

# SEC Posts Guidance for Investment Advisers on Disclosing Paycheck Protection Program Loans

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On April 27, 2020, the Division of Investment Management (the “Division”) of the Securities and Exchange Commission (the “SEC”) posted a question and answer on its Coronavirus (COVID-19) Response FAQs web page which provides some guidance for investment advisers applying for loans under the U.S. Small Business Administration’s Paycheck Protection Program (the “PPP”). According to the Division’s response, an investment adviser’s fiduciary obligation to disclose material facts related to its advisory relationship with clients may require the adviser to disclose that it applied for a PPP loan, even if the adviser’s application was denied.

The following is the entire question and answer as posted on the SEC’s website:

Question II.4.

*Q. I am a small advisory firm that meets the requirements of the Paycheck Protection Program (PPP) established by the U.S. Small Business Administration in connection with COVID-19. If I receive or have received a PPP loan, what are my regulatory reporting obligations under the Investment Advisers Act of 1940 to my firm’s clients?*

*A. As a fiduciary under federal law, you must make full and fair disclosure to your clients of all material facts relating to the advisory relationship. If the circumstances leading you to seek a PPP loan or other type of financial assistance constitute material facts relating to your advisory relationship with clients, it is the staff’s view that your firm should provide disclosure of, for example, the nature, amounts and effects of such assistance. If, for instance, you require such assistance to pay the salaries of your employees who are primarily responsible for performing advisory functions for your clients, it is the staff’s view that you would need to disclose this fact. In addition, if your firm is experiencing conditions that are reasonably likely to impair its ability to meet contractual commitments to its clients, you may be required to disclose this financial condition in response to Item 18 (Financial Information) of Part 2A of Form ADV (brochure), or as part of Part 2A, Appendix 1 of Form ADV (wrap fee program brochure). (Posted April 27, 2020).<sup>[i]</sup>*

As indicated in the Division’s response, the analysis for determining whether an investment adviser must disclose that it has applied for a PPP loan depends on whether the circumstances leading the adviser to seek a PPP loan or other type of financial assistance constitute material facts relating to its advisory relationship with clients. In the view of Division staff, an adviser would need to disclose that it applied for a PPP loan or other type of financial assistance if, for example, the adviser “requires such assistance to pay the salaries of its employees who are *primarily* responsible for performing advisory functions for [the adviser’s] clients.”<sup>[ii]</sup> Like all informal Division staff guidance, this example has no legal force or effect but it does highlight an important consideration for advisers who have pursued PPP assistance.

PPP loan applicants are required to certify that “current economic uncertainty makes this loan request *necessary* to support the ongoing operations of the Applicant.”<sup>[iii]</sup> Moreover, the U.S. Small Business Administration has stated that “borrowers must make this certification *in good faith*, taking into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.”<sup>[iv]</sup> Given the nature of an adviser’s business, paying the salaries of employees who are primarily responsible for performing advisory functions for its clients may qualify as “necessary to support the ongoing operations” of the adviser. The SEC’s guidance implies there could be facts and circumstances behind efforts to procure a PPP loan that would not be “material” facts requiring disclosure. However, we expect the SEC and other regulators will take a very narrow view on this issue. Thus, any advisers considering not disclosing efforts to obtain a PPP loan would be wise to closely review the details of the justification submitted for the loan. Moreover, given the nature of the certification, any adviser that applied for and did not obtain a PPP loan (or alternate financing) should absolutely disclose these facts. In addition to determining whether an adviser is required to disclose its application for a PPP loan, the adviser must determine whether the circumstances leading it to apply for the PPP loan are such that the adviser is required to amend Part 2A of its Form ADV. The Division suggested that an adviser may be required to disclose any financial conditions that

are reasonably likely to impair the adviser's ability to meet contractual commitments to its clients in Part 2A of Form ADV, or as part of Part 2A, Appendix 1 of Form ADV.

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[i] Securities and Exchange Commission Division of Investment Management, Coronavirus (COVID-19) Response FAQs, Question II.4 (Apr. 27, 2020).

[ii] Id. (emphasis added).

[iii] 15 U.S.C. 636(a)(36)(G)(i)(I).

[iv] Small Business Administration & Department of the Treasury, Paycheck Protection Program Loans Frequently Asked Questions (FAQs), Question 31 (Apr. 23, 2020) (emphasis added).