Coronavirus Pandemic – Compliance Challenges and Best Practices

April 8, 2020

Since the publication of our March 18, 2020 blog from Les Abromovitz – *Coronavirus Pandemic Creates New Compliance Challenges*, there have been several communications issued from the Securities and Exchange Commission ("SEC"), FINRA, the Investment Advisors Association and many other regulatory agencies and industry experts related to the coronavirus pandemic.

Overall, the message from regulators has been very understanding of the challenges that advisors are facing, as regulators and their staff are experiencing the same struggles with working remotely under extraordinary circumstance. The SEC continues to extend relief to certain companies, funds and investment advisors affected by the novel coronavirus (COVID-19); see the order from March 25th, SEC Press Release – 3/25/2020. Advisors that are currently under examination by the SEC are being encouraged by the SEC to openly communicate any challenges or difficulties they are experiencing with their examiner.

In order to manage the risks presented by the COVID-19 pandemic, advisors should be thinking about their client communications and disclosures, business continuity plans, vendor due diligence, cybersecurity and remote supervision.

Advisors are also encouraged to check for COVID-19-related jurisdictional restrictions. For example, New York recently enacted a law that prohibits unsolicited telemarketing calls to New York residents during a declared state of emergency. The North American Securities Administrators Association ("NASAA") has established a resource page to collect COVID-19-related updates from state and provincial securities regulators. The NASAA website does not cover all restrictions; therefore, advisors should contact the relevant state securities regulators for additional information. Please see the helpful links at the end of this article.

COVID-19 – Disclosure Updates

The impact of COVID-19 on investment advisory firms and its future effects are uncertain. Investment advisors should consider whether COVID-19-related disclosure is material and would be meaningful to their clients, especially retail investors.

- ADV Part 2A – Advisors should review existing disclosures and risk factors in their Forms ADV Part 2A to determine whether risks associated with business disruptions, pandemics or unforeseen market events are already addressed. If not, advisors should consider whether recent issues have caused, or could potentially cause, a material risk to a particular product or strategy that should prompt a disclosure.
- Private Funds – Sponsors currently engaged in fund raising or distributions should review current disclosures in the fund's private placement memorandum or offering documents and consider whether updates are needed due to the impact of COVID-19.
- ADV Part 1 – Other Offices – The SEC has issued guidance that if employees are working remotely on a temporary basis as part of the firm's business continuity plan due to COVID-19-related circumstances, staff would not recommend enforcement action if the firm did not update either Item 1.F of Part 1A or Section 1.F of Schedule D in order to list the temporary teleworking addresses.
- State Registration Requirements – Will remote working trigger advisor or investment advisor representative state registration requirements? Although no formal guidance has been provided, the issue has been raised to NASAA by the IAA. The answer could vary from state to state, but given the SEC's *temporary* teleworking guidance, it would seem reasonable that states will adopt a similar flexible approach and refrain from enforcing registration requirements triggered by temporary COVID-19 related teleworking arrangements.

Business Continuity/Vendor Oversight/Cybersecurity

The SEC has already expressed interest in how business continuity plans ("BCPs") are working given the current circumstances related to COVID-19, as indicated in the March 23rd OCIE Statement on Operations and Exams. Advisors should be reviewing their BCPs to ensure that critical areas including investing, trading, investor relations, compliance, required books and records and regulatory filings are operating accordingly.

- Advisors should check with their IT departments and/or IT vendors to verify technology and systems are working as anticipated.
- Advisors should document how their current BCPs are working and any deviations from the existing plans in order to continue business operations. If something in the BCPs do not work as expected, advisors should document the active measures being taken to address the

deficiency.

- Whether or not advisors choose to be proactive or reactive with notification to clients as part of their BCP, it's important to ensure material information is distributed to all clients and not on a selective basis. Material disruptions to the functioning of the business would require notifications to clients. For example, if a firm's trader could not trade, this would be an issue that clients would want to know about.
- If an advisors BCP states that they will notify their regulator(s) about business disruptions, then pro-active notification should be done.
- Advisors should check with their key vendors to ensure their BCP is working. If a key vendor is not able to support your business, consider a back-up provider. Document the responses from key vendors to evidence your ongoing due diligence.
- The current remote work environment is ripe for cyber criminals to take advantage of known weaknesses. Employees accessing the company's network remotely should be using a VPN, Citrix or other secure method to login. Employees should only connect through wi-fi using a secured connection (i.e. not public).
- If the recent work environment has caused employees to use any new systems, applications or technologies (ex. Zoom), ensure that due diligence has been conducted and any security risks presented by such new systems, applications or technologies have been considered and mitigated.
- Supervision of employees working remotely can be challenging but is especially important. Consider increased email and social media surveillance during this time of social distancing and remote work situations.
- CCOs and supervisors should consider sending e-mails to remind employees of the firm's policies and procedures, so employees remain vigilant during the duration of the teleworking situation. Key reminders should include the use of personal email and text messaging. Additionally, staff should be reminded of the importance of confidentiality; i.e., who is listening to conversations, seeing screens/monitors and has access to printed information when working remotely.

Valuations, Pricing and Other Market Considerations

Significant market disruptions can cause increased risk of pricing and valuation issues, especially with less liquid assets.

- Certain non-marketable or illiquid securities may carry valuations that are 'as of' certain dates. Advisors should consider market volatility disclosures for changes that have occurred since 12/31 and the Q1 quarter-end valuations.
- Advisors should follow their valuation policies and procedures. However, if a change in methodology is necessary, given broader market considerations, advisors should document the rationale for the change.
- Given market volatility, advisors must ensure that client restrictions and investment policy statements are being actively reviewed, especially where liquidity concerns may arise. Even securities that are generally

liquid, such as commercial paper markets, can become illiquid during times of stress.

Code of Ethics – Personal Trading

Advisors should review current restricted lists and consider if additional securities should be added. Changes in market conditions could cause increased conflicts with client investments that were not previously an issue. CCOs should be aware of an increase in day trading, including shorting securities and use of derivatives. Fiduciaries must be focused first and foremost on client accounts, as opposed to their own personal investments.

Succession Planning and Key Person Insurance

Investment advisors owe a fiduciary duty to their clients to have succession plans in place to ensure continuity of services and the daily operations of the business, as well as to smoothly wind down the advisor's business in the event of death or incapacity of key members of the firm. Advisors should review these plans along with their insurance policies and ensure that they are up to date.

Conclusion

During these stressful and challenging times for investment advisors and their staff, it is important to be reminded of the critical role investment advisors as fiduciaries play as a reassuring and stable resource for the investing public. CCOs and their staff can also serve as a stabilizing force, helping to ensure that the risks presented by the current environment are mitigated, while not losing sight of other priorities.

As always, Foreside is here to help. Please do not hesitate to contact your Foreside consultant with questions and concerns.

Helpful Links:

SEC – Coronavirus (COVID-19) Response

NASAA – COVID- 19 Updates

IAA – Coronavirus Updates

FINRA – COVID-19 / Coronavirus

Contact Your Regulator – NASAA's State Regulator Contact Info Chart