

Memorandum

COVID-19: Considerations for Private Investment Fund Sponsors

March 16, 2020

The rapid spread of the coronavirus disease 2019 (“COVID-19”) across the globe has presented private investment fund sponsors with a variety of challenges, as well as potential opportunities. We have been working proactively with our private fund clients to consider the steps required to meet the direct and collateral consequences of these circumstances. Below are some considerations that we believe all private fund sponsors should consider in today’s tumultuous environment.

Disclosure and Reporting

- *Disclosures:* Sponsors should consider including specific disclosure regarding the impacts of COVID-19 in fund offering documents and ADVs. Although most fund disclosure documents already include disclosure regarding the risks associated with epidemics and pandemics, broadening these disclosures to capture the widespread impact of COVID-19 is advisable.
- *Performance Impact:* Sponsors with anticipated fund closings before Q1 2020 financials are available should consider appropriate pre-closing disclosures regarding the impact that the current market environment has had and could have on both prior performance and investment valuations.
- *DDQs:* We are seeing many existing and prospective investors inquiring about the impact that COVID-19 will have on a fund’s performance, investment activities and portfolio company operations. Sponsors should seek feedback from their portfolio companies and consider preparing appropriate responses to address these concerns to ensure consistent messaging to investors.
- *Regulatory Reporting:* On March 13, 2020, the SEC announced regulatory relief for registered investment advisers and exempt reporting advisers (as applicable) whose operations are affected by COVID-19. In particular, subject to the satisfaction of certain conditions and requirements (including notifying the SEC staff of the intention to rely upon the order and disclosing information on the adviser’s website about its reliance upon the order), the SEC is providing temporary relief from: (1) the requirement to file an amendment to Form ADV and reports on Form ADV Part 1A; (2) requirements to deliver amended brochures, brochure supplements or summary of material changes to clients; and (3) the requirement to file Form PF (as applicable to certain private fund advisers). This relief is limited to filing or delivery obligations through April 30, 2020 and should be met as soon as practicable, but no later than 45 days after the original due date.

- *Audited Financial Statements:* We are not currently aware of the SEC issuing relief to extend the requirement to provide audited financial statements within 120 days of a private fund’s fiscal year end for private fund advisers that rely on the audited financials delivery requirement to comply with the Custody Rule. However, the SEC has previously issued guidance that it would not recommend enforcement action for a violation of the Custody Rule for failing to distribute the fund’s audited financial statements within the 120-day deadline due to certain unforeseeable circumstances.¹ Until any additional guidance or relief is issued by the SEC, sponsors should assume that the 120-day requirement will remain in effect. Sponsors should proactively discuss with their auditors and valuation advisors the feasibility of meeting these deadlines. In addition, given that fund-level financials are often reliant on delivery of portfolio-level information, sponsors should consider proactively discussing timing of financial information delivery with their portfolio companies.

Fundraising

- *Impact on Fundraising Activities:* Anecdotally, we have been hearing from investor relations teams at our private fund clients that the spread of COVID-19 has begun to impact fundraising activities—from investors delaying investment decisions (whether due to substantive concerns about market volatility or simply due to administrative challenges) to bans on travel to the inability to meet face-to-face with investors. Regardless, we are continuing to see substantial activity in the fundraising environment for private funds.
- *Investor Administrative Challenges:* We have been seeing COVID-19 present administrative challenges for investors’ decision making and subscription processes (e.g., delays in convening of investment committee meetings to approve fund investments, unavailability of signatories and unavailability of service providers). We are working proactively with our clients to find creative technology and other solutions to these issues and to ensure smooth closing processes.
- *Electronic Subscription Documents:* In light of the administrative challenges presented by the spread of COVID-19, we are seeing a renewed and invigorated interest in electronic subscription documents to ease the administrative burden on entire investor offices working remotely. We have made electronic subscription documents with DocuSign available to all our clients (we note that there can be some legal issues with the use of this technology in certain jurisdictions and/or certain categories of investors).
- *Subsequent Closings:* Sponsors of closed-end funds that have acquired material assets prior to the final closing that have decreased substantially in value should anticipate that subsequent closing investors may have issues with the traditional “cost plus” true up mechanism.

Operations

- *Business Continuity and Employee Policies:* Fund sponsors should consider preparing and reviewing business continuity plans and employee policies and asking their portfolio companies to do the same

¹ See “Staff Responses to Questions About the Custody Rule – Question VI.9” at https://www.sec.gov/divisions/investment/custody_faq_030510.htm.

(note, SEC-registered investment advisers are already required to maintain business continuity plans). Sponsors should proactively test work-from-home capabilities. We've seen a number of private fund clients encourage all of their employees to work remotely, with some clients moving to complete remote working.

- *Investor Meetings:* We have seen our private fund clients either cancel annual investor meetings or host them entirely over webcast. Sponsors with planned investor meetings in the near- to medium-term should consider contingency plans in case in-person meetings need to be cancelled/postponed and/or replaced with webcast.
- *Insurance:* Sponsors should review insurance policies to determine their level of coverage for potential claims resulting from disruption of business, travel and similar issues. We note we have started to see insurers seek to carve-out losses related to COVID-19 in new policies.
- *Lender Requests:* Lenders may request additional information in connection with existing debt arrangements and may seek additional covenants and restrictions in connection with proposed debt arrangements.
- *Material Adverse Events:* Sponsors should consider consulting with counsel to determine whether the impact of COVID-19 may constitute a material adverse effect or "force majeure" under existing agreements, including with respect to investments that have not yet closed.

Investment Issues

- *Portfolio Capital Needs:* Sponsors should begin to consider whether their fund documents permit funding additional capital into existing portfolio companies. Key issues in this regard include expiration of commitment period, treatment of deal-specific co-investment vehicles that do not have available capital and cross-fund investments where one participating fund does not have available capital.
- *Open Market Purchases:* We are seeing sponsors seeking to find attractive opportunities in public securities resulting from the current market volatility. Sponsors should consider revisiting their investment limitations in fund governing documents to determine their capabilities.
- *Debt Investments:* Sponsors that identify opportunities in debt instruments of existing portfolio companies in which they are an equity holder should consider applicable issues, including whether such investments can be made by the applicable equity fund, board level fiduciary issues (both in making the investment and on a go-forward basis), use of confidential information and tax considerations.

We are all available to answer questions regarding the topics above among others. Please do not hesitate to reach out to your Simpson Thacher Partner contact with any questions.

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