

Securities Regulators Issue Guidance to Financial Advisors and Firms on Disclosures, Investigations and Enforcement Actions During the Coronavirus Pandemic

May 6, 2020

On May 5, 2020, the U.S. Securities and Exchange Commission (“SEC”) issued broad modified guidance on its regulation and enforcement of the markets during the coronavirus (COVID-19) pandemic.[1] The Financial Industry Regulatory Authority (“FINRA”) has also issued general guidance on its regulation and enforcement of the securities firms under its jurisdiction during the pandemic.[2] Separately, various divisions within the SEC and FINRA have offered more tailored statements and guidance on the sectors of the financial and investment markets and firms they regulate.

This Alert focuses on the disclosure and regulatory guidance offered by the SEC and FINRA as it pertains to SEC-regulated investment advisers and FINRA-regulated registered persons, followed by a summary of guidance from the enforcement arms of the SEC and FINRA as it pertains to protecting investors during the uncertain market events created by the pandemic.

Disclosures and Exemptions

On April 28, 2020, the staff of the SEC Division of Investment Management (“the Staff”) released guidance answering various questions relating to COVID 19 operations for investment advisers and investment companies regulated by the SEC.[3] The Staff addresses the following topics, among others, relating to investment advisers:

1. Disclosure of Paycheck Protection Program (“PPP”) Loans in Part 2A of an investment adviser’s Form ADV filed with the SEC,
2. Exemption from certain deadlines for advisers to deliver Form ADV brochures and related documents to clients, and
3. Exemptions for rules relating to advisers with custody of client funds and securities

As it pertains to PPP Loans, the Staff indicates that the Investment Advisers Act of 1940 may require advisers to disclose receipt of these loans in two circumstances:

1. The circumstances leading the adviser to seek the PPP Loan constitute material facts relating to the advisory relationship with clients. As an example, the Staff cites a situation where the adviser requires the PPP Loan to pay salaries of employees who are primarily responsible for performing advisory functions for advisory clients.
2. If the adviser is experiencing financial conditions that are reasonably likely to impair its ability to meet contractual commitments to its clients.

If the adviser discloses the PPP Loan, the Staff recommends the adviser disclose the nature, amounts, and effects of the PPP Loan.

Investment advisers who are part of a corporate or organizational structure where another entity is receiving PPP Loan funds that flow to the advisor for administrative or advisory services may need to consider the Staff’s guidance as well. Similarly, financial firms regulated by FINRA or the SEC may seek to consider whether their supervised persons should

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provide disclosures on their Form U-4 or Form ADV Part 2B Brochure Supplement. FINRA has issued guidance that financial professionals regulated by FINRA do not need to disclose PPP Loans as a “compromise with creditors” on their Form U-4 “if the loan or part of the loan is forgiven consistent with the original terms of the loan.”[4] The SEC has not yet issued similar guidance for investment adviser representatives or other supervised persons, but the Form ADV Part 2B Brochure Supplement instructions do remind advisers to inform clients of material information “that could affect the advisory relationship” as it relates to supervised persons.

The SEC has not “approved or disapproved” of the Staff’s COVID-19 guidance, which has “no legal force or effect” and does not “alter or amend applicable law” nor does it create “new or additional obligations for any person.”

Enforcement

The SEC and FINRA have indicated that the quarantines required by the coronavirus pandemic will not slow their enforcement efforts. On March 23, 2020, the co-heads of the SEC’s Division of Enforcement released a statement indicating that “the Enforcement Division is committing substantial resources to ensuring that our Main Street investors are not victims of fraud or illegal practices in these unprecedented market and economic conditions.”[5] FINRA’s enforcement head stated that in the midst of COVID-19, “FINRA’s commitment to protecting investors and market integrity” has not changed, and that “[n]ow, more than ever, it is important that FINRA Enforcement act quickly and aggressively to stop those who would use these uncertain times to take advantage of vulnerable investors or to manipulate the markets”[6]

As for examinations, the SEC’s Office of Compliance, Inspections and Examinations issued “OCIE Statement on Operations and Exams – Health, Safety, Investor Protection and Continued Operations are our Priorities,” stating that it will be conducting examinations off-site through correspondence, unless it is absolutely necessary to be on-site.[7]

Miller Canfield’s securities litigators have handled these and other issues for financial clients operating in this historic market, and have published advice on how to navigate the current regulatory and enforcement environment. Please contact the author or your Miller Canfield attorney with further questions.

This information is based on the facts and guidance available at the time of publication, and may be subject to change.

[1] The SEC Coronavirus (COVID-19) Response can be found at the following link <https://www.sec.gov/sec-coronavirus-covid-19-response>.

[2] FINRA’s Frequently Asked Questions Related to Regulatory Relief Due to the Coronavirus Pandemic can be found at the following link: <https://www.finra.org/rules-guidance/key-topics/covid-19>

[3] The SEC Division of Investment Management Coronavirus Response FAQs is contained in full at the following link: <https://www.sec.gov/investment/covid-19-response-faq>.

[4] FINRA’s full guidance on PPP Loan disclosure obligations is contained at the following link: <https://www.finra.org/rules-guidance/key-topics/covid-19/faq>

[5] The SEC Enforcement Division’s full statement is contained at the following link: <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>.

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[6] FINRA Enforcement's full statement is contained at the following link: <https://www.finra.org/rules-guidance/enforcement>

[7] OCIE's full statement is contained at the following link: <https://www.sec.gov/ocie/announcement/ocie-statement-operations-health-safety-investor-protection-and-continued>