

COVID-19: EVALUATING THE NEED FOR IN-PERSON FUND BOARD MEETINGS AND OTHER CONSIDERATIONS FOR U.S. ASSET MANAGERS

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U.S. Investment Management Alert

By: Lori L. Schneider, Marguerite W. Laurent, Elizabeth M. Johnson

The pandemic coronavirus ("COVID-19") has significantly disrupted certain industries and markets and captured the attention of market participants. This client alert reviews the March 4, 2020 U.S. Securities and Exchange Commission ("SEC") guidance issued in response to the potential impacts of COVID-19, which permits certain delayed filings by public companies and non-in-person approvals by mutual fund boards of directors. In addition, we highlight key areas of operational consideration for all asset management firms and fund boards of directors.

SEC GUIDANCE ON COVID-19

On March 4, 2020, the SEC issued an order announcing conditional regulatory relief and assistance for companies affected by COVID-19 ("SEC Order"). [1] The SEC Order provides reporting companies an additional 45 days to file certain disclosure reports that would otherwise be due between March 1, 2020 and April 30, 2020, subject to certain conditions. Please see the K&L Gates client alert, "SEC Announces Conditional Relief for Companies Affected by Coronavirus" for further information on the SEC Order. [2]

In conjunction with the SEC Order, the Division of Investment Management ("IM") released a statement regarding the impact of COVID-19 on investment advisers and funds ("IM Statement"). [3] The IM Statement expands the no-action relief issued to the Independent Directors Council ("IDC Letter") last year [4] with respect to unforeseen or emergency circumstances that make it impossible or impracticable for directors to travel to attend a meeting in person. Specifically, the IM Statement extends the relief to cover all approvals and renewals of contracts, plans, or arrangements under Section 15(c) or Rules 12b-1 or 15a-4(b)(2), *including material changes to such contracts, plans, or arrangements*, as well as the selection of a fund's independent public accountant pursuant to Section 32(a) where such accountant is not the same accountant as selected in the immediately preceding fiscal year. The IM Statement is effective through June 15, 2020 and may be extended as circumstances warrant. By issuing the IM Statement and extending the relief beyond what is permitted in the IDC Letter, the SEC staff is acknowledging that the risks of COVID-19 have created unforeseen or emergency circumstances that may make it impracticable for directors to travel to attend a meeting in person. Notably, the relief includes the approval of new advisory contracts for a new fund or a new sub-adviser, which were not covered in the original no-action relief in the case of unforeseen or emergency circumstances. In addition, the IM Statement encourages investment advisers and funds to plan and prepare for potential impacts, evaluate business continuity plans and valuation procedures, and assess other relevant policies, procedures, and systems.

In our recent experience, fund boards of directors, in consultation with fund advisers, have begun to consider alternative options to in-person board meetings in light of COVID-19 concerns. Some have decided to hold their

meetings telephonically, while others have opted to permit those directors who would need to travel to the meeting to instead attend the meeting telephonically with those who live in close proximity to the meeting location attending in person. Fund complexes likewise have been reviewing meeting agendas to determine whether any in-person approvals are required under the 1940 Act. To the extent that they are, funds that determine to rely on the IDC Letter and/or IM Statement should have the board make a determination (presumably before or at the beginning of the meeting) regarding the unforeseen or emergency circumstances that make reliance on the no-action position appropriate.

It is worth noting that reliance on the IDC Letter or IM Statement is not without risk as they are not the law, a rule, or official legal position of the SEC but are only a statement that the SEC staff will not take enforcement action. [5] Thus, there is some potential risk in following this approach, for example, to have the board of directors approve the Section 15(c) annual contract renewals at a non-in-person meeting. It is possible these approvals could be raised in a Section 36(b) claim to question the adequacy of the board's process or that such an advisory contract, and the advisory fees paid thereunder, could be challenged as not properly approved under the 1940 Act. While we think it is unlikely that these types of challenges would be successful, particularly given the unusual circumstances created by COVID-19 and the SEC staff's express position, advisers should assess this risk to determine whether other alternatives are practicable under the circumstances, such as trying to have a majority of directors who are close in proximity to the meeting location attend in person, with the other directors who must travel attending telephonically.

KEY AREAS TO CONSIDER

Below is a list of potential topics and actions for advisers and fund complexes to consider as you prepare for the possible impacts of COVID-19 on your business:

- **Review existing business continuity, contingency, and/or incident response plans** for the adviser, any sub-advisers, and other service providers to evaluate whether they contemplate the depth and breadth of the current situation, and update as necessary. This should be an ongoing assessment as the situation develops.
- **Communicate with key stakeholders**, where appropriate, regarding plans and procedures in place, including investors, fund directors, employees, and key vendors. Communications should be ongoing, if necessary, as the situation develops.
- **Evaluate operational processes** and how they would be impacted if your organization, or some portion thereof, was required to work remotely for an extended period of time. In this regard, also evaluate key vendor relationships and how an extended remote or other work plan for their workforce would impact operations.
- **Prepare for and address any potential trading, valuation, and liquidity issues** in light of ongoing developments. Review any unusual redemption activity or large fund outflows, the operation of the liquidity risk management program, whether there has been a significant increase in the fair valuations necessary for any fund, or any other valuation challenges. Consider whether policy updates are needed to address issues, such as pricing procedures for securities that trade on Chinese or other foreign exchanges with price limits.

- **Discuss the impact of market volatility** on portfolio management, including a review of stress testing and any other risk management processes.
- **Identify any funds with significant exposure to regions or sectors/industries significantly impacted by COVID-19**, review and consider related risk disclosures, and, if warranted, implement any necessary risk mitigation measures.
- **Review the upcoming calendar of events and travel** for your business and whether any items should be postponed or cancelled. As part of this consideration, evaluate any resulting ripple effects to your business. For example, are there any legal or contractual requirements driving a specific meeting, and is there any relief from such requirements?

The considerations listed above may also provide a basis for the topics fund directors may wish to discuss with fund investment advisers pursuant to the board's fiduciary responsibilities to oversee fund operations and the adviser's risk management of the funds. Relevant risks span a large spectrum, including operational, investment, valuation, liquidity, compliance, and third-party risks, among others. Fund directors should make sure they are receiving adequate information and updates from investment advisers about the funds' preparedness to deal with these issues.

QUESTIONS OR COMMENTS

We are advising clients on an array of legal and operational questions in light of COVID-19. Please reach out with any questions you may have as you prepare your business for the potential impacts of COVID-19.

NOTES

[1] *Exemptions from Specified Provisions of the Exchange Act and Certain Rules Thereunder*, Exchange Act Release No. 34-8818 (Mar. 4, 2020), <https://www.sec.gov/rules/other/2020/34-88318.pdf>. See also SEC Press Release, *SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 (COVID-19)* (Mar. 4, 2020), <https://www.sec.gov/news/press-release/2020-53>.

[2] *SEC Announces Conditional Relief for Companies Affected by Coronavirus*, by Mark L. Johnson, Sean M. Jones, and Coleman Wombwell (Mar. 5, 2020), <http://www.klgateshub.com/details/?pub=SEC-Announces-Conditional-Relief-for-Companies-Affected-by-Coronavirus-03-05-2020>.

[3] IM Staff Statement, *Fund Board Meetings and Unforeseen or Emergency Circumstances Related to Coronavirus Disease 2019 (COVID-19)* (Mar. 4, 2019), <https://www.sec.gov/investment/staff-statement-im-covid-19>.

[4] *Independent Directors Council*, SEC No-Action Letter (pub. avail. Feb. 28, 2019), <https://www.sec.gov/divisions/investment/noaction/2019/independent-directors-council-022819>. This no-action relief allows fund boards to make these required approvals at meetings held by telephone, video conference, or other similar methods instead of in person under two specific sets of circumstances: (1) when directors are unable to meet in person due to unforeseen or emergency circumstances that make it impossible or impracticable for directors to attend a meeting in-person; or (2) the directors had previously met in person and discussed all

material aspects of a proposal, but did not vote on the proposal at the in-person meeting. For more information, see *SEC Staff Eases Certain "In-Person" Board Approval Requirements*, by Lori L. Schneider, Marguerite W. Laurent, and Jin Ahn (Mar. 21, 2019), <http://www.klgateshub.com/details/?pub=SEC-Staff-Eases-Certain-In-Person-Board-Approval-Requirements-03-20-2019>.

[5] Last year, SEC Chairman Jay Clayton issued a public statement noting that "all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties." Public Statement by SEC Chairman Jay Clayton, *Statement Regarding SEC Staff Views* (Sept 13, 2018), <https://www.sec.gov/news/public-statement/statement-clayton-091318>. Similarly, the IM Statement includes the following statement: "This IM Staff Statement represents the views of the staff of the Division of Investment Management. It is not a rule, regulation, or statement of the Securities and Exchange Commission. The Commission has neither approved nor disapproved its content. This Staff Statement, like all staff guidance, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person."

KEY CONTACTS



LORI L. SCHNEIDER
PARTNER
WASHINGTON DC
+1.202.778.9305
LORI.SCHNEIDER@KLGATES.COM



MARGUERITE W. LAURENT
PARTNER
WASHINGTON DC
+1.202.778.9403
MARGUERITE.LAURENT@KLGATES.COM

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