Webinar for DPs for Capital and Financial Management – advice on Covid-19 related issues.

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Moderator:
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This webinar was one in a series of webinars to be held over the coming weeks providing updates and a forum to exchange information within the DP peer group. The discussion covered various issues including the following:

1. **Completion of Audit and Financial Statement Process for Year End December 2019**

- Despite the CBI deadline extension for April filings most Boards seem to be working towards an April 30 completion date.
- Coordinating the financial statement approval process has been a challenge with everybody working from home.
- Appropriate audit queries and disclosures should be included in the financial statements.
- Companies with a Feb/March year end will face issues regarding liquidity and pricing.
- Financial Statements have a presumption that an entity will continue as a "going concern". Boards must ensure they are happy to stand by this assertion.
- From a management company perspective, revenue forecasting is important, what will the impact on the manager be over the next few months as a result of poor performance/redemptions?
- The industry hasn't seen the wave of redemptions as was previously anticipated, potentially because the crisis is hitting all sectors equally. However, there has been a large number of redemptions where the underlying investor has to gain liquidity themselves e.g. to meet hedging requirements or for institutional investors.

2. **Statements/Letters of Representation**

- In the initial stages of Covid 19 relatively innocuous disclosures recognising the pandemic were being included in the statements but now directors are concerned with how managers are satisfying themselves that a fund will be able to continue. This may require additional disclosures to be made. The statements should include the exact actions that have been taken by managers.
- Where there is material uncertainty or where a product has been closed the audit opinion will include the emphasis that "going concern" is no longer applicable and the disclosure should highlight decisions taken by the board of directors in that regard.
- In the UK, the FRC issued a moratorium for audit opinions to allow audit firms and directors to get to grips with the pandemic's effects.

- In Ireland- disclosures should be reflective of the situation, directors should take a considered approach and have conversations with service providers/auditors etc.

- The DP should be heavily involved and ensure active engagement with key stakeholders.

3. Performance

- Don't just look at short term performance, look at the long term and consider the peer group and stated/proxy benchmark.

- Assessments need to be carried out where the DP needs to engage with DP for Distribution and the fund distributor to understand the client base and the likelihood/probability that they will redeem and whether that will have an impact on operations.

- Important that the DP engages with the DP for Fund Risk Management to ensure risk disclosures (particularly those re liquidity risk) are adequately disclosed and addressed in the financial statements.

- Where an investment managers report was drafted months ago this will need to be revisited and redrafted accordingly, particularly the outlook section.

4. Sign Off/ Filing of Financial Statements

- The security of certain video conferencing platforms has been questioned therefore most meetings seem to be via conference call. Need to ensure the availability and capability of directors to sign and scan pages and ensure that auditors and depositaries are willing to accept electronic copies. DP needs to discuss this with relevant parties.

- CBI are accepting e-filings of approved accounts but must ensure that constitutional documents are reviewed in the context of the dissemination of accounts to shareholders. If you have stated it will be provided to them in hard copy, what contingencies are in place?

- Constitutional documents should also be checked to ensure the capability to host telephonic/virtual meetings. The location of directors is also an issue. Irish revenue has issued guidance in relation to this.

5. Volatility in the Market Place and Continuing Business

- Where assets have changed dramatically or where there has been a decrease in AUM for ManCos, look at the minimum capital requirements to reflect any losses. For firms with MIFD top-ups it is important to revise ICAP to see whether pillar 2 cap requirements in relation to pandemic risk have been met. These may not have been considered initially.

- A decrease in AUM will effect the viability of previously prepared budgets.

- A decrease in AUM will have an impact on expense ratios. Many service providers insist on minimum fees. DPs should ensure these are being accounted for.

- KIID processes were completed for December year ends but it is important to look at the impact of a decrease in AUM and consider whether any amendments to the KIIDs are required.

6. NAVs

- Will need to be considered whether a non-adjusting event should be disclosed by subsequent event notes.
- Valuing assets will be a challenge. Valuations are being run 2/3 times a day to manage margin for collateral calls.
- As there are not a lot of buyers and sellers in the market, when selling at knock down prices it needs to be considered whether this is a distressed or non-distressed price.
- Clients should be prepared to challenge valuations/prices.
- With less liquidity in the markets there is an increase in sales prices/single broker quotes. It is important to remember the case in 2008 involving investment manager Morgan Keegan who cherry picked asset backed security prices and misrepresented the colour of the market - resulting in over valuations. When dealing with specific asset classes, challenge managers as to their specific approach. DP must ensure those responsible for valuations are acting independently and impartially.
- Valuation committees should be made up of people within the investment manager and not necessarily independent directors. If this committee hasn't met yet, they should meet now and group assets into key areas of risk and the tolerances for each group assessed and protocols established. Consider the consequences for a breach of protocol.
- Valuation vendors such as IDC, Bloomberg and Market are trusted but still don't be afraid to challenge them.
- For February/March year ends-the accounting treatment of level 3 investments needs to be considered.
- Ensure the administrator has appropriate processes in place to make necessary disclosures in financial statements. Ensure the DP coordinates the process between the valuation committee, pricing team, risk management team and the administrator to ensure they have all necessary info to facilitate disclosure in financial statements.

7. A snapshot of the subsequent Q&A:

- What lessons have been learned from the 2007/2008 Financial Crisis that would be applicable now?

  There wasn't as much legislation at that time. AIFMD emphasises the importance of proper policies and procedures. Any reviews conducted by regulators now will be to ensure compliance with these policies and procedures and whether there has been any deviation therefrom. Where there has been a deviation it will be examined whether this was for significant/material reasons and whether this should have been disclosed to investors.

- The main differences between SMICs, 3rd Party Mancos and managed funds in this time?

  Comes down to organisational structure and how engaged the interaction is between the relevant persons. Use technologies available to have active dialogue between the relevant parties. It is key that all relevant shareholders are actively engaged.