



After the onboarding: The importance of ongoing sponsor due diligence

The alternative investments industry has developed increasingly rigorous practices for the initial onboarding of investment product sponsors. The review that precedes a selling-group agreement is, in most cases, thorough and well structured, built around protecting registered investment advisers (RIAs), their individual adviser representatives and the retail investors who depend on their recommendations.

A meaningful – and increasingly consequential – gap persists in current industry practice: the ongoing review of the sponsor itself, separate from the product-level due diligence that most firms conduct with regularity. While the industry has developed a robust onboarding diligence model, what is often missing is a defined framework for ongoing sponsor due diligence. This article makes the case for why updated sponsor opinions should be requested on a more defined schedule and what RIAs stand to gain by doing so.

That case has become more urgent. The SEC's sustained focus on supervisory systems, including the adequacy of RIA due diligence frameworks, has raised the stakes for firms that cannot demonstrate ongoing oversight of their sponsor relationships. Regulatory examiners do not grade on a curve when a sponsor deteriorates after approval, and a firm has no documentation of subsequent review. The question is no longer whether ongoing sponsor due diligence is a good idea. The question is whether the absence of it creates an exposure firms can afford.

The onboarding process and the sponsor opinion

When an RIA enters a selling-group agreement with an alternative investment product sponsor, the review preceding that relationship is typically comprehensive. Organizational history, key personnel, financial condition, track record, compliance infrastructure and investment strategy are all examined, whether through internal due diligence resources or a qualified third-party due diligence firm.

A central output of that process is the sponsor opinion. Prepared by an independent third-party firm and often accompanied by an onsite visit to the sponsor's principal offices, the sponsor opinion evaluates the entity behind the product, not merely the product itself. For many RIAs, it is among the most consequential documents produced during onboarding.

At the most basic, sponsor-level due diligence involves the independent verification and analysis of sponsor-provided facts. For example, instead of taking a sponsor's purported track record at face value, a reputable due diligence provider would verify such track record by examining purchase agreements, settlement statements, financial records, check stubs, etc. Ideally, the due diligence should be conducted by individuals with education and experience in business, law, finance, and taxation.

In some cases, sponsor opinions are issued by law firms and structured as formal legal opinions. This distinction is meaningful.

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A legal opinion reflects not only an independent assessment, but also a professional standard that carries with it accountability and, where necessary, the ability to support RIA clients in legal or regulatory proceedings. Not all third-party due diligence reports are created equal in this regard, and the nature of the report itself should be considered as part of a firm's overall diligence framework.

The practical difference between a legal opinion issued by a law firm and a standard due diligence report is not merely stylistic. A law firm issuing a formal opinion is subject to professional responsibility standards, attorney-client confidentiality, bar requirements and potential malpractice liability. That creates a level of rigor and accountability that a consulting-style due diligence report does not carry by default. When an RIA is responding to a regulatory inquiry or defending a customer complaint, the origin and standing of its sponsor opinion matters. Firms should understand precisely what type of document they are receiving – and whether it would withstand scrutiny in a proceeding.

The gap that develops after onboarding

Once a sponsor has been approved and a selling group agreement is in place, attention appropriately shifts to the products being offered. Program-specific opinions are requested and updated as new offerings come to market. The sponsor opinion, however, is frequently not revisited, or at least not as often as it could be.

Sponsors are not static entities. Leadership, capital structure, investment strategy and organizational health can all shift materially over time, sometimes gradually and sometimes quickly. In effect, many firms are relying on a point-in-time

assessment of a sponsor that may no longer reflect the organization as it exists today.

Consider the range of changes that can occur within a sponsor organization between onboarding and the present: senior leadership departs or is replaced; The firm acquires a new business line or divests a core one; litigation or regulatory action is initiated; a key executive is named in an outside proceeding; the firm's financial condition deteriorates; a compliance officer or chief investment officer leaves without a disclosed successor. Any of these developments could be material to the RIA's decision to continue the relationship. And yet, without a systematic process for ongoing review, none of them may surface in a timely way.

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Best practices for RIAs

RIA firms should implement a defined process for ongoing sponsor due diligence. At a minimum, sponsor opinions should be refreshed on an annual or biennial basis for all active sponsor relationships. Material events – such as leadership transitions, regulatory developments or changes in financial condition – should trigger immediate review.

The supervisory rationale for this is straightforward. As a fiduciary, the RIA must exercise the highest duty of care in managing its clients' money. In a similar vein, FINRA Rule 3110 requires broker-dealers to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws and FINRA rules. Regulators have increasingly interpreted this to include the oversight of sponsor relationships, not just the suitability of individual product recommendations. In both cases, a firm that approved a sponsor five years

ago and has no subsequent documentation of review is, in practical terms, operating on stale diligence – and that creates exposure in the event of a regulatory examination, customer complaint or arbitration proceeding.

RIAs should also consider the nature of the third-party provider issuing the opinion, including whether the opinion carries legal standing and the extent to which the provider is positioned to support the firm if questions arise. This consideration takes on added significance in the context of ongoing due diligence. A due diligence firm that produces a periodic update report and a law firm that issues a refreshed legal opinion are providing fundamentally different products – with different standards of care, different levels of professional accountability and different utility in a legal or regulatory context. RIAs building or revisiting their internal monitoring framework should be clear on which type of third-party analysis they are receiving and why.

Absent a defined process for ongoing sponsor-level review, firms may find themselves exposed to risks that were neither visible nor documented within their supervisory framework. Documentation is not incidental to this process; it is the point. When a broker-dealer can demonstrate to a regulator, an arbitration panel or a plaintiff's attorney that it conducted a formal review of a sponsor at defined intervals, that it received an updated legal opinion from a qualified provider, and that it responded appropriately to material developments as they arose, it has built a defensible record. The absence of that record is itself a liability.

Conclusion

Whether conducted internally or through a third-party provider, sponsor-level due diligence must be a prerequisite for any subsequent product onboarding. Moreover, the rigor applied at onboarding should not be treated as a one-time investment. Sponsor relationships evolve, and the due diligence framework around them should evolve accordingly. RIAs that formalize and document ongoing sponsor due diligence – through regularly updated sponsor opinions and event-driven reviews – will be better positioned to identify emerging risks, demonstrate supervisory rigor and protect investor outcomes. Those that do not will find themselves in a difficult position when conditions change, and in this industry, conditions always change.

In an environment where conditions can change quickly, relying solely on onboarding diligence is no longer sufficient.

CORPORATE OVERVIEW

Mick Law, P.C., based in Omaha, is a boutique law firm focused on broker-dealer, registered investment adviser, family office and bank/trust company representation, as well as real estate finance. The firm's due diligence representation includes reviewing and opining on offerings of various asset classes including DSTs, real estate equity funds, REITs, qualified opportunity zones, cryptocurrency, oil and gas/alternative energy, private equity, development/conservation, life settlements, equipment leasing, managed futures and hedge funds.

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