



Special Issue on COVID-19 Related Developments

# Investment Services Regulatory Update

April 2020

Monthly Version

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# COVID-19 RELATED DEVELOPMENTS

## SPECIAL REGULATORY UPDATE

### New SEC Guidance on PPP Loans, Form ADV Brochure Delivery and the Custody Rule

On April 27, 2020, the staff of the Securities and Exchange Commission (the “SEC”) updated its Division of Investment Management Coronavirus (COVID-19) Response FAQs and Staff Responses to Questions About the Custody Rule FAQs to address the following topics in light of the COVID-19 pandemic:

1. Disclosure of Paycheck Protection Program (“PPP”) Loans: Whether an adviser needs to disclose receipt of a PPP loan in its Form ADV Part 2A (“Brochure”). In discussing this issue below, we also discuss the Small Business Administration’s (the “SBA”) recent guidance on a new Interim Final Rule.
2. Delay of Brochure Delivery for Wrap Fee Programs: How a participating adviser in a wrap fee program may rely on the SEC Order permitting the temporary delay of Brochure delivery.
3. Delay of Distribution of Pooled Audited Statements and Custody Rule: Whether the SEC will recommend enforcement for a violation of the Custody Rule if audited financial statements are not distributed in time due to certain unforeseen circumstances.

#### PPP Loans – Brochure Disclosure

(FAQ II.4, available [here](#))

The guidance states that investment advisers that receive a PPP loan (or other type of financial assistance) must disclose this arrangement if the circumstances that led the firm to seek the loan constitute “material facts relating to your advisory relationship with clients.” For example, it is the staff’s view that an adviser would be expected to provide disclosure if it requires financial assistance to pay the

salaries of employees primarily responsible for performing advisory functions to clients. In addition, it is the staff’s view that an adviser may be required to disclose its financial condition in response to Brochure Item 18 (Financial Information) or as part of the Brochure’s Appendix 1 (wrap fee program brochure) if it is experiencing conditions that could impair its ability to meet contractual commitments to its clients. Such disclosure would consist of the nature, amounts and the effects of the financial assistance and arises from an investment adviser’s fiduciary duty to make full and fair disclosure to clients of all material facts relating to the advisory relationship.

#### PPP Loans – Eligibility Criteria

(Interim Final Rule, available [here](#))

On April 13, 2020, the SBA published supplemental guidance on an Interim Final Rule regarding the eligibility for PPP loans (effective April 24, 2020). The guidance makes clear (under Question 2.a.) that hedge funds and private equity firms are not eligible to receive a PPP loan because these entities are “primarily engaged in investment or speculation.” However, the guidance (under Question 2.b.) also provides that a portfolio company of a private equity fund may be eligible for a PPP loan in the same manner as any other business, including applicable affiliate rules.

#### Delay of Brochure Delivery for Wrap Fee Programs

(FAQ II.5, available [here](#))

A participating adviser that has contracted with a wrap fee program sponsor to deliver the Brochure to applicable clients may rely on the SEC Order (the “Order”) (available [here](#)) that permits delayed Brochure delivery in the event the program sponsor cannot deliver the Brochure by the appropriate deadline due to circumstances surrounding the COVID-19 pandemic. To rely on this temporary relief, the participating adviser must comply with the conditions of the Order. The guidance noted the following considerations with respect to wrap programs:

The adviser must disclose on its public website (or if it does not have a public website, provide notice to clients) that it is

relying on the Order. In the case of clients that primarily or exclusively interact with the participating adviser through the wrap program sponsor, the SEC staff believes the sponsor should also consider posting on its public website notice that the participating adviser is relying on the Order.

The adviser must notify the SEC staff via e-mail that it is relying on the Order. It is the staff's view that the program sponsor could provide such notice on the participating adviser's behalf if in its e-mail, the program sponsor identifies each participating adviser that is relying on the Order and represents that it has the authority to submit the e-mail on behalf of those advisers. If the participating adviser is relying on the Order with respect to clients for which the program sponsor is not contractually obligated to deliver the Brochure, the participating adviser would need to separately satisfy the above notice conditions.

### **Delay of Distribution of Pooled Audited Statements and Custody Rule**

(FAQ VI.9, available [here](#))

The SEC staff will not recommend enforcement against an investment adviser to a pooled investment vehicle where the adviser is relying on the "audit provision" of the Custody Rule and reasonably believed the pool's audited financial statements would be distributed within the 120-day, 180-day (fund of funds or pool investing in fund of funds) or 260-day deadlines (top-tier pooled investment vehicle investing in one or more funds of funds), but failed to have them distributed in time under certain unforeseeable circumstances.

## **Board Oversight in the Age of COVID-19: Part Six**

*Part 6 of a weekly series detailing approaches that independent board members are utilizing to address coronavirus-related matters and highlighting emerging issues. [Part 1](#), [Part 2](#), [Part 3](#), [Part 4](#) and [Part 5](#) of the series may be accessed on our website. Please visit our [Coronavirus Task Force](#) page for more information.*

We seem to be in a holding pattern, as all eyes turn to the states to see if, when and to what extent the economy can be reopened. With that in mind, we have decided that we will provide future updates when noteworthy practices or issues emerge. Perhaps the SEC's Division of Investment Management was sending a subtle message last week by issuing its long-awaited Valuation Proposal in the midst of a global pandemic, in a sense telling the asset management industry, and in particular independent directors, that yes, we are living in strange times, but at the end of the day, we all still need to focus on doing our jobs, and funds must strike an accurate Fund NAV, one day at a time. (We briefly summarize the Valuation Proposal below, and will have more to say about it in a future Vedder client bulletin.)

### **What Are Boards Doing Now?**

Below are some highlights of actions boards are currently taking as they continue to exercise their fiduciary duties.

**Adviser Stability.** As the pandemic lingers on and there is no consensus on how and when states should reopen their economies, Boards are asking investment advisers for more information regarding impacts on their operations over the longer term, including consideration of alternative scenarios for the duration/severity of the pandemic, and its impact on an investment adviser's financial standing/balance sheet, personnel (especially in light of hiring freezes and layoffs), and key technology and other infrastructure projects (for example, whether important projects are being put on hold).

**Board Meeting Format.** Boards are continuing to assess the most efficient format to hold board/committee meetings on a long-term basis. Many recognize that video formats are more effective than conference calls, but have drawbacks, including the greater potential for meeting fatigue, as well as operational concerns if participants are connecting from more remote locations with less reliable service. They also recognize that telephonic meetings can be effective, but perhaps are not optimal depending on the issues to be discussed. An emerging approach is to mix and match formats, even within the context of a single day of meetings, as the variation in format may lessen meeting fatigue. We are

also seeing boards holding shorter sessions, with more breaks, and holding meetings over more days. With travel restricted and most directors sheltering in place, the typical scheduling concerns with this approach do not appear to be as pronounced. In fact, many directors are now deciding to participate in meetings of committees of which they are not a member.

**Business Continuity Plans.** The SEC's inspection staff has been conducting calls with asset managers to discuss their responses to the pandemic, including whether the firms have experienced any unexpected issues with their business continuity plans. Boards continue to ask investment advisers questions about the implementation and effectiveness of their business continuity plans, including any challenges they have faced. Boards are having discussions with management about whether adjustments need to be made to the firm's BCPs given the expectation that the "new normal" will continue for at least several more weeks in some form or fashion.

### What's Next – Emerging Issues

Below are some emerging issues that came to light over the past week, which boards may want to consider as they continue to exercise their fiduciary duties.

**Target Term Closed-End Funds.** There are a number of target term closed-end funds with termination dates coming up in 2020–2022 that have investment objectives to return a target NAV per share (typically original NAV per share) at termination. The recent market downturn has resulted in declines in the NAVs of these funds well below their target NAVs, and there may not be enough time for markets to recover to permit these funds to return their target NAVs at the termination date, especially as target term funds are typically managed more conservatively as they approach their end dates. Boards of such funds may want to consider discussing with the adviser the likelihood of the fund being able to return its target NAV at termination and steps that may be taken, including whether to make use of provisions permitting the extension of the term; reviewing disclosures in the original registration statement about the target NAV; and

considering what current disclosures should be made regarding the impact of recent market events on the objective of returning the target NAV.

**Valuation Regulations.** As the pandemic had the effect of intensifying the focus on valuation, on April 21, 2020, the SEC proposed long-promised regulations to modernize the framework for fund valuation practices. The proposed rule would establish requirements for satisfying a fund board's obligation to determine fair value in good faith for purposes of the Investment Company Act of 1940. The rule would require a board or the fund's investment adviser to assess and manage material risks associated with fair value determinations; select, apply and test fair value methodologies; oversee and evaluate any pricing services used; adopt and implement policies and procedures; and maintain certain records. If a fund's board assigns the required determinations to the fund's investment adviser, robust board oversight of the adviser is expected. The comment period for the proposed regulation will be open until July 21, 2020.

## Board Oversight in the Age of COVID-19: Part Five

*Part 5 of a weekly series detailing approaches that independent board members are utilizing to address coronavirus-related matters and highlighting emerging issues. [Part 1](#), [Part 2](#), [Part 3](#), and [Part 4](#) of the series may be accessed on our website. Please visit our [Coronavirus Task Force](#) page for more information.*

### What Are Boards Doing Now?

**Board Communications.** Boards continue to evolve the nature of the periodic updates they are receiving. In addition to periodic board-level presentations, some committee chairs have added informal calls with their company contacts, which they then report to the full boards by e-mail or at the next full board meeting. Not only are these calls informative, they demonstrate diligence on the part of the board. These and other efforts to stay abreast of

developments should be captured in the minutes of the next board meeting.

**Future Board Meetings.** An increasing number of boards have determined that their May or June meetings will be held virtually. They are taking steps to ensure the success of those meetings:

- Routine agendas are being assessed to consider if certain items can be deferred or instead addressed in a memorandum to the board that is taken “as read” and not discussed during the meeting other than responding to any questions.
- To lighten the load, committee meetings and executive sessions are being held on days without board meetings.
- Presentations are being limited to shorter blocks of time, depending on the subject, or encouraged to be focused on “exception reporting.”
- For meetings over 2-3 hours (video or audio only), breaks are being inserted to allow participants time to stretch and clear their heads.

**Conducting Virtual Meetings.** We are starting to see trends in how boards are conducting remote board meetings:

- Video conferencing appears preferable to telephonic meetings. We have seen a number of different vendors selected for this purpose. If a video conference is expected, prior to the virtual meeting, management is hosting a “practice session” for trustees to test their ability to access the virtual site. Also, pointers are being discussed, such as muting all microphones that are not in use and protocols for asking questions to avoid speakers talking over one another.
- For all-day meetings, there is a morning session and an afternoon session, each with a comfort break about halfway through. Each session is 2.5 to 3.5 hours long, and separated by a 45-minute lunch break, with participants staying connected to avoid delays in reconvening the meeting.

- If executive sessions and committee meetings will be held on the same day as the board meeting, some boards are using different call-in numbers for executive sessions. This not only preserves the privacy of executive sessions, it avoids the interruptions caused by announcements (which can be silenced) and the addition of pictures as people join for the next session (which cannot be as easily controlled on some hosting sites).

**15(c) Requests.** Boards and their independent counsel continue to evaluate additional questions for 15(c) Request Letters to include COVID-19 matters, impacts of the recent volatile market (recognizing that there has been a great deal of change since the end of the reporting period), and the utilization of extensions to meet filing deadlines. Boards are requesting and expect to receive some form of “bring down” update from Fund management closer to the date of the meeting.

**May/June 15(c) Meetings.** For boards with May or June contract renewal meetings, which can involve additional pre-meetings and certainly include an increase in materials, the approaches utilized to manage agendas and the increased volume of materials is evolving. This pressure is more acute for those boards that are using online materials rather than paper for the first time. Some boards that have not previously had pre-meetings have added them to provide an opportunity to raise specific questions that may be able to be resolved in writing in advance of the 15(c) meeting.

### **What’s Next – Emerging Issues**

Below are some emerging issues that came to light over the past week, which boards may want to consider as they continue to exercise their fiduciary duties.

**Contract Provisions.** In a previous Client Bulletin, we noted that some advisory contracts may include a requirement for the annual contract approval to be voted at an in-person meeting. Because of this contractual requirement, an amendment to the agreement or a waiver is needed for approvals via a telephonic or virtual meeting. We have learned that this same issue may be present for some

distribution agreements and 12b-1 plans that likewise require in-person annual approvals.

**Disclosure.** The SEC has posted a statement on its website reminding registrants to update disclosures when there have been changes and to meet all delivery requirements, including paper prospectuses to new investors. Particular attention should be paid to financial statements, valuation issues, liquidity issues, risk disclosures and disclosures that may be relevant to a particular type of fund. Many registrants make 485(b) filings, typically reserved for nonmaterial changes, at this time of year and may consider additional disclosures in light of the SEC's statements.

**Business Continuity Plans.** Most Business Continuity Plans (BCPs) were designed for temporary situations. As pandemic-related mandates require longer term arrangements by the adviser and other key service providers, it will become important to monitor such arrangements for sustainability and address any weaknesses that have become apparent over the extended period of "work from home."

**Closed-End Funds.** In conformance with a registration statement undertaking, some closed-end funds have had to suspend offering new shares until such time as an amended prospectus was filed because the price dropped more than 10% from the NAV at the time of registration. This is most likely to impact funds that release new shares in offerings at market prices. The SEC has provided guidance that, if the decline is due to COVID-19-related market conditions, the undertaking can be satisfied by filing a prospectus supplement under Rule 497 rather than as a post-effective amendment. The guidance also addresses required notification to the Disclosure Review and Accounting Office staff reviewer and suggested disclosure for the prospectus supplement.

[Click here](#) for further information.

## Board Oversight in the Age of COVID-19: Part Four

*Part 4 of a weekly series detailing approaches that independent board members are utilizing to address coronavirus-related matters and highlighting emerging issues. [Part 1](#), [Part 2](#), and [Part 3](#) of the series may be accessed on our website. Please visit our [Coronavirus Task Force](#) page for more information.*

The surreal nature of the current coronavirus environment in the United States continues. The number of new cases appears to have peaked in New York City and the Bay Area, while the S&P 500 ended the week down only about 13.5% year to date, and is higher now than on January 1, 2019. Yet, unemployment claims surged and are approximately 8.5 times higher than levels from the 2008–2009 financial crisis, and scores of businesses across the country remain shuttered and face bankruptcy. So the question of the past four weeks remains — where exactly do we go from here?

### What Are Boards Doing Now?

**Board Communications.** Boards continue to evolve the nature of the periodic updates they are receiving. In addition to hearing about fund performance and operational matters, now some are including presentations from those asset management employees that focus on macro-economic themes, including the head of fixed-income research or those in similar positions.

**Future Board Meetings.** Boards continue to evaluate their June board schedules, and more are expecting to hold these meetings virtually. Some are also considering the need to hold additional telephonic board meetings to address items already deferred from meeting agendas in March, and expected to be deferred from June meeting agendas, as boards continue to assess the maximum length and most efficient structure of virtual board meetings.

**15(c) Requests.** Boards and their independent counsel continue to evaluate additional questions for 15(c) Request Letters to address COVID-19 matters. While the nature and extent of these requests is dependent on the types of

periodic updates the board is already receiving, most are expecting to request and receive some form of “bring down” update from Fund management closer to the date of the meeting during which 15(c) renewals will be considered.

### **What’s Next – Emerging Issues**

Below are some emerging issues that came to light over the past week, which boards may want to consider as they continue to exercise their fiduciary duties.

**Liquidity**. Some complexes are filing Form N-LIQUID with respect to funds that have breached the 15% limit on illiquid securities, and related reports are being made to the board, along with a remediation plan. Breaches may be due to a more careful review of holdings or to changes in the character of holdings. Alternatively, some complexes are reporting issues with liquidity categorizations provided by third party service providers causing Liquidity Risk Program Administrators to consider overriding or challenging the liquidity classifications provided. The SEC staff has been open and willing to discuss such filings and related matters, and we are aware that OCIE staff has been participating on some of these calls.

**Service Providers**. As the impact of the virus is expanding globally, boards are considering the types of risks that may be presented by service providers with operations in less developed countries, including India, where BCP plans may be less robust, do not contemplate “work from home” opportunities for all employees and may be harder to implement. This may be a heightened concern for ETFs, as these funds tend to have more unaffiliated service providers with offshore operations.

**Index Providers**. Fund management has noted the benefit of advance communication with index providers to address the potential impact of market halts or bankruptcies of companies included in an index. While most index rebalances have been suspended, the impact of other market developments remains.

**Back Office Issues**. Fund management continues to consider operational matters, including the speed and efficiency of processing customer orders and the working

relationship with financial printers, where production delays and other operational concerns are occurring.

**Borrowing Relief**. So far, we are not seeing many Funds utilizing this relief to access liquidity, as fund management considers operational issues.

**Closed End Funds**. The advantages of holding virtual annual shareholders meetings are being weighed against potential disadvantages, including that certain proxy solicitation firms may object to hosting a virtual meeting if it is contested and concerns that activists could take advantage of this format to hijack the meeting.

**Interval Funds**. Boards are closely monitoring management’s preparation for upcoming periodic repurchase offers to assess liquidity and valuation issues. In addition, boards are discussing whether repurchase amounts should be set at levels that seek to clear out shares tendered or to prorate, and considering the impact of such decisions on the management of the portfolio, continuing sales and liquidity for future repurchase offers.

## **Board Oversight in the Age of COVID-19: Part Three**

*Part 3 of a weekly series detailing approaches that independent board members are utilizing to address coronavirus-related matters and highlighting emerging issues. [Part 1](#) and [Part 2](#) of the series may be accessed on our website. Please visit our [Coronavirus Task Force](#) page for more information.*

Unfortunately, it seems the worst of the pandemic is yet to come and our “new normal” will be with us for some time. As this new reality begins to set in, all participants in the fund ecosystem — asset managers, service providers and board members — are starting to look further down the road and assess how best to continue “normal” operations in the face of the continuing health crisis and a potentially worsening economic environment.



## What Are Boards Doing Now?

**Board Communications.** Boards continue to receive periodic updates from fund management to track matters impacting the funds they oversee. As boards move forward and accept the reality that this is not a short-lived situation, some are considering adjustments to their prior communication approaches and are seeking to establish a routine that reflects the “new normal.” For example, some boards are requesting a weekly email addressing key developments, then utilizing a periodic (bimonthly or monthly) conference or video call for more detailed reports and the opportunity to ask questions.

**Future Board Meetings.** Boards are starting to look at their meeting calendars and think about their second quarter meetings. We are not aware of any board that plans to hold an in-person meeting in April, and some have already decided to hold their May and June meetings telephonically as well. Some are using video conferencing and finding that it is not as challenging as they may have thought. When using video conferencing for the first time, we suggest a “dry run” to establish that all participants are able to utilize the applicable technology on their home devices. Boards may also want to confirm with management the security protocols associated with the selected technology.

**Electronic Delivery of Materials.** Recognizing the challenges of the manual assembly of hard-copy board books, many fund groups previously using them are now delivering materials to boards through electronic means only. We likewise have largely adopted the practice of sending executive session materials to our board clients electronically.

**Liquidity.** We continue to hear reports of funds that are experiencing greater strains on liquidity. Likewise we are seeing fund management and boards thinking about “what if” scenarios, including an assessment of likely sources of funding to meet redemptions if and when needed, and the process to involve boards or board committees as required or as appropriate. Some boards are considering a board

presentation to review this potential process even if they are not yet facing liquidity issues.

**Disclosure.** Fund complexes are actively preparing and filing supplemental disclosure related to actual and potential risks that may impact a fund due to the current health pandemic. Boards are asking fund management whether the disclosure for the funds they oversee needs to be updated, or whether current disclosures are adequate. We have seen enhancements to existing market risk disclosures, as well as the creation of new, specific COVID-19 disclosures. In each case, the disclosures are focused on risks related to market volatility and disruption caused by the current pandemic.

## What's Next — Emerging Issues

Below are some emerging issues that came to light over the past week that boards may want to consider as they continue to exercise their fiduciary duties.

**15(c) Requests.** As the June board cycle approaches, boards are considering whether to include specific inquiries in their 15(c) requests related to the current environment. The form and content of these additional inquiries is evolving, recognizing that boards are already receiving periodic updates on this topic and that responses to any request may need to be updated in real time closer to the meeting date as events unfold.

**15(c) Meetings.** While the SEC has extended the relief permitting in-person meetings to be held telephonically to August 15, 2020, some fund management agreements require that annual approval votes take place at in-person meetings. As a result, this text would need to be addressed (e.g., by amendment to the agreement or a waiver reflected in the minutes) if a board expects to consider such approvals at a telephonic meeting.

**Liquidity Issues — Debt Purchases by Affiliates.** The staff of the SEC granted no-action relief on March 26, 2020 that permits the adviser and certain affiliates of a registered open-end fund (excluding ETFs and money market funds) to purchase debt securities from the fund to give it additional liquidity or help it meet redemptions. Boards are monitoring when and if the utilization of such relief could be needed.

**Reg BI & Form CRS Compliance Date.** SEC Chairman Jay Clayton released a public statement on April 2 regarding the implementation of Reg BI and Form CRS in light of COVID-19, noting that the June 30, 2020 compliance date for each rule will not be extended. This announcement may place additional pressure on those intermediaries selling fund shares. Chairman Clayton also stated that the OCIE division of the SEC will be issuing two Risk Alerts to provide information on how regulators will perform initial examinations for both Reg BI and Form CRS.

**Closed End Funds.** Fund managers are addressing issues related to holding annual shareholder meetings by remote communication in lieu of in person. Fund managers need to confirm that both state law meeting requirements and a fund's charter documents permit virtual meetings and request that the boards make the requisite board approvals. In addition, some boards are evaluating the appropriateness of a reverse stock split for funds whose values have decreased substantially. Board action would be required to implement such a stock split.

**Daily Pricing.** Boards continue to oversee issues impacting the pricing of fixed income funds. Boards may want to ask about the levels of out-of-tolerance prices and pricing challenges, divergence between primary and secondary pricing services, and any modifications to normal valuation procedures. It may be appropriate to consider modifications to fund valuation procedures due to the large number of exceptions generated by normal tolerance thresholds.

**Order Processing/Redemptions.** There have been increased requests for modifications to fax and medallion signature guarantees from intermediaries. Boards may want to ask whether a fund group has modified its transfer agency procedures regarding medallion guarantees or other processes, whether new processes have been put in place or are being contemplated to ease the burden on shareholders but to appropriately protect funds from risk of fraud, and whether the fund group is seeing issues with the implementation of new processes.

## Special Considerations for Registered Closed-End Funds

This Alert focuses on special considerations for closed-end funds registered under the Investment Company Act of 1940, as amended (the '1940 Act'), arising from COVID-19 (coronavirus) and related regulatory relief of interest to such funds. Recent market volatility and dislocations arising from COVID-19, together with remote operations, raise special considerations for registered closed-end funds with shares that trade on a national exchange that are not present for mutual funds. Please visit our [Coronavirus Task Force/Investment Services Resources](#) section of our website for additional Alerts applicable to all registered investment companies.

### Offering and Disclosure Considerations

- Closed-end funds generally cannot issue shares at below net asset value ('NAV'), subject to limited exceptions. Current volatile market conditions may eliminate premiums and widen trading discounts. As a result, funds may be unable to offer additional shares or may be required to suspend the offering of their shares (see below). This is particularly relevant for funds with a shelf registration statement.
- The undertaking under Item 34.1 of Form N-2 requires a closed-end fund to suspend the offering of its shares until the prospectus is amended if, subsequent to the effective date of the registration statement, the NAV of the offered shares declines by more than 10% from the NAV as of the effective date of the registration statement. As of the date of this Alert, some closed-end funds have announced suspensions of sales. The SEC staff recently issued guidance stating that a closed-end fund whose NAV has declined more than 10% as a result of current market conditions relating to COVID-19 may satisfy the Item 34.1 undertaking by filing a prospectus supplement under Rule 497, provided the fund gives the staff one business day's advance notice. The fund may restart offering shares when the prospectus supplement is filed. The guidance also

discussed disclosure that a closed-end fund may wish to include in the prospectus supplement, including the extent of, and reasons for, the closed-end fund's NAV decline, that the decline caused the fund to suspend its offering pursuant to the undertaking, and the date on which the fund will restart offering shares, as well as any other material information, including how current market conditions have affected the fund and its investments.

- Any closed-end fund relying on no-action relief to conduct Rule 415 shelf offerings makes the applicable undertakings in Item 512 of Regulation S-K. Among these is the undertaking in Item 512(a)(1)(ii) "to reflect in the prospectus any facts or events arising after the effective date of the registration statement . . . which, individually or in the aggregate, represent a fundamental change." This undertaking requires an amendment to the registration statement (not merely the form of prospectus) when there is a 20% change in the maximum aggregate offering price from that set forth in the calculation of the registration fee table in the effective registration statement. Note that a new set of undertakings applicable to closed-end funds that rely on Rule 415 will become effective August 1, 2020 in connection with revisions to Form N-2 being implemented as part of closed-end fund offering reform.
- Closed-end funds that have shelf registration statements or are conducting other offerings, including private placement offerings for leverage purposes, may want to evaluate whether to add or increase disclosure regarding market disruption or "force majeure" risks or other risk related to the impact of COVID-19. For leverage related offerings, funds may also wish to evaluate disclosure regarding a failure to meet asset coverage tests or other covenants, as well as disclosure regarding the implications of declining interest rates on preferred dividends.
- Closed-end funds may wish to assess whether additional disclosure is warranted in shareholder reports or otherwise regarding market conditions, impact on leverage facilities and asset coverage tests, any

changes in investment strategy or other COVID-19 related risks.

## Shareholder Meeting Considerations

- Closed-end funds with shares that trade on an exchange are required to hold an annual meeting of shareholders to elect directors. The staff of the Securities and Exchange Commission (SEC) has issued guidance with respect to changing the date, time or location of an annual meeting, as well as guidance regarding conducting virtual or hybrid meetings (see our [Alert](#) discussing this relief). Some states, including Massachusetts, have issued relief regarding virtual and hybrid meetings. Many closed-end funds with meetings occurring during the pendency of "stay-at-home" orders or guidelines have evaluated and are implementing these options. It is important to consult counsel regarding state law requirements and to evaluate whether any bylaw amendments are necessary to implement these options. In addition, funds with contested elections or heavy dissident activity should carefully weigh the advantages and disadvantages of these options.
- To the extent that a closed-end fund is conducting a special meeting, including for business combinations, the staff of the SEC has confirmed that the above guidelines regarding annual meetings would apply.
- The staff of the SEC has encouraged issuers, to the extent feasible under state law, to provide shareholder proponents with the ability to present their proposals through alternative means, such as by phone, during the 2020 proxy season (see our [Alert](#) on this topic).

## Trading Considerations

- Closed-end funds that have experienced significant declines in market value in recent weeks may be at risk of violating the continued listing standards of their listing exchange. Under NYSE rules, a closed-end fund would fail these standards if (1) the average closing price per common share over a consecutive 30-trading-day period is less than \$1.00; or (2) the total market value

and aggregate net asset value of publicly held shares (i.e., shares not held by directors, officers, their immediate family members or 10% owners) is less than \$5 million over 60 consecutive calendar days.

- Funds that have experienced significant declines in the market value of their shares may wish to evaluate conducting a reverse stock split whether or not listing conditions are in jeopardy. A reverse stock split necessarily results in fewer shares outstanding and impacts daily trading volumes. In establishing a conversion ratio, funds may want to balance considerations with respect to share price objectives and liquidity.
- Markets for certain asset classes in which closed-end funds invest, including both taxable and municipal fixed-income securities as well as preferred and capital securities, have experienced significant volatility and lack of liquidity in recent weeks. In addition, closed-end fund trading discounts have generally widened—in some cases significantly—which has resulted in investor losses exceeding declines in net asset value and created opportunities for activist investors.

### Leverage Considerations

- Closed-end funds that have outstanding borrowings, debt securities or preferred shares may wish to review processes for monitoring asset coverage and effective leverage covenants in leverage documents and familiarize themselves with notification requirements, cure periods and options to remedy breaches. Breaches of these requirements typically require prompt notification to the lender or holder of shares, often in a specified format.
- The SEC has temporarily exempted closed-end funds from the requirement to provide 30 days' advance notice of redemptions on Form N-23C-2 through August 15, 2020 (see our Alert regarding this relief). Funds that are considering relying on this relief should ensure that an abbreviated notice period is consistent with state law

requirements and documentation governing the securities.

- Closed-end funds that have outstanding leverage that is rated by a rating agency may want to evaluate their continued ability to comply with rating agency guidelines and the implications of a failure to do so.
- Funds that have leverage facilities that are expiring or approaching their term redemption date may want to allow ample time to evaluate refinancing options. Certain lenders or banks may be unwilling to continue leverage facilities at all or under existing terms.
- Closed-end funds may want to evaluate the terms of documentation for both structural leverage (i.e., borrowings, debt securities or preferred shares) and financial leverage (i.e., derivatives). Among other things, funds should identify and evaluate events of default or termination events and material adverse change clauses that may be implicated by COVID-19 related events.

### Other Operational Considerations

- Closed-end funds may hold less liquid asset classes. Funds may want to review processes for monitoring the performance of pricing vendors and evaluating when prices become unreliable.
- For closed-end funds that do not publish daily NAVs, funds may wish to consider whether updates to the last published NAVs are necessary.
- For closed-end funds operating pursuant to managed distribution exemptive orders from the SEC, funds may want to consider whether market conditions impair the fund's ability to satisfy the conditions of the order. Such conditions include limitations on public offerings if the fund does not maintain certain performance-to-distribution rate ratios.
- If a fund implements material policy changes as a result of market events surrounding COVID-19, such as material changes to leverage amounts, changes in distribution policies or material investment policy changes, a fund may want to consider whether such

changes require or warrant a press release or notification to the exchange.

## FINRA Guidance and Regulatory Relief

The Financial Industry Regulatory Authority (“FINRA”) has published multiple Regulatory and Information Notices and created a webpage within FINRA.org to address the COVID-19 outbreak.<sup>1</sup> Key highlights concerning FINRA guidance and regulatory relief are summarized below.

- **Review of Business Continuity Plans (“BCPs”).**

Member firms are encouraged but not required to notify FINRA if they activate their BCPs. If they do decide to notify FINRA, member firms should reach out to their FINRA Risk Monitoring Analyst to discuss any issues they are facing such as disruption of business operations, whether resolved or ongoing.

- **Supervision of Remote Associated Persons.** Many member firms have implemented certain measures such as remote office locations and telework arrangements (e.g., working from home) to mitigate the pandemic. Importantly, member firms must maintain written supervisory procedures addressing how associated persons will be supervised from such temporary locations and document any changes to such procedures.<sup>2</sup> On-site inspections of branch offices may also be temporarily postponed (perhaps entirely) for 2020 depending on the pandemic’s duration and severity.

- **Form U4 and Form BR Suspensions.** FINRA has suspended the requirement that member firms update Form U4 to reflect an employee’s work address and file Form BR for new branch office locations provided that such locations are temporary and established due to the COVID-19 outbreak. From a practical standpoint, this means member firms do not have to file Form BR for certain non-branch offices where supervision is being conducted, provided such locations are temporary and due to the pandemic.

- **Emergency Office Locations.** If a member firm relocates multiple personnel to a temporary location that is not currently registered as a branch office or regular non-branch location, the firm should use its best efforts to provide written notification to its FINRA Risk Monitoring Analyst as soon as possible.
- **Filings and Regulatory Responses.** Member firms that require extra time to respond to open inquiries, investigations or upcoming filings (e.g., FOCUS filings, Form Custody filings and supplemental FOCUS information pursuant to FINRA Rule 4524) should contact their FINRA Risk Monitoring Analyst or the relevant FINRA department to seek extensions.

Member firms are encouraged to review the “FAQ Related to Regulatory Relief Due to the Coronavirus Pandemic” within FINRA’s COVID-19 webpage as it is an especially useful tool in navigating through this crisis.<sup>3</sup> Additional topics discussed within the FAQ that could be helpful to members include the following: (i) issues related to advertising and customer communication; (ii) annual independent AML testing; (iii) best execution; (iv) issues related to fingerprinting requirements; (v) qualification exams; (vi) reporting of customer complaints; and (vii) annual submission of the Rule 3120 report to senior management.

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<sup>1</sup> For Regulatory and Information Notices, see Regulatory Notice 09-59 (FINRA Provides Guidance on Pandemic Preparedness), Regulatory Notice 20-08 (Pandemic-Related Business Continuity Planning, Guidance and Regulatory Relief) and Information Notice – 3/26/20 (Cybersecurity Alert: Measures to Consider as Firms Respond to the Coronavirus Pandemic (COVID-19)). For FINRA’s webpage dedicated to the COVID-19/Coronavirus, see <https://www.finra.org/rules-guidance/key-topics/covid-19>.

<sup>2</sup> The supervision of personnel working from remote office locations could include enhanced review of personnel’s communications and network access as well as personal trading activity.

<sup>3</sup> See <https://www.finra.org/rules-guidance/key-topics/covid-19/faq>.

# CARES Act Provisions Affecting the Asset Management Industry

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was signed into law. The CARES Act aims to ease the financial burden on businesses and individuals caused by the COVID-19 pandemic. Asset management firms and investors should be aware of the CARES Act lending programs and provisions below as they navigate the financial uncertainties surrounding the outbreak and the variety of effects on businesses, industries and employees, and contact their lenders, tax professionals or a Vedder Price attorney for additional details.

## **SBA Paycheck Protection Program:**

The CARES Act establishes a \$349 billion lending program under the Small Business Administration (SBA) to originate “paycheck protection” loans to eligible small businesses (generally, those businesses with no more than 500 employees) where the uncertainty of current economic conditions make a loan request necessary to support ongoing operations. Loans under the program are subject to certain conditions, such as prohibitions against stock buybacks and executive compensation. Loans may be made by current SBA-approved lenders and will be 100% guaranteed by the SBA. Asset managers whose operations have been disrupted by COVID-19 may wish to consider whether they are eligible for the program.

Asset managers should note that the employee counts of certain affiliated entities may be aggregated for determining eligibility under the program. However, businesses that receive financial assistance from the same small business investment company (SBIC) will not be deemed to be affiliated for this purpose.

[See here](#) for additional information, including detailed eligibility requirements, loan characteristics and loan forgiveness criteria, as well as information with respect to other lending programs established by the CARES Act.

## **Payroll Tax Credit:**

The CARES Act provides a refundable payroll tax credit for 50% of “qualified wages,” up to a maximum of \$10,000 of qualified wages per employee, for employers (i) whose operations were fully or partially suspended due to a COVID-19-related governmental order, or (ii) whose gross receipts during a calendar quarter within a defined period declined by more than 50% compared to the same quarter in the prior year. The definition of “qualified wages” differs by employer size. Eligible asset management firms that have suspended operations pursuant to a governmental order or have seen a significant reduction in fees or other revenue due to market decline, outflows, write-down of investments, etc. should consider claiming the tax credit. [See here](#) for additional information.

## **Excess Business Losses Deduction:**

The CARES Act provides relief to owners of pass-through entities by permitting excess business losses beyond the standard \$250,000 limit for individual taxpayers to be deductible for taxable years beginning before January 1, 2021. Investors in investment vehicles organized as partnerships or limited liability companies taxable as partnerships may more easily utilize losses and amend prior year returns to obtain additional liquidity during the coronavirus crisis. [See here](#) for additional information.

## **Business Interest Expense and Net Operating Loss Deductions:**

The CARES Act will increase the amount of business interest expense that taxpayers may deduct from 30% to 50% for taxable years beginning in 2019 and 2020. Asset managers running leveraged strategies or with outstanding lines of credit should be aware of this increase. Additionally, the limitations on deducting net operating losses (i.e., 80% of taxable income and no ability to carry back to prior taxable years) have been lifted by the CARES Act, subject to certain limitations. [See here](#) for additional information.

## Penalty-Free Early Distributions from Qualified Retirement Plans:

The CARES Act allows for early, penalty-free distributions from qualified retirement plans of up to \$100,000 prior to the end of 2020. Asset managers with 401(k), pension fund or other qualified retirement plan clients should note this provision and consider any potential effects on the asset manager's business. [See here](#) for additional information.

## “Essential” Investment Company/Advisory Functions in the Wake of Shelter in Place Orders

In an effort to contain the spread of COVID-19, several state and local governments (and more are soon to follow) have taken the unprecedented action of issuing “stay at home” or “shelter in place” orders that mandate the closure of “non-essential” or “not critical” businesses for varying periods of time. (Please click [here](#) to obtain additional information regarding these orders and the various other actions employers should be contemplating.) In the wake of these orders, investment company and adviser personnel will need to identify which, if any, of their business operations cannot be properly continued by personnel working from home and then determine whether such operations are “essential” or “critical” to the well-being of the public such that they can continue to be performed on-site.

As a threshold question, decision makers should identify which aspects of their operations, if any, require on-site functionality, including physical processing and support of mail and other systems. In determining whether any such operations are exempt under the orders, and therefore may continue unabated, decision makers should review the specific requirements of all applicable orders (especially where city, county or other local orders overlap or depart with statewide or federal orders) and thoughtfully consider the role such operations play in the country's critical capital,

liquidity and other financial markets including, but not limited to, maintaining (i) essential investor services at a time when financial markets may be experiencing significant volatility and uncertainty, (ii) critical information technology and data security to defend against cyberattacks, to support financial indexes or other benchmarks and to process trades or other transactions and (iii) the integrity and privacy of proprietary data, systems and investor information.

For assistance with navigating these orders, establishing appropriate protocols and procedures, and making “essential” or “critical” business function determinations, investment company and adviser personnel are encouraged to consult with their counsel and other advisors. In some situations, an exemptive order or other governmental assurance may be sought to ensure continued operations will not violate such orders.

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# VedderPrice

## Investment Services Group

With significant experience in all matters related to design, organization and distribution of investment products, Vedder Price can assist with all aspects of investment company and investment adviser securities regulations, compliance issues, derivatives and financial product transactions, and ERISA and tax inquiries. Our highly experienced team has extensive knowledge in structural, operational and regulatory areas, coupled with a dedication to quality, responsive and efficient service.