Financial impacts and disclosures for investment management (IM)

The current landscape
There is limited precedent into how COVID-19 will impact the financial markets. Drawing on experience with past major events, including the credit crisis, it is important to be prepared for related financial results, volatility, and associated messaging to stakeholders as well as the impact of emergency regulatory action and related disclosures.

Impacts will likely be felt across the reporting landscape

Market volatility and loss emergence will drive both risk and financial statement impacts that IM organizations should plan for and analyze

Financial statement users will expect IM organizations to provide additional insight into COVID-19 impacts on their business and investment portfolios

Analysts will look for interest rate and credit risk sensitivity insights, both short- and medium-term outlooks for capital position, and clarity around significant estimates, scenarios, and assumptions

Virtual environments pose complications for the performance of SOX controls; new or compensating controls or process adjustments may be needed

COVID-19 financial impacts and IM areas of focus

<table>
<thead>
<tr>
<th>Focus area/challenge</th>
<th>F/S Risk</th>
<th>P&amp;L Impact</th>
<th>B/S Impact</th>
<th>Considerations and response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>- Capture any new fee waivers granted; assess fee impacts from assets under management (AUM) fluctuations, and portfolio company valuations</td>
</tr>
<tr>
<td>Valuation</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>- Revise valuation pricing processes, considering market volatility, and loss emergence driven complexities in impairment and valuation considerations</td>
</tr>
<tr>
<td>Goodwill impairment</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Low</td>
<td>- Evaluate whether the potential economic downturn (both in market and macroeconomic terms) constitutes a triggering event requiring a detailed assessment</td>
</tr>
<tr>
<td>CECL</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Low</td>
<td>- Reconsider economic scenarios for current market conditions and potential prolonged economic recession; consider if use of extreme economic scenarios would yield reasonable results (in light of interest rate impact on marking credit concerns)</td>
</tr>
<tr>
<td>VIEs and equity method investments</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>- Revisit existing variable interest entity (VIE) conclusions for any control power implications in response to counterparties becoming insolvent or having liquidity constraints</td>
</tr>
<tr>
<td>Hedging</td>
<td>Moderate</td>
<td>Low</td>
<td>Low</td>
<td>- Anticipate counterparty downgrades in hedge effectiveness reassessments (e.g., credit spreads, ratings, financial health, recent downgrade/grades, liquidity)</td>
</tr>
<tr>
<td>Service provider oversight</td>
<td>Moderate</td>
<td>Low</td>
<td>Low</td>
<td>- Reinvigorate oversight of critical service providers (e.g., administrators, brokers, custodians, transfer agents), understand service provider impact from COVID-19</td>
</tr>
<tr>
<td>Liquidity</td>
<td>Low</td>
<td>Moderate</td>
<td>Low</td>
<td>- Analyze liquidity classifications for form N-PORT given market volatility</td>
</tr>
</tbody>
</table>

SEC filing deadline relief and other relief

On March 17, 2020, the SEC emphasized that Question VI.9 of the SEC Staff FAQs on the Custody Rule provides relief for advisers of pooled investment vehicles that rely on SEC Rule 206(4)-2(b)(4) (Custody Rule) and fail to distribute the pool’s audited financial statements within the 120-day deadline under certain unforeseeable circumstances.

On March 20, 2020, the Commodity Futures Trading Commission (CFTC) announced that the Division of Swap Dealer and Intermediary Oversight (DSIO) is providing relief from enforcement action against Commodity Pool Operators regulated by the CFTC for failure to comply with certain reporting requirements and deadlines for reports due on or before April 30, 2020.

On March 25, 2020, the SEC issued an order, that gives public companies an additional 45 days to file certain disclosure reports that would otherwise have been due between March 1 and July 1, 2020, if specified conditions are met.

To use the relief allowed by the order, a registrant must file a current report on Form 8-K (or Form 6-K, as applicable) that discloses, among other things, (1) why the issuer is “unable to meet a filing deadline due to circumstances related to COVID-19,” (2) the estimated date by which the related filing will be made, and (3) if appropriate and material, a risk factor describing the impact of COVID-19 on the registrant’s business.

On March 25, 2020, the SEC announced regulatory relief to certain investment companies and investment advisors whose operations may be affected by COVID-19, with additional time to meet certain filing and delivery requirements. In general, filings covered by the relief include those with original due dates on or after March 13, 2020, but on or before June 30, 2020. Entities must notify the SEC staff and/or investors of the intent to rely on the relief offered above.

On April 8, 2020, the SEC announced conditional temporary relief for business development companies (BDCs) to issue/sell senior securities and to participate in certain joint arrangements in order for BDCs to provide additional capital support to portfolio companies. Deloitte will continue to monitor any further announcements by regulatory bodies and update our publications accordingly.
Thinking through disclosures and messaging

COVID-19-specific disclosures
- Communicate with investor relations and industry groups to identify initial pertinent information for disclosure. Portfolio composition, AUM, changes in net assets, investor redemption activity, and financing agreements/debt covenants are candidates for enhanced disclosure.
- Assess need to update these disclosures in subsequent events based on investor behavior and market events.
- Impact on overall capital and liquidity position and outlook.

Investor guidance
- Consider potential impacts on forecasts/guidance and provide updates to investors as needed to manage expectations.
- For analyst calls, perform sensitivity analysis around economic factors (interest rates, portfolio returns, etc.) and be prepared to clearly communicate potential exposure.
- Communicate strategy to refresh investment decision processes timely in response to rapid market movement.

Financial instruments
- Consider providing additional insight into asset valuation, portfolio strategy, and impact from pricing volatility.
- Assumptions about risk-inherent in inputs or valuation techniques (nonobservable inputs) from private companies.
- Some typical Level 1 assets may now require significant level (1) inputs resulting from lack of observable inputs from decreased market activity.

MD&A and risk factors
- Assess whether economic and market conditions or potential pricing exposures such that a risk factor needs to be added concerning COVID-19.
- Assess a fund’s ability to continue as a going concern (e.g., highly leveraged funds whose portfolios become highly illiquid and/or unable to meet its obligations).
- Consider debt covenant triggers, ability to meet obligations, and other liquidity or capital requirements.
- Consider tailoring MD&A to discuss trends or uncertainties that may have an impact on indicators of financial health.

Internal control considerations
With the potential for additional disclosures, there may be new or adjusted quantitative calculations and data required to support those disclosures. Entities will need to ensure that they have properly designed and implemented controls related to the selection and application of GAAP for the accounting and disclosure issues. As such, companies should be proactive in assessing controls that will need to be designed and implemented over any newly key end-user controls (EUCL), key reports, or business processes. Further, as risk assessments are being performed and reviewed, the impact of COVID-19 should be considered as a factor when determining internal controls over financial reporting (ICFR) risk in financial statement lines and business processes where the market and macroeconomic impacts are most felt.

Issuers are reminded that any changes in internal controls that have materially affected, or are reasonably likely to materially affect, entities’ ICFR must be disclosed in Item 4 of Form 10-Q (or the equivalent).

Deloitte support
As your organization responds to the impacts stemming from COVID-19, Deloitte stands ready to help you tackle your most complex strategic, financial, and operational issues. A sample of areas in which we can assist include:

Accounting, finance reporting & BAU support
- Program management and communications.
- General accounting (US GAAP, IFRS, local).
- External financial reporting.
- Management reporting.
- Regulatory reporting.
- Valuation.

Virtual close risk management
- Virtual close risk assessment.
- Real-time monitoring.
- Close resource support.
- Issue identification, triage, and resolution.
- Regulatory affairs monitoring and response.
- Data security and infrastructure.

Governance, risk, and control
- Risk assessments, including emerging cyber and fraud risks.
- Emerging risks control review.
- Audit readiness support.
- Refresh policies, procedures, and controls to reflect evolving environment.

Deloitte insight

COVID-19 and the investment management industry

The heart of resilient leadership: Responding to COVID-19
A guide for senior executives

Contacts

Crystal Andersen
Partner
Deloitte & Touche LLP
crystalandersen@deloitte.com

Jade Shopp
Partner
Deloitte & Touche LLP
jadeshopp@deloitte.com

Mojan Vakili
Partner
Deloitte & Touche LLP
mvakili@deloitte.com

This publication contains general information only, and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, “Deloitte” means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to all clients under the rules and regulations of public accounting.

Copyright © 2020 Deloitte Development LLC. All rights reserved.