

Risk Alert – Compliance Considerations for CARES Act Loans

April 20, 2020



In response to the Coronavirus (COVID-19) pandemic, small business owners in all U.S. states, Washington D.C., and territories are eligible to apply for an Economic Injury Disaster Loan (“EIDL”) advance of up to \$10,000. This advance will provide economic relief to businesses that are currently experiencing a temporary loss of revenue. In addition, the federal government has also established the Paycheck Protection Program (“PPP”) under the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act. The PPP is a loan designed to provide a direct incentive for small businesses to keep their workers on the payroll. PPP loans will be forgiven if certain conditions are followed, principally that all employees are kept on the payroll for eight weeks, the money is used for payroll, rent, mortgage interest, or utilities, and the borrower is otherwise in compliance with the terms of the loan agreement. In response to these programs, many registered investment advisers have applied or are considering applying for one or both loans. Registered investment advisers should be aware that taking advantage of these loans could trigger certain disclosure requirements.

Form ADV Part 2A Disclosure Brochure Item 18 requires disclosure of any “financial condition that is reasonably likely to impair your ability to meet contractual commitments to clients.” Since the PPP loan requires that the signatory certify that “Current economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant,” the certification can be relevant to a determination regarding whether the firm has a financial condition likely to impair its contractual obligations.

While certain advisers in immediate financial difficulty might consider

taking a loan to stay afloat, other advisers not in immediate financial trouble might be considering taking a loan as a safety net or as a precautionary measure. Regardless of the motivation for the loan, advisers applying for one of these loans should be sure to maintain documentation supporting the rationale and purpose for taking the loan. If an adviser taking a loan determines that disclosure of an adverse financial condition is not required or appropriate, such internal documentation should discuss why the loan was necessary to support ongoing operations in light of the COVID-19 pandemic despite the fact no adverse financial condition exists likely to impair the firm's contractual obligations.

In relation to individual disclosure requirements, FINRA has recently issued guidance as it relates to the PPP and has indicated that, if a registered person, or their business, obtains a PPP loan and the loan, or part of the loan, is forgiven, the registered person will not be required to report that forgiveness in response to Question 14K on their Form U4 as a "compromise with a creditor" as long as the PPP loan is forgiven in accordance with the original terms of the loan. FINRA's FAQ explains that "a compromise with one or more creditors 'generally involves an agreement between a borrower and a creditor in which a creditor agrees to accept less than the full amount owed in full satisfaction of an outstanding debt, unless such an agreement is included in the original terms of the loan.' (Emphasis added). Because a PPP loan contemplates forgiveness of some or all of the loan as part of the original terms of the loan, such forgiveness will not involve a new agreement by the creditor, but will be an event consistent with the loan's original terms."^[1] Any forgiveness beyond the original terms of the loan would be considered a "compromise with creditors." As of the date of this notification, FINRA has not addressed the EIDL program but their guidance likely would be the same in regards to that loan.

^[1] [FINRA Form U4 and U5 Interpretive Questions and Answers](#)

[Home](#)