

Practice Update

COVID-19 Impact on the Investment Management Industry

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As the outbreak of the coronavirus disease (COVID-19) spreads across the globe, its impact on markets, businesses and portfolios continues to grow. The challenges and opportunities COVID-19 presents to those in the investment management industry will be accompanied by a number of legal and compliance considerations. A summary of several key considerations is included below.

SEC Relief for Registered Investment Advisers – Form ADV and Form PF

Recently, SEC issued two conditional exemptive orders under Section 206A of the Investment Advisers Act of 1940 (the Advisers Act) as a result of COVID-19. Together, the two orders, issued March 13, 2020[1] (the March 13 Order) and March 25, 2020[2] (the March 25 Order), respectively, provide registered investment advisers (RIAs) and exempt reporting advisers (ERAs) with conditional time-limited extensions for certain filing and delivery obligations under the Advisers Act. The March 25 Order superseded and extended the filing periods covered in the March 13 Order.

Pursuant to the March 25 Order, RIAs that have been impacted by COVID-19 now have 45 additional days to comply with Form ADV and Form PF filing and delivery requirements, which are otherwise due before June 30, 2020. Specifically, RIAs that are

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unable to meet standard deadlines due to circumstances related to *current or potential* effects of COVID-19 are temporarily exempt from the (1) Form ADV filing requirements pursuant to Rule 204-1 under the Advisers Act, (2) delivery requirements of Form ADV Part 2 (the brochure) or a summary of material changes pursuant to Rules 204-3(b) and (b) (4) under the Advisers Act, respectively, and (3) Form PF filing requirements pursuant to Rule 204(b)-1 under the Advisers Act. Exempt reporting advisers are temporarily exempt from the requirement to file Form ADV Part 1 pursuant to Rule 204-4 under the Advisers Act. RIAs and exempt reporting advisers relying on the temporary exemptions must satisfy the Form ADV and Form PF filing and delivery requirements no later than 45 days after the original due date for filing or delivery, as applicable.

How to Qualify for the Relief

With respect to Form ADV, an RIA or ERA relying on the March 25 Order promptly must notify the SEC of its intention by sending an email to IARDLive@sec.gov and the RIA or ERA's clients by posting on its website (or, if it does not have a public website, promptly notifies its clients and/or private fund investors). With respect to Form PF, an RIA relying on the March 25 Order promptly must notify the SEC of its intention by sending an email to FormPF@sec.gov. There is no requirement to notify the RIA's clients with respect to Form PF.

At this time, the SEC has not offered any guidance with respect to an extension of the filing deadline for Form CRS, which remains due by June 30, 2020[3].

Updating Risk Disclosures

The SEC encouraged investment advisers, asset managers, and all companies to be mindful of their responsibility to provide investors with updated disclosures regarding any material risks to their business and operations resulting from COVID-19 in an ongoing effort to keep clients informed of

material developments[4]. Where an adviser is aware of a risk related to the pandemic that would be material to clients or investors, steps should be taken to prevent engaging in any securities transactions until clients or investors have been appropriately informed of the risk. Risk disclosures may also be warranted concerning individual business continuity plans, travel restrictions, “key person” undertakings, and how advisers respond to the changing business landscape as events continue to unfold. Where advisers do disclose material information related to the impacts of COVID-19, such information should be disseminated broadly, avoiding selective disclosures.

Business Continuity Considerations

As asset managers across the country activate their business continuity plans (BCP), new compliance considerations are likely to arise. While the SEC has yet to adopt its proposed Adviser Business Continuity and Transition Plans rule[5], which would have required RIAs to adopt comprehensive BCPs, Rule 206(4)-7 under the Advisers Act requires each RIA to adopt and implement written policies and procedures reasonably designed to prevent the RIA from violating the Advisers Act. In furtherance of the same purpose, Rule 204-2 under the Advisers Act tasks RIAs with maintaining certain specified books and records, including electronic storage media to reasonably safeguard them from loss. Particularly in the wake of previous catastrophic events and market stress[6], the Office of Compliance Inspections and Examinations (OCIE) has made it a priority during exams to review advisers’ BCPs to assess their compliance with these and other applicable laws, rules, and regulations relating to the same. We understand OCIE has begun sweep exams on firms’ BCPs. In a recent Statement on Operations and Exams,[7] OCIE noted a comprehensive and well-executed BCP is particularly important during a time of widespread disruption and alternate workplace options. In response to the increased use of remote workers, the Department of Homeland Security published an alert

encouraging businesses to adopt a heightened state of cybersecurity, and offering specific cybersecurity considerations regarding teleworking[8]. To help ensure the ongoing protection of clients and the integrity of the markets, special consideration should be given to remote working policies, third-party vendors with respect to cyber security and data protection, and maintaining open lines of communication with advisory staff and clients, and have a BCP that covers pandemics.

Custody Rule/Form ADV Guidance

The SEC has also updated its Frequently Asked Questions (FAQs) regarding Rule 206(4)-2 under the Advisers Act (the Custody Rule) to provide guidance related to COVID-19, remote working, and the implications such arrangements may have with respect to the custody of client assets. Pursuant to the Custody Rule, advisers who inadvertently receive funds or securities from their clients must return the funds or securities to their clients within three business days in order to avoid having “custody” of such assets. According to the updated FAQs, where, pursuant to the adviser’s BCP and in response to COVID-19, office disruptions have prevented staff or personnel from accessing mail or deliveries, the SEC staff would not consider the adviser to have received client assets at the primary office location until the adviser is able to access the office and retrieve the mail or delivery[9]. As a result, the three-day requirement does not begin to run with respect to custody until such time.

Where an advisory firm is subject to the surprise examination requirement under the Custody Rule, an independent accountant generally must complete its surprise examination and submit Form ADV-E to file its certificate of accounting with the SEC within 120 days after the date chosen by the independent public accountant for the surprise examination. According to an update to the FAQs posted March 30, 2020, where the advisory firm had a reasonable belief the accountant would complete the examination and submission of the Form ADV-E by

the 120 day deadline, but the accountant was ultimately unable to do so as a result of disruptions caused by COVID-19, the advisory firm would not be deemed to be in violation of the Custody Rule. However, the accountant must file such report as soon as practicable, but not later than 45 days after the original due date.[10]

Lastly, the SEC has updated its FAQs regarding Form ADV to state that where an adviser's employees are temporarily teleworking as part of the adviser's BCP is not required to update its Form ADV to list the temporary teleworking address of its employees.[11]

SEC Examinations

At this time, the SEC has indicated that they remain fully operational[12], continuing to monitor for fraud, illicit schemes, and other misconduct affecting U.S. investors. OCIE remains fully operational nationwide and continues to monitor and examine advisers through the use of off-site correspondence[13]. Subject to safety precautions, on-site examinations and appearances are continuing where absolutely necessary for OCIE staff to be on-site. Examination staff are aware of the regulatory relief being provided to advisers and continue to monitor for updates. In an effort to encourage advisers to utilize relief where needed, reliance on such relief will not be a risk factor or consideration for OCIE in determining whether to initiate an examination.

[1] Order Granting Exemptions from Specified Provisions of the Investment Advisers Act and Certain Rules Thereunder, Investment Advisers Act Release No. 5463 (Mar. 13, 2020), available at <https://www.sec.gov/rules/other/2020/ia-5463.pdf>.

[2] Order Granting Exemptions from Specified Provisions of the Investment Advisers Act and Certain Rules Thereunder, Investment Advisers Act

Release No. 5469 (Mar. 25, 2020), available at <https://www.sec.gov/rules/other/2020/ia-5469.pdf>.

[3] See Form CRS Relationship Summary; Amendments to Form ADV, Exchange Act Release No. 86032 (June 5, 2019), codified in 17 CFR 240.17a-14(f), 17 CFR 275.203-1(a)(2) and 204-1(e); Instruction 7.C. to Form CRS, *available at* https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary#_edn2.

[4] See Press Release, SEC, SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 (COVID-19) (March 4, 2020), *available at* <https://www.sec.gov/news/press-release/2020-53>

[5] See Press Release, SEC, SEC Proposes Rule Requiring Investment Advisers to Adopt Business Continuity and Transition Plans (June 28, 2016), *available at* <https://www.sec.gov/rules/proposed/2016/ia-4439.pdf>

[6] See OCIE Risk Alert, Vol. 2, Issue 3, SEC Examinations of Business Continuity Plans of Certain Advisers Following Operational Disruptions Caused by Weather-Related Events Last Year (August 27, 2013), *available at* <https://www.sec.gov/about/offices/ocie/business-continuity-plans-risk-alert.pdf>

[7] See Announcement, SEC, OCIE Statement on Operations and Exams – Health, Safety, Investor Protection and Continued Operations are our Priorities (March 23, 2020), *available at* <https://www.sec.gov/ocie/announcement/ocie-statement-operations-health-safety-investor-protection-and-continued>

[8] See DHHS, Cybersecurity and Infrastructure Security Agency, National Cyber Awareness System Alert AA20-006A, Enterprise VPN Security (March 13, 2020), *available at* <https://www.us-cert.gov/ncas/alerts/aa20-073a>.

[9] See SEC, Frequently Asked Questions, Staff Responses to Questions About the Custody Rule, Section II, Question 1, Definition of Custody; Scope of the Rule, (Modified March 16, 2020), *available at* https://www.sec.gov/divisions/investment/custody_faq_030510.htm (See FAQ Question II.1)

[10] *Id.* at Section IV, Question 7, Account Statements; Surprise Examinations (Posted March 30, 2020).

[11] *Id.* at Form ADV, Item 1.F (Posted March 16, 2020).

[12] See SEC, Announcement, SEC Coronavirus (COVID-19) Response (Modified March 30, 2020) <https://www.sec.gov/sec-coronavirus-covid-19-response>

[13] *Id.* n. 7, *supra*

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