LOT OF SIMILAR REQUIRED TRAITS

The article does not cover the financial and quant skills that are directly related to an investment process. Reason being is that these depend upon the investment strategy. However, there is a continuum, overlap and cross dependency between individual behavioral traits versus pure technical skills and abilities. Two important social traits, being cooperative and having a team mentality, are addressed as combined with the individual behavioral traits these will improve the quality of the analysis and decision making of the team.[3]

ASSESSMENT OF TRAITS AS A CRITICAL PART OF THE DD-TOOLBOX

My humble goal is to describe several important traits to consider during a DD process and why these are important. Each part of the investment process, including decision making, that is assessed by a DD-team is influenced by human behavior impacted by traits. So, the objective for listing these is to use the list when building a DD-team and performing the actual DD. Deliberately paying close attention to traits and assessing these during a DD will add to the comprehensiveness and quality of the process as well as the assessment of the investment manager and his team. It improves the understanding of the investment process and assists in identifying minor and major risks in the strategy and the investment management organization. Subsequentially, it also matters for decision making regarding in or out as well as sizing the investment in the manager. Therefore it also relates to risk management and it is relevant for both Investment DD-(IDD) and Operational DD-processes (ODD).

The traits in the two subsequent paragraphs are relevant for both DD-teams and an actual investment teams, though their degree of importance differs. The relative importance relates to the following factors:

1. The number of decisions a team makes.
2. The role and potential usage of feedback without too much delay.
3. The ability and costs to adjust the investment decision afterwards.

A DD team investing in just a few managers on an annual basis will be less able to learn from its decisions, compared to a manager investing in listed equities with a relative diversified active investment approach. The latter can learn from making hundreds of investment decisions, including sizing and trading, each year, thus learning from recent experiences when applying the process. Mauboussin (2012) expands on this point further. In addition the portfolio manager (PM) can easily adjust positions if he determines he wants to exit. This contrasts with investing in private equity or funds with longer term lock-ups funds or even directly in illiquid private investments. For these investments, both the IDD and ODD-teams or the investment management team has to make sure it has done all the thorough efforts and deep dive research before making an investment. Adjusting afterwards, based upon new information that potentially could have been uncovered during the DD process, often results in significant transaction costs switching to another manager. Therefore traits like being skeptical and surgical are relatively more important for the latter strategy.

OBJECTIVES OF A DD: FINDING A STRONG PERFORMER AND UNCOVER MOST OR ALL RISKS

Selecting an external investment manager and assigning mandates worth millions or even billions of Euros requires a high level of fiduciary duty. Risks associated with selecting a 'disappointing' manager can result in monetary losses like lagging performance or misappropriation of funds in the event of fraud, but also less directly through performance drag from locked up capital, switching costs to another manager, reputational risks and even claims from asset owners or beneficiaries. Therefore, a thorough and structured DD is required to reduce above stated risks. It adds to the quality of decision making and documentation of the different steps and being more comfortable with the selection. However, one should never rule out the possibility that investments turn out different than expected.

The initial stage of a DD process involves describing the objectives and scope of the DD. In this article, the aims of a DD are to provide an extensive and thorough assessment of the quality of an investment manager and its ability to deliver upon the investment objectives of the asset owner. I.e. delivering at least the expected (relative) performance within the agreed upon risk- and ESG-parameters. Some of the most important activities of a DD are:

1. Assessing the quality of the investment philosophy, process, team, firm and its ESG qualifications.
2. Assessing the consistency across the triangle of:
   a. investment process as described in the document like a Requests For Proposal,
   b. verbal descriptions of the process and most importantly,
   c. detailed performance analysis.

   This assists in assessing if historical performance was achieved via luck or skill.
3. Identify red flags that can result in risks after making the investment. This concerns both IDD and ODD-topics which potentially can be mitigated or avoided via contractual agreements or organizational adjustments.

The scope of the article is not specifying all the different steps, stages and analysis of a DD process and subsequent decision making. However, awareness of behavioral biases and heuristics is part of each step as performing each stage is influenced by humans and not just a pure technical exercise. It always includes judgement around which information to use, the observations from data analysis, reflections on interviews etc. This determines the behavioral requirements of the team performing the DD. These are described in more detail in the following paragraph.

BEHAVIORAL TRAITS OF DD-TEAMS AND RELATED TOOLS & TECHNIQUES

This paragraph describes the basic traits each DD-team needs to have. It additionally lists several related behavioral tools and techniques that can assist the DD-team.

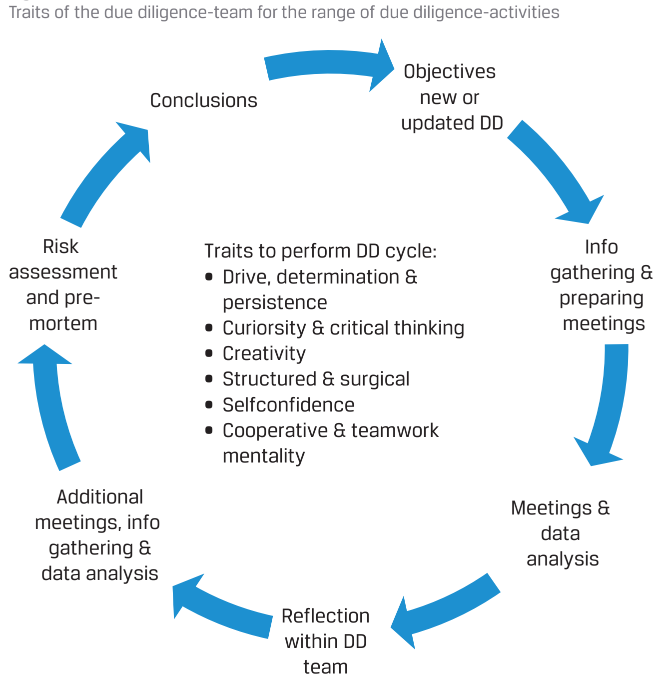
TEAM TRAITS AND COMPLEMENTARITY

As stated above, a DD requires a range of different steps and a very thoughtful and meticulous approach. This can only be achieved if the DD team, besides having the investment and analytical skills, data and tools, sufficient time and budget, has a range of essential behavioral qualities among them. It is not required that each member exhibits all traits, however a CIO or manager leading DD-activities must assess if each trait is sufficiently present across the DD-team. Not only should each trait be present in the team, the team also needs to use all traits at each stage of the DD. These traits are important for the depth and breadth of the analysis and reduce risks from biases and heuristics during this process. Figure 1 contains the list of important traits after which the role of each trait in the DD process is substantiated. One should note that it is often the amalgamation of several traits that makes the role of these traits for a DD easier to comprehend. A CIO has to spend sufficient time to assemble a DD-team that has all traits, but also the complementary additional investment and analytical skills. Explicitly: the proper composition of the team. He should pay special attention to the complementarity of characters, skills and traits, but also on how associates or juniors can be part of a team to train and mentor these persons. In addition, when performing an update DD on a current external manager always at least one pair of fresh eyes should be included. It reduces endowment effects, anchoring and confirmation biases. Finally, to round off on team traits, diversity in the team and a 'healthy' level of staff turnover is appropriate to reduce group think, but it should not be to the detriment of decisiveness.

SIDESTEP: ARE INVESTING AND SPORTS ALIKE?

It is by no means a coincidence that several of these traits are also important in professional sports and some of the tools and techniques stated below are derived from analytical tools and concepts used in sports to increase the odds of the outcomes of skill versus luck.[4] Also there have been examples of coaches that have been used by investment firms, not to explain how finance works, but to share information on how an investment team can learn how to assess and use traits and skills related to 'performance' in multiple ways. Professional cycling, football, and even F1 teams are continuously updating their 'hardware' and combining it with psychologists to improve performance, thereby bridging the gap between art and science, but also combining soft skills with hard skills. Investing and performing DD is comparable to professional sports at the highest levels and this comparison is amplified as the stakes are similarly high.[5] These high stakes are not based on the extent of '*fame and glory*' achieved, but instead the millions and billions that can be gained or lost when selecting and sizing an investment and especially an investment manager.[6]

Figure 1
Traits of the due diligence-team for the range of due diligence-activities



Source: Mark Geene

In the next subsections the background of the traits is explained.

DRIVE AND PERSISTENCE 'DRIVES' DD QUALITY

Drive and a passion to achieve strong results for clients and beneficiaries are maybe the most important traits for a thorough DD and amplify the impact of the other traits. One might have a curious mindset, embrace critical thinking and have attention to detail, it still requires going for the extra mile to uncover risks and seek an ever wider set of available information. Drive ensures the DD will be both sufficiently broad and deep.
Drive and determination also assist in the thorough preparation for the DD-meetings with the investment team, including preparation for different scenarios across a DD-process as well as during meetings. One needs to study the portfolio in sufficient detail as well as the fundamentals of companies in the current portfolio and/or previous positions to go in depth with the PM and analysts to assess the quality of their analysis and portfolio management skills. Otherwise, one would take their observations and investment conclusions for granted, while being unable to challenge them with varying views. It could result in falling into the trap of anecdotal evidence.

DETERMINATION AND NOT GETTING CLEAR ANSWERS AS A RED FLAG

During the process, the team has to be determined to have their questions answered whereby its members also understand the reasoning behind the answers. If the manager does not want to answer a question or evades it, one should carefully consider if one wants to proceed with the DD and a potential subsequent investment. A DD-team has a fiduciary duty towards its employer and beneficiaries to be determined to undercover and understand all issues.

CURIOSITY, CRITICAL THINKING AND BEING SKEPTICAL COMBINED WITH CREATIVITY REDUCES BIASES AND BEING NAÏVE.

Any member of the DD-team has to be sincerely interested to understand the entire investment process and be willing to critically assess and validate its foundations and the execution of the process. One trait in line with curiosity and critical thinking is a skeptical mindset and embrace the ‘trust but verify’ mentality. That latter trait, combined with persistence and perseverance and creative thinking can overcome availability and confirmation biases and avoids neglect. This entails putting the effort into finding different information sources, interviewing additional people etc. In other words, a deep dive in the ‘dark matter’, activities and processes that are harder and less often or not researched, and seeking non-conforming evidence. It also includes playing devil’s advocate, especially towards the finalization of the conclusions of the report, i.e. the decision making. Preferably this includes a pre mortem as well. These techniques also assist in overcoming herding behavior. Again, drive is important as often times one encounters interference, resistance or even obstruction when researching unexplored ‘territory’, sometimes even within its own company. Critical thinking also assists in avoiding basing conclusions on lively anecdotes of past, usually profitable, investments of the manager or being deluded when bombarded with a breath of mostly irrelevant information. In addition to avoiding availability and information biases, critical thinking also reduces the risk from representativeness biases.[7]

> DUE DILIGENCE IS NOT TICKING THE BOX, BUT THINKING OUTSIDE THE BOX

Traits linked to creativity are also being flexible and agile. The investment industry is changing constantly and investment processes differ between managers and even more between asset classes. Being sufficient flexible is an important trait for the DD-team, especially when researching unexplored territory.

TRUST BUT VERIFY AND CONSISTENCY CHECKS

A ‘trust but verify’ and a skeptical mindset are both important for the consistency checks in a DD as one of its goals. I.e. assessing if statements in a RFP are consistent with the verbal explanation of the process by the investment team members as well as the subsequent actual and historical investments (sizing, trading, etc.). Trust but verify also comes into play after a DD meeting, when one digests and recaps the breath of information. If one cannot comprehend the information or inconsistencies are identified and concerns arise, one should address it again and again until the issue is resolved. Traits as determination and perseverance are again important for this.

ANALYTICAL SKILLS: METHODOLOGICAL, DISCIPLINED, STRUCTURED, ATTENTION TO DETAIL AND SURGICAL PRECISION

A DD-process should never be a chaotic unorganized set of activities. It requires a methodological, disciplined, structured, well thought out planned set of activities. This reduces risks linked to neglect and the availability bias. It is important to determine the objectives of each step in the DD-process, the meetings, the different analyses and how to structure all information gathered in such a matter that an informed conclusion can be made. Preparing, examining and digesting all the information sources during the DD-process requires having sufficient analytical skills within the team. Also part of the analytical traits and skills in this article is sufficient attention to detail and being surgical in ‘peeling down’ the investment process and performance attribution from high level characteristics, to the individual parts like positions and trading decisions.

SELF-CONFIDENCE

Last but not least, one important trait is having sufficient self-confidence in one’s ability to assess the breadth and depth of the information and being comfortable (‘no stress’, ‘no fear’) to discuss these at an informed level with the PM and analysts. I.e. not being submissive. Self-confidence is partially ingrained (or not ingrained) in the individual, but can be enhanced by the combination of experience with DD’s (number, frequency, breath of strategies). The drive and determination to be thoroughly prepared on the investment process, attribution, single historical and current positions, bios of team members, information from background checks can also increase the level of self-confidence ahead of the DD-meetings. One must also be convinced that there are no meaningless or foolish questions. If one worries about asking the wrong or stupid question, one is already inclined to err on the side of caution of not asking the final decisiveness question to get to the bottom of an issue.

Often times the representative of an investment manager is a very senior person and respected both insight and outside the firm, i.e. an 'authority'. This does not mean one should not ask a diverse set of detailed questions. One should also not shy away from insisting on a clear and direct answer to a question instead of an evasive answer. Being skeptical, having self-confidence combined with a determination to continue to ask questions to resolve an issue is especially important during an ODD to avoid any potential fraud risks in the investment infrastructure or operational processes and procedures.

COOPERATIVE AND TEAMWORK MENTALITY

The DD-process, including the resulting reports and conclusions, involves the combined effort of a diverse team and a range of difference analysis. For both the analysis and the decision making to arrive towards the final DD-conclusions requires being cooperative and having a teamwork mentality combined with the other traits. The manager of the DD-team plays a crucial role to actively solicitate the individual team member, often times somewhat different, conclusions to arrive to a final recommendation or view. For this purpose the process of deliberating with each other is as important as the analysis itself. Synergies arise from being cooperative and having a true teamwork mentality. This implies being curious in and having an open mindset towards different opinions within the DD-team itself and actively solicitate contradictory opinions.[8] Having drive, attention to detail, perseverance and being curious is one part. Having a process to digress on the wealth and breath of information and diverse opinions and bringing it together in a manner that debiases the decision-making process is the second part. The DD-team leader plays a crucial role in preserving that the decision-making structure is in harmony with the behavioral traits and structure and diversity of the team.[9]

ADDITIONAL BEHAVIORAL SKILLS AND TOOLS USEFUL FOR DD-PURPOSES

In addition to the traits above, several skills and tools linked to behavioral traits are relevant in a DD. The first two are important for the DD-team to incorporate, while the remainders are relevant for assessing the behavioral characteristics of the investment manager.

1. **Cross-examination and communication skills.** This concerns skills related to the proper sequencing of topics and questions for a meeting and how to phrase these questions. The latter not only relates to using open or closed questions, but also the specific language used and tone of voice. Especially when going over historically negative contributors to performance or issues at the investment team or firm, this might feel 'confronting' for a PM. One should not shy away from these critical questions. Discussing how these negative events occurred, how he or she responded and how he or the firm has learned from them, should be done in a professional manner.[10] The DD-team members should avoid letting the conversation run out of control. The way the investment manager responds to challenging questions is also informative in itself. Cross-examination and communication skills can be informed by seeking assistance from investigative journalists or (ex)-intelligence agents.
2. **Negotiation skills:** Negotiating fees and other contractual terms, often times at the latter stage of 'positive' DD's, requires a list of additional skills and traits for which some are unrelated to the above. However, these are important to incorporate somewhere in the firm as the negotiations on terms are the cheapest means to improve upon actual results via cost reductions and modification or exclusion of risks. Terms may include but are not limited to: *fees and expenses, key men clauses, most favored nation clauses, redemption terms, liability risks etc.* How to negotiate, including the sequence of matters, use of language, also requires certain skills and traits. Negotiation courses or procurement departments can be used to acquire these.[11]
3. **Background checks on key individuals of the asset manager** will further improve the assessment of the characters of the persons responsible for the investments. It includes verification of bios, reviewing public judicial filings of the corporation and most importantly it's key decision makers. Several specialist firms operate in this field. One can draw parallels with when your firm hires senior staff. It will also assess behavior during interviews and frequently will perform background checks. Why not doing so when allocating billions on behalf of your beneficiaries? In addition, interviews can be held with departed employees and previous investors to gain further insights into, among others, the behavior of key persons.
4. **Behavioral analytics:** These analytical tools assess behavioral decision-making regarding sizing, but most importantly trading in and out of winning versus losing positions. These tools magnify the information about the actual buying, selling and sizing process of the manager. It is used to assess the consistency of the process in writing and by verbal account of the PM with actual behavior around winners versus losers. It will inform you about the role of loss aversion and endowment effects. Several specialist firms on behavioral analytics have tools available to offer these insights if provided with daily position data (Inalytics, Cabot).[12] These techniques can also be used, however somewhat adapted, to both quantitative strategies and private investments. For the latter it relates to assessing potential historical behavior on 'throwing good money after bad money' investments and timing of exits.

BEHAVIORAL TRAITS OF THE INVESTMENT MANAGER

This paragraph provides an overview of the behavioral traits of an investment manager, those of their underlying team members, and their role to be assessed during the DD process. The scope of these traits and skills is broader than those listed for a DD-team as described above. Reason being is that the investment manager is the one who has the discretion to operate within the guidelines and is actually making the investments on a daily basis. This also implies increased tension caused by significant market events (leading to potentially fight or flight reactions with respect to portfolio management), fundamental developments in companies or the negotiations of private investment deals with numerous stakeholders. Due to size limitations, it is not possible to go in depth into each of the traits to be assessed, and how these are directly or indirectly related to investment behavior including potential biases and heuristics. However, because this article concerns behavioral elements relevant in DD, an overview of the relevant traits of the manager itself should be included. The traits should be assessed and documented by the DD-team and evaluated in relation to the investment strategy, process and results achieved. Namely once again the consistency assessment between the process in writing, as implemented by the team and subsequent results.

ASSESSING TRAITS OF THE KEY DECISION MAKERS, THE PM AND IMPORTANT INVESTMENT TEAM MEMBERS

An assessment of the traits of both the PM and other potential key decision makers should be made as well as other important investment team members, including analysts. The importance and role of traits and skills often differs between them. Furthermore, as stated in the previous paragraph all the traits important for the DD-team are also important for actual investment teams. For the sake of completeness, these are included in the list below.

SPECIAL ATTENTION TO KEY DECISION MAKER FOR INVESTMENTS AND THE BUSINESS

The most important reason to place particular focus on the personality of the key decision makers is that personality is ingrained and hardly changes over time. Therefore it will be present during the lifecycle of the investment and likely to be especially present across financial cycles and/or periods of poor performance, in which emotions and cortisol levels increase. Also the personality of a key decision maker is likely the dominant factor driving the philosophy, process, strategy, how he works with staff and not the other way around. As stated above, there should be considerable consistency between his character, personal traits and skills and the way he invests. In other words, character and personality should be significantly reflected in the investment strategy and process of an investment manager (besides his investment skills). Therefore, especially if the ultimate success of both the company and investment strategy is determined by a single person, a deep dive into his traits and skills is required. This includes a detailed background check. If the personality of the key decision maker does not match with the required traits for the specific investment strategy, process and team set up, then a red flag should be raised: avoid a PM wearing a straightjacket that does not fit him.

Character and traits are important in how a person manages the investment, but likewise as much as how he manages the business, the people in the organization as well as how he treats and works with his current, past and future investors and service providers. Also this management behavior has to be consistent: for instance pleasant and friendly to his investors while not being a bully for analysts, traders or brokers either. The DD should also assess his motivations to set up the business and investment strategy: are these consistent and sufficiently aligned with its investors?

USE A STRUCTURED APPROACH INSTEAD OF JUST INTUITION TO GENERALIZE ABOUT A PERSON'S CHARACTER

It is very natural for people and almost automatic to review personality and character, but it is similarly natural to make a mistake at an unguarded moment to fail to assess and/or missing just a relevant personal trait to make a proper assessment. Intuition in the assessment of personality is well acknowledged and helpful, i.e. reliance on 'blink' in daily life matters. However, when investing billions a deeper dive is required. Combining intuition with a documented characterization of a person during a DD further strengthens the assessment and reflection about the traits of key people.

WHY REQUIRE A PSYCHOLOGICAL ASSESSMENT OF A NEW SENIOR COLLEAGUE WHILE NOT FOR YOUR INVESTMENT MANAGER MANAGING BILLIONS?

The assessment of a list of traits is not just a checklist and tick the box exercise. Each considered trait and skill should be assessed as well as discussed among the DD-team as judgements on traits can differ among team members. Listing and describing each briefly makes sure that these are at least assessed and subsequently can be used to cross check with the description of the investment process and how the team operates and makes decisions. Furthermore, a list can be used to reconcile how the manager acted on previous investments using behavioral analytics.

RELATIVE IMPORTANCE OF EACH TRAIT DEPENDS UPON THE INVESTMENT STRATEGY AND THE PERSON'S ROLE IN THE PROCESS

The traits are not meant to be applicable for all investment strategies or all investment staff to the same extent. For example: for more quantitative strategies, traits like being structured and analytical play a more dominant role than for a concentrated short term equity trading style investment strategy. For the latter decisiveness, flexibility, market savviness are more relevant.

Several traits are important for all strategies like drive, passion, being honest and ethical.

Please also note that a 'larger' or 'higher' degree or 'level' of a trait is NOT always preferred (i.e. more is better) for several of the traits listed. Stated differently, perceived quality is not always a positive function of a 'level' of a certain trait. For instance, too much structure implies often that a PM becomes too rigid and not sufficiently adaptive to changing environments. In line with this, too much flexibility often times leads to short termism and insufficient attention towards the consistent application of the process. Depending upon the strategy, the DD-team has to assess if the degree of a certain trait present at a PM and other team members is sufficiently close to the appropriate degree, while the DD-team should also be aware of the balance and trade-offs between the traits. The appropriate degree likewise depends upon the person's role in the process. For instance having an analytical mindset and attention to detail are very important traits for analysts, but these can be paralyzing for a PM. For him the capacity to know what matters and disregard peripheral detail is often critical. Analysts need to focus on the trees and the PM on the forest.

Figure 2 contains three segments of traits and skills, whereby the segment concerning behavioral traits includes several social skills. It also contains a more extensive list of traits and skills versus the other two segments. Reason being is that these latter are not the focus area of this article.

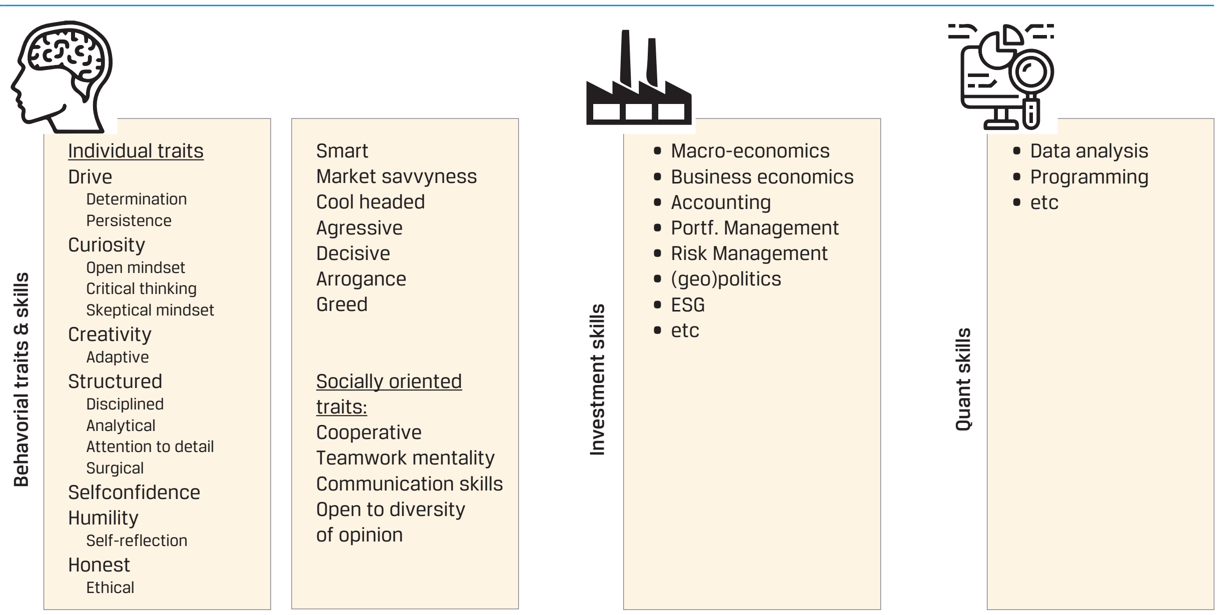
Not all traits in the first segment are described at length because most are self-explanatory or already described above. Below, several important ones and those that require additional explanation are highlighted below and in the following subparagraphs:

- Drive, result oriented: The passion for investing and generating excess returns and go for the extra mile.
- Curiosity and being open minded: Constant seeking new and additional information to avoid confirmation biases. It also entails being skeptical towards, among others, input and research from external sources like 'experts' and sell side research.
- Adaptive and constant learning: Society and financial markets are changing constantly. Together with being open minded, an investment manager should be sufficiently adaptive and eager to learn if changes to the process and portfolio are required.
- Humility and self-reflection: This includes awareness and acknowledging one's own weaknesses resulting in mitigation efforts towards these vulnerabilities. It requires a 360 degree mentality, not letting ego stand into the way of investments and being open minded. I.e. frequently critically looking in the mirror on process, business and staff. In addition to actively soliciting feedback from colleagues and investors, it includes systematically collecting and analyzing previous good (could be luck) and bad investment decisions for learning purposes. One of the questions one should always ask during a DD is: *How frequent do you assess any vulnerabilities, biases or heuristics in your investment process and how do you debias the process including decision making?* Subsequently one can ask about the experiences from applying debiasing techniques have been.[13]

HOW HAVE YOU DEBIASED YOUR INVESTMENT PROCESS?

- Honest and ethical. These traits of key decision makers should be applied by them at all levels of activity: investing, business matters, including interaction with staff and investors. It includes straight talking and providing direct answers to

Figure 2
Overview of traits and skills to be assessed during a due diligence



Source: Mark Geene

investors. It implies not hiding information or come up with evasive answers or unrepresentative anecdotes.

- ‘Smart’ and ‘wisdom’: With smart and wisdom I mean something different from intelligence. It concerns the proper, profitable and relevant application of intelligence towards the investment objectives, but also including most of the above like acknowledging and mitigating personal weaknesses. *Know what you don’t know or not capable of.*

THE COMBINATION OF TRAITS AND THE TRADE OFFS

It is the combination of traits that determines the quality of the investment manager. In addition one has to have an appropriate ‘level’ of relevant traits in the team. Too much drive and ambition to achieve results, combined with overconfidence can result into hubris, blind spots, doubling down on poorly performing investments and/or pressing staff too hard resulting in turnover or unethical behavior.[14] Also the manager might press for an increase of assets under management (business goal) and spend too much time on the investor side of the business at the detriment of the investment objectives. He should also always remain critical and avoid becoming attached to positions. The combination of a sufficient degree of curiosity, eagerness to learn and humility is helpful to introduce measures to mitigate or even avoid biases including self-attribution bias, overconfidence and hubris as well as the affect heuristic.

Depending upon the investment process and strategy one carefully has to assess if the PM is aware of the subsequent tradeoffs and how he balances traits as creativity, adaptiveness, open minded and critical learning versus being structured and disciplined. A few examples of these trade-offs are:

- For a more long term fundamental or systematic investment strategy: How does he avoid jumping on the latest fads or promising (sub)sectors in the market or in investment data and analytics (like AI, big data etc.) versus a rigorously developed, implemented and time tested process? How do you balance an open mind and adaptiveness to new information regarding a company or (sub)sector or technical market events drifting prices away from your own fundamental assessment versus remaining disciplined and determined (persistent) to the position in a company and/or investment theme?
- For a more shorter term or trading style strategy: how does he combine being disciplined and cool-headed, and not letting emotions drive decision making while also remain market and risk savvy and act aggressive and decisive if needed?[15] This includes seizing upon investment opportunities in difficult times and the ability and willingness to act contrarian by not letting emotions of team members or clients stand in the way of taking advantage of market circumstances. Such tradeoffs are informed by having self-confidence and remain emotionally detached from individual positions.

TRAITS TO BE AVOIDED

This paragraph rounds off with several traits that are mostly negatively related to the quality of an investment manager. If present at the key decision maker, these should be assessed thoroughly in how these influence the investment process. If one is sufficiently comfortable, one can proceed with the DD-process, otherwise one can either terminate the process prematurely or introduce mitigating measures in the investment contract and develop specific monitoring items subsequent to the investment.

- Arrogance: A moderate degree of self-confidence for a PM is important. Reason being is that, for active strategies, he must have the view that markets are wrong or are underestimating the value of an investment. He must also have confidence he can outperform the markets, which is already difficult when the majority of empirical and academic evidence is against it. However, a too high degree of self-confidence can result in arrogance, overconfidence and attribution biases, but also in risks of not taking into account diversity of opinions or views on the process and actual investments. I.e. risks arising from the availability bias and neglect. If the key decision maker acts arrogant it can also negatively impact team morale and result in unnecessary turnover.
- Greed and seeking status among peers: Too much greed can severely harm investment results. It can lead towards asset gathering beyond the maximum capacity of the strategy at the detriment of performance. Greed can also result in being overly focused on performance instead of balancing it with risks involved. Especially greed and a singular focus on financial results will be ‘tested’ in the secular drive towards ESG- and impact investing. In the new era, a manager has to balance financial goals with sustainability and impact objectives.

CONCLUSION

This article described the reasoning behind and the role of behavioral traits of DD-teams and the traits of an investment manager to which the DD-team has to pay attention. These traits are important for both public and private investors and DD-teams focused on public and private investments and investment strategies (long only, long/short, active, passive). The balance and importance of the different traits depends, among others, upon the frequency and distribution of the duration of the actual investments and the ability to adjust afterwards including associated costs. The most important traits for both teams, either performing a DD or making actual investments, are drive, curiosity, creativity, being skeptical but combining it with adaptiveness and a cooperative mindset.

The assessment of, and importance of traits and ‘soft’ skills will become even more mission critical when investments objectives secularly expand beyond a sole focus on return and risk towards including ESG and sustainability. It requires paying attention to often times new and/or less well developed processes, insufficient and inadequate datasets and modifying the composition of investment teams with the inclusion of a broader and more diverse set of skills and experiences. Decision making will be less focused on one parameter (risk adjusted performance), but instead more geared towards balancing multiple objectives (performance, risk, sustainability, impact). It will make investment decision more challenging and complex (and interesting) and therefore requires a broader set of skills and traits. I.e. not predominantly investment and quant skills, but an increased level of the behavioral traits as described above.

The two main take aways of this article are the following:
1. Assess the behavioral traits and skills of the DD-team members and make sure that for each DD-assignment the complementary set of team members exhibit the entire list of required traits and skills. Don't shy away from 'embedding' a psychologist in your team.
2. Make sure that the DD-team assesses via a structured and methodological process the behavioral traits and skills. This assessment is ideally augmented by several of the analytical tools and other techniques as described above.

While the key take aways are geared towards DD in this article, these have general application towards and are relevant for all investment and regulatory professionals in todays (investment) environment. Additionally, the conclusions can be applied in related financial activities like corporate finance, investment banking and forensic accountancy.

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Notes

1 This article is written in a personal capacity and represents the opinions of the author and not those of PGGM. I like to thank several anonymous reviewers from both academia and the industry for their input.

2 This refers to the endless list of publications from respected academic authors like Kahneman, Thaler, Shiller, Lovallo, Sibony and di Mascio. Bazerman ea. (2012) is especially relevant for several biases and heuristics described in this article, including the concept of bounded rationality in decision making.

3 The article is not meant to be a definitive list of all relevant traits where each trait can be fully substantiated with both empirical data and psychology theory. However, these are based on a combination of experience and academic foundations. A lot of these also simply come down to common sense, but often times are not checked or verified if present or absent during a DD. A worthwhile expansion on this article can be enriched by psychologists, both academic and practitioners. I have not come across academic papers that specifically address the role, measurement and impact of behavioral traits on a DD-process or actual investment results of funds. Eventhough several empirical studies have shown the role of biases, like loss aversion, on historical trading behavior.

4 See for instance Syed (2016) and Mauboussin (2012).

5 The same can be said for observing physiological reactions like increased adrenaline and cortisol levels, caused by stress, that are mentioned in research on trading and sports. Intense DD-meetings and actual investing likely result in similar physiological reactions of the body.

6 As stated above, please again note that the traits listed in the subsequent paragraph for investment managers also are very relevant for the DD. One example is an open mindset. If one junior analyst undercovers issues at a well-established firm that has been used by the asset owner, in addition to his trait of self-confidence to speak up, his seniors need to have an open mindset and take issues seriously. It also implies the acknowledgement and acceptance of the critical role of inclusion within teams.

7 Being skeptical also implies not taken for granted information gathered via ChatGPT or similar AI-applications.

8 For a practical toolkit to improve decision making see Thinking Ahead Institute (2018).

9 https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/the-case-for-behavioral-strategy#/

10 Related to this is being sufficient sensitive towards the person(s) interviewed and having proper judgement on personalities. Some PMs and analysts are not the best presenters or perform well during DD-meetings, while other PMs are great presenters and do well in beauty parades. It is key for the DD-team to see through this during meetings.

11 Please note that if the DD-team also negotiates fees several biases can arise as relationships are formed.

12 These tools are frequently used by investment firms themselves to assess and improve the investment process, decision making and actual sizing and trading behavior of the PM. I.e. lessons learned and feedback is provided with granular data on individual positions, versus more top down and 'static' return based attribution results per sector, country, style. It provides critical information about the 'dynamics' of the manager: https://www.inalytics.com, https://www.cabotintech.com.

13 One should also assess if the manager is sufficient aware of the concept of time value of money as this is linked to potential biases including endowment effects and stalemate biases.

14 One can compare this again with experiences in sports. LeBron James, Michael Jordan and Tom Brady used the combination of physical ability with an unparalleled drive to perform to lead their teams to years of glory. However, the drive of Lance Armstrong pushed himself and subsequently he pushed his team into unethical behavior. This has also been frequently observed in finance.

15 This includes avoiding reliance on intuition and gut feeling. These traits are hard to assess for the DD-team and raises questions regarding the repetitiveness of the process.

Why LGBTIQ+ inclusion should matter to investors

Lisa Hayles and Martijn Huijnen

LGBTIQ+ rights are often overlooked in investments. They matter from a financial, social and legal perspective. In this paper we provide steps every investor can take to take these rights into account.

In recent years, investors have been paying increasing attention to Diversity, Equity, and Inclusion – DEI -in part because of social justice protests which have swept the globe-. Though these terms collectively refer to corporate values, practices or policies that ensure that people of various backgrounds and social identities feel welcome and can contribute and thrive in the workplace, they each have a distinct definition. Broadly, **Diversity** refers to the presence of differences within a given setting; in the workplace, that may mean differences in race, ethnicity, gender, gender identity, sexual orientation, age and socioeconomic background. **Equity** is focused on fairness – ensuring that everyone has access to opportunity, resources and power. **Inclusion** captures how employees experience the workplace and the degree to which employees feel they can make meaningful contributions. Much has been written about the importance of DEI to employees so that they feel 'welcomed, valued and supported.'[1] In our view, an important aspect of DEI in the workplace is the inclusion of LGBTIQ+ employees.

By LGBTIQ+ we mean

LGBTIQ+ is an initialism that stands for Lesbian, gay bisexual, transgender, intersex and queer identity and experience.[2]

Despite progress in corporate culture, legislation, and regulations, LGBTIQ+ employees still face challenges and hardships in their daily lives- including in the workplace. In 2020 for example, 40% of LGBTIQ+ employees surveyed by the Boston Consulting Group in the United States (U.S.). reported not being out at work[3] with 26% of employees wishing they could acknowledge their sexuality in the workplace. Even worse, 75% of respondents reported at least one negative interaction pertaining to their LGBTQ+ identity in the workplace during the past year, and over 40% reported experiencing over ten types of these interactions.

BUT SURELY THE SITUATION IS BETTER IN EUROPE…

Under European Law, LGBTIQ+ people have benefited from protections from discrimination on the grounds of sexual orientation at work for more than two decades. However, the acceptance and integration of LGBTIQ+ community varies tremendously across the region, and progress in terms of

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ensuring equal rights for all has been uneven. For example, a recent report documents signs that progress on LGBTIQ+ equality has regressed in some countries during the coronavirus epidemic.[4] Such shifts are part of a worrying trend that has seen a variety of anti-LGBTIQ+ policies adopted across parts of Eastern Europe alongside increased attacks on the advancement of LGBTIQ+ rights globally.[5]

THE SHAREHOLDER CASE FOR INCLUSION

As investors, we believe that there are both moral and financial arguments which support creating inclusive workplaces. Shareholders have a clear interest in ensuring the companies they invest in create environments where employees can feel welcomed and safe. The moral argument is clear: all individuals should have equal rights and access in society. Moreover, our modern workforce is increasingly diverse in terms of personal characteristics such as race, ethnicity, gender, national origin, religion, gender identity, and sexual orientation and therefore building workplaces where inclusive policies and practices are the norm has become critical. But the business case may be even more compelling for some. For individual employees, LGBTIQ+-supportive policies result not only in less discrimination and increased openness about being LGBTIQ+, but have also been found to directly correlate with LGBTIQ+ employee engagement, productivity and effectiveness, lower turnover and higher retention rates, hence directly impacting the bottom-line.[6]

At the firm level, evidence is mounting that diverse and inclusive workplaces attract and retain top talent, improve customer orientation, decision-making, employee satisfaction, and help secure the organization's license to operate.[7] We believe that talent is equally distributed across all people, though opportunity is not. To ensure the companies we invest in can benefit from the range of experiences and expertise that a diverse workforce can bring, we encourage them to prioritize diversity, equity and inclusion as part of their human capital management through for example:

- direct dialogue with companies in our investment portfolios
- by exercising our proxy votes in favor of greater diversity,
- filing shareholder resolutions in favor of setting targets for great diversity in senior management and
- Supporting public policy that demands better disclosure on diversity metrics at every level of the firm

Research from the Williams Institute has also shown that LGBTIQ-supportive policies lead to positive business outcomes, lower staff turnover, and increased job satisfaction.[8] Strong diversity and inclusion practices, in our view, are linked to long-term shareholder value creation.

INCLUSIVENESS AS COMPETITIVE ADVANTAGE

The creation of a safe and inclusive space for all has social and economic benefits for employees, customers, suppliers and the wider community, but is of particular interest to the LGBTQ+ community.[9] A good example is Accor (Ibis) Hotels which was among the first large hotel chains to partner with the Proud Certified training program. Thirty percent of LGBTQ+ travelers fear judgement when they check into a hotel and certification by a third party ensuring a welcoming environment creates goodwill and the likelihood of repeat business[10]
The partnership recognizes the strong demand from LGBTQ+ travelers for spaces where they can feel welcome and safe.

RECRUITMENT AND RETENTION FOR INCLUSION

In 2016 Trillium filed a shareholder proposal at Arkansas-based transportation company J.B. Hunt asking the company to amend its equal employment opportunity (EEO) policy to protect all (LGBTIQ+) employees. At the time, LGBTIQ+ employees did not benefit from workplace protections against discrimination in 28 states in the U.S. The proposal led to conversations with senior management and the proposal was reviewed by the board. Despite the request to add just 5 words (sexual orientation and gender identity) to the EEO policy the company declined to make this change. In accordance with the shareholder proposal process Trillium presented the proposal at the company's June annual meeting in Lowell, Arkansas. Although J.B. Hunt management advised shareholders to vote against these changes, the proposal received a remarkable 54.7% vote.[11] In response to the majority vote, the board immediately appointed an internal task force to study, compile, and identify the practical effects of amending its EEO policy to include sexual orientation and gender identity or expression. One month later the board met again, and the J.B. Hunt directors approved the policy amendment, ultimately providing protections for its 19,000 employees across the country.[12] Happily, in 2020, the Supreme Court extended employment protections across the U.S. to LGBTIQ+ workers from workplace discrimination.

THE BIGGER PICTURE

In this article we focus on the discrimination of LGBTIQ+ employees and the effects it has on them, on companies and on shareholders. We strongly believe that much of this analysis is not exclusive to LGBTIQ+ employees but there are similarities between this analysis and those for employees of color, with mobility challenges, neurodiversity etc. We choose to focus on one aspect of diversity – recognizing and encouraging the use of this approach with respect to other disadvantaged groups and especially when these groups overlap.

GLOBAL APPROACHES TO LGBTIQ+ INCLUSION

Unsurprisingly, the laws and regulations regarding the disclosure of personal sensitive information including sexual orientation and ethnicity differ considerably around the world as do attitudes towards the LGBTIQ+

Despite recent court cases advancing the protection of LGBTQI+ rights, there remain at least 69 countries where homosexuality is criminalized and only 77 countries have employment non-discrimination laws that protect the rights of LGBTI+ workers.[13]

Globally, customs and legislation differ. While this article focuses on the US and Europe investors can always ask companies wherever they operate globally to support the creation of an inclusive environment for their own employees. For example, companies should ensure that family and medical benefits extent to LGBTQI+ families. In cases where this is prohibited by law companies should seek to offer health insurance and/or pension plans that allow the employee to name a beneficiary who is unrelated to them. Some health insurance and/or pension plans may include naming a beneficiary of the employees' choice. Companies can be a positive force in defending the rights of their LGBTQI+ employees even in countries where their rights may not be legally recognized. Before the right to marry in the US was granted to same-sex couples for example, many companies such as Ford extended benefits to the same sex partners of employees.[14]

US AND EUROPE – SOME CULTURAL DISCLOSURE DIFFERENCES THAT ARE GOOD TO KNOW FOR INVESTORS

In the U.S., all companies with more than 100 employees are obliged to report to the Equal Employment Opportunities Commission (EEOC) concerning employees' job categories, and ethnicity, race, and gender. However, there is no requirement to make these reports public nor is there a requirement to collect information on the sexual orientation or gender identity of employees. A relatively new requirement approved by the Securities and Exchange Commission (SEC) in 2021 requires companies listed on the NASDAQ U.S. exchange to have at least two diverse directors, including one self-identified woman director as well as one director who self-identifies as an underrepresented minority or an LGBTIQ+ individual. Conservative groups and seventeen states controlled by Republicans have supported a lawsuit challenging the diversity rule. In the face of this growing backlash, fueled in part by populist politicians across at least the U.S. and (partly) Europe, we believe that meaningful inclusion of marginalized populations within the workforce is an important facet of responsible business behavior and an additional indicator of long-term thinking by corporations.
There is also reasonable cause to believe that LGBTIQ+ inclusion is legally threatened in the future. Though a Supreme Court decision in 2019 (Bostock v. Clayton County),[15] protects LGBTIQ+ workers from workplace discrimination other rights are at risk. For example, federally recognized gay marriage remains legal, but in his opinion that overturned the constitutional right to an abortion, Justice Clarence Thomas of the U.S Supreme Court called for his colleagues to re-examine and potentially overturn rulings that protect gay marriage and access to birth control.[16] Unfortunately, in addition to protecting the rights and dignity of LGBTIQ+ employees we already see other areas where corporations may be called upon to provide human rights protections for their employees where politicians or the courts threaten these rights.

In Europe, employees cannot be forced to reveal their gender identity, sexuality, ethnicity etc. We believe it is possible to collect diversity data from employees in a way consistent with the requirements of the European General Protection Data Regulation (GPDR) as long as surveys are voluntary and anonymous. Several good examples such as SER Diversity at Work exist of how to do this consistent with European Law.[17]

HOW RESPONSIBLE INVESTING CAN CONTRIBUTE TO CREATING A SAFE AND INCLUSIVE WORKSPACE

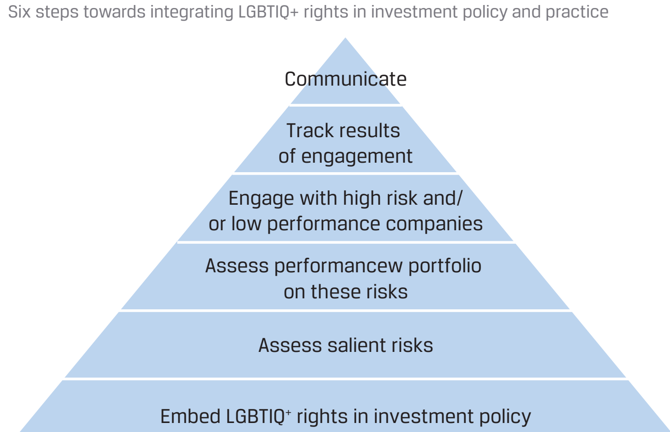
Investors should of course not micromanage a company but as responsible owners, they can and should advocate for safe and thus productive work environments. Not every measure (identified below) will be suitable for every investor. Smaller investors can also outsource some of the steps suggested and/or collaborate with a larger group.

Below we provide six steps on how LGBTIQ+ right can achieve a mature place into Responsible Investment practices. These six steps are inspired by the UN Guiding Principles on Business & Human Rights and the OECD-guidelines,[18] and for each step we provide suggestions what could be done. Not every step is usually necessary in a case.

1. **Embed LGBTIQ+ rights into the responsible investment policy**
   In your investment policy, check whether you've a check on labor conditions at investees and add LGBTIQ+ workplace safety to it. This can be used for exclusion, best-in-class and ESG-integration techniques, depending on the investment strategy of the fund manager.

2. **Identify where LGBTIQ+ rights are most at risk in your portfolio**
   Several (combination of) perspectives can be taken to identify the most salient sectors, countries and companies:
   – An approach that maps the countries in which LGBTIQ+ rights are most at risk and which companies are active in those countries
   – Specific sectors for which the topic is most relevant from an employee or client's perspective

Figure 1
Six steps towards integrating LGBTIQ+ rights in investment policy and practice



- A perspective that maps companies based on their performance on the topic.

3. **Assess performance on LGBTIQ+ rights in the most salient parts in your portfolio**
   In assessing corporate performance several proxies can be used. From checking if a company has LGBTIQ+ policies in place, more importantly whether the company reports on this issue in workplace satisfaction and also general indicators such as work harassment and indications for bullying can be used. Data on practice is more meaningful than data on policies.

4. **Engage the most relevant companies from a salience and performance point-of-view, with the following engagement goals**
   - *Policy:* Developing LGBTIQ+ policies. For example, addressing topics such as policies that provide LGBTIQ+ employees with the same rights.
   - *Governance:* the topic is on the agenda of the board and/or is assigned to a board committee. Board members are informed by experts, research and a structural dialogue with LGBTIQ+ representatives of employees to enable effective board oversight.
   - *Corporate monitoring:* The company monitors employee satisfaction under their LGBTIQ+ staff and reaches actively out to employees on the topic.
   - *Implementation:* What does the company do in practice to enable LGBTIQ+ rights. Do LGBTIQ+ employees for example get leave for child adoption or do companies take additional steps to protect LGBTIQ+ employees in countries in which LGBTIQ+ rights are at risk?
   - *Grievance Mechanism:* Have sufficient grievance mechanisms that are safe to use for LGBTIQ+ employees or clients.
   - *Remediation:* In case of significant damages done by the unsafe working conditions, encourage the company to remediate this with the (ex) employees.

5. **Track implementation and results**
   - Take ownership and follow up: get in touch with the company on a regular basis and monitor the status of progress and encourage steps to be taken.

   Escalate when necessary, for example
   - Raise the issue at shareholder meetings (AGMs)
   - Work together with other investors on this topic. For example, through a joint letter.
   - Vote against remuneration and/or the nomination of board members if the topic is not sufficiently addressed at board level.
   - File a shareholder resolution on the topic.

6. **Communicate how impacts are addressed**
   Report on your policy, dialogue and voting in your engagement and voting reports. Show what you did and share, if possible, what's on your to-do-list.

TO CONCLUDE

Progress is more important than perfection. We believe these steps will create a safer, healthier and more productive workplace for LGBTIQ+ employees in particular, but with positive impacts for all employees in the end because it stimulates people to appreciate differences and feel welcome to be themselves. Making workplaces safe and positive environments enables people to focus on their performance instead of fear. A place where people get the job done is the best investment.

We would like to thank Frank Wagemans of Achmea IM, for his extensive input, which we highly appreciate.

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Eenvoudige oplossingen

Door Ronald Kok

We spreken met emeritus hoogleraar Sylvester Eijffinger[1] over een reeks actuele onderwerpen. Hij spaart hierbij geen heilige huisjes. Het gebrek aan vertrouwen in de financiële wereld, de opkomst van de digitale euro als een aardverschuiving, het gebruik van de verkeerde rekenrente en zorgen over lagere pensioenen zijn enkele van de kwesties die de oud-professor met bezorgdheid aanschouwt. Voor diverse complexe problemen zijn volgens hem echter eenvoudige oplossingen te vinden, zoals het gebruik van voortschrijdende gemiddelden voor zowel de rekenrente als bij de vermogensrendementsheffing.

In een eerder interview met CFA Society Netherlands voorspelde Eijffinger al correct de stijgende rentes en dalende waarde van cryptomunten.

REKENRENTE NU TE AD HOC

De emeritus hoogleraar maakt zich ernstige zorgen dat een groeiend deel van de samenleving in een financieel kwetsbare positie komt te verkeren. Vooral de personen met een beperkt pensioen hebben het moeilijker door de gestegen kosten. "*Een gepensioneerde leraar, met bijvoorbeeld 800 euro pensioen en 800 euro AOW heeft het enorm zwaar door alle gestegen kosten. Ik heb daar erg mee te doen*" aldus een bezorgde Eijffinger. Volgens hem is dit allemaal onnodig, omdat er geen enkel kapitaaldekkingsstelsel bestand is tegen extreem lage rente. De gebruikte rekenrente, de ultimate forward rate (die in 2007 is ingesteld door het FTK) is volgens hem te veel een momentopname. Hij verwijst naar grote exogene factoren zoals de inval in Oekraïne en de hoge inflatie, die de rentes hebben opgedreven en op korte termijn de koopkracht van pensioenen onder druk zetten. Volgens hem is het veel relevanter om een rekenrente te hanteren die over een langere periode wordt berekend, bijvoorbeeld een 5-jaars voortschrijdend gemiddelde. Dit is volgens hem eerlijker en dempt de impact van exogene schokken. "*Op deze manier worden pieken en dalen geëgaliseerd en is het veel beter uitlegbaar*".

BELANGENVERSTRENGELING LIJKT WIJDVERSPREID IN DE PENSIOENSECTOR

Veel van de huidige problemen rondom pensioenen hadden eenvoudig voorkomen kunnen worden door simpelweg een andere rekenrente te gebruiken. Volgens Eijffinger is het gebrek aan actie deels te wijten aan belangenverstrengeling binnen de sector. Hij wijst op bestuurders die soms tot vijf posities bekleden bij verschillende pensioenfondsen. Vanuit een risicomanagement- en governance perspectief is dit onuitlegbaar, aldus Eijffinger. "*Deze wirwar aan belangen komt deels door het ontbreken van een constitutioneel hof. In Nederland hebben wij als hoogste rechtscolleges de Hoge Raad en de Raad van State, maar geen constitutioneel hof*" benadrukt Eijffinger. Hij verwijst naar Thorbecke in 1848 waarbij de koning kon instemmen met wetgeving of niet. "*Er is nu discussie*

Sylvester Eijffinger is emeritus hoogleraar financiële economie aan de Tilburg University en Jean Monnet hoogleraar Europese financiële en monetaire integratie. Sylvester heeft uitgebreid gepubliceerd in vooraanstaande economische tijdschriften, waaronder Journal of Money, Credit and Banking, Journal of Banking and Finance, Journal of Public Economics, Oxford Economic Papers, Open Economies Review, European Journal of Political Economy en het Journal of International Economies. In het verleden was hij bovendien verbonden aan verschillende instanties, waaronder de commissies Maas en Wijffels en heeft hij nauwe banden gehad met centrale banken. Eijffinger is één van de meest geciteerde[2,3] wetenschappers in Nederland.

of bepaalde zaken wel rechtmatig zijn. Er is dus een pensioenwet die voor alle Nederlanders geldt, behalve voor politici. Senatoren die vaak nog parttime banen hebben, mogen dit niet zomaar naast zich neerleggen. Ze stemmen notabene over hun eigen pensioen" aldus een verontwaardigde Eijffinger.

TEVEEL TAKEN OP HET BORD VAN DE BELASTINGDIENST

Eijffinger ziet ook overeenkomsten met de vermogensrendementsheffing, die veel kritiek krijgt. Ook hier is veel discussie en is het systeem alleen nog in stand gehouden door een uitspraak van de Hoge Raad. Anders zou de kwestie van de vermogensrendementsheffing bij het Europese Hof liggen. Net zoals bij de vermogensrendementsheffing in box 3, waar tegen veel bezwaar is ingesteld, verwacht Eijffinger een vergelijkbaar tumult over het nieuwe pensioenstelsel. "*Want er is geen enkel land dat pensioenen invaart in een nieuw stelsel*".

IMPACT DIGITALE EURO WORDT ZWAAR ONDERSCHAT

Met betrekking tot de vermogensrendementsheffing stelt Eijffinger dat het nog erg onzeker is of deze uiteindelijk gebaseerd zal worden op het gerealiseerde rendement: "*want de systemen van de Belastingdienst kunnen dit niet aan*". Eijffinger prijst Marnix van Rij, die zich eerder afkeerde van het fictieve rendement in box 3. Daarnaast verwijst hij naar de waarderingsproblematiek van vastgoed in box 3, dat vaak weinig liquide is. "*Als je meer vermogen hebt betekent dat niet per se dat je risicovoller gaat beleggen. Stel dat je aan het einde van je leven bent met veel vermogen, dan ga je niet ineens risicovol beleggen*" stelt Eijffinger. Volgens de emeritus hoogleraar is het differentiëren van vermogen daarom een verkeerde keuze, omdat de risicobereidheid daar los van staat. En het stellen van een fictief rendement van 6% bij een rente van destijds 0% is volgens Eijffinger een onjuiste veronderstelling. Die twee uitersten liggen niet eens bij elkaar in de buurt. Het is volgens hem veel redelijker om ook hier een voortschrijdend gemiddelde te gebruiken: van de rentetarieven, aandelenkoers enzovoort. Dat is veel eenvoudiger en beter uitlegbaar. Hij vindt het echter wel fair om vastgoedbeleggers aan te pakken en hen naar box 1 door te schuiven.

WEL DUIZENDEN COMPLIANCE-MEDEWERKERS MAAR FILIALEN SLUITEN

Volgens Eijffinger zijn er de afgelopen jaren te veel taken toebedeeld aan de belastingdienst en is het stelsel aan regelgeving te complex waardoor de Belastingdienst al haar taken simpelweg niet goed meer kan uitvoeren.

ECB ZIT KLEM

Net zoals bij de rekenrente en de berekeningen in box 3 lijkt het veel redelijker om te werken met lange termijn gemiddelden. "*De exogene schokken zijn te groot. Het ene jaar kan de beurs sterk dalen en het jaar er op weer sterk stijgen. Hetzelfde geldt voor inflatie en de huizenprijzen. Hiertegen is geen beleid bestand. "Himmelhoch jauchend zum Teuten betrübt, zoals de Duitsers zeggen*", aldus Eijffinger. Hij uit ook kritiek op de Europese Centrale Bank (ECB), aangezien één van de beleidsdoelstellingen van de ECB nota bene een stabiel prijsniveau is. Hij verwijst naar de periode Duisenberg/Trichet, waarin de ECB volgens conventioneel monetair beleid netjes intervenieerde op de kapitaalmarkt. Na de crisis veranderde dit onder Draghi en in 2012 met de uitspraak "*Whatever it takes*", gevolgd door opkoopprogramma's die niet conditioneel waren. Het interveniëren op de kapitaalmarkt heeft de ECB een groot probleem opgeleverd, omdat zij nu enorm veel beleggingen (ter waarde van 8 biljoen euro) op haar balans aanhoudt die zij in de markt moet plaatsen. Zowel Eijffinger als Lex Hoogduin en Edin Mujagic hebben hier al jaren geleden voor gewaarschuwd.

MODERN MONETARY THEORY IS NIET RELEVANT

Dit staat in contrast met de Federal Reserve (Fed), die onder Jay Powell eerst passief de beleggingen afbouwde en daarna pas de rente geleidelijk verhoogde. Volgens Eijffinger is de rente van de ECB nu nog te laag en zou deze volgens de (ex-post) Taylor-regel (die de FED wel volgde) eigenlijk moeten stijgen tot 4 à 5 procent. Dit is natuurlijk weer een enorme dreun voor obligaties, die de ECB nog in overvloed op de balans heeft staan. De hoge inflatieverwachtingen zullen ook nog een stimulans zijn om de rente verder te verhogen. Eijffinger vindt ook dat de ECB te kortzichtig is in de inflatieberekeningen via Philip Lane,[5] omdat deze voornamelijk zijn gebaseerd op invoergegevens zonder veel rekening te houden met exogene schokken. Volgens de bezorgde wetenschapper is zo'n model niets meer dan een extrapolatie van het verleden. Hij merkt op dat Lane de inflatie al onderschatte voor de Russische inval in Oekraïne en de inflatiepiek van 2022 ten onrechte als tijdelijk bestempelde. Zowel de ECB als het CBS zaten dus volledig mis met hun inflatieverwachtingen (omdat hun modellen te stochastisch zijn en amper ruimte bieden voor exogene schokken). De uitgesproken inflatieverwachtingen van de ECB zijn ook niet consistent met het rente pad.

DRIE FACTOREN DIE RENTE BEPALEN OP DE KAPITAALMARKT

Volgens Eijffinger bepalen de volgende drie factoren de rente op de kapitaalmarkt:

1. Risicopremies;
2. Inflatieverwachtingen (vooral beïnvloed door overliquiditeit, beleid Draghi/Lagarde);
3. Reële rentedeel wordt op de wereldkapitaalmarkt bepaald en is redelijk constant.

Eijffinger verwijst voorts op de verschillende eurocrises waarbij met name de spreads van Griekenland opliepen. Dit kan worden beperkt door het opkoopbeleid van de ECB, bijvoorbeeld via TPI[6] (Eijffinger noemt trouwens TPI ook wel gekscherend: "*To Protect Italy*"). Op deze manier worden de risicopremies (spreads) weliswaar verminderd, maar tegelijkertijd wordt er meer liquiditeit in de markt gebracht, wat weer leidt tot hogere inflatieverwachtingen. Zonder TPI zouden de inflatieverwachtingen beperkter zijn, maar zouden de risicopremies weer stijgen. Bij het reële rentedeel zijn er dus twee communicerende vaten: inflatieverwachtingen en risicopremies.

SAMENGEVAT REËLE RENTE MET EN ZONDER TPI

	kapitaalmarkt-rente
TPI activeren: risicopremies omlaag en inflatieverwachtingen omhoog	omhoog
TPI niet activeren: risicopremies omhoog en inflatieverwachtingen omlaag	omhoog

CONDITIONELE FORWARD GUIDANCE EEN RAMP

Het hele proces van de forward guidance is volgens Eijffinger buitengewoon slecht geweest. Hij heeft grote bezwaren tegen het aankondigen van conditionele rentestappen. "*Deze voorspellingen zijn te sterk afhankelijk van grote schokken zoals de Russische aanval op Oekraïne, de energiemarkt, klimaatverandering, stikstof, enzovoort. Het is dan niet verstandig om het pad van toekomstige renteveranderingen van tevoren aan te kondigen*" aldus Eijffinger. Hij merkt op dat Christine Lagarde inmiddels haar les heeft geleerd en bescheidener is geworden op basis van haar recente interviews. Eijffinger is teleurgesteld dat er slechts twee echte monetaire specialisten (Philip Lane, een duif en Isabel Schnabel, een havik) in de top van de ECB zitten. Hij keurt het uitgebreide interveniëren op de kapitaalmarkten sterk af en vindt dat we nu de gevolgen daarvan ondervinden. Hoewel het begrijpelijk was dat er tijdens de crisis ingegrepen moest worden (gezien de enorme spreads van bijvoorbeeld Griekenland en Italië), is volgens hem het opkopen van leningen uit die landen veel te lang doorgegaan.

BELASTINGSCHIJVEN SLAAN VEEL TE VROEG AAN

Eijffinger schrijft het feit dat Nederland al jaren kampioen is in deeltijdwerk enerzijds toe aan een lager arbeidsethos en anderzijds aan de belastingdruk. Volgens hem slaan de belastingschijven veel te snel aan, met zeer hoge tarieven als gevolg. Hij begrijpt dan ook dat mensen ervoor kiezen om minder te werken, omdat het anders vanuit belastingoogpunt minder aantrekkelijk is. Bovendien zijn er nog steeds veel toeslagen die mensen kunnen aanvragen om met een lager aantal werkuren toch voldoende inkomen te krijgen. Dit draagt volgens Eijffinger niet bij aan vooruitgang in het land, aangezien er al een enorme krapte op de arbeidsmarkt is. "*Als mensen met goede opleidingen, waarin een hoop geld is geïnvesteerd, juist minder gaan werken dan is dat zeer verontrustend. De hoge marginale tarieven werken dan juist averechts*". Marginale tarieven zijn tussen één en twee maal modaal tussen 70 en 80%

SLECHT WEER VOOR HYPOTHEEKGEVERS

Eijffinger is niet hoopvol gestemd over de situatie van de Nederlandse hypotheekbezitters vanwege de gestegen rente en de zeer hoge leencapaciteit (LTV, loan to value). In tegenstelling tot bijvoorbeeld Duitsland, waar er veel meer eigen vermogen nodig is voordat men een huis kan kopen, hebben Nederlandse hypotheekhouders een veel minder conservatievere benadering. Eijffinger had destijds al in de commissie Wijfels geadviseerd om een maximaal leenbedrag van 80% aan te houden. Echter, de LTV is nu weer rond de 100, wat volgens Eijffinger een stevige tol gaat eisen van veel hypotheekgevers. Met mega-hypotheken waarin bijvoorbeeld ook de kosten voor verbouwing, keuken en zwembad zijn gefinancierd en een stijgende rente, bevinden huizeneigenaren met hoge hypotheken zich potentieel op gevaarlijk ijs. Eijffinger heeft zijn advies voor een lagere LTV's gegeven aan alle 5 voorgaande ministers van financiën.

> ONBEGRIJPELIJK DAT GROS VAN DE MARKT HOGERE RENTES NIET ZAG AANKOMEN

Eijffinger betreurt ten zeerste de (opgelegde) cultuur van wantrouwen in de financiële wereld. Hij verwijst hiermee onder andere naar het plan van Sigrid Kaag om alle transacties vanaf 100 euro te gaan monitoren. "*Banken hebben al duizenden compliance-medewerkers maar de lokale filialen sluiten en met deze micro-monitoring zullen de grote boeven echt niet gevangen worden. Alle voordelen van digitalisering en kunstmatige intelligentie gaan verloren aan nutteloze zaken,*" aldus de emeritus hoogleraar. Al deze monitoring is gebaseerd op wantrouwen en daar kunnen we geen samenleving op bouwen, volgens Eijffinger. Hij ziet hetzelfde probleem in de universitaire wereld, waar ook talloze compliance-medewerkers rondlopen.

OVERREGULERING IN NEDERLAND

Eijffinger, weliswaar officieel met pensioen, is van mening dat het vasthouden aan vaste pensioenleeftijden een aanzienlijk verlies aan potentieel met zich brengt. Hij bekritiseert de regulering en pleit voor meer flexibiliteit. "*Stel dat mensen graag door willen werken, dan is dat alleen maar positief en scheelt weer pensioenuitkeringen. Of geef mensen de mogelijkheid om deeltijd te werken," aldus Eijffinger.* Hij wijst er echter nogmaals op dat deze starheid deels ook wordt veroorzaakt door de fiscale druk, waardoor mensen minder gestimuleerd worden om meer of langer te werken. Hij pleit ervoor om al deze kwesties (fiscaliteit en pensioenen) gezamenlijk aan te pakken. "*Wat betreft de nieuwe pensioenwet: we zijn niet allemaal gelijk, zowel niet wat onze capaciteiten betreft als wat we willen,*" betoogt Eijffinger.

NIET TEVEEL IN EIGEN MODELLEN GELOVEN

Eijffinger geeft eerlijk toe dat veel academische onderzoeken eigenlijk strenger zouden moeten zijn en dat we daarom veel studies met een korreltje zout moeten nemen. De financiële crisis van 2008 was het absolute voorbeeld dat de Efficiënte Markt-

Juni 2023, keynote speech getiteld "Threats to Central Bank Independence and irrelevance of Modern Monetary Theory" door Sylvester Eijffinger op het congres 'Asobancaria Banking Summit'.[4]

hypothese van Nobelprijswinnaar Eugene Fama[7] juist niet werkt. De finance-professoren verklaren het falen door te zeggen "*het zit niet in onze modellen*". Echter, beleggen heeft uiteraard te maken met finance, macro-0.0 en monetair beleid. Eijffinger roemt de professoren zoals Richard Thaler[8], Robert C. Merton[9] en John Y. Campbell[10] die deze drie vakgebieden juist wel combineren. Het stoort Eijffinger dat veel beleggers zich voornamelijk richten op de financiële aspecten en het macro-economische spectrum vaak negeren, terwijl alles uiteindelijk afhankelijk is van de macro-economie.

DIGITALE EURO: BANKEN HEBBEN NIET DOOR WAT ER GEBEURT

De impact van de opkomst van de digitale euro wordt volgens Eijffinger vooral door de banken enorm onderschat. Op dit moment verloopt het proces van geldschepping in twee stappen: van centrale banken naar banken, en vervolgens naar consumenten. Met de komst van de digitale euro zullen de banken buiten spel worden gezet, omdat er dan een directe verbinding ontstaat tussen centrale banken en consumenten. Consumenten die momenteel geld op een bankdeposito hebben staan, kunnen dit dus straks ook bij de centrale bank stallen (de 'lender of last resort'). Dit kan volgens Eijffinger tot een leegloop leiden bij traditionele banken, waarbij deposito's worden verplaatst naar de centrale bank. De uitvoering van het monetaire beleid zal met de digitale euro aanzienlijk veranderen, en dit wordt volgens hem ernstig onderschat.

Aandachtspunten voor de digitale euro zijn wat hem betreft:

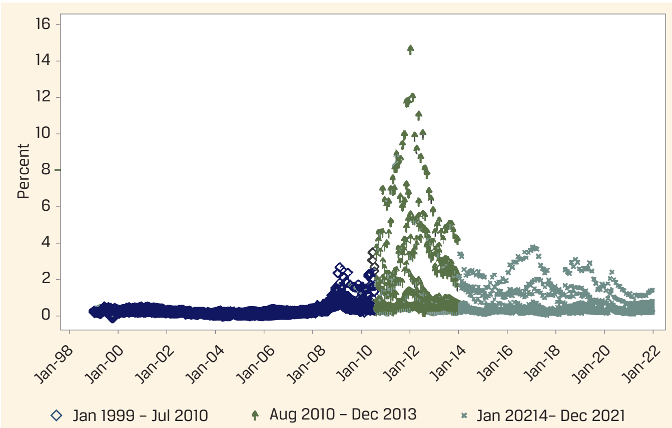
- Nog niet democratisch gelegitimeerd;
- Verdienmodel banken onder druk;
- Implicaties uitvoering monetair beleid.

Deze drie aspecten worden volgens hem nog steeds ernstig onderschat. Een roepende in de woestijn is Kenneth Rogoff.[11] Hij stelt dat de digitale euro onvermijdelijk is, maar dat de implementatie tot nu toe verre van goed doordacht is. Eijffinger is uiterst sceptisch of alle autoriteiten wel voldoende voorbereid zijn op de komst van de digitale euro.

BELASTINGBETALER DRAAIT UITEINDELIJK OP VOOR VERKOPEN OVERVOLLE ECB-BALANS

Tot slot spraken we nog over zijn meest recente onderzoek '*Eurozone Government Bond Spreads: A Tale of Different ECB Policy Regimes*' (2023)[12] met Mary Pieterse-Bloem over de verschillende beleidsregimes bij de ECB. Specifiek wordt er gekeken naar de invloed van macro-economische en marktrisico-variabelen op de spreads in de eurozone gedurende periodes van verschillende ECB-presidenten. Tijdens het regime van Jean-Claude Trichet blijken de macro-economische variabelen zeer relevant en kunnen ze de spreads verklaren. Na de periode Trichet waren de macro-economische factoren amper nog relevant en waren het voornamelijk de marktrisicofactoren die de spreads

Figure 1
Regimes in Eurozone sovereign bond spreads, defined by sequential breakpoint analysis



verklaren. Het onderzoek toont aan dat de drijvende krachten achter de spreads van de Europese staatsleningen aanzienlijk verschilden tijdens de verschillende beleidsregimes bij de ECB.

Eijffinger verwacht dat wanneer de kwantitatieve verruimingsmaatregelen worden afgebouwd (met naar verwachting een bedrag van 15 miljard euro per maand, wat marginaal is in vergelijking met de ruim 5.000 miljard euro op de balans), de spreads zullen toenemen. Het zal dus nog heel lang duren voordat de ECB haar balans significant kan afbouwen.

Alles bij elkaar leren we van dit interview dat grote problemen niet per se complexe oplossingen zouden moeten vergen. Eenvoudige oplossingen lijken vaak beschikbaar en veel effectiever zoals Eijffingers idee om 5-jaars voortschrijdende gemiddelden te gebruiken bij de belastingschijven en inflatiebeleid. Voor de ECB liggen de zaken ingewikkelder. De ECB zal nog lang haar handen vol hebben aan balansafbouw en de integratie van de digitale euro zo sluit Eijffinger af.

Noten

1 https://nl.wikipedia.org/wiki/Sylvester_Eijffinger
2 https://www.researchgate.net/profile/Sylvester-Eijffinger
3 https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=952
4 https://www.facebook.com/664424049/videos/1065844351243599/4
5 https://www.ecb.europa.eu/ecb/orga/decisions/html/cvlane.en.html
6 https://www.ecb.europa.eu/press/pr/date/2022/html/ecb.pr220721~973e6e7273.en.html
7 https://www.jstor.org/stable/3216840
8 https://www.chicagobooth.edu/faculty/directory/t/richard-h-thaler
9 https://mitsloan.mit.edu/faculty/directory/robert-c-merton
10 https://scholar.harvard.edu/campbell/home
11 https://scholar.harvard.edu/rogoff/home
12 https://www.eur.nl/en/media/2023-02-paper-m-pietersebloem-suerf

ESG Assessment Challenges in Investment Manager Due Diligence

Sarita Gosrani, Kathryn Saklatvala, Frans Verhaar[1]

When selecting and monitoring external investment managers, it is increasingly important to develop a clear understanding of their credibility in ESG, sustainable and impact investment matters. The subject is a challenging one, with asset managers' practices (and appearances) evolving rapidly.

Institutional investors are coming under growing pressure to get this right. Regulators are evidently willing to show teeth on the greenwashing subject, with a few asset managers already facing financial penalties – such as Goldman Sachs Asset Management, which incurred a $4 million fine in a recent particularly high-profile ruling by the US Securities and Exchange Commission.[2] Such cases can also inflict reputational damage on asset managers' clients. Meanwhile, attempts by regulators and policymakers to provide clarity via categorisation and oversight, while in many ways positive, have generated controversy and confusion. This double-edged effect is illustrated by the evolution of the European SFDR (Sustainable Finance Disclosure Regulation) framework and asset managers' widespread reclassifications of funds, such as downgrades from SFDR Article 9 to 8 or from Article 8 to 6.[3]

Looking beyond such pressures and regulatory interventions, we also believe that ESG analysis and sustainable investment practices are fundamental to sound investment decision-making. Many pension schemes, endowments, insurers and other investors have – independent of regulatory expectations – made clear, high-level commitments on ESG integration and related subjects such as decarbonisation and impact. Those commitments must now be delivered for stakeholders, with the support of investors' asset manager partners.

To assess and monitor investment managers effectively, investors must evaluate ESG practices at both product/strategy level and firm level. In this article, we highlight four key challenges that investors face today during ESG analysis. While there are many facets to ESG and impact due diligence, a focus on these four issues can help investors to gain clarity on the credibility of their prospective and current partners.

- **Challenge 1:** Assessing managers' commitment to sustainability amid great marketing.
- **Challenge 2:** Identifying stronger versus weaker approaches to climate change.
- **Challenge 3:** Ensuring ESG integration through the full investment lifecycle.
- **Challenge 4:** Cutting through 'impact washing'.

The article presents some quantitative data on managers' practices in these areas, gathered through recent surveys and research. Yet, as the discussion below reveals, it is crucial to look

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beyond superficial indicators, which can often be misleading: the devil is in the detail and sound ESG integration processes can rarely be identified via box-ticking or fund labels. Assessments should also be sensitive to the specific asset class and those analysing managers should have a strong up-to-date awareness of current ESG practices within that asset class. Finally, due diligence should straddle both 'investment' and 'operational' aspects, even though investors typically handle these two subjects separately. This can be difficult, since personnel on each side do not tend to have the full picture, are likely to have different priorities and may lack specific expertise on ESG/impact subjects.

CHALLENGE 1: ASSESSING MANAGERS' COMMITMENT TO SUSTAINABILITY AMID GREAT MARKETING

It's been nearly twenty years since management consultant Peter Drucker coined the phrase: 'culture eats strategy for breakfast'. When considering asset managers' ESG credibility, one of the most important and desirable characteristics is also one of the hardest to assess: robust sustainable investment commitments and beliefs running through the organisation, from senior leadership downwards.

Identifying genuine commitment has become far more difficult now that ESG has become a commercial imperative for asset managers. Firms are keen to convey an ESG-aware image to their investors and stakeholders and, in our day-to-day experience, risk losing assets if they do not. While we should not take away from the strides that investment managers have made on this subject, the presence of strong commercial motivations does naturally encourage a degree of greenwashing.

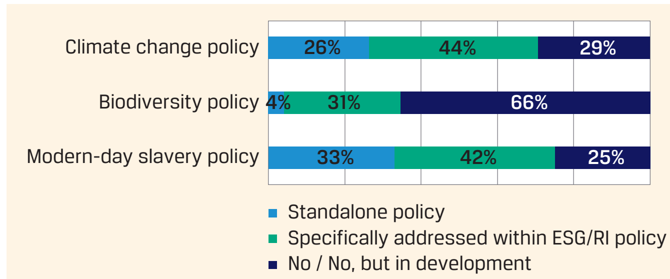
It is not always easy to look beyond the polished marketing materials, mission statements, sustainability reports and well-versed salespeople. It can help to examine three subjects more closely: firm-level commitments, accountability and ESG staffing. In all cases, the analysis must be nuanced: it is not enough to understand whether managers have policies and an ESG headcount; overly simplistic scorecards should be avoided. Examinations should also be sensitive to variables such as the size of firm and the asset classes covered.

POLICY SUBSTANCE CAN DEMONSTRATE FIRM-LEVEL COMMITMENT TO SUSTAINABILITY

While the vast majority of firms do now have an ESG or responsible investment policy (or policies), they are not all equally detailed in terms of substance. It remains common, for example, for policies to lack asset class-specific guidelines, which can be helpful in ensuring alignment and consistency while also highlighting areas of necessary difference. Moreover, there is also clear differentiation between firms in terms of the degree of internal accountability for those policies.

Our research indicates that 70% of asset managers address climate change at policy level – either within the ESG/RI policy or in a standalone policy – while just 34% of managers address biodiversity at policy level (and only 4% have a standalone policy on this subject). From a social perspective, notably, 25% of managers do not address Modern Day Slavery at policy level. Where the manager addresses a topic within their ESG/RI policy, this can indicate a high-level reference rather than in-depth coverage.

Figure 1
Asset managers' policies



Source: bfinance, ESG asset manager survey (72), 2023

When thinking about policies, it is also worth looking at companies' corporate social responsibility (CSR) programmes, in part to understand whether a manager 'walks the walk' as a company, as well as 'talking the talk'. According to our latest data, only 57% of managers have firm wide CSR policies. While 80% have a policy on Diversity, Equity and Inclusion (DEI), many are not able to provide specific data points relating to this subject in their firm – although we believe that this is now improving quite rapidly.

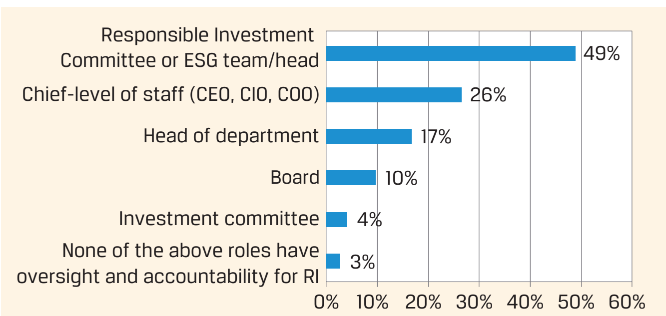
Firm-level pledges or objectives can also take the form of participation in external bodies and initiatives. ESG and sustainability are subjects that inherently need industry collaboration if meaningful progress is to be made. Many asset managers can provide long lists of initiatives to which they subscribe, but the bar for involvement can be low. Indeed, Principles for Responsible Investment (PRI) has received criticism over the years for its failure to impose requirements beyond signatories' financial contributions; they began to delist signatories for the first time in 2020 but there have been very few cases thus far.[4] Investors can go further and ask for tangible examples of asset managers' contributions within those initiatives.

ACCOUNTABILITY AND OVERSIGHT PROCESSES REVEAL ESG GOVERNANCE

As well as the substance of ESG policies, investors can look at the nature of accountability and oversight. This subject can easily be overlooked but has a key role to play in the asset manager's own ability to mitigate greenwashing internally. It also helps to show the importance that is placed on the topic by the senior leadership of the firm. Ensuring strong accountability and audit of the ESG approach is not only important in 'investment due diligence' but is also increasingly relevant in 'operational due diligence', given the potential consequences of inadequate controls in today's market.

Managers can take a vague approach to accountability. More than one in eight say that formal accountability for ESG/RI oversight lies with a department head; nearly half say that the Responsible Investment Committee is formally accountable for ESG/RI matters. Only one in four place responsibility with the senior leadership (C-level). We typically prefer to see policies approved by the Board and accountability lying with senior leadership alongside a dedicated ESG individual. Going a step further, we would argue that best practice entails running risk management, compliance and internal audit processes at product level to assess how an investment team has applied the firm's policy to ESG within a specific fund: this practice is growing among asset managers today.

Figure 2
Who has formal oversight/accountability for ESG/RI



Source: bfinance, ESG asset manager survey (72), 2023

ESG RESOURCING IS NOT A CLEAR-CUT ISSUE

As an asset management firm develops a stronger focus on ESG, this will typically be accompanied by a rising headcount dedicated to this subject as well as the purchase of data (discussed in a subsequent section) and the provision of other relevant resources.

On the staffing side, our recent research indicates that 90% of asset managers have dedicated ESG personnel. Team size varies greatly, with some managers having just one dedicated individual and others more than 30. The structure of the ESG teams also varies: centralised functions, dedicated specialists within asset classes or a combination of both are all common. This is supplemented in some cases with external expertise, be it consultancy/advisory or academic. Scientific involvement can be particularly helpful in certain subjects, such as climate change and biodiversity, given the complexities surrounding these topics.

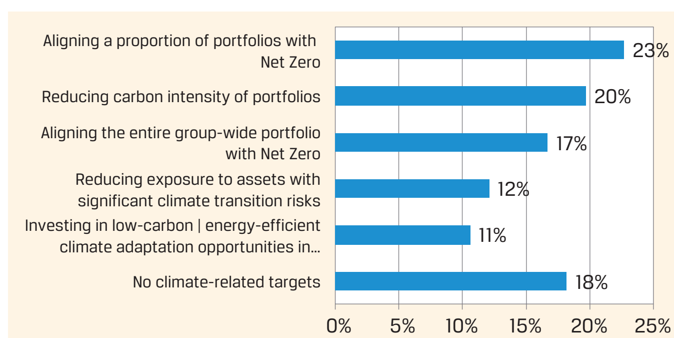
There is no right or wrong answer when it comes to the size or structure of an ESG team, though larger managers without obvious resource constraints are expected to demonstrate a strong headcount. As ever, the devil is in the detail. While ESG headcount can be a useful indicator of genuine firm-level commitment, ESG teams and specialists can often be siloed and may lack clout with underlying investment teams. It is therefore very important to understand the roles and responsibilities of ESG individuals and their interactions with the investment team: do they offer support and guidance or conduct the full ESG analysis? The rapidly evolving nature of ESG issues calls for dedicated expertise. Yet we consider genuine ESG integration to be visible where there is no longer a stark separation between ESG and financial analysis and when sector analysts and portfolio managers can all enthusiastically describe ESG risks and opportunities inherent in their investments without the ESG team's presence.

CHALLENGE 2: IDENTIFYING STRONGER VERSUS WEAKER APPROACHES TO CLIMATE CHANGE

The risks posed to society and the economy by climate change are now well articulated and quantified. There is no lack of information and data to support the view that climate risk considerations are financially material and should therefore be incorporated into the investment process.

Regulatory requirements, investor demands, and even potential reputational risks have led investment managers to take a stance on climate change, including establishing climate-related targets. We now estimate that nearly a quarter of asset managers are aligning at least a proportion of their portfolios with 'Net Zero' goals, and fewer than one in five have no climate-related targets at all. Interestingly, the PRI estimates that only 14% of signatories link climate-related KPIs to management team remuneration and just 10% link them to executive remuneration.

Figure 3
Asset managers' climate-related targets

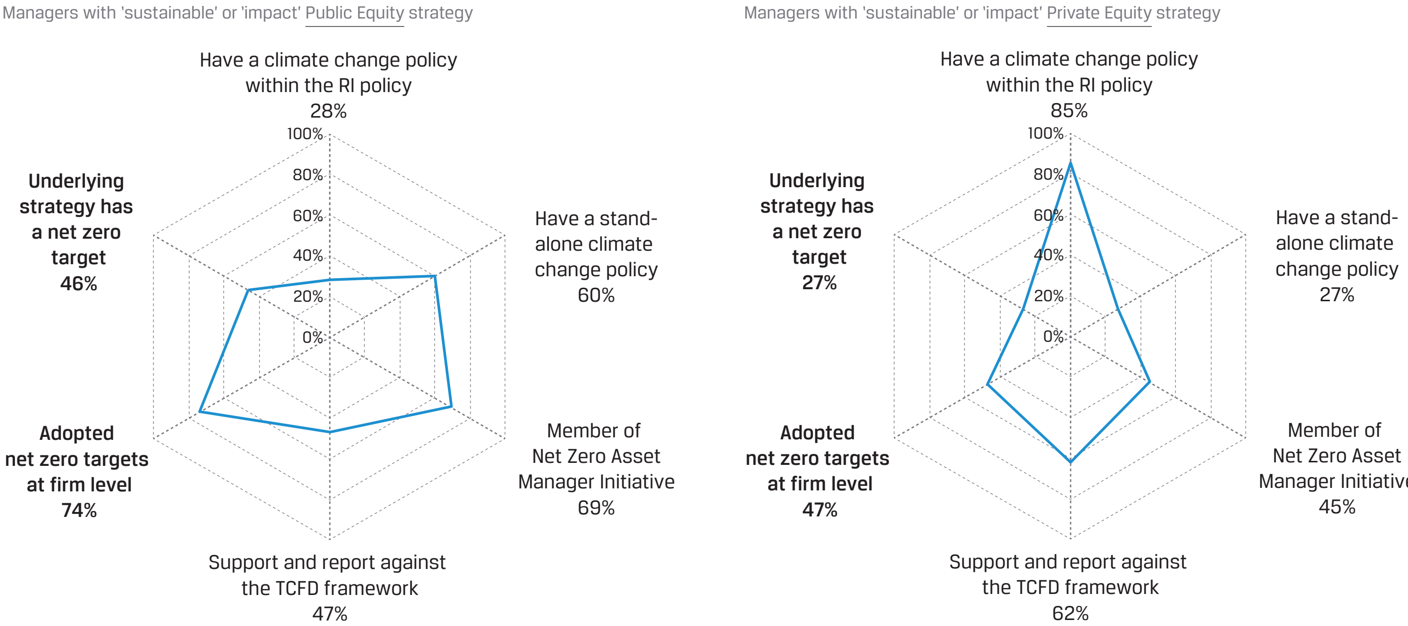


Source: bfinance, ESG asset manager survey (72), 2023

At firm level, targets and commitments are often connected to managers' involvement with programmes such as the Net Zero Asset Manager Initiative, the Taskforce for Climate Related Financial Disclosures (TCFD) and Climate Action 100+, to name a few. Participation in these initiatives can be key to kick-starting change internally, while industry collaboration also helps to drive forward the climate agenda. The Net Zero Asset Manager Initiative (NZAMI) has currently 301 signatories representing around €55 trillion in AUM. However, there is still a long way to go: only 43% of PRI signatories, for example, publicly support TCFD recommendations.

It is important to observe that firm-level Net Zero targets and involvement in initiatives such as NZAMI do not necessarily

Figure 4
Climate-related commitments from asset managers with 'sustainable' or 'impact' strategies in different asset classes



Source: bfinance, 2023. Data covers 103 managers with a 'sustainable' or 'impact' public equity strategy and 55 managers with a 'sustainable' or 'impact' private equity investment strategy (self-selecting). Where a manager has both strategy types they are included on both sides.

translate to commitments for the manager's underlying funds. Interestingly, as shown below, this is true even where the underlying fund has a specific 'impact' or 'sustainable' remit (and, as such, might reasonably be expected to be more likely to embody the manager's 'Net Zero' objective than other products in their roster). Moreover, this significant difference between firm-level Net Zero commitments and strategy-level Net Zero objectives (even for sustainable/impact strategies) persists across both liquid and illiquid strategies, so it cannot simply be attributed to the often-discussed data availability challenges in private markets. For example, 74% of managers with 'sustainable' or 'impact' strategies in Public Equity have firm-level Net Zero targets, but only 46% have a Net Zero target for the strategy in question (a ratio of about 1.6:1). On the Private Equity side the figures are lower (47% and 27% respectively), with a similar ratio of 1.7:1.

Moreover, even where fund-level Net Zero targets are in place, the existence of these objectives is not necessarily commensurate with managing climate risks within the investment process; managers' approaches to implementing those net zero targets vary greatly in terms of sophistication. Climate-related targets, the strategy for delivering those targets and the degree of success in achieving those targets should be considered through both 'investment due diligence' and 'operational due diligence' lenses: different questions will be prioritised on each side. Investors must also consider the extent to which they will be satisfied the achievement of those targets superficially in their portfolio versus the delivery of 'real-world change' through reducing the carbon footprint of investee companies (ideally with holistic assessments of investee companies' exposure to climate risks) or supporting the development of less environmentally damaging technologies and processes.

Many asset managers in public and private market asset classes have now developed methodologies to explicitly incorporate climate change within the investment and risk management processes. Data from the PRI indicates that 50% of signatories incorporate climate-related risks when considering traditional investment risks (e.g. credit, market, liquidity, operational). Meanwhile, 35% say that their risk committee is formally responsible for identifying, assessing and managing these risks. Our own analysis indicates that only 55% of managers provide climate-related data to investment professionals on the same platform that is used for traditional financial data and analysis. Active ownership programmes also increasingly show a strong focus on driving positive outcomes relating to climate change among investee companies, but our recent research indicates that only around half of asset manager stewardship policies specifically mention climate risks and opportunities.

One interesting area of current development, in our view, is the way in which a manager approaches the financials of decarbonisation in an investee company. The more common route is to assess whether the company has set a net zero target, whether it is ambitious and whether it is in line with the Science Based Target Initiative. Yet targets can be superficial or even problematic if the financials do not stack up. As such, we do now see approaches that involve pricing in and/or assessing the viability of the CAPEX and OPEX required to truly decarbonise the company, and pushing for that to include 'Scope 3' emissions where possible. This approach, however, is still not widespread.

CHALLENGE 3: ENSURING ESG INTEGRATION THROUGH THE FULL INVESTMENT LIFECYCLE

There are many stages to the lifecycle of an investment, from determining the potential investment universe through to investment selection and due diligence, followed by managing the asset – which may include active ownership, monitoring and reporting – and ultimately concluding an exit/sale. Whatever the asset class, it is important for asset managers to have a thorough, cohesive approach from the start to end of the investment lifecycle rather than focusing heavily on two or three areas and overlooking others. Furthermore, 'best practice' at each stage should look different depending on the asset class, sub-sector (e.g. geography) and investment style (e.g. holding periods): ambiguous process descriptions that are not asset class specific should be viewed with caution.

At pre-investment stage, it is important to understand how the asset manager has defined the investment universe, including (positive or negative) screens and data sources used for the screening process. While this part of the process can be more challenging in private markets, there are number of third-party providers that can be used to support assessment and subsequent monitoring.

Once the investment universe has been defined, managers should be able to demonstrate a robust, repeatable process to incorporate ESG considerations into due diligence. Characteristics of strong practice include developing ESG data using proprietary analysis, combining this with third-party data sources, forming views on the material risks and opportunities affecting an investment and reflecting these in the investment thesis or investment committee memos which are used in the decision-making process. Leading managers even go a step further and demonstrate the weight placed on ESG within decision making and may even make valuation adjustments to 'price in' ESG, whether that takes the form of integration into financial assumptions, covenants or costed corrective actions (such as in the 100-day post-investment plan for private market assets).

In practice, however, we find during our day-to-day investment consultancy activities that asset managers' practices deviate considerably from this ideal. We do still see some asset managers placing excessive reliance on third-party data providers: external data does have a pivotal role to play in ESG programmes but investors should be particularly wary of managers depending heavily on a single provider and taking their data at face value without further interpretation. We also see some firms giving portfolio managers a large amount of discretion on whether to incorporate ESG analysis into their decision-making: investment managers with personal biases on the topics and/or a lack of willingness to adapt their existing decision making may take a superficial tick-the-box approach or, worse, ignore the topic all together. We've also experienced firms offering artificial polished examples of due diligence memos, rather than real-life redacted samples in which ESG features prominently. Some managers only reveal red flags during live due diligence discussions, such as a tendency for investment seniors to deflect ESG-related questions to the ESG person in the room.

Following the investment, asset managers should demonstrate strong active ownership processes. Stewardship is fundamental to managing ESG risks and achieving real world change relating to sustainability; investors can look for a high degree of transparency, robust practices in voting and engagement, use of milestones, evidence of tangible positive outcomes and escalation processes. Monitoring/reporting and clear inclusion of ESG issues within risk management are also key in the post-investment stage. We see many examples of weak practice here. By way of an illustrative example, we recently assessed a private markets manager who relied on periodic manual internet searches to reveal real-time news about controversies affecting their holdings.

ESG considerations are also highly relevant when exiting an investment. Where the asset can be traded, managers take different views on the role of divestment as part of a credible ESG-oriented strategy. For closed-end private market strategies that require exits in order to realise value for Limited Partners in the fund, it is useful to consider how the manager has sought exits that promote sustainability rather than undermine it.

CHALLENGE 4: CUTTING THROUGH 'IMPACT WASHING'

Investors can now access a rapidly expanding range of 'impact' strategies across various asset classes, some of which adopted the EU SFDR 'Article 9' label though others chose not to take this path. These target the dual objective of generating measurable positive environmental and social outcomes alongside financial returns (although some highly impact-focused investors may place less focus on the latter).

Not all impact products are created equal, however, and this sector is particularly difficult to navigate given its immaturity. Due diligence of impact products must assess not only of the credibility of the impact process – with *intentionality*, *additionality* and *measurability* in mind – but also the manager's ability to balance impact outcomes and financial returns. The sector is rife with 'impact washing', wherein strategies can be dressed up to look significantly more impactful than is justified by a more thorough analysis of their processes.

Impact washing often takes the form of 'SDG washing', whereby managers seek to associate investments with the UN Sustainable Development Goals. While SDG alignment can be interesting and helpful when done well, there is no standardised approach. In practice, managers have been very creative in aligning companies to SDGs: one recent manager assessment, for example, saw a luxury chocolate retailer being mapped to the 'Zero Hunger' goal. Assessment is primarily based on 'percentage of revenue' alignment to an SDG, but the thresholds used by managers vary, with figures as low as 50% of revenues. Furthermore, alignment with the high-level SDGs can be extremely superficial versus a more granular approach that looks at the 169 underlying targets and, even then, further probing can be required on subjects such as the geographies targeted (e.g. emerging versus developed markets).

There is huge differentiation between managers in terms of their approaches to impact investing and the picture is evolving rapidly. Best practice involves focusing on a company's philosophy to deliver positive outcomes, quantifying target KPIs for impact in line with financial analysis and considering the ESG risks and potential negative impact of the company. Investment managers leading the charge in this space tend to incorporate industry initiatives such as the 'five dimensions of impact' from the Impact Management Project (IMP), and have created methodologies to consider the impact per dollar invested.

Here, again, we see significant differences between managers based on the asset class in which they operate. If we revisit the universe of explicit 'sustainable' and 'impact' strategies that was examined in 'Challenge 2', we find some interesting distinctions at play; a couple of these are illustrated in the charts shown here.

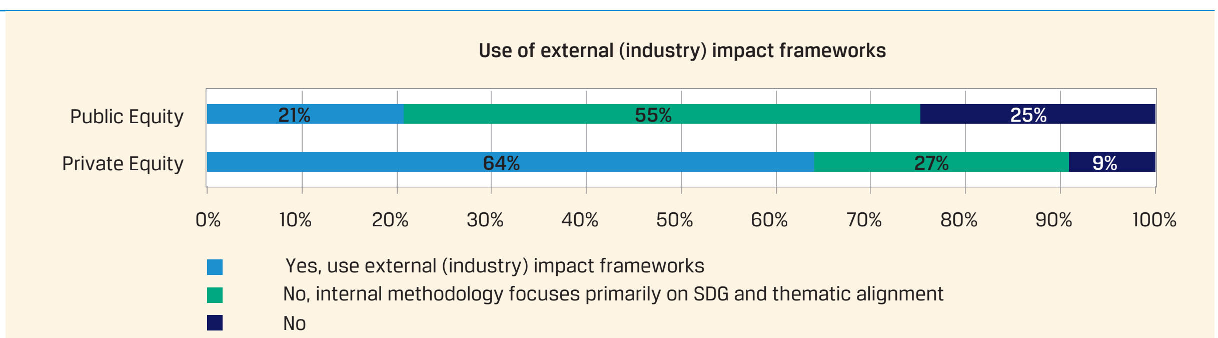
Public Equity managers lean towards SDG-based and thematic alignment while Private Equity managers are more likely to leverage industry frameworks. One could argue that those frameworks maybe somewhat more well-suited to illiquid assets: where the investments are more direct, GPs tend to take majority stakes and portfolios are concentrated. Yet it's important to note that one in five public equity strategies *are* using such frameworks, demonstrating the art of the possible. In addition, we find that Private Equity managers are more likely to consider 'under-served populations' in their methodologies. It is important to consider the beneficiaries of impact, and under-served populations in particular: among other things, clarity on the beneficiaries can be extremely helpful as a tool for understanding the 'additionality' of impact offered by the investment (a subject where listed equity strategies are sometimes, in our view, less convincing).

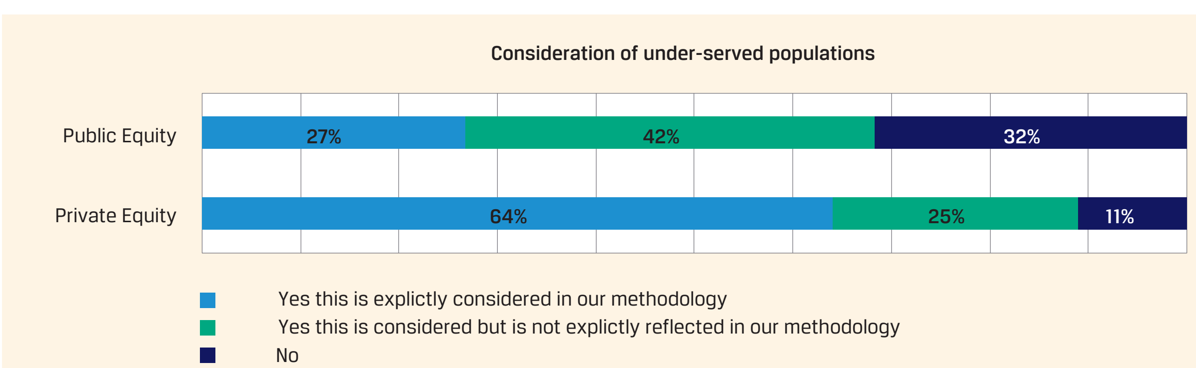
As always, investors should be very cautious when relying on managers' assertions in response to impact-related questions. Closer examination of managers' philosophy and methodology is not always supportive of their assertions. For example, while well over half of managers with sustainable/impact strategies claim to consider under-served populations within their methodology (either explicitly or implicitly), this is less strongly evidenced in practice than we would wish.

'IMPACT ECONOMY' AND 'DOUBLE MATERIALITY' CONCEPTS ARE BECOMING MORE MAINSTREAM

At present, 'impact investing' remains a somewhat niche consideration for investors, often approached via a siloed allocation and/or a specific mandate(s). That being said, we see proponents increasingly encouraging investors to consider 'impact' across their full investment portfolio. After all, every single investment has a variety of environmental and social effects – both negative and positive. This is the increasingly widely recognised concept of 'double materiality': the notion that companies are affected by ESG issues ('outside-in') but, at the same time, are having an effect on society and the environment ('inside-out'), such as contributing to biodiversity loss.

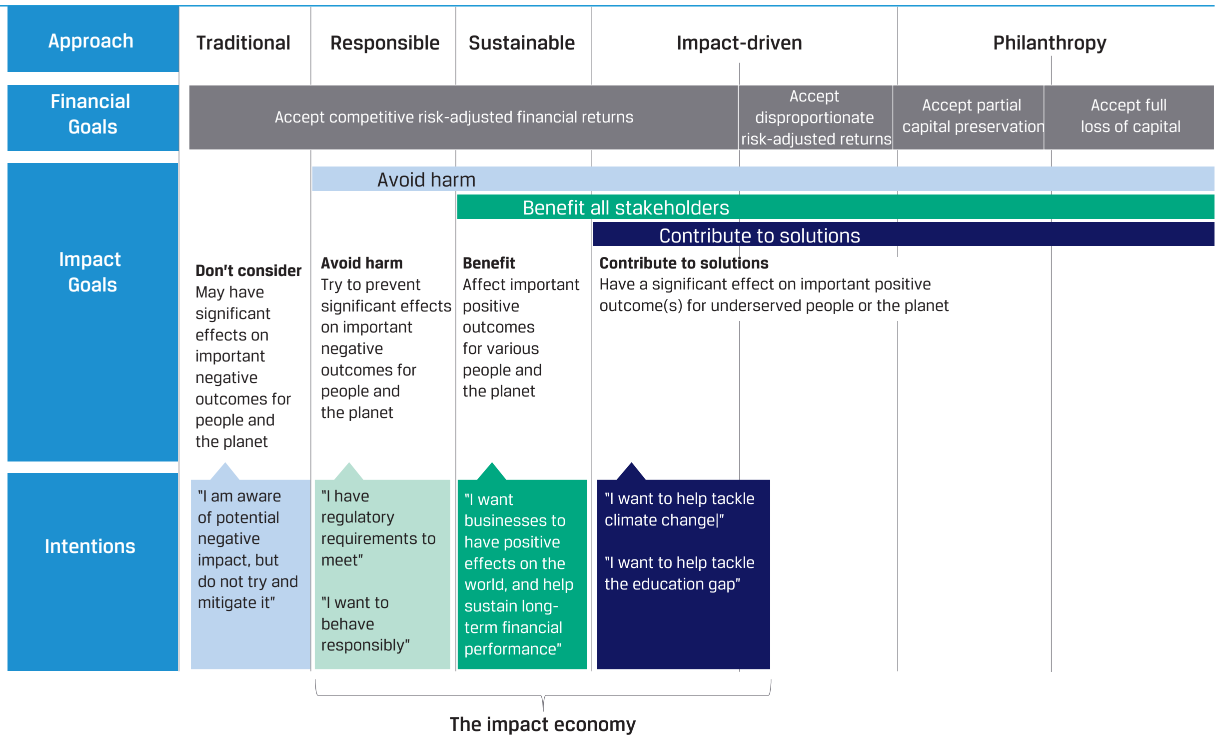
Figure 5
Analysis of 'sustainable' or 'impact' strategies





Source: bfinance, 2023. Data covers 103 managers with a 'sustainable' or 'impact' public equity strategy and 55 managers with a 'sustainable' or 'impact' private equity investment strategy (self-selecting). Where a manager has both strategy types they are included on both sides.

Figure 6
The 'spectrum of capital'



Source: bfinance, adapted from The Bridges Spectrum of Capital[6]

One related term that investors will increasingly see referenced is the 'Impact Economy'[5]: this involves paying regard to the positive and negative externalities (full costs and benefits) of all companies or productive activities and accounting for them more effectively. While impact investors are often under pressure to answer the question 'does investing for impact entail sacrificing returns?', concepts of this type push the debate towards a different question: 'returns at what cost?'

The 'Impact Economy' mindset extends the concept of impact investing – typically pushed to the far end of numerous industry infographics that show investment activities on a spectrum from 'traditional' to 'philanthropic' – back into the mainstream. In this paradigm, impact investing would not be siloed but would be relevant to all asset managers and asset owners. As such concepts gain traction, investors should question fund managers of all types on their ability to assess a variety of types of impact and the ways in which they mitigate harmful outcomes as effective stewards of capital.

CONCLUSION

Assessing investment managers' ESG credibility, in an environment where ESG marketing is so dominant, is not an easy task. Investors that seek to deliver sustainable long-term returns, support decarbonisation or fulfil their mission to act as responsible stewards of capital must now wade through a minefield of style over substance, even though the substance itself has improved significantly over the past decade.

Yet there is, in fact, very clear differentiation between asset managers that are stronger and weaker on this subject. This is particularly visible when we look beyond some of the more popular headline variables (boxes that are increasingly ticked 'yes') and examine approaches in more detail. Effective due diligence that is sensitive to the specific asset class and spans both investment and operational aspects can identify best practice as well as highlighting 'red flags'.

Moreover, an investor should keep a close eye on the selected asset managers' capabilities following their appointment. The bar is being raised and 'best practice' is a continually moving target. We anticipate that institutional investors' expectations and requirements will continue to escalate, with stakeholders becoming increasingly cognisant of the full overall cost – financial, environmental and social – of investment returns.

Notes

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2 *SEC Charges Goldman Sachs Asset Management* (press release), Securities and Exchange Commission, November 2022

3 *European asset managers blame regulatory confusion for downgrade of ESG funds*, Financial Times, November 2022

4 *PRI Delists Five, Plans to Raise Minimum Requirements*, Investment & Pensions Europe, September 2020

5 *Introducing the Impact Economy*, Griffith University Professional Learning Hub

6 *The Bridges Spectrum of Capital*, Bridges Fund Management, 2017

Cocktail van psychologische valkuilen

Op 10 december 2008 kreeg de Amerikaanse hoogleraar psychologie Stephen Greenspan het eerste exemplaar van zijn nieuwe boek *Annals of Gullibilty* in handen. De hele geschiedenis van de menselijke goedgelovigheid komt hierin voorbij. Van het Paard van Troje in de klassieke oudheid tot moderne e-mailoplichters die de erfenis van een Afrikaanse prins beloven.

Twee dagen later, op 12 december 2008, was het M-day zoals Greenspan het zelf noemt. Die dag kwam hij erachter dat een flink deel van zijn pensioen in rook was opgegaan in de grootste Ponzi-fraude aller tijden: die van Bernie Madoff.

Tragikomisch natuurlijk, en het internet lachte zich suf om de goedgelovigheid van de goedgelovigheidsprofessor. Had hij zijn eigen boek wel gelezen?

Nu wíst Greenspan niet dat hij in Madoff investeerde, sterker nog: hij had nog nooit van de man gehoord. Hij was in zee gegaan met een kennis die als financieel adviseur belegde in een van de *feeder funds* van Madoff. Greenspan zocht een stabiel fonds voor zijn pensioen en geeft ruiterlijk toe dat hij zelf niet zo veel financiële kennis had.

Maar eigenlijk is het niet zo verwonderlijk dat een bijna gepensioneerde wetenschapper in Madoffs val trapte. Veel interessanter is waarom die *feeder funds* in Madoff investeerden. Zij hadden immers wél kennis van zaken. Bovendien waren er wel degelijk signalen dat het niet helemaal pluis was.

Zo zat onze goedgelovige professor een paar maanden na M-day in een panel om over zijn financiële misfortuin te praten. Een van de andere deelnemers was een consultant die op verzoek van zo'n *feeder fund* ooit onderzoek had gedaan naar Madoff. Hij rapporteerde meerdere rode vlaggen zoals handgeschreven handelsbewijzen en grote transacties die anderen in de markt hadden moeten opvallen. Maar de CEO van het fonds wilde er niks van weten. Hij vertrouwde op Madoff, een man van aanzien.

De zaak-Madoff is het ultieme voorbeeld van hoe het mis kan gaan als uitbestedingsrisico's niet of niet goed genoeg worden onderzocht, het thema van dit nummer. Maar het is ook een verhaal dat mij destijds als beginnend journalist enorm fascineerde.

Een verhaal over geld, maar vooral over mensen en hun gedrag, over een intrigerende cocktail van psychologische valkuilen en *biases* – een geliefd onderwerp van uw nieuwe columnist.

Zo speelde hier kuddegedrag een rol, en wat Greenspan de *social feedback loop* noemt: als iedereen het doet zal het wel goed zijn toch? Gecombineerd met wat FOMO – *fear of missing out*, nog een dosis hebzucht en je gaat voor de bijl.

Al gaat dát dan weer niet op voor toezichthouder SEC. Die ontving al sinds de jaren '90 serieuze klachten, maar vond nooit wat. In 2005 – twee jaar voordat professor Greenspan zijn pensioengeld zou investeren – stuurde klokkenluider Harry Markopolos de SEC een document met daarin dertig aanwijzing dat Madoff 'zeer waarschijnlijk' een Ponzi runde.

De SEC reageerde 'met scepsis en ongeloof', staat in een rapport over het handelen van de toezichthouder. Madoff voldeed nu eenmaal niet aan het 'profiel' van fraudeur. Onderzoek leverde niets op, ook omdat de onderzoekers nalieten Madoffs transacties te checken. Ze vertrouwden hem blind. Leemtes in verklaringen werden zelf ingevuld en inconsistenties genegeerd.

Hier was de ***confirmation bias*** aan het werk: de neiging om informatie te zoeken die overeenkomt met de eigen ideeën. In combinatie met een vorm van autoriteitsbias. Want als een man van de statuur als Madoff zegt dat het in orde is, dan geloof je dat. Bij een betrouwbare partij is geen diepgaand onderzoek meer nodig.

Professor Greenspan schreef een aantal jaar geleden nog een boek, *Anatomy of Foolishness*. Daarin definieert hij gezond verstand als het herkennen van overduidelijke risico's. Maar het besef van de *niet* voor de hand liggende risico's, schrijft hij, dat is wijsheid.

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Operational Due Diligence in an Era of Change

COVID AND TECH AS A BLESSING IN DISGUISE

Michiel Vetkamp, Evelien Starren, Hylke Bijma en Matthijs Verspeek

INTRODUCTION

These are turbulent times. Recently, the world experienced a challenging pandemic and soon thereafter got confronted with serious geopolitical tensions. Additionally, the tech world is evolving rapidly. These developments have affected our daily lives and, from a professional standpoint, have made us question the impact on the way we perform operational due diligence (ODD). In this article we focus on the effects of the pandemic and tech developments. We will make a case that the challenges faced by the pandemic have revealed the vulnerabilities of the old way of working and made ODD practitioners reconsider their professional approach and routines.

One could debate whether the pandemic has changed the ODD practice for the better or the worse. Obviously, progress in tech is one of the important drivers of change in this respect. We will delve into how technology has played a crucial role in coping with pandemic-induced challenges and how it may further contribute to the ODD practice in the future.

COVID AND ITS CONSEQUENCES ON OPERATIONAL DUE DILIGENCE

In early May 2023, officials from the World Economic Organization (WHO) announced that COVID no longer constitutes a global health emergency, which can be seen as a symbolic end to the pandemic. Although the authors of this article admit that they are not often reminded anymore of the personal drama and hardship the world had to endure, they believe that there are valuable lessons to be learnt from the experience. Additionally, it is fair to assume that the way we had to cope and adapt is having a lasting impact on both our social and professional lives.

To provide a more cohesive explanation of the impact of ODD practices, it is important to first understand the reason d'être of these practices. Asset managers not only manage assets internally through their portfolio management organization but also engage with external partners who have a great responsibility in servicing the investment exposure entrusted to them. To assess the operational capabilities of these external parties, ODD must be performed periodically. ODD focuses on

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the operational risk profile of these external parties and to what extent they are capable of identifying, managing, and monitoring these risks.

In general, the external party is provided with a tailored questionnaire and requested to respond and provide additional documentation. To supplement this information, interviews with company officers are often conducted, which may take place during onsite visits.

ODD FOCUSES ON THE OPERATIONAL RISK PROFILE

The COVID-19 pandemic has caused a significant shift in the way ODD is conducted. Before the pandemic, onsite visits were the primary method of conducting ODD, allowing teams to assess operational practices, meet key personnel, and gauge the culture and environment of a target company. However, travel restrictions, health concerns, and logistical challenges associated with COVID-19 have disrupted these traditional practices and necessitated a shift towards remote work and virtual interactions. This shift naturally extended to the realm of due diligence, where investors and consultants turned to technology to conduct assessments without physically visiting the target site. Remote assessments, aided by video conferencing, data sharing platforms, and virtual tours, allowed for some level of continuity during the pandemic-imposed restrictions

Some of the challenges that ODD practitioners have had to face due to remote work are:

- **TECHNICAL CHALLENGES**

One had to rely heavily on technology and particularly stable internet connections. This introduced potential technical difficulties that might disrupt the smooth execution of remote due diligence.
Also, the exchange and storage of sensitive information became more important. Businesses had to ensure that robust data security measures were put in place to protect confidential information and adhere to privacy regulations.

- **REDUCED PERSONAL CONNECTIONS**

In-person meetings provide for a wonderful opportunity to foster relationships and build trust. In remote due diligence, while convenient, the interviewers might miss the opportunity to establish personal connections that could enhance collaboration and cooperation.

Additionally, cross-cultural and language barriers can be more pronounced in remote due diligence, making it harder to avoid miscommunication or misunderstandings. In-person meetings, though not perfect, may provide some sense of these intangible elements that play a significant role in evaluating potential investments. Reading the interviewee and nonverbal communication is difficult in a virtual setting, but these signals can be highly relevant for gauging corporate culture and boardroom dynamics.

- **LIMITED SITE CONTEXT**

In remote assessments, one had to rely heavily on the information and data provided by the firm's representatives. This forced ODD experts to be aware of and pay extra attention to verification and cross-referencing to protect against (un)intentional bias or misrepresentation.
Also, onsite visits provide the opportunity to walk around at the site, see assets and meet with other company officials. Thereby, the ODD professionals can gain valuable context and a comprehensive understanding of the operational environment.

THE SECTOR DEMONSTRATING ITS CAPACITY TO ADAPT

The above may appear to paint a gloomy picture for the ODD profession. That being said, it also forced industries including the ODD profession to be inventive and pragmatic. As a result, there are notable positives that resulted from this. These were predominantly triggered by technological advancements.

DIGITAL INTERVIEWS HAVE ALLOWED ODDS TO CONTINUE

The COVID-19 pandemic has accelerated the adoption of remote technologies in various aspects of business operations, including onsite operational due diligence. Video conferencing tools such as Zoom and MS Teams have made real-time collaboration possible, enabling remote interviews to replace onsite ones. Although digital interviews can have some disadvantages, they have allowed ODDs to continue, including the much-needed interviews. Furthermore, remote ODD allows for flexible scheduling, enabling more frequent interactions with target companies. The increased speed of information exchange has also triggered discussions on the need for extensive travel, thereby reducing the carbon footprint and expenses.

Another significant technological development has been the surge in workflow management tooling to digitalize ODD efforts. One of the most significant challenges faced by ODD teams is the overwhelming amount of data and documentation that must be processed and analysed.
The introduction of workflow management systems brings structure and organization to this complex landscape, streamlining the entire ODD process. By providing a centralized platform to manage tasks, track progress, and automate routine activities, these systems empower teams to work more efficiently, saving valuable time and resources. These solutions also may enable ODD teams to measure data like turnaround time, quality of analysis, and adherence to best practices. Various

vendors nowadays offer digital solutions to share questionnaires and analyse responses, thereby optimizing the information exchange between ODD expert and subject company.

WORKFLOW MANAGEMENT SYSTEMS HOLD IMMENSE PROMISE

While the introduction of workflow management systems holds immense promise for ODD teams, there are challenges to be mindful of. Integration with existing systems, data security and privacy, and ensuring user adoption are among the considerations that organizations must address. A comprehensive implementation strategy, involving adequate training and change management, is crucial to maximize the benefits of workflow management systems and ensure their successful adoption.

THE MEDIUM-TERM PERSPECTIVE

While COVID is no longer considered a global health emergency, it has left a lasting impact on the ODD practice. The ODD profession has not fully returned to its pre-pandemic way-of-working. ODD practitioners can now travel again to conduct onsite visits when necessary, but asset managers now have the option to choose between onsite visits or digital interviews. The decision between virtual or in-person ODDs is made on a case-by-case basis, considering factors such as travel cost, travel time, carbon footprint, and the inherent operational risk profile of the subject company. The decision may also depend on whether it is a new investment or an existing relation previously already subjected to an onsite ODD. Ultimately, this approach leads to a better-balanced risk-based approach, in which resources are deployed more efficiently and attuned to the inherent operational risks. However, a caveat remains that information on the ground may be more accurate than information shared by management in virtual meetings.

As this is new territory for all asset managers, another challenge of this new approach is the lack of historical market data to come up with an optimal mix of onsite versus digital visits. Different strategies regarding this mix are still being developed per type of firm, considering the various factors such as the nature of the business, the level of risk involved, the outcome of the latest ODD, how much influence the investor can exercise on the manager, and the specific objective of the ODD. Regarding the latter, the objective of the ODD, it may at times be strategic to include a surprise factor. This could be done by conducting an onsite visit after having conducted multiple virtual interviews in the past. Although the virtual availability of information might be sufficient, the objective of the onsite ODD could shift more towards boardroom dynamics and balance of powers, something that is hard to gauge virtually. Ultimately, a combination of both approaches provides the most comprehensive assessment while optimizing resources.

Technological advancements will continue to play a crucial role in driving change, particularly with the implementation of workflow management systems. These systems can transform the landscape by streamlining ODD processes and facilitating information exchange between internal and external stakeholders. Furthermore, they have the potential to analyze data across various dimensions, such as investments, investment strategies, and regions, providing an unprecedented level of reporting.

INFORMATION ON THE GROUND MAY BE MORE ACCURATE

Similarly, Artificial Intelligence (AI) can have a lasting impact on ODD practice. AI technology facilitates the processing and analysis of large amounts of natural language data, extracting information and insights from documents or the web. This technology can help ODD practitioners scan large amounts of documents, extract specific information, and make inferences.

CONCLUSION

Overall, COVID has not only seriously impacted societies on a global scale, but also had a lasting impact on the ODD practice. ODD practitioners were forced to confine to digital meetings as it was practically impossible to hold on-site visits. Virtual meeting platforms enable the sector to replace on-site meetings with digital sessions, but this has its limitations.

Post-COVID, fortunately, ODD practitioners have a choice between performing either onsite ODDs or digital sessions only. While technology has enabled remote assessments and virtual interactions, the value of an onsite visit cannot be overstated. Ultimately, the decision of going onsite will depend on various considerations, including the subject company's anticipated operational risk profile, results from prior visits, travel costs and time spent as well as carbon footprint. As such the profession has been able to adjust to a new reality of a better-balanced risk-based approach.

Not in the least, the sector is also benefiting from technological advancements in workflow management and AI solutions.

Due diligence en uitbestedingsrisico: wettelijke eisen

Peter Laaper

INLEIDING

Uitbesteding brengt risico's met zich. Deze moet men beheersen. Dat vereist dat men de risico's eerst in kaart brengt. Immers, risico's die men niet kent, kan men niet beheersen. Het is als in volle vaart autorijden op de snelweg, maar zonder goed zicht.

Om de risico's in kaart te brengen, voert men een due diligence-onderzoek uit. Is de due diligence goed uitgevoerd, dan kan men bepalen (i) welke risico's te accepteren, (ii) op welke wijze risico's te beheersen als men de risico's niet wil accepteren of (iii) om geheel af te zien van uitbesteding aan de beoogde partij.

Een goede due diligence is niet alleen verstandig. Vanwege het cruciale belang voor de risicobeheersing bij uitbesteding is ze ook verplicht. In regelgeving worden al veel onderwerpen genoemd die in de due diligence moeten worden meegenomen. Dit is geen afvinklijst: er zijn ook onderwerpen die opvallend onvermeld blijven, zoals onderuitbesteding. Met het afstrepen van de onderwerpen die in de wet genoemd zijn, is men er dus nog niet: men moet zelf blijven nadenken wat de risico's bij *deze* uitbesteding van *deze* werkzaamheden aan *deze* dienstverlener zijn. Voorts komt de vraag op wat met de geïdentificeerde risico's gedaan moet worden: moeten ze volledig worden geëlimineerd of slechts teruggedrongen? En kan dat zuiver contractueel door de verantwoordelijkheid volledig of grotendeels bij de dienstverlener te leggen, of houdt de uitbesteder zelf ook een actieve rol?

Deze vragen zijn niet te beantwoorden zonder eerst een blik te werpen op doel en ratio van de wettelijke uitbestedingsvoorschriften. In deze bijdrage begin ik daarmee. Daarna ga ik in op de in een due diligence te betrekken onderwerpen. Tot slot behandel ik hoe de geïdentificeerde risico's te beheersen en hoever men moet gaan in het treffen van risicobeheersingsmaatregelen.

Deze bijdrage schrijf ik met het oog op de (AIFMD)-beheerder van een beleggingsportefeuille die een derde inschakelt om een deel van het vermogensbeheer uit te voeren. Dit verhoogt de lees-

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baarheid omdat de specifieke voorschriften vaak net wat verschillen tussen bijvoorbeeld AIFMD-beheerders en ICBE-beheerders, pensioenfondsen en verzekeraars, maar ook beleggingsondernemingen en *bank*beleggingsondernemingen. Voor een goed begrip van de uitbestedingsvoorschriften hebben deze verschillen echter weinig belang: in alle gevallen geldt dat elke uitbestedende onderneming alle relevante risico's moet onderkennen (de due diligence) en beheersen.

DOEL EN RATIO VAN DE REGELGEVING

Beheerders mogen best risico's nemen, maar alleen verantwoorde risico's. Beheerders moeten daarom de risico's die zij nemen, beheersen. Dat volgt uit hun fiduciaire zorgplicht naar hun klanten. Ze zijn het ook verplicht op grond van de Wet op het financieel toezicht (Wft). Juridisch heet dit dat de manager over een *beheerste en integere bedrijfsvoering* moet beschikken. In vlot jargon heet het dat hij *in control* moet zijn.

RISICO'S DIE MEN NIET KENT, KAN MEN NIET BEHEERSEN. HET IS ALS IN VOLLE VAART AUTORIJDEN OP DE SNELWEG, MAAR ZONDER GOED ZICHT

Het probleem met uitbesteden is dat een deel van die bedrijfsvoering in feite buiten de eigen onderneming wordt geplaatst. Of anders geformuleerd: de bedrijfsvoering van de dienstverlener wordt onderdeel van de eigen bedrijfsvoering. Dat is prima waar het voordelen betreft, zoals lagere kosten, betere kwaliteit of toegang tot specialistische kennis. Maar de uitbestedende beheerder haalt ook de risico's en tekortkomingen in de bedrijfsvoering van zijn dienstverlener binnen. Als de ingeschakelde vermogensbeheerder ongeschikte beleggingen selecteert, staat de portefeuille aan ongewenste beleggingsrisico's bloot. Administreert de vermogensbeheerder onjuist de beleggingen, dan kan de beheerder niet correct rapporteren aan zijn cliënten en toezichthouders. En erger: door de uitbesteding kan hij ook niet meer (rechtstreeks) ingrijpen om tekortkomingen te herstellen. De uitvoering ligt immers bij een ander: zijn dienstverlener. Is de beheerder dan nog wel *in control* over de uitbestede werkzaamheden, over het uitbestede deel van wat in feite zijn eigen bedrijfsvoering is?

De oplossing van de wetgever is rigoureus: een uitbestedende onderneming blijft jegens cliënten en toezichthouders volledig verantwoordelijk voor het handelen en nalaten van zijn dienstverlener als was het zijn eigen handelen en nalaten. De uitbesteder heeft maar te organiseren dat hij *in control* blijft.[1] Van belang hierbij is dat *total control* onnodig is: *in control* is voldoende. De ratio van een uitbesteding is dat de dienstverlener een activiteit beter of goedkoper kan dan de uitbesteder dat kan. Die hele rationale valt weg als de uitbesteder *micro-managent* zijn dienstverlener moest vertellen wat wanneer te doen. De dienstverlener kan dat ook niet accepteren: hij zou zelf niet meer in control zijn over zijn eigen bedrijfsvoering. Waar het om gaat is dat de uitbesteder *voldoende* control kan uitoefenen om de omvang van de risico's te reduceren tot een niveau dat verantwoord is.

DOOR UITBESTEDING WORDT DE BEDRIJFSVOERING VAN DE DIENSTVERLENER ONDERDEEL VAN DE EIGEN BEDRIJFSVOERING

Daarvoor is noodzakelijk een capabele dienstverlener te selecteren die aantoonbaar in staat is om de uitbestede werkzaamheden voldoende consistent conform vastgestelde (minimum)normen te verrichten. Dat is de stap waar due diligence op ziet. Immers, de bedrijfsvoering van de dienstverlener is onderdeel gemaakt van de eigen bedrijfsvoering, en de eigen bedrijfsvoering moet beheerst en integer zijn.

IN DE DUE DILIGENCE TE BETREKKEN ONDERWERPEN

Uit het voorgaande zijn een aantal categorieën aan onderwerpen af te leiden waar in een due diligence op gelet moet worden. Ik onderscheid: (i) zijn de primaire processen van de dienstverlener in staat om de werkzaamheden conform de gestelde eisen te verrichten? (paragraaf 1-2); (ii) kan hij dat consistent en ook bij verstoringen? (paragraaf 3-6); (iii) kan de dienstverlener ook voldoen als de wettelijke eisen of de wensen van de beheerder veranderen? (paragraaf 7).

Deze categorieën kunnen worden uitgewerkt. Zo zijn andere eisen te stellen naar gelang de aard van de werkzaamheden (bijvoorbeeld portefeuillebeheer, risicobeheer, administratie of ICT-ondersteuning). En hoe hoog de lat ligt op die eisen is afhankelijk van het gewenste kwaliteitsniveau.

Uit regelgeving is een lange lijst van eisen te destilleren die in een due diligence meegenomen moeten worden. In deze bijdrage is geen ruimte om deze eisen allemaal te behandelen. Bovendien biedt de regelgeving geen sluitende lijst. Ik beperk mij daarom tot een aantal onderwerpen die (i) specifiek op vermogensbeheer zien, (ii) vanwege hun belang aandacht behoeven, of (iii) in de praktijk vaak onvoldoende aandacht krijgen.

1. PRIMAIRE PROCESSEN

Primaire processen zijn de processen die direct bijdragen aan de dienstverlening. Voor de casus in deze bijdrage gaat het om het vermogensbeheer. De beheerder moet zich ervan vergewissen dat de primaire processen van de externe vermogensbeheerder op orde zijn en zo kunnen worden ingericht dat de gevraagde diensten geleverd worden. Het gaat over processen als de selectie van beleggingen en de orderuitvoering, maar ook of de externe vermogensbeheerder kan voldoen aan het ESG-beleid van de beheerder.

2. RAPPORTAGES

Rapportages kan men zien als onderdeel van de primaire processen: een uitbesteding zonder rapportages bestaat niet. Voor zijn beeld van de uitvoering van de uitbestede werkzaamheden is de beheerder immers afhankelijk van de rapportages van zijn dienstverlener. Elke dienstverlener biedt standaardrapportages. De beheerder kan eenvoudig onderzoeken of de standaardrapportage alle gewenste informatie bevat en duidelijk weergeeft. DNB constateerde in het verleden dat de inhoud en complexiteit van rapportages niet altijd aansluit op de behoeften van opdrachtgevers.

3. BEHEERSTE EN INTEGERE BEDRIJFSVOERING

De bedrijfsvoering van de dienstverlener wordt onderdeel van de eigen bedrijfsvoering en moet daarom beheerst en integer zijn. Het gaat niet alleen over de primaire processen; het gaat ook om de secundaire processen: de processen die het primaire proces ondersteunen, zoals ICT, compliance en management. Dit zijn belangrijke onderwerpen. Immers, ook bij de dienstverlener gaan in de bedrijfsvoering onvermijdelijk dingen mis. Dat is inherent. Bij een beheerste en integere bedrijfsvoering blijven de gevolgen voor de beheerder binnen de perken.

EEN UITBESTEDENDE ONDERNEMING IS TEGENOVER CLIËNTEN EN TOEZICHTHOUDERS VERANTWOORDELIJK VOOR HET HANDELEN EN NALATEN VAN ZIJN DIENSTVERLENER ALS WAS HET ZIJN EIGEN HANDELEN EN NALATEN

De beheerder kan onderzoek doen naar beleidsdocumenten zoals het ICT-beleid, het *cloud*-beleid, het beloningsbeleid, het compliancebeleid en het integriteitsbeleid. Minstens zo belangrijk is of het beleid ook wordt uitgevoerd. Bestaan er werkelijk backup- en noodvoorzieningen? Functioneren die ook? Het kan zinvol zijn om de laatste rapporten van de compliance-afdeling in te zien. Uiteraard wordt een ISAE 3402-verklaring[2] opgevraagd, maar het is belangrijk om ook de inhoud van het rapport te bestuderen. Ziet het rapport bijvoorbeeld op alle relevante processen of is de scope beperkter dan dat?

Voor de digitale voorzieningen van de dienstverlener is het verstandig alvast voor te sorteren op de eisen die per 17 januari 2025 zullen gelden. De *Digital Operational Resilience Act* (“DORA”)[3] stelt verhoogde eisen aan de robuustheid van de digitale systemen van financiële ondernemingen en hun dienstverleners.

4. BELANGENTEGENSTELLINGEN

Bij uitbesteding van portefeuille- of risicobeheer moet de beheerder vaststellen of er sprake is van belangentegenstellingen en, zo ja, of die reeds afdoende worden beheerst. Of sprake is van belangentegenstellingen inzake portefeuille- of risicobeheer moet worden bepaald aan de hand van verscheidene criteria. De meeste daarvan zien op de waarschijnlijkheid van belangentegenstellingen. Een andere aanwijzing voor belangentegenstellingen is wanneer, door het bestaan van groepsverbanden of contractuele relaties, (i) de dienstverlener zeggenschap kan uitoefenen in de beheerder of (ii) een belegger zeggenschap kan uitoefenen in de dienstverlener.[4] Het portefeuille- of risicobeheer mag sowieso niet aan de bewaarder worden uitbesteed.[5] De bewaarder heeft namelijk diverse controletaken tegenover de beheerder.[6]

5. ONDERUITBESTEDING

Waarschijnlijk maakt de dienstverlener zelf ook gebruik van diensten van derden. Vanuit het perspectief van de beheerder is dat een onderuitbesteding. De beheerder moet in de due diligence vaststellen of hiervan sprake is en verzekeren dat de (keten van) onderuitbesteding voldoet aan zowel het wettelijk voorgeschreven als het door de beheerder gewenste kwaliteits- en beheersingsniveau.[7]

6. REPUTATIE EN REFERENTIES

Dit is geen juridisch voorgeschreven eis, maar wel een heel praktische. Op papier en in theorie kan men alles mooi maken, maar het is de weerbarstige werkelijkheid die telt. Er is nauwelijks een snellere en effectievere manier om door een papieren werkelijkheid heen te prikken dan door referenties op te vragen. Resultaten uit (andermans) verleden bieden geen garantie, maar scheppen wel verwachtingen voor de toekomst.

TOTAL CONTROL IS ONNODIG, *IN CONTROL* IS VOLDOENDE

Het is verstandig óók referenties op te vragen bij voormalige klanten. Waarom zijn ze weggaan? Zijn ze ook gedurende de overgangsfase keurig behandeld?

7. WIJZIGING VAN EISEN

In de loop van de uitbestedingsrelatie kunnen eisen wijzigen. Dit kan het gevolg zijn van nieuwe regelgeving. Het is ook mogelijk dat veranderde marktomstandigheden bij de beheerder tot andere wensen aan de uitvoering van de werkzaamheden leiden. Wat de oorzaak ook moge zijn: dienstverlening die perfect voldoet aan de overeengekomen, maar inmiddels verouderde afspraken, is van weinig nut. Dit kan bij langlopende overeenkomsten een probleem zijn. Er moeten dan mechanismen bestaan om – met inachtneming van de redelijke belangen van de dienstverlener – toch tot wijziging van eisen te komen.

BEHEERSING VAN DE GEÏDENTIFICEERDE RISICO'S

Nadat de relevante risico's zijn geïdentificeerd, komt men toe aan het adequaat beheersen ervan. Adequaat beheersen betekent niet dat risico's moeten worden uitgebannen. Door het nemen van risicobeheersingsmaatregelen moet het risico dat met de uitbesteding gepaard gaat, worden beperkt. De omvang van het risico dat overblijft, moet zo klein worden dat de beheerder het kan accepteren. Anders gezegd: het *restrisico* moet kleiner zijn dan de *risk appetite*[8] van de beheerder.

Hieruit volgt dat het bij het treffen van beheersingsmaatregelen niet om individuele beheersingsmaatregelen gaat. Het gaat om het geheel aan genomen maatregelen dat bepaalt of risico's adequaat worden beheerst. Dat is nuttig, want de dienstverlener kan zijn eigen redenen hebben om bepaalde beheersingsmaatregelen niet of niet volledig te willen. Die beheersingsmaatregelen grijpen immers in in *zijn* bedrijfsvoering.

AAN DE HAND VAN DE GEÏDENTIFICEERDE RISICO'S MOET DE BEHEERDER RISICOBEHEERSINGSMAATREGELEN VASTSTELLEN OF UITONDERHANDELEN WAARDOOR HET RESTRISICO KLEINER IS DAN DE *RISK APPETITE* VAN DE BEHEERDER

Stel bijvoorbeeld dat de beoogde dienstverlener vanwege een beperkte kapitalisering of een risicovol mandaat, een relatief kleine aansprakelijkheid voor schade wil accepteren. Dat betekent een financieel risico voor de beheerder wanneer zulke schade zich voordoet. Dit financiële risico kan hij verkleinen door bijvoorbeeld verzekering van het risico te eisen, een korte contractuele opzegtermijn zodat steeds verder oplopende schade niet lang oploopt, of frequente rapportages in combinatie met ruime mogelijkheden om wijzigingen aan te brengen in de uitvoering van het vermogensbeheer. Voor beheerder en dienstverlener valt er dus wat te kiezen en te onderhandelen, om zo tot een voor beide acceptabel resultaat te komen.

Adequaat beheersen betekent evenmin dat de dienstverlener contractueel volledige verantwoordelijkheid en aansprakelijkheid moet aanvaarden voor wat eventueel fout gaat. Dat lijkt misschien best redelijk: gaat iets mis in de bedrijfsvoering van de dienstverlener, dan moet hij de gevolgen maar dragen. Weliswaar blijft de beheerder verantwoordelijk en aansprakelijk jegens beleggers en toezichthouder, maar de beheerder kan zich op zijn beurt omdraaien naar de dienstverlener en hem aanspreken. Toch is dit geen oplossing – als de dienstverlener er al in zou meegaan.[9] De ratio van de wettelijke uitbestedingsvoorschriften is dat de uitbestedende beheerder *in control* blijft over de uitbestede werkzaamheden. Dat duidt op actief monitoren en zo nodig bijsturen, niet op het achteraf doorleggen van de rekening.

CONCLUSIE

De due diligence is een cruciale stap om in control te zijn over het uitbestede vermogensbeheer. De beheerder moet vaststellen of de dienstverlener (i) in staat is om de werkzaamheden conform de gestelde eisen te verrichten, (ii) over een beheerste en integere bedrijfsvoering beschikt, en (iii) ook kan voldoen als wettelijke eisen of de wensen van de beheerder veranderen. Aan de hand van de geïdentificeerde risico's moet de beheerder risicobeheersingsmaatregelen vaststellen of uitonderhandelen waardoor het restrisico kleiner is dan de *risk appetite* van de beheerder.

Noten

1 P. Laaper, Uitbesteding in de financiële sector, Deventer: Wolters Kluwer 2015, par. 2.3.

2 Een ISAE 3402-verklaring is een door een auditor afgegeven verklaring die inhoudt dat de organisatie waaraan processen zijn uitbesteed, zodanige interne beheersingsmaatregelen heeft getroffen dat zij "in control" is over de eigen bedrijfsvoering. Er zijn twee typen verklaringen. Type I geeft zekerheid over de opzet en het bestaan van interne beheersingsmaatregelen. Type II geeft zekerheid dat de beheersingsmaatregelen ook werken.

3 Verordening 2022/2554 betreffende digitale operationele weerbaarheid voor de financiële sector.

4 Art. 80 lid 1, sub a en b, Gedelegeerde Uitvoeringsverordening AIFMD (Vo 231/2013).

5 Art. 20 lid 2 sub a en 21 lid 4 sub a AIFMD.

6 Art. 21 AIFMD en Hoofdstuk IV Gedelegeerde Uitvoeringsverordening AIFMD.

7 Art. 20 lid 4 AIFMD.

8 De *risk appetite* is de risico-omvang die iemand bereid is te accepteren. Een stevig gekapitaliseerde beheerder zal doorgaans een grotere *risk appetite* hebben: gaat er wat mis en moeten dure herstelmaatregelen genomen dan hij de financiële tegenvaller incasseren zonder daar wezenlijke problemen van te hebben.
De *risk appetite* van de beheerder moet men onderscheiden van die van de beleggers. De *risk appetite* van de beleggers ziet vooral op het risico-rendementprofiel van de beleggingsportefeuille. De *risk appetite* van de manager ziet op de risico's die *hijzelf* loopt bij verstoring van de bedrijfsvoering van hemzelf of van de dienstverlener voor wie hij volledig verantwoordelijk is.

9 De vermogensbeheerder kan geen onbegrensde aansprakelijkheid accepteren. Het potentiële risico staat in geen verhouding tot de vergoeding die hij normaal ontvangt. (Bijna) onbegrensde aansprakelijkheid zou enkel kunnen bij zeer forse tariefsverhoging.

Due Diligence XP

In de praktijk wordt de essentie van het due diligence proces samengevat door het gebruik van een acroniem namelijk de 3P's van due diligence: People, Process en Philosophy. Er bestaat echter geen consensus over deze 3P's. In de praktijk wordt ook wel gewerkt met uitbreidingen naar 4P's (Performance), 5P's (Portfolio) of zelfs 6P's (Planet). Deze uitbreidingen komen mede voort door een bredere reikwijdte van de due diligence en de veranderende tijdgeest, waarbij er bijvoorbeeld steeds meer aandacht is voor duurzaamheid. Men zou daarom kunnen spreken over het 'XP model van due diligence'.

De introductie van het acroniem XP brengt interessante communicatie uitdagingen met zich mee voor de verschillende generaties die momenteel actief zijn in vermogensbeheer. De meer ervaren generaties zullen waarschijnlijk bekend zijn met het 3P due diligence model en de uitbreidingen ervan in de afgelopen jaren. Tevens kunnen hun gedachten teruggaan naar het bekende en beruchte Windows XP, waar deze generaties lang mee hebben gewerkt. Aan de andere kant zullen de jongere generaties Y en Z waarschijnlijk andere associaties hebben bij het acroniem XP. Zij kennen XP als experience punten in computerspellen zoals Fortnite, Call of Duty, MineCraft en vele andere spellen. Experience punten worden verdiend door opdrachten of missies in een spel te voltooien (of te kopen). Op basis van het aantal behaalde experience punten kan de speler naar een nieuw niveau gaan.

De praktijk toont aan dat een goede due dilligence meer vereist dan het afwerken van de checklist van het XP model. Sterker nog, voldoende ervaring is onontbeerlijk om een gedegen due dilligence uit te kunnen

voeren. Dit geldt des te meer voor vermogenscategorieën waarbij de uitkomst van het due dilligence onderzoek doorslaggevend kan zijn voor de beleggingsbeslissing om al dan niet met een manager in zee te gaan of een object aan te kopen. Denk bijvoorbeeld aan het beoordelen van kleine opkomende (niche) vermogensbeheerders of aan vermogenscategorieën met een verhoogd operationeel risico, zoals directe beleggingen in vastgoed of infrastructuur. Het Hoog Catharijne-arrest van de Hoge Raad uit 1996 toont aan dat er bij het uitvoeren van een due diligence onderzoek altijd een spanningsveld bestaat tussen de onderzoeksplicht van de koper en de informatieplicht van de verkoper. In dit geval ontdekte de koper pas na de overname van Hoog Catharijne twee leningen die moesten worden terugbetaald en spande een rechtszaak aan. Uiteindelijk heeft de Hoge Raad de koper in het ongelijk gesteld, met als argumentatie dat de koper de betreffende due diligence grondiger had moeten uitvoeren.

Vanwege het grote belang van de uitkomsten van een due diligence onderzoek verdient het geen betoog dat deze onderzoeken op de best mogelijke manier moeten worden uitgevoerd. Zowel een degelijk en robuust proces alsmede voldoende ervaring van de betrokken experts zijn hierbij kritische succesfactoren. De combinatie van het XP model met voldoende experience punten resulteert in XP due diligence, waarin zowel de ervaren generaties als opkomende jonge generaties zich zullen herkennen.

Gerben de Zwart
hoofdredacteur VBA Journaal

The Intelligent Fund Investor: Practical Steps for Better Results in Active and Passive Funds

Review by Lodewijk van der Kroft, Partner at Comgest

Literature on investing exists in abundance and there has been a marked focus, over the past few decades, on the implications of behavioural biases in our investment decisions. However, books on fund (or manager) selection are hard to find and especially those written in a light-hearted style. 'The Intelligent Fund Investor' is such a book. The author, Joe Wiggins, has worked for several years as an analyst and fund manager, and is currently chief strategist for Fundhouse, an independent UK consultancy.

The book offers a guide to the beliefs and behaviours that will help an investor achieve long-term financial goals, while highlighting the dangers and traps that can lead one astray. In ten chapters, each followed by a ten-point fund investor checklist, Wiggins discusses a range of relevant topics, such as the risks of star managers: his advice is to run for the exit when the manager makes frequent, high-profile media appearances or starts to invest outside of her/his circle of competence. And why good stories make for bad investments: thematic investing is usually built on great supporting arguments; unfortunately, by the time the story is strong enough, most of the gains have already been made.

Of particular interest is chapter two *'The death of Active Funds has been (somewhat) exaggerated'*. According to Wiggins, passive management has some strengths but that does not mean active management is doomed, quite the contrary. The fact that passive funds have done much better than active funds in recent years is not only to do with costs.
The market also played a role. Wiggins goes on to explain that over the past 15 years, indices based on market capitalisation have outperformed equal-weighted indexes, especially in the United States. But looking back at rolling five-year returns, the author also identifies periods when you see the opposite: equal-weighted indices then outperform indices based on market capitalisation. This market condition is far more favourable to active management. Unfortunately, Wiggins does not present a crystal ball to anticipate these good times for active management, but does suggest adopting a 50/50 allocation to pure index and selected active approaches, which can be rebalanced yearly. The target weighting should only be altered if two thresholds are met: (1) The performance differential over five years between equal-weighted and market cap-weighted is extreme (+ or –20%) and (2) the valuation gap between the two is evident (a minimum difference of 20%).

In chapter three *'Smooth Fund Performance Conceals Risks'*, Wiggins questions the industry-wide view on volatility as a risk management tool and investing in private equity as a means to diversify away from market risk. He does not deny that there can be good reasons to invest in private equity but he is unconvinced that private equity holds up better during a stock market crisis than listed equities. He argues that the losses will be as severe (if not worse) as those in public markets; they might arrive just a little later – when the valuation models catch up with reality. After all, why should companies that are not listed be less risky than those that are? If they operate in the same sector, they are exposed to the same risks.

Author: Joe Wiggins
Publisher: Harriman House
ISBN: 978-0-85719-876-1

In chapter seven *'Past Performance is a Terrible Way to select a Fund'*, Wiggins states that investors derive too much from past performance in assessing the qualities of active managers. Even the most skilled fund managers will have periods when they do worse than the market. Those periods can be long, sometimes years apart, but underperforming the market does not always mean the manager is incompetent. Smart investors look at the underlying process. Wiggins describes PROCESS as seven interrelated components – Path, Repetition, Objective, Calibration, Edge, Specification and Success – in an amusing parallel with golfing.

Wiggins' book provides ample food for thought, even for seasoned professionals, and can be best described by the quote he uses from Dutch mathematician E.W. Dijkstra: 'Simplicity is a great virtue but it requires hard work to achieve it and education to appreciate it. And to make matters worse: complexity sells better.'

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Max Kisman

De in het VBA Journaal geplaatste artikelen geven de mening weer van de auteurs en niet noodzakelijk de mening van de redactie.
Het VBA Journaal noch de auteurs beogen met de geplaatste artikelen beleggingsaanbevelingen te doen. De inhoud van de artikelen dienen dan ook uitdrukkelijk niet als zodanig te worden opgevat. Eventuele verwijzingen in de geplaatste artikelen naar specifieke financiële instrumenten strekken slechts ter illustratie dan wel onderbouwen enkel de beschrijving van feiten.

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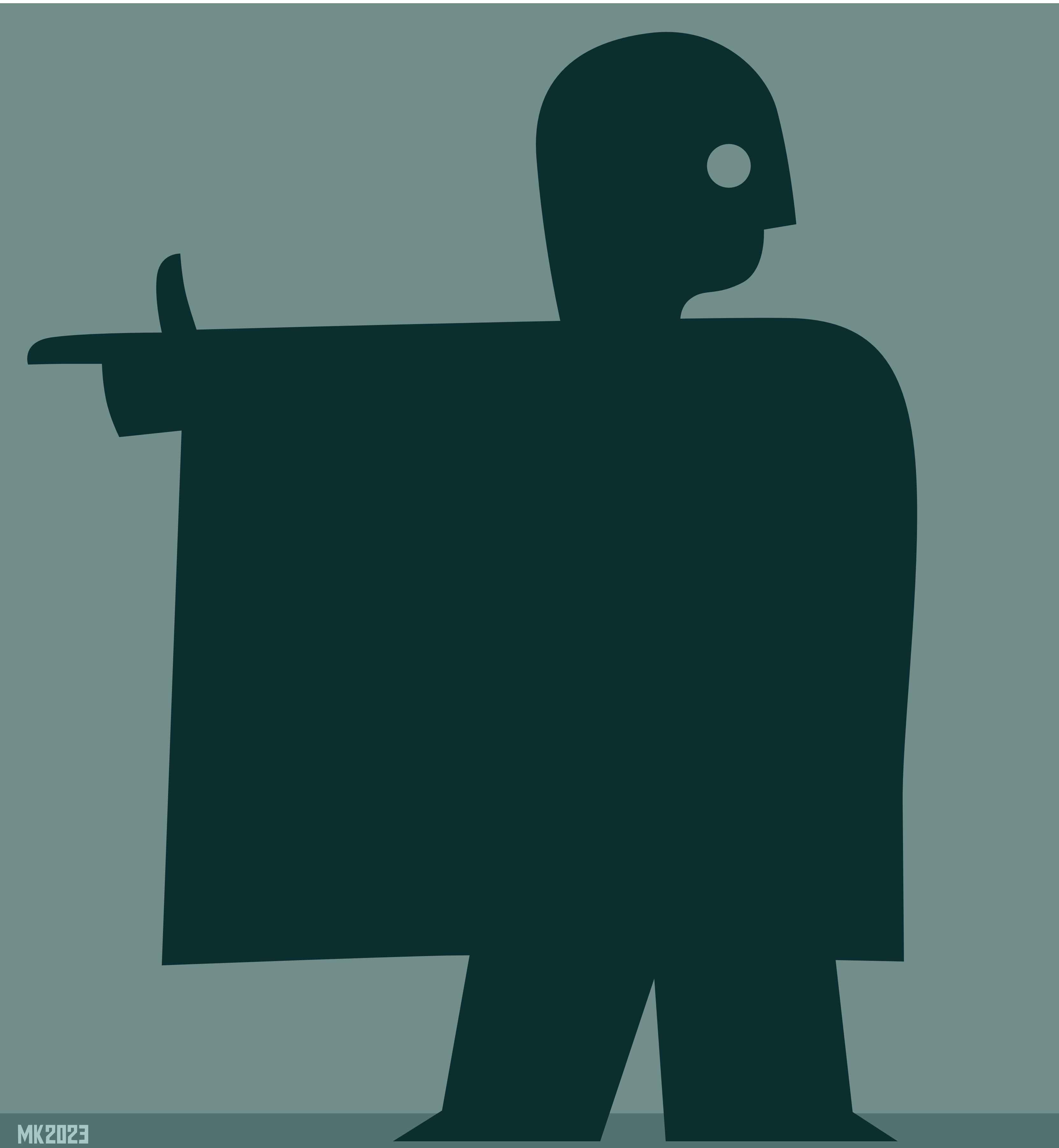
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