GIBSON DUNN

April 27, 2020

COVID-19: FUNDRAISING CONSIDERATIONS FOR PRIVATE INVESTMENT FUND SPONSORS

To Our Clients and Friends:

This briefing covers steps sponsors should consider taking when fundraising in the current environment.

Investor Sentiment

Investor interest in private investment funds is generally expected to remain subdued in the months ahead. Based on recent industry surveys:

- a majority of surveyed investors are generally open for business or are at least in the market to "re-up" with existing sponsor relationships;
- many investors plan to reduce, or are considering reducing, new fund commitments this year;
- a minority of investors are proceeding only with investment opportunities that were in progress prior to the pandemic or are pausing investments for the time being;
- fundraising is expected to be quite difficult for debut sponsors and sponsors with whom an investor has no pre-existing relationship;
- travel restrictions and social distancing measures are key practical barriers hampering investors from meeting in person with sponsors and conducting on-site diligence, which is contributing to a stronger preference for re-ups;
- some investors have liquidity concerns given the prospect of smaller distributions and accelerated drawdowns by some sponsors, including to pay down balances under subscription lines; and
- due to the public markets "denominator effect," institutional investors with less flexible portfolio allocation requirements (e.g., pension funds) may need to scale back their alternative investment programs.

These trends may become especially challenging for less established sponsors throughout 2020 and into 2021. Sponsors currently or soon to be fundraising should plan to be proactive in communicating with investors about the impact of the pandemic on their investments and operations.

Offering Materials

Sponsors should update disclosures in fund offering materials to ensure their continued accuracy, including:

- *Market/industry outlook.* Discussion regarding the relevant market or industry may need to be revised to account for material changes in market conditions and expectations.

- *Track record.* Discussion of predecessor fund performance should include disclaimers that prior performance was achieved in different market circumstances. Any detailed financial information should be accompanied by an explanation of any material changes since the relevant measurement dates.

- *Case studies*. Sponsors should revisit whether particular case studies are appropriate under current market conditions and may need to include additional disclaimers or omit such case studies from the offering materials.

- *Risk factors.* Risk factors should be revised to reflect the foreseeable impact of the pandemic (including macro-level and fund-specific risks), as well as other future pandemics or similar disruptions.

Investor Due Diligence

Given investor scrutiny of the impact of the COVID-19 pandemic, sponsors should consider preparing standard responses to potential inquiries, including:

- *Existing portfolios.* What have been the adverse effects on predecessor funds' portfolios, and what steps has the sponsor been taking in response? Is there an expanded need for follow-on investments or bridge financings with respect to existing portfolio companies under stress from the pandemic?

- *Pipeline concerns.* What is the expected impact on the sponsor's investment pipeline and ability to deploy capital given travel restrictions that are affecting the ability to conduct onsite research with respect to potential investments, potential changes in cost and availability of financing, risk of deal-level MAC clauses being triggered, and potential delays in closing transactions because of COVID-19 mitigation policies?

- *Valuation methodology.* Should portfolio investments be revalued, or do recent market disruptions make publicly traded share valuations less indicative of fair market value than they normally would be? Any changes with respect to valuation methodology and assumptions need to be clearly disclosed to and discussed with investors.

- *Business continuity plans and disaster recovery plans.* Do the sponsor's business continuity and disaster recovery plans, both for itself and its portfolio companies, take account of disruptions from this and potentially from other pandemics?

- *ESG and COVID-19-related community service.* How are the sponsor and its portfolio companies helping those most affected by the pandemic?

- *Information use*. Given office closures and work-from-home arrangements, do the sponsor's IT policies and infrastructure relating to cybersecurity, data privacy and confidentiality meet current challenges, such as affording staff remote VPN access and defending against increased phishing attempts, the emerging videoconference hacking trend, etc.?

- *Reporting*. Does the sponsor have a plan to minimize any potential delays in providing financial reports, including potential delays by portfolio companies in providing information necessary for the sponsor's funds to complete their financial reports?

Closings

As the fundraising pace is expected to slow over the next several months, sponsors should consider:

- *Fundraising period.* While there are pros and cons, it may be suitable for some sponsors to seek a longer fundraising period (e.g., 18 months instead of 12 months) from the outset rather than having to seek a fundraising period extension later.

- *Rolling closings.* As prospective investors may be subject to disparate constraints and timelines for when they can subscribe, sponsors should consider holding smaller, more frequent closings than usual in order to secure capital as it becomes available in 2020 and into 2021.

- *Dry closings.* Making the initial closing a dry closing (i.e., delaying the commencement of the investment period and the management fee) may provide a time buffer allowing greater flexibility in extending first closing benefits to investors making commitments across a wider initial closing window.

Regulatory Considerations

For marketing efforts into non-U.S. jurisdictions that require regulatory filings or approvals to comply with local private placement rules, sponsors should build in extra time for pre-closing steps. Regulators may be less responsive (or temporarily unresponsive) during the pandemic and could remain backlogged after resuming operations.

Sponsors must consider where prospective investors are physically located in assessing which jurisdiction's rules will apply to an offering. In particular, as a result of the COVID-19 pandemic, high net worth individuals may not be located in the country where they normally reside.

Communications with Existing Investors

Finally, given expected increased reliance on re-ups in any fundraising process, sponsors should be providing clear, meaningful and more frequent portfolio updates to maintain trust and maximize investor goodwill.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding the issues and considerations discussed above. For further information, please contact the Gibson Dunn lawyer with whom you usually work, or the following authors:

John Fadely – Hong Kong (+852 2214-3810, JFadely@gibsondunn.com)
Bill Thomas – Washington, D.C. (+1 202-887-3735, WThomas@gibsondunn.com)
Kevin Heilenday – Washington, D.C. (+1 202-887-3507, KHeilenday@gibsondunn.com)
Alicia Shi – Hong Kong (+852 2214-3745, AShi@gibsondunn.com)
Kobe Chow – Hong Kong (+852 2214-3769, KChow@gibsondunn.com)