COVID-19 Checklist & Considerations for Private Fund Advisers

With COVID-19 (*i.e.*, the novel coronavirus) concerns and market volatility, advisers should consider compliance challenges that are likely to arise. This **COVID-19 Checklist & Considerations for Private Fund Advisers** highlights key compliance issues, questions and considerations with respect to the COVID-19 outbreak and government response. Please note that if an adviser does not document its compliance efforts, the Securities and Exchange Commission (SEC) will assume that such efforts did not occur. This checklist is not exhaustive and does not, for example, cover Commodity Futures Trading Commission considerations, which are discussed in a separate client alert.

Liquidity Considerations

✓ ***Gates.*** If fund offering documents contemplate the implementation of gates in the case of an influx of redemptions, it is important to follow these gating procedures carefully.

- Have fund offering documents been reviewed to determine the mechanics (*e.g.*, are gates discretionary or mandatory)?
- Has the adviser consulted the fund's administrator, counterparties, and, if applicable, the fund's board?
- What are the firm's gating policies and procedures?
- What can be done in advance to plan for proper gating and appropriate investor communications?

✓ ***Suspensions.*** Redemption suspensions may be required when an influx of investor redemption requests is received. In addition, suspension of the calculation of net asset value may be required in certain circumstances.

- In what circumstances are suspensions of redemptions and/or calculation of net asset values authorized under relevant fund offering documents?
- Has the adviser consulted the fund's administrator, counterparties, and, if applicable, the fund's board?
- Has a system been established to ensure fair and proper suspensions and that clients are treated fairly?
- Have reserve determinations been made?

✓ ***In-Kind Distributions***. Distributions in-kind can be a useful tool for making distributions during periods of unstable prices.

- Have fund documents and agreements concerning in-kind distributions been reviewed with respect to the form and manner in which they can be distributed?
- Has the adviser consulted the fund's administrator, counterparties, and, if applicable, the fund's board?

✓ ***Side Pockets.*** Side pockets can be a useful tool during times of market illiquidity and valuation concerns, but they should also be planned for in advance.

- Has the firm researched and sought relevant approvals in connection with the establishment of desired side pockets?
- Have fund and investor agreements been reviewed to ensure conformance with prior disclosures and requirements relating to side pockets?
- Has the adviser consulted the fund's the fund administrator, counterparties, and, if applicable, the fund's board?

✓ ***Side Letters.*** Side letter provisions may be triggered during times of stress.

- Have side letters been reviewed to determine if investors negotiated special rights in connection with periods of crisis and market turmoil, such as with respect to special informational or withdrawal rights?

✓ ***Capital Calls.*** As a result of this crisis, investors may be unprepared to meet fund capital calls.

- Have capital call provisions in fund documents been reviewed in preparation for potential defaults?
- Have future capital deployments been considered with capital call issues in mind?
- Have investors with committed capital been contacted prior to deciding upon future capital deployments to ensure that sufficient funds will be available to satisfy such capital calls?

Filing and Reporting Considerations

✓ ***Form ADV and Risk Disclosure.*** COVID-19 may affect the adviser's Form ADV disclosures and relevant filing deadlines. As a result, the SEC has granted up to an additional 45 days for filings due prior to June 30 for registered investment advisers and exempt reporting advisers unable to meet the filing deadline or delivery requirements of Form ADV as a result of COVID-19. An adviser seeking such relief must promptly notify the SEC. In addition, in light of the current market dislocation and potential impact on client portfolios, advisers may wish to consider including additional risk disclosures in both Form ADV Part 2A as well as potentially in private fund offering documents. Maintaining consistent messaging to clients and regulators will be critical during this period. In addition, since employees may be working in states other than the state in which the adviser has its principal place of business, this may result in state notice/registration requirements, absent state relief. As a result, advisers must consider whether state notice/registration updates should be included in their Form ADV amendment. Updates on state relief can be found here.

- Should an extension in filing the Form ADV be sought?
- Should additional risk disclosures be included in Part 2A and/or fund offering documents relating to epidemics and other similar events, as well as geographic and sector-specific risks (such as travel, hospitality, etc.)?
- If employees are working in states other than the principal business location of the adviser, are any state notice/registration provisions triggered or has state relief been granted?

✓ ***Form PF.*** Similar to the relief available with respect to Form ADV as noted above, advisers may seek relief if they are unable to meet the Form PF filing deadline as a result of COVID-19. For filings due prior to June 30, firms are entitled to an extension of up to 45 days beyond the form's original due date, but must notify the SEC and describe the reason for the delay in filing.

- Should an extension in filing the Form PF be sought?

✓ ***Form 13G.*** Advisers that are unable to timely file their Form 13G due to circumstances relating to COVID-19 will be granted 45 additional days to make their filing. In making the filing, the adviser must disclose that it relied on this relief and explain the circumstances surrounding its late filing. Notice of reliance on the relief beforehand is not required. This relief is not available to Form 13D filers. Remember that insider trading considerations remain especially relevant during this time.

- Should extension relief for filing the Form 13G be relied upon?

✓ ***Delayed Audited Financials.*** During these periods of market stress, difficulties may arise in producing timely financials. While not in the context of COVID-19, the SEC has previously indicated that its Division of Enforcement would not recommend enforcement action for a violation of Rule 206(4)-2 (the Custody Rule) under the Investment Advisers Act of 1940 (Advisers Act) against an adviser that is relying on the "audit provision" under Rule 206(4)-2(b)(4) of the Custody Rule if that adviser reasonably believed that the fund's audited financial statements would be distributed within the 120-day deadline, but failed to have them distributed in time under certain unforeseeable circumstances.

- Is the possibility of producing late financials reasonably foreseeable, and have auditors been consulted accordingly?
- If so, have fund offering documents and the firm's policies and procedures been reviewed to determine the adviser's rights and obligations in connection with delayed financial statements?

Supervision and Remote Work Considerations

✓ ***Supervision and Remote Work.*** Compliance supervision can be especially challenging when most, if not all, of an adviser's personnel are working from home. The OCIE had previously highlighted remote working as a concern in its 2019 Risk Alert relating to compliance and supervision.

- What is the firm's plan of supervision during this period of remote working, especially in regard to implementation of the stated investment strategy?
- Is staff aware of the supervisory chain and each staffer's responsibilities?
- Does staff have access to all automated supervision controls to which they are accustomed?
- Is a Business Continuity Plan in place and being followed?
- What cybersecurity and data-security precautions are being taken, especially in consideration of the COVID-19 cyber alert from the U.S. Department of Homeland security relating to remote working? See our alert on remote security considerations here. Also, note that advisers are subject to state breach notification requirements.

Counterparty Considerations

✓ ***Counterparty Risk.*** During periods of market stress, an adviser's counterparty risk tends to increase.

- Since the crisis, has the adviser communicated with and researched its counterparties to evaluate the firm's counterparty risk exposure?
- Is the adviser continually monitoring counterparties (*e.g.*, for rating downgrades, widening credit default swap spreads or negative press)?
- How can the adviser seek to mitigate any such risk, such as by diversifying providers and spreading assets across other counterparties?
- In cases of concern, have counterparty agreements been reviewed to determine courses of action in the case of counterparty failures?

✓ ***Contract Triggers.*** Times of financial strain can result in unexpected defaults and other problematic triggers of contract provisions, such as with respect to derivatives and credit agreements.

- Have key contracts been reviewed to determine if any triggers or default provisions have been, or are soon to be, activated?
- Have key contracts been reviewed together, such as ISDA and prime brokerage agreements, to determine whether the terms of one contract may trigger cross-default or termination events under another agreement?
- Have any ratings or NAV-decline triggers been triggered, potentially resulting in notification requirements, margin calls or termination rights?
- If triggers may be tripped, should waivers be requested of dealers/other signatories ahead of time?
- If so, how can the adviser protect itself in light of the potential consequences?
- Can force majeure provisions be relied upon by the adviser or other signatories? See our alert discussing, in part, force majeure considerations here.
- Have key contracts been reviewed to determine whether any disclosures or otherwise are triggered under the "material change" notice provisions?

ERISA Considerations

✓ ***Non-ERISA Funds.*** Private funds that are structured to avoid being subject to the U.S. Employee Retirement Income Security Act of 1974 (ERISA) by reason of the significant participation/25% exception should carefully monitor to ensure that redemptions out of a fund do not result in "benefit plan investors" (i.e., ERISA plans, individual retirement accounts, and "plan assets" fund-of-funds, etc.) holding 25% or more of any equity class of the fund. For a description of the significant participation test, please see our recent client alert here.

- The fund sponsor/manager may have contractually committed to preventing the fund from holding "plan assets," in which case it should refer to and comply with such commitments. Amendments to these terms will likely require consent of the ERISA plan, and even potentially governmental plan, investors.

ERISA Considerations

- If redemptions inadvertently cause the fund to hold "plan assets," the sponsor/manager may face significant obstacles in terms of ERISA compliance. For example, special care should be taken where the investment manager is newly formed, where a performance fee is paid to the investment manager, and/or where the investment manager enters into transactions with affiliates.

✓ ***ERISA Funds.*** Sponsors and managers of funds that are structured to operate as "plan assets" vehicles, and, therefore, comply with ERISA, will likely be relying upon the QPAM Exemption. The QPAM Exemption contains multiple technical conditions, some of which may be stressed in volatile times. For example, the QPAM Exemption would not cover transactions otherwise consummated by the investment manager on behalf of the fund if one or more investing plans of an employer (or affiliates of the employer) constitute more than 20% of the total client assets (i.e., inside and outside of the fund) managed by the investment manager at the time of the transaction. Investment managers that lose numerous, or particularly important, clients could potentially run afoul of this condition, which would mean they would have to rely on some alternative exemption, such as Section 408(b)(17) of ERISA, for its trading. Finally, in terms of significant volatility of pricing, investment managers operating ERISA "plan assets" funds should be careful about using their own valuation methodologies of fund holdings so as to avoid potential self-dealing concerns.

Please do not hesitate to reach out to any of the Stradley Ronon authors listed below with any questions and concerns you may have during this period.

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