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COVID-19: Certain Considerations for Hedge Fund Managers

The outbreak of the coronavirus (COVID-19) continues to impact markets and businesses in myriad (and uncertain) ways, creating a variety of challenges, as well as opportunities, for hedge funds. Hedge fund managers should consider the following steps to best position themselves and their funds to tackle these issues.

Understand the Fund's Liquidity Tools

The recent market turmoil arising from COVID-19 may result in an increase in withdrawal/redemption requests for the upcoming liquidity cycles and/or a decrease in the liquidity or intrinsic value of certain portfolio holdings. Hedge fund managers should understand—and be prepared to implement—the full suite of tools available under their fund documents.

Mechanisms such as gates, side pockets, in-kind distributions and suspensions can help manage investor liquidity requests as well as address investments that, due to exigent circumstances, experience less liquidity or cease to reflect the assets' intrinsic value. However, each of these tools is typically subject to certain procedural, timing and approval parameters that should be followed in order to implement them in the most efficient and legally protective manner. For example, fund documents often require the definitive steps for a liquidity tool to be taken *prior* to the effective time of the relevant withdrawal (*e.g.*, before close of business on the last business day of the quarter), or to be approved by the fund's directors or an independent committee.

Managers should ensure that they and any directors or committee members understand how each of these mechanisms operates and how each can be a useful tool under the circumstances, as well as what needs to be done in order to implement them properly should the need arise.

At the same time, hedge fund managers should review existing side letters for any limitations or exceptions to their ability to implement restrictive liquidity measures, either in general or in the event of significant drawdowns or exceptional market circumstances.

Check in with Key Service Providers

Like any business, hedge funds depend on a variety of service providers on a daily basis. As the COVID-19 outbreak disrupts day-to-day operations across the market, hedge fund managers may want to consider reaching out to critical service providers such as brokers, custodians, administrators and IT providers—and directors or independent committee members—to ensure that these service providers have business continuity plans in place that will enable them to remain reachable and functioning with as little disruption as practicable going forward.

Review Financing Documents

Managers should consider reviewing their funds' financing contracts and reaching out to lending counterparties to get ahead of any NAV triggers, margin calls or other contingent obligations that may arise in connection with outstanding transactions.

Refresh Business Continuity Plans and Insurance Coverage

As with external service providers, the COVID-19 outbreak provides a logical opportunity for hedge fund managers to review their own business continuity plans, including considering how their systems would handle a scenario in which personnel are required to work remotely for an extended period. Managers may also want to consider reviewing or expanding the insurance coverage applicable at the manager and fund levels or evaluate what, if any, claims are available under existing coverage (*e.g.*, costs of cancelling business travel).

Memorialize Steps Taken

Managers may recall that under similar circumstances (*e.g.*, Hurricane Sandy), regulators have expressed interest after the fact in understanding how investment advisers fulfilled their obligations during periods of market disruption. Managers may therefore consider whether to memorialize the steps they take to prepare for and work through the effects of the COVID-19 outbreak.

Be Proactive in Information Sharing, Valuations and Reporting

- *Information Sharing/Selective Disclosure*: Managers are encouraged to be proactive with LP requests for information regarding the manner in which they are dealing with COVID-19's impact on operations. Managers should be consistent with the types of information and responses that are provided to LPs, particularly when approaching a withdrawal/redemption notice deadline, to mitigate selective disclosure issues, and may want to consider creating standard responses or holding an investor call to disseminate information consistently to all LPs.

- *Valuations*: The changing valuations of investments may impact the calculation of management fees, performance allocation and withdrawal/redemption values. Managers may want to pay particular attention to ensuring compliance with any valuation provisions in their fund documents and their valuation policies, especially for less liquid investments and investments that are the subject of any side pocket or in-kind distribution determination.

- *Financial Statements*: Many fund-level financial statements rely on the delivery of information regarding underlying investments (which will likely be delayed given the current situation). Managers may want to review whether the fund documents provide flexibility to go beyond the customary 90 or 120 day delivery timeframe, or if the offering documents contain disclosure relating to delayed reporting or force majeure risk. Potential delays beyond 120 days may impact custody rule compliance as well.

Consider Committed Class Structures; Subscription Line Facilities

Hedge fund managers who believe that market volatility presents investment opportunity may want to consider raising additional capital in committed classes or vehicles, that can be deployed opportunistically in distressed, volatility-based or other appropriate strategies when circumstances warrant. Managers may also consider implementing private equity-like credit facilities in these funds to provide the flexibility to act quickly in these situations.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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