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

Article By:

Marguerite C. Bateman

Kimberly Karcewski Vargo

Bruce A. Rosenblum

Cathy Gonzales O'Kelly

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.

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.

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