

## ALERTS

## Investment Management Client Alert Regarding COVID-19

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As the COVID-19 pandemic continues to roil the global markets, private fund managers across the alternative asset spectrum (*e.g.*, hedge, credit, private equity, etc.) have been confronted with a host of novel issues touching all aspects of their businesses. Managers should leverage historical context in communicating with their stakeholders, managing novel risks, and seizing on perceived opportunities. In doing so, managers should take the following factors into consideration:

Review Fund Documentation. Managers should review their fund document suites (including the PPM, LPA, IMA, subscription agreements, and any investor side letters) to understand critical elements such as investment limitations, portfolio rebalancing or diversification/concentration requirements, key man provisions, investor kick-out rights, and reporting obligations – with a careful eye to suspension and withdrawal/gating rights for open-end funds, and default penalties, subsequent closing true-up provisions (which typically employ a “cost plus” formula), investment period extension rights, and capital call rights with respect to follow-on investments for closed-end funds.

As in the case of the 2008/2009 financial crisis, managers to open-end funds should be prepared for a possible uptick in redemption requests that may not align with the funds’ underlying portfolio liquidity profiles, such that the imposition of gating provisions may become necessary. Managers to closed-end funds may consider seeking amendments to their fund documents where more time is required to execute acquisition, disposition, or repositioning strategies. Managers of all types of funds should understand their distribution provisions and when distributions may be delayed, held back, reserved, or made in-kind. Managers may also receive additional transfer requests from investors seeking to exit funds through secondaries, which transfers are often subject to specific requirements (*e.g.*, delivery of a legal or tax opinion, transferor/transferee payment of associated costs, etc.)

Managers that rely on subscription or other credit facilities should be in contact with lenders to monitor for any issues regarding a fund’s ability to draw down on its facility to fund investments or expenses. Managers should also contact fund service providers and monitor for any servicing interruptions.

Maintain Open Channel with Investors. As is typical during periods of market turmoil, managers should expect to receive a high volume of investor inquiries regarding fund operation, management, and performance expectations. Managers should remain cognizant of any confidentiality obligations and securities law requirements applicable to the dissemination of fund or portfolio information and should ensure that investor reporting is conducted in accordance with the governing documents. Subject to these

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considerations, managers should seek to maintain an open channel with investors, who are understandably concerned by recent events, and recognize that, in this context, investors typically appreciate more updates rather than fewer, even where the news is not always good.

Assess Fundraising Plans. Depending on whether a fund is open-end or closed-end and whether it has deployable capital, its manager will view current market conditions very differently. Funds with dry powder likely are preparing to bargain hunt for discounted assets as soon as markets re-stabilize. Funds without dry powder or that were in the midst of or preparing for a capital raise likely are reevaluating investor appetite. Managers should recognize that any near-term capital raises may depend more heavily on raises sourced from an existing investor base rather than new investors, given the practical difficulties in performing customary investor due diligence, which often involves face-to-face meetings and on-site visits, and convening investment committees to evaluate and approve new fund mandates. Existing investors, on the other hand, who are already familiar with a manager and its products and track record, may be more amenable to conducting remote due diligence on the basis of video or teleconferences and virtual data rooms.

Managers seeking to raise a new blind pool should anticipate an elongated capital raise and the possibility that economic “carrots,” in the form of management and performance fee discounts, co-investment rights, and rights of first offer on future vehicles, may be necessary to consummate even a scaled-down raise. Depending on a manager’s investment focus and track record, fundraising alternatives may include new “flagship” blind pools, sidecar co-investment funds (typically raised to co-invest alongside the flagship fund in a subset of its investments), “annex” funds (typically raised to invest in existing investments of the flagship fund), and “overage” funds (typically raised to invest contemporaneously alongside the flagship fund in its new investments).

Valuation. Managers should carefully monitor fund valuations, as macroconditions may trigger impairment events or justify potential changes in valuation models and assumptions. Forecasts and models, and the financial and non-financial assumptions underlying them, should all be reviewed and revised where warranted. NAV determinations and valuation of illiquid investments may both become more challenging as market volatility and uncertainty increase.

Disclosure and Reporting. Managers should consider updating their Form ADVs and fund offering documents to include specific disclosure regarding the impact of COVID-19 on manager, fund, and portfolio company operations and performance. While existing risk factors typically mention pandemics in general terms, managers should provide expanded disclosure regarding the widespread effects of COVID-19 on the relevant investment sectors, markets, and economies.

On March 13, 2020, the SEC provided regulatory relief for registered investment advisers and exempt reporting advisers who were affected by COVID-19 by extending the deadline to file an annual amendment to Form ADV and reports on Form ADV Part 1A, to deliver amended brochures, brochure supplements, and summaries of material changes to clients, and to file the Form PF (subject to satisfaction of certain conditions and requirements, including notifying the SEC staff of a manager’s intention to rely on the applicable order and publishing certain information on the manager’s website regarding the manager’s reliance on such order). Notably, the SEC’s extension of the Form ADV filing deadline does not provide relief to state registered investment advisers, who instead must look to the individual states in which they are registered for potential

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extensions. Further, as of the date of this publication, the authors are not aware that the SEC has extended the requirement to provide audited financial statements to private fund investors within 120 days of the fiscal year-end for managers relying on the “audited exception” to the custody rule under the Advisers Act. Managers should therefore actively engage with their fund auditors to understand any issues relating to timely completion of the audits.

Business Continuity Plans; Employee Policies; Cybersecurity Policies. Managers should review and update their business continuity plans (which SEC-registered investment advisers are already required to have in place), employee policies, and cybersecurity policies and evaluate the performance of their work-from-home capabilities. In light of rapidly evolving circumstances, managers should treat their policies as “living documents” and update them accordingly as circumstances warrant. Likewise, managers should liaise with their portfolio companies regarding their policies and the performance of their remote work systems. Any novel cybersecurity vulnerabilities or other considerations arising from the stress/strain of wholesale work-from-home operations should be considered, as should any risks posed by new technologies adopted to facilitate remote work.

Moore & Van Allen has considerable experience in counseling private fund managers across an array of alternative asset class and strategies, and we will continue to track the impact of COVID-19 on our clients and the industry more generally.

Should you have any questions regarding these developments, please do not hesitate to contact us.