

THE IMPORTANCE AND VALUE OF MANAGER DUE DILIGENCE

Where do you see opportunities to have impact in the later stages of manager due diligence?

Matt Salotti: While understanding fees, arrangements with third-party service providers, and alignment of interests are essential components of the manager research process (as discussed in a prior Perspectives piece, *The Importance of a Manager Evaluation Framework*), there are often instances where an allocator can add value beyond just evaluating the stated terms in later phases of due diligence. Depending on the structure of an investment vehicle and the intended purpose of the individual strategy, in the context of a broader portfolio, there may be opportunities to propose amendments that strengthen governance for all fund investors and/or enhance the effectiveness of an investment for a specific subset.

Can you elaborate on the timing of these proposals and what you mean by a “specific subset” of investors?

MS: While most of these recommendations occur in the later stages of the diligence process, it's typically a function of prioritizing initial research to understand the merits and risks of the underlying investment strategy. Furthermore, as we become more familiar with the strategy and organization, we are naturally better equipped to identify potential terms and/or resources to pursue. As it relates to a “subset” of investors, I am referring to representing the direct interests of our clients as opposed to all investors in a third-party strategy.

Could you provide an example of a proposal that enhanced governance for all fund investors collectively?

MS: Several years ago, when streaming music platforms were still largely considered an emerging technology, we evaluated a strategy focused on acquiring digital music copyrights. Because the fund would only be acquiring royalties related to streaming consumption - as opposed to live performances, direct purchases, or radio transmission - we believed it essential to have an independent law firm review the purchase agreements used in acquiring the music catalogs. By leveraging our team's personal relationship with the founder of a successful music publishing business, we proposed several changes that were incorporated in the revised contracts to include additional legal assurances and could ultimately protect the fund's ability to sell the derivative rights in the future.

Do you have any examples that were approached specifically in the interest of Colony clients?

MS: We had completed the majority of our diligence on a strategy that invested a portion of their capital in inexpensive options that would perform well in a negative market environment. Having invested in similar strategies in the past, we had a strong appreciation for the value of being able to access the proceeds generated by those hedges and reinvest them in other assets or markets that had experienced significant drawdowns. While the stated redemption terms for the strategy were generally appropriate, the portfolio's underlying liquidity actually improved during periods of market stress as demand for the options contracts tends to increase with volatility. As a result, we were able to negotiate conditional redemption terms with the manager - on behalf of Colony clients - that would provide improved liquidity triggered by varying performance thresholds in the equity markets.

Once an investment is made, are there future opportunities to have a similar impact?

MS: In some cases, a member of our team has a seat on the fund's Limited Partner Advisory Committee (LPAC). These roles are typically intended to provide feedback to a manager that is representative of investors' collective views and best interests. We recently initiated a conversation to encourage a manager to consider refinancing their leverage facility and pursue other cost-saving alternatives. The manager ultimately refinanced, which reduced their interest expense and enabled a distribution to limited partners. Being part of the LPAC, however, is not a necessary condition in being able to advocate for investor-friendly changes. We have also been quite insistent with private strategy managers as it relates to their valuation policies, continuously encouraging them to mark individual positions more conservatively based on secondary market transactions or publicly announced write-downs by large institutions.



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Matt is a Senior Portfolio Manager of the Diversifying Strategies Portfolio. He leads the institutional diversifying strategies team and is responsible for all public and private market credit, fixed income, intellectual property royalty, real asset, and specialty finance investments globally. Matthew is also directly involved in the management of several institutional client portfolios.

Matt served as Managing Director and was a member of the diversity, equity, and inclusion team at New Providence Asset Management prior to their merger with The Colony Group in 2021. Previously, Matthew was an Associate in the Corporate Advisory Services Group at Thomson Financial and an Associate in the Financial Services group at Navigant Consulting.

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