FUND DIRECTIONS

# Covid-19 puts directors on wartime footing

**Julien Bourgeois, Jon Rand and Stephanie Chaung of Dechert have penned a deep dive for directors on Covid-19 as part of Fund Directions' new Advisory Board platform**

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***Fund Directions'*** recently launched Advisory Board hosts over a dozen industry professionals who will occasionally pen thought pieces on issues of importance. In the article below ***Julien Bourgeois***, ***Jon Rand*** and ***Stephanie Chaung*** of ***Dechert*** have laid out the steps independent directors can take to can best combat the impacts of the Covid-19 pandemic on the asset management industry with flexibility, energy and pragmatism.

## Wartime Directors

Mankind is at war. The enemy is Covid-19 and the world economy is one of its victims, with consequences for the livelihood and savings of all. Indeed, this situation has no modern precedent and its global impact could be the largest since World War II. No one would conflate the contribution of those in the asset management industry to healthcare and other essential workers who risk peril to enable us all to live. But the industry is in the vanguard, playing an essential part in the life of our capital markets and thus our working economy. Mutual fund directors are part of that corps, working to safeguard and guide the funds for the benefit of millions. Although this conflict is unprecedented, many directors are battle-tested with knowledge and experiences from past crises.

In the current environment, directors should be energized and be prepared to mobilize flexibly. Directors should be tolerant of protocols forsaken. Results deserve primacy over process.

Fund directors should continue to fulfill their regular fiduciary responsibilities while adapting to focus their oversight on specific areas of stress. An effective plan of attack should include (i) identifying key risks and vulnerabilities for a fund complex, individual funds and their shareholders, and (ii) ensuring that management addresses these and pursues fund interests positively and proactively. Below are some high-level focus areas that directors should consider while this battle continues.

- ***Frequency and Nature of Meetings*** Directors need to shift nimbly to fulfill their fiduciary duties in a remote environment. The SEC and its Staff have provided relief to enable funds to hold board meetings remotely, even for "15c" meetings. They should expect to have more frequent and informal discussions with management, both regularly scheduled and ad hoc. Directors should master the appropriate technology for remote meetings and be aware of heightened cyber risks. They should also anticipate specific matters they want to discuss during meetings and other calls and clearly communicate expectations with management, for example discussing frequency of reporting, topics of particular interest, the format of data delivered, and specific speakers or presenters that they would like to hear from. Directors and management should also consider the communication plan to follow for escalating issues that may arise in between meetings. While directors will not want to distract management during a crisis, they also have a responsibility to oversee material developments for a fund, whether explicitly required by a rule (*g.*, the liquidity risk management program rule) or otherwise.

*Julien Bourgeois*

- ***Business Continuity*** The outbreak has caused unprecedented disruption to worldwide operations. Funds, their service providers, the markets in which they invest, their shareholders and even their directors are not immune. Fund directors will want to hear from management directly, and through management from key service providers, on the functioning of business continuity plans and ask that management continuously review and reassess plans as new industry and global developments arise. Business continuity plans were usually designed to withstand smaller, more localized and temporary disruptions. Therefore, the plans will need to evolve on the fly based on new experiences and new resources. Directors must recognize that they are not immune to risk. They should openly discuss their own contingency plans, whether at the individual or group level. Redundancy in board leadership is a fair topic for discussion.

- ***Key Personnel*** Directors should be aware of key personnel that are essential to management's operations, including portfolio managers, executives, traders, analysts, accountants, lawyers and compliance and risk professionals. Directors should ask that management review succession plans in place to account for unforeseen emergencies, including communication breakdowns, infrastructure issues or illness.

*Jon Rand*

- ***Communication*** In addition to having a communication plan between the directors and management, directors should assess management's communication plans internally across departments and to fund shareholders, third-party service providers and market intermediaries. The communication plans should consider how material issues are escalated to appropriate individuals and how information is transferred. With respect to shareholder servicing, directors should be aware of the call volumes and trends. Working across silos is more important, and more difficult, than ever, particularly in large organizations. At the same time, information barriers should be respected, and there should be a keen awareness of issues of selective disclosure and material nonpublic information.

- ***Performance*** Directors should evaluate how their funds are performing individually and relative to industry peers and any comparable products. They should press management to explain differences. They should consider the current market environment, and how volatility in the market affects different asset classes and how they relate to each other. Is the momentum "risk-on" or "risk-off?" Directors should continue to be aware of shareholder activity levels and inflows and outflows from the funds, including exchanges among funds and activity of funds of funds, both affiliated and unaffiliated. Are there differences in activity among proprietary and unaffiliated distribution channels? Directors should look not just at aggregate numbers but also focus on outliers, expecting candid reports from management and assessments of anticipated changes.

- ***Liquidity*** Directors for open-end funds and exchange-traded funds should particularly focus on the liquidity in the markets and the ability of management to continue to trade and value fund assets. Directors should understand how traders operates in an illiquid market environment and how they attempt to access market liquidity focusing, again, on outliers and niche strategies. Directors should also encourage management to update internal stress testing scenarios to see how the funds will perform in a continued stressed market environment. Additionally, understanding shareholder composition and behavior is also key to understanding liquidity risk.

- ***Valuation*** Directors should understand the interrelationship between liquidity and valuation. Directors should be aware of the funds' valuation processes and methodologies and how market events and certain dislocations impact them. Directors should encourage management to inform the board of material valuation issues or significant changes. Directors should also explore how the funds' pricing vendors are performing in comparison to actual trading activity.

*Stephanie Chaung*

- ***Cybersecurity*** Directors should discuss with management any heightened cybersecurity risks that may arise as a result of a remote working environment for the funds, service providers and themselves.

- ***Disclosure Considerations*** Directors should discuss fund disclosures and other communications (shareholder reports, website, media contacts, letters to investors and marketing presentations) and how they account for the new environment. What started as a local epidemic is now one of the largest economic and human crises we have endured. How does management communicate about it to current and prospective investors? Is it thoughtful and consistent across communication channels? Is there a sound process to review and possibly update investment information and risks? What is the right line to draw between providing relevant new fund and risk information, and becoming a pandemic clipping service.

- ***Updates*** Directors should stay abreast of the various developments, economic, legal or otherwise, that affect funds, their investments and their shareholders. Directors could discuss with management how their funds are specifically affected by the various federal programs that have been put in place to assist the markets. They also should inquire about conversations that take place between management or trade associations with regulatory authorities, including the Federal Reserve and the SEC. Law firms, trade associations, accounting firms and others offer numerous opportunities, such as webinars or publications, to stay abreast of relevant developments.

The world and thus the US fund industry will eventually surmount this crisis. In the meantime, directors will want to continue to fulfill their duties to protect funds and by extension their shareholders in a pragmatic fashion, adapting to the new environment.

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