Katten

FINANCIAL MARKETS AND FUNDS ADVISORY

COVID-19: Considerations for Private Investment Fund Managers

March 17, 2020

This Katten Advisory highlights considerations around COVID-19 that may be relevant for private investment funds and their managers. Notwithstanding the current pandemic, fund managers owe fiduciary duties to their clients, which means that managers must take steps to protect client interests from being placed at risk as a result of a manager not being able to fulfill its duties. Many of the items enumerated below relate to a review and analysis of internal contracts and other legal documentation. While our personnel are working remotely, the Katten team is always available to assist in navigating these challenging and unchartered waters.

Employee-related considerations

- Implement and/or test systems for communicating with employees.
- Communicate essential aspects of the firm's business continuity plan (BCP) to employees and ensure that all employees understand their roles and obligations should the BCP be activated.
- Plan for long periods of working from home (WFH).
  - Understand that firms will still be subject to obligations to properly monitor and supervise employees.
  - Assume mass adoption of WFH will raise new issues and/or pose larger issues than have been implicated in the past (e.g., internet bandwidth, compatibility of home systems, videoconference capacity and/or connectivity, access to physical files and resources, such as printers and scanners).
  - Accept that WFH processes will likely result in inefficiencies and difficulties connecting with employees; these may result in an adverse impact on funds' net asset values and returns to investors.
  - Be sure that confidentiality and data privacy will maintained as needed.
  - Be on high alert for cybersecurity attacks, as risk of a cybersecurity incident can be heightened as a result of WFH settings (e.g., employees might access data through unsecured and unsafe Wi-Fi networks and personal devices to perform work remotely; employees might use personal email accounts to transfer corporate data; directors, officers and employees might be more vulnerable to potential phishing attacks).
    - Continuously remind employees to remain vigilant of potential phishing scams, exercise caution when handling emails, and report any suspicious communications.
    - Develop clear guidance for employees to follow regarding mandatory use of secure Wi-Fi networks and, if available, the firm's virtual private network (VPN).
    - To the extent possible, advise employees to conduct work only on their firm-issued devices; where use of firm-issued devices is not possible, encourage the use of home computers that are as secure as company laptops and desktops.
    - Mandate the use of secure conference call lines, enable two-factor authentication for access to the firm's network and systems (in the absence of VPN), and communicate the appropriate offsite handling of physical documents that contain sensitive or confidential information (particularly for those materials that would otherwise remain onsite).

  - Emphasize that maintaining proper identification and access controls should be a multi-departmental focus; firm management should coordinate with information technology and human resources specialists to establish information security controls and ensure that employees are properly trained on those controls in the WFH context.
- Prepare for (at least temporary) disruptions to investment decision-making and trading processes.
  - Determine plan in case of unavailability of key analysts or portfolio managers.
  - Review and update internal trading authorizations; ensure appropriate desk coverage.
  - Review and update critical external authorizations (e.g., with respect to brokerage accounts, custodial relationships, and fund administrators).
- Consider and seek to mitigate the impact of mandatory travel bans, implement standard procedures to limit travel and put forth quarantine procedures for symptomatic personnel.
- To the extent not already mandated by national, state or local regulation, implement restrictions on nonessential business travel and on-site due diligence visits.
- Review key person provisions in fund documents and side letters; ensure plan is in place with respect to those persons, should any provisions be triggered.
- Understand the firm's legal obligations with regard to medical privacy, as well as employee compensation and leave entitlements; monitor for legislative updates with respect to these issues.

Contractual, credit and trading concerns

- Review fund documents, side letters and key deal documentation for provisions that might be implicated given the COVID-19 outbreak (e.g., material adverse effect, force majeure, and notice provisions; investment/leverage restrictions) and confer with counsel for assistance in interpreting provisions that may be ambiguous.
- Review all relevant documentation relating to fund credit lines and/or margin agreements, paying particular attention to provisions with respect to covenants, conditions on borrowing, and collateral arrangements.
- Consider potential for margin calls; assess whether degree of leverage and counterparty exposure is appropriate in light of market volatility.
- Consider counterparty risk given market volatility.
- Monitor that investment allocations among client accounts and between client accounts and proprietary accounts are being made in accordance with allocation procedures and disclosures.
- Conduct stress tests to identify any potential or nonobvious risks to firm liquidity.
- Note that the US Treasury and the White House, the UK's FCA and Luxembourg's CSSF have indicated that changes to existing market rules are not necessary or contemplated at this time; however, it is important to stay abreast of communications from regulators, as this position could change quickly.
- Over this past weekend, Federal Reserve Chairman Powell committed to use the "full range of tools" available to support households, businesses and the economy; keep abreast of further monetary policy developments to determine if they should influence investment decision-making and strategies.
- Ensure compliance with valuation policies and procedures, so that valuations reflect all reasonably available inputs.

Key third-party dependencies

- Identify key service provider and other third-party relationships (e.g., with brokers, clearing firms, custodians, fund administrators, telecommunication systems, outsourcing/off-shoring providers, mail services, utilities) and how COVID-19 might impact these relationships; establish plans in case of potential disruptions in service.
- Establish and/or test backup lines of communication with these third parties.
- Review contracts with relevant third parties for provisions that might be implicated by COVID-19 (including risk allocation provisions around reduced or incomplete performance) and for important information in case of material breach; consider updating service agreements to include protections or procedures around pandemic operations.
- Review the firm's BCP, key providers' BCPs, and/or backup or contingency plans of key third party vendors for potential interdependencies or weaknesses, and create a plan to address such shortcomings.
- Pay particular attention to offshore providers/relationships, as risks with respect to such providers may be more significant than those with onshore providers.

Regulatory disclosures and investor relations

- Review all disclosures around the firm's BCP and other situations that may be encountered as a result of COVID-19 disruptions (e.g., investment losses, force majeure clauses, key person policies, potentially applicable insurance coverage).
- Review all fund documentation and side letters to determine what (if any) investor communications are required should a BCP be activated.
- Consider whether any additional or amended disclosures or BCP provisions might be required as a result of COVID-19 exposures; these disclosures could be relevant in the context of updates to public/regulatory filings and/or supplements or amendments to fund documents.
- Consider proactively reaching out to investors to keep them abreast of fund operations/updates, particularly with respect to funds that are currently open to new investors; however, be mindful to avoid providing information only to select investors or only on a partial basis.
  - Be sure to communicate ***all*** material information in a timely manner.
  - Communications should be clear and issued on a continuing basis.
  - Be particularly cognizant of communication obligations with respect to any deterioration or worsening of the firm's financial condition.
- Ensure plans are in place for responding to queries from investors, prospective investors, or regulators, even with reduced resources, and ensure that all communications are consistent and accurate.
- Prepare new plans and/or review existing plans for handling routine investor- or prospect-facing matters (e.g., capital calls/redemptions, side letter negotiations, consent processes) given potential limitations on manager and investor operations.
- Note that on March 13, the SEC has made available conditional relief from filing/delivery obligations for filings due on or before April 30 (which would include many advisers' annual Form ADV and Form PF filings) ***if*** a filer cannot meet a deadline due to the impact of COVID-19; the relief allows for an extension of the relevant filing deadline for up to 45 days from its original date.

- To take advantage of this relief with respect to Form ADV, the adviser must promptly communicate to the SEC and its clients or investors why it has chosen to avail itself of the relief and when it expects to file and/or deliver its Form ADV.
- To take advantage of this relief with respect to Form PF, the adviser must promptly communicate to the SEC why is has chosen to avail itself of the relief and when it expects to file its Form PF.

- Continue to monitor and review all communications from regulators in all the jurisdictions with which fund interacts.
  - Regulators and key self-regulatory organizations (like exchanges) may provide additional, limited regulatory relief.
  - Regulators will expect firms to take all reasonable steps to comply with regulatory obligations, even if such compliance occurs at backup sites or with alternative staffing arrangements.
  - All major regulatory-related decisions should be documented and should conform with policies and procedures of the firm, in case ever scrutinized.
- To the extent possible, be sure to ensure continuing and timely compliance reconciliation and recordkeeping procedures and obligations.

Insurance considerations

- To prepare for realized or potential losses, review commercial insurance policies for any potentially available coverage options, including, for example, under provisions relating to pandemics/infectious diseases, business interruption, business travel or evacuation related losses, and key person coverage; carefully review any express exclusions or limits with respect to available coverage.
- Assess requirements for notices or claims under existing insurance policies, especially relating to proof and quantification requirements, and have a plan in place to prepare and send such communications to insurers promptly once a loss has been incurred.
- Determine whether liability insurance policies will cover emergency actions taken by agents of the firm, including directors, officers, and employees; understand limitations on such coverage and be prepared to document decisions and justifications for actions in a manner that would support potential claims on those policies.

CONTACTS

Knowledge of COVID-19 and its impact on the community is quickly evolving day by day. The best practice that any firm can follow is to closely monitor communications from government sources for additional guidance and information. Please contact the following Financial Markets and Funds attorneys, or any member of your Katten team, with any questions on implementing the best practices identified in this advisory.

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