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Board Oversight in the Age of COVID-19

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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 J. 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.

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