



## IMpact: An investment management podcast series

### Episode 12: Risky Business: The Evolution of Operational Due Diligence

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#### Guest:

**Richard Schnuerer**, founder, Starrlight Advisory

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**Reese Blair:** Hello, everyone. I'm Reese Blair, your host of IMpact, the investment management podcast series from Deloitte. In every episode, we come together to explore the issue shaping the industry, whether it's regulation, recession, or resiliency. By diving deep into the latest news, trends, and challenges, we'll discover how collaboration and shared insights can drive progress for professionals across investment management. So, tune in, learn something new, and walk away with insights that can help you make an impact on the IM industry and the world around you.

Welcome back to the IMpact podcast. I am your host, Reese Blair, and today, we're exploring the evolution of operational due diligence, or ODD, in the investment management industry. I'm joined by my good friend Richard Schnuerer, founder of Starrlight Advisory. Rich, thank you for joining us.

**Richard Schnuerer:** Thank you, Reese. It's great to be here and appreciate this opportunity. Really excited to be here today and to talk about this topic, which has really transformed over the last decade.

**Reese Blair:** Thank you, Rich, and again, appreciate you being here. I know you're very busy. But let's maybe start with your background. You've worked with some of the biggest names in the business. I'm wondering if maybe, for our listeners, you can share a bit about your journey and what you're focused on today.

**Richard Schnuerer:** Thanks, Reese. I've certainly covered the three legs of the stool from a private markets perspective. I cut my teeth early in the professional services world, mostly in the audit function at Deloitte. I segued into being a limited partner, or LP, as an operational due diligence analyst for Merrill Lynch, and then onto the general partner side, or GP, where I've held several CFO and CCO leadership roles at various alternative investment firms.

Leveraging my background in experiences across these, I've recently founded Starrlight Advisory, where we provide outsource CFO and CCO services to alternative investment firms. I continue to serve in such capacities for several market participants.

Given I've worked on both the LP and GP sides, I've noticed that private wealth isn't really a distinct investor class anymore. It's become more embedded within large GP organizations as they continue to curate distinct products within that asset class.

On the LP side, I've seen large broker-dealers centralize access to private markets through their platforms, which can syndicate curated products from all the major GPs. The infrastructure for private wealth has really proliferated, and that's how due diligence and investor relations is approached.

**Reese Blair:** That's a fascinating observation, and what a way to kick off the discussion, Rich. Listen, I want to maybe dive into how the investment management ecosystem has adapted to industry changes, in your experience. Where are you seeing some of these new pockets of growth?

**Richard Schnuerer:** Sure. The growth and the demand from the private wealth sector has really buoyed the infrastructure and its need to grow rapidly, and as a result, there's just a higher demand for sophisticated solutions to address operational due diligence as a means of empowering private wealth investors. In order to help meet their needs of institutional-grade due diligence, investors can prioritize access to education and due diligence resources and manager selection.

Much of the reporting is also now outsourced to specialists, thereby allowing GPs to focus on investor returns and managing investor relationships. The industry has really shifted to being client-and investor-centric whereby they can balance strong controls and safeguards with the need to also deliver returns.

**Reese Blair:** Rich, you said a lot there, and one word really jumped out to me, and it's that word "prioritize"—prioritize access to education. That's really fascinating to see greater prioritization of the investor experience by many in the industry.

For our listeners who may not be as familiar, can you maybe break down what operational due diligence actually involves and how you've seen it evolve recently?

**Richard Schnuerer:** Sure. Historically, operational due diligence might have been viewed more as a check-the-box exercise, making sure that the right service providers were in place, counterparty risks were understood and evaluated, and there were no major issues that were unearthed in the background check or public record search processes.

Now, it's really about developing a deeper understanding of both the operational risks and the controls that GPs have in place across the entire back office. There's now a need to not just underwrite the fund, but also the investors themselves, especially when considering asset allocators and secondary funds.

It's about harmonizing the needs of both sides, making sure controls are robust, but also that the investor experience is as seamless as it can be. There's a growing demand for continued transparency; data-driven insights from the GP, its funds, and its portfolio companies. There's just more that's involved in the ODD process today relative to the (I don't like to say it) check-the-box exercise that ODD might've been viewed in the past.

**Reese Blair:** Rich, the only thing that remains constant is change. I've said that countless times, and that's certainly true here, and that's certainly a big change. And look, with a rise in qualified purchasers, accredited investor products, we've had conversations around democratized products, secondary players—I mean, there's so many things that GPs are juggling.

I'm wondering how you see GPs adapting to their approach to ODD. Are you seeing more maybe outsourcing?

**Richard Schnuerer:** We are, and I believe GPs are looking at this through the lens of being investor-centric. And with the influx of all these new investor types and products that are structured around them, GPs are increasingly relying on outsourcing for specialized functions alongside technology to provide clear and more consistent reporting to investors.

Some outsource firms are also taking on certain operational functions within the GP, thereby affording GPs with increased capacity to focus on returns and investor engagement. But it's important that GPs still own the relationships and have operational oversight in the process. Outsourcing can certainly help with scale, but there should still be strong internal controls and governance as part of the GP's investor focus.

LPs are also becoming more data-driven and are leveraging software to streamline their requests and queries to their GPs. Of particular focus, both from the perspective of the GP and LP, are registered private equity funds and registered private credit products, which can function similar to traditional hedge funds vis-à-vis, they accept monthly subscriptions as well as permit liquidity through a shared tender process.

This is going to result in an increased volume of ODD requests, both initially as part of upfront due diligence as well as ongoing monitoring thereafter.

**Reese Blair:** It sounds like ODD has essentially evolved to help suit the needs of investors, and some institutional and certainly other sophisticated investors may be looking for an expedited ODD process to support their investment decision-making, which is often obviously more dynamic, more forward-thinking.

There's also a balance that should be struck between efficiency and control. Speaking of which, I'm wondering how you think about which fund expenses GPs should bear versus passing along to investors.

**Richard Schnuerer:** I can say that GPs, they tend to want to manage their internal costs and optimize around that, but not at the expense of delivering fund returns and managing investor expectations. It's about execution, delivering great quality service to their clients, and managing expense ratios. All of these are equally important, but you also still need to evaluate and consider the qualitative value.

There's independence, objectivity, and the quality of oversight and governance. Sometimes paying a bit more for a leading service is worth it, and investors are increasingly looking at whether the cost structure is fair and aligned with their interests as well.

**Reese Blair:** Rich, you said something that it resonates with me, and I actually adopted in my personal life: You get what you paid for. And you really offered some great perspective there, and at the end of the day, it's about execution. I couldn't say it any better.

So, the point around, it's not just about the numbers; it's really about the value behind those numbers. And so, I'm curious and recognizing that some GPs may think that they're superhuman, sometimes they've got to leverage support. And so, I'm curious, what are some ways that you're seeing GPs leverage their specialists, whether they're insourced or outsourced, to amplify their due diligence efforts?

**Richard Schnuerer:** Sure, Reese. Specialists are very critical to the overall process, and you want to ensure having that right expertise, whether it be legal, operations, tax, finance, compliance—you want to have those resources in place as if you don't, they could break down your ODD process. The trend is towards a more hybrid model today

where core functions are certainly kept in-house for control purposes, but specialized tasks can be outsourced for both efficiency as well as practical expertise.

The goal ultimately is to deliver the highest quality of service for the lowest relative price, and that means being strategic about where you're deploying both your expertise and your dollars.

**Reese Blair:** That is really, really helpful for anyone thinking about building out their own ODD capabilities. I'm actually reflecting on one of our previous episodes. We had someone come in and actually talk about and explore considerations when you need to balance in-house experience with outsourced expertise. So, shameless plug to go back and listen to that episode.

But I was curious, have you seen challenges in building and maybe maintaining qualified ODD teams in the current talent market? Are there maybe certain vendor qualities that you think GPs should consider in their service models?

**Richard Schnuerer:** Sure, and it's a very core topic to where we are today, just given the rise of technology, but also the human capital element. And you mentioned it: It is a very competitive talent market out there. There is a premium that's being placed on professionals with both the traditional operational knowledge and emerging skill sets like cybersecurity, regulatory environment, and technology.

In order to find those skilled at both, we look for people who are highly motivated and adaptable to new technology and processes. All of these factors really put pressure on increasing the compensation budget for these professionals, but striking that balance with technology vendors for data aggregation, reporting—it's a really helpful process to help inform that human capital that is conducting the operational due diligence.

**Reese Blair:** Rich, it's clear that the vendor landscape appears to be getting more sophisticated, and so how do we match that sophistication? Technology! GPs are typically looking to increase their profits while certainly meeting client diligence demands. But I'm wondering on that topic of technology, what leading practices are you seeing from GPs who are navigating these sometimes competing priorities, and does technology play a role?

**Richard Schnuerer:** That's right, Reese, there is a competition of priorities in the marketplace and striking that balance is important. Good GPs, they tend to be transparent about their expense structures, while ultimately, focusing on delivering value, not just optimizing costs.

They're investing in technology and people to ensure their ODD processes are robust. They're communicating openly with their investors about what they're doing and why they're doing it. Independence, objectivity, and governance are of the utmost importance, and investors want to know that their interests are being put first and aligned to those of the GP.

From a technology perspective, it's really both streamlined but also complicated the ODD processes. The digital tools available can be viewed as a double-edged sword whereby they might automate the previously manual and burdensome work to help speed up the diligence process and better identify blind spots; however, the increased use of technology also still requires a human monitoring and testing to ensure that the proper controls and data privacy measures are in place.

There's a lot that can be conducted by doing onsite operational due diligence. That human factor matters. Meeting with professionals at their offices, you can deduce a lot from that where technology can also lack just by being in front of a computer screen. ODD is also meant to be a human factor of this. Having onsite operational due diligence where you're meeting with the leadership of the GPs, asking questions, having dialogue, a lot can be informed through the ODD process by being in that onsite environment that technology cannot solve for.

**Reese Blair:** I love that, Rich, and look, I think using... and I've said this before—I think about technology as like a power tool. Let's use technology to work smarter, not just harder, and so I want to maybe switch gears a bit. Let's widen the aperture.

As US investors look to deploy capital overseas and vice versa, how have you seen GPs manage ODD across different jurisdictions, especially with the varying data and transparency requirements? With increased globalization, there's going to be obviously more complex regulatory requirements, so curious to get your thoughts there.

**Richard Schnuerer:** Yeah, certainly.

As we've seen US investors continue to increase their global mandates of asset allocation, whether it be from Asia real estate funds or European infrastructure funds, there are core ODD focus areas regardless of jurisdiction.

There are definitely nuances in these unique jurisdictions, whether it be from special reporting requirements, tax, or other regulatory considerations in that market. GPs need to synthesize their processes and be able to rely on outsourcing to help with those unique reporting, tax, and compliance requirements in the markets in which they're investing.

This should include ODD teams with personnel or expertise in more jurisdictions, and equipping them with tools to organize and present those requirements. Of course, that can further impact the talent models and implementation of technologies in the ODD process, which we've previously touched upon.

**Reese Blair:** That global perspective, Rich, is so important and it can't be understated quite frankly. And look, before we wrap this thing up here, I want to maybe just do a completeness check. Just want to make sure we're not leaving anything on the table here. Is there anything that we just haven't maybe touched on that you'd like to add?

**Richard Schnuerer:** Reese, I think that ODD is just really continuing to evolve, and its evolution is just very rapid. And as we move into the next frontier, it's going to be about harmonizing the needs of both GPs and LPs, particularly as private wealth and secondary funds continue to grow in that market. Technology will certainly help us, but at the end of the day, it's about delivering value and building trust.

**Reese Blair:** Building trust. Rich, I couldn't think of a better note to end on. Thank you for that, and I know I said we were wrapping this up, but I've got one last question. What's the biggest takeaway that (and I can't help myself) you think our listeners should remember? Where do you see ODD possibly heading in the future?

**Richard Schnuerer:** Reese, ODD in the future is just going to become more prevalent, more important as the industry continues to grow more complex. ODD is on a parallel path with traditional investment due diligence. Sophisticated investors and asset allocators have both tracks in place now, Reese, from both an investment perspective and an operation perspective.

The winners will likely be those who can balance robust controls with a client-first mindset, leveraging technologies to drive efficiency and transparency. It's about harmonizing interests and striving for best-in-class execution.

Also, not to be repetitive, but dovetailing from this will be the continued growth within the private wealth sector and the curated products that are within that asset class. Traditional hedge fund ODD, which includes both initial and ongoing due diligence will likely move into the private market sector as well. GPs need to be ready for that. They need to be mindful of the increased levels of due diligence from their LPs that's associated therewith.

**Reese Blair:** Rich, thank you for that. As we close out today's exploration of operational due diligence, it's clear that looking beyond the numbers and diving deep into operational foundations is what truly separates the successful firms—or successful investments, rather—from those that merely look good on paper.

The most sophisticated financial models and attractive return projections, they just can't compensate for inadequate systems or operational blind spots that surface when markets turn challenging. By making operational due diligence a cornerstone of your investment process, you're not just protecting your wealth, you're positioning your business for sustained success across generations.

Rich, I can't thank you enough, man. Thank you for joining us, sharing your experience, sharing your insights. Truly, truly good to catch up with you again. It's been great.

**Richard Schnuerer:** Thank you, Reese. I appreciate it.

**Reese Blair:** Absolutely, and listen, thank you to our listeners for tuning in. Until we meet again, keep questioning, keep learning, and of course, keep making an impact.

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