

## Navigating the Impact of COVID-19 for Registered Investment Advisers and Broker-Dealers

By Patrick D. Hayes and Jaclyn Moody

COVID-19 has impacted the operations of all businesses and financial institutions, including registered investment advisers and broker-dealers. In many areas, the regulators have provided additional support to help market participants address their business, operations, and compliance protocols in light of the pandemic. Armed with this new guidance and other industry best practices, we have prepared the following tips for compliance professionals to keep in mind as they navigate this tumultuous time.

### Review Risk Disclosures

If the aftershocks of this pandemic are anything like the last financial crisis, advisers should be ready for quite a rollercoaster ride. In volatile markets, it's important to take inventory of what risks are present in your own investment strategies, and perhaps more importantly, what risks you have previously disclosed to clients. Most firms should take some comfort in knowing that the disclosures it already had in other documents like Form ADV or client agreements will typically cover volatility and distressed markets. That said, our guess is that most firms did not contemplate its key professionals working remotely for an extended period of time. It's unlikely that many advisers had previously disclosed specific risks attributable to pandemics, though most likely will moving forward. Compliance professionals should consider this a good time to start bulking up relevant disclosure forms and corresponding policies. This should include Form CRS and Regulation Best Interest materials, as SEC staff indicated its intent to proceed with examinations after the June 30, 2020 compliance date,<sup>1</sup> even while working under a "good faith effort" framework.

### Communicate with Clients Early and Often, But Avoid Hyperbole

During these times of stress, financial advisors often find themselves as a trusted resource and positive influence to help their clients remain optimistic and stay invested in the market. That said, it can be easy to let optimism or politeness paint a more cheerful picture than actually exists. Equipped with patience and purpose, firms should be cautious not to provide any guarantees or flowery descriptions of future performance to clients despite their elevated emotions, which could help mitigate against any future risks of litigation and/or client complaints. In particular, compliance professionals will want to pay extra attention to their firm's evergreen marketing materials including their website and social media platforms, as well as individual client communications for any inaccurate information (i.e. email review).

The partnership between marketing and compliance is often a hallmark of successful firms, and during times of crisis, fostering this partnership even further can pay substantial dividends. Over the last several weeks, many firms have spent significant resources and made herculean efforts to develop and build out business continuity plans ("BCPs"), privacy policies, and oversight of third-party service providers. Showcasing a firm's response in times of crisis can be excellent marketing material for existing and prospective clients. Compliance professionals are thus in a unique position to help firms maximize the business development return on these efforts by showcasing the ongoing steps it has taken (or plans to take) to further protect its clients and employees. As you start to coordinate these materials, here are a few items to consider:

- how trading and investment strategies have been impacted and appropriately adjusted
- improvements made to enhance cybersecurity
- new protocols to manage U.S. mail delivery
- how certain business units work remotely
- best ways to contact the firm and access any necessary funds and securities.

### About the Authors

Patrick D. Hayes is Senior Counsel at [Calfee, Halter & Griswold LLP](#). He can be reached at [phayes@calfee.com](mailto:phayes@calfee.com).

Jaclyn Moody is a Senior Compliance Officer at [Burgundy Asset Management Ltd.](#) She can be reached at [jmoody@burgundyasset.com](mailto:jmoody@burgundyasset.com).

Both currently serve on the NSCP Board of Directors.

1. <https://www.sec.gov/files/Risk%20Alert%20-%20Form%20CRS%20Exams.pdf>;  
<https://www.sec.gov/files/Risk%20Alert%20Regulation%20Best%20Interest%20Exams.pdf>

Finally, The COVID-19 pandemic presents new opportunities for fraudsters, and state and federal securities regulators are alerting financial advisors and investors to be on guard against an anticipated surge of fraudulent investment schemes. According to the North American Securities Administrators Association (“NASAA”),<sup>2</sup> industry participants should be on the lookout for these types of pandemic-based frauds:

- Private placements and off-market private deals
- Claims of “safe” or “guaranteed” investments in commodities like gold or silver
- Recovery and other “buy-low sell high” schemes
- Get-rich-quick and replacement swap schemes
- Declaring real estate investments are “safe and secure.”

In addition, NASAA urged investors to take steps to protect themselves by:

- Asking questions and research the investment and person offering it
- Don’t fall for phishing scams
- Understand that there are no miracle cures for COVID-19
- Avoiding fraudulent charity schemes claiming to help individuals affected by COVID-19
- Being wary of any schemes by individuals claiming to be government officials.

### **Establish Supervision That’s Appropriate for a Crisis**

In a remote work setting, the ongoing monitoring of employees and escalation of compliance and other material issues at an adviser can present unique challenges. Internal reporting channels may be cut off as a result of isolated employees and the inability of individuals to connect in-person.

To ensure the proper escalation of issues occurs, firms should consider building an escalation infrastructure that can function even during the execution of a business continuity plan. Some specific items firms should consider include:

- Providing key stakeholders and those holding critical information with multiple outlets and points of contact. Should systems fail, having a backup plan to access critical information is essential.
- Having a process in place for both the proper internal and external escalation of issues that may occur, including details of the supervisory chain. To mitigate cyber risk, frequent reminders of who to contact should a breach occur could save precious time and big bucks spent on rectifying the issue. Firms should also consider implementing additional cyber security training and penetration tests to confirm the firm’s security posture.
- Leveraging technologies like Zoom, Microsoft Teams, and Cisco WebEx to provide enhanced supervision where in-person connectivity isn’t available. Compliance professionals should also understand the risks of using such technologies and how to defend against video-teleconferencing hijacking and “zoom-bombing.”<sup>3</sup> Firms may also want to consider providing employees with additional training materials on how to safely use teleconferencing tools. For those firms using Zoom, we have prepared a list of practical tips and guidance to assist with this type of employee training.
- Directing firm leadership to connect with each other and their direct reports as often as they can, even daily if possible. Practicing high touch points isn’t just good supervision, it’s also an excellent way to foster employees’ positive well-being and mental health. Firm-wide outreaches and advanced connectivity help manage anxiety during these stressful times.
- Keeping a watchful eye for internal compliance issues, specifically insider trading and related activity. In a statement<sup>4</sup> setting out the Commission’s initial response to the crisis, the SEC pledged that its enforcement and examination programs will continue to execute their missions and are fully operational. In particular, the Co-Directors of the SEC’s Division of Enforcement have emphasized “the importance of maintaining market integrity and following corporate controls and procedures.”<sup>5</sup>

Finally, in regard to the proper supervision of registered representatives, firms should remain vigilant on regulatory guidance for state licensing requirements. The COVID-19 pandemic presents uncharted territory in the duration of time that certain individuals may be forced to work from home. For those representatives whose office may be located in a state other than their own residence, firms should start preparing for the prospect that they need to register individuals in new territories.

2. <https://www.nasaa.org/54534/covid-19-related-investment-schemes-anticipated/>.

3. <https://www.us-cert.gov/incas/current-activity/2020/04/02/fbi-releases-guidance-defending-against-vtc-hijacking-and-zoom>

4. <https://www.sec.gov/sec-coronavirus-covid-19-response>.

5. <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>. The SEC noted that material nonpublic information available to corporate insiders may be even more valuable during the COVID-19 crisis. The Staff cautioned people with access to material non-public information (i.e. directors, officers, employees, consultants and other outside professions) to be “mindful of their obligations to keep this information confidential and comply with the prohibitions on illegal securities trading,” and to help prevent misuse of material nonpublic information.

## Keep “Good” Documentation of Books and Records and Information Security

Even in a crisis, firms must continue to meet their regulatory burden of keeping accurate books and records and protecting the sensitive information of their clients. Issues arising need to be identified, remediated and analyzed.

*Identification:* As issues arise in the execution of a firm’s business continuity plan and in any remote work setting, compliance professionals should be explicit in the documentation of issues that arise that affect the normal course. Some specific items to consider include:

- Increased cyber-attacks and unauthorized activity
- Disruptions to accessing systems
- Inconsistent supervision and oversight
- Late filings or delivery of client statements
- Complications in client interactions; identifying new clients, meeting suitability and best interest requirements, and approvals of transactions
- Changes to pricing and valuations during market volatility.

Furthermore, firms should document the specific cybersecurity and data privacy precautions that are being taken to protect client information, particularly in light of the COVID-19 cyber alert<sup>6</sup> and additional guidance<sup>7</sup> from the U.S. Department of Homeland Security. Firms should be on heightened alert for pandemic frauds such as client or vendor impersonations and insider trading. and should document (and escalate) any red flags and cyber-attacks accordingly.

*Remediation:* Where firms discover certain inconsistencies or irregularities from their ability to execute day-to-day operations (including issues with proper recordkeeping), firms should document in detail the cause of disruption and how the firm attempted to fix the issue to the extent possible. Instead of noting generically that “issues arose due to COVID-19,” firms should document specifics such as “loss of internet connection,” “system overload,” or “persistent delays in remote accessibility and operation” caused a delay that was remediated as soon as possible. The notes the firm takes will likely serve as the best protection against future deficiencies in regulatory exams and provide relief from possible enforcement.

*Analysis:* Never let a good crisis go to waste. With the challenges presented by COVID-19, firms will also have unique opportunities to dramatically enhance their ability to sustain business operations in the event of future significant business disruptions, cybersecurity threats, global pandemics, etc. The “good” documentation and notes outlined by firm employees throughout the crisis can not only serve to highlight the effectiveness of the firm’s business continuity plan (and compliance program), it can also serve as the best learning material to develop an impact analysis and enhance the firm’s internal controls in the future. No area is a better example of this than in due diligence a firm conducts on its third-party service providers.

## Conduct Focused Vendor Due Diligence Reviews

Firms already have an obligation to conduct reasonable initial and on-going due diligence on outsourced service providers. Although policies may be in place, firms should be sure to examine and document vendors’ response to the COVID-19 virus and conduct an internal analysis of the impact. Compliance professionals should review vendor contracts and business continuity plans (including controls for cybersecurity and significant business disruptions) and assess if there is a risk of the vendor closing or suspending services. During the review, consideration should be given to how easily accessible vendor contacts are in a time of panic or if systems fail.

To start a dialogue, below is a list of inquiries firms should consider as part of their due diligence efforts:

- How has the vendor’s services been impacted by COVID-19?
- Does the vendor expect any future disruption to the services provided?
- If operations are temporarily impacted or halted, how long would complete recovery take?
- Has the vendor updated its BCP specifically due to COVID-19?
- Have there been any stresses on certain systems and/or failures in the vendor’s BCP, and what additional measures has the vendor taken in response to the current environment?
- In the event remote operations continue for an extended period of time, how long can the vendor provide uninterrupted delivery of products and services?
- In light of the pandemic, what measures has the vendor taken to enhance information security protocols?

6. <https://www.dhs.gov/coronavirus/cybersecurity-and-critical-infrastructure>.

7. <https://www.cisa.gov/sites/default/files/publications/CISA-Guidance-on-Essential-Critical-Infrastructure-Workers-1-20-508c.pdf>.

## Consider Effects on Private Funds

Given the tumult experienced in the public markets, private fund advisers might feel protected from many of the compliance and operational challenges facing most advisers. That said, private fund advisers face their own set of distinctive challenges in light of COVID-19.

Private fund advisers relying on the “audit provision” of the Custody Rule<sup>8</sup> should consider if they will be able to produce their financials in a timely fashion. Outside of COVID-19, the SEC has previously said they would not recommend enforcement if “unforeseeable circumstances” caused the adviser’s inability to provide audited financials on time, so long as the adviser had reasonably believed the fund’s audited financials would be distributed within the 120-day deadline. After an internal analysis, if a firm determines it is unlikely to distribute the audited financials on time, the firm should document in specific detail the “unforeseeable circumstances” that will not allow for proper distribution.

In addition to the above, private fund advisers should be sure to reexamine fund offering documents to consider the following types of considerations:

- Are there any gates or suspensions triggered by high levels of redemptions?
- Do any side letters contemplate special rights or preferential redemptions in periods of crisis?
- Does the fund allow for in-kind distributions in certain situations?
- Have any ongoing capital calls been interrupted or halted as a result of potential defaults?

Finally, as private fund assets become increasingly illiquid, firms should be wary of shifting valuation methodologies. Having learned from the last financial crisis, the SEC will evaluate the basis for any crisis-related changes to internal policies and procedures with a skeptical eye—particularly shifting valuation strategies that benefit the adviser.

## Where Possible, Avoid Regulatory Relief

The SEC has issued subsequent orders (March 13, 2020<sup>9</sup> ; March 25, 2020<sup>10</sup> ) which extend the deadlines of certain regulatory filings (and related delivery requirements) if certain conditions are met, most notably to inform the SEC (via direct message) and its clients (posting on the firms website that the firm will not be able to meet the previous deadline.

To the extent possible, firms should attempt to complete their regulatory filings in a timely fashion, thus removing any potential cause for alarm by clients or setting off any red flags with the SEC regarding the adviser’s own operations and compliance program (and business continuity plan). That said, compliance professionals should not be so reticent to use the relief if there are any chances that present operational challenges could lead to inaccurate reporting. The relief is there for just that type of situation—take advantage of it.

## Don’t Let Perfect Get in the Way of Better

Remember that we are all in uncharted territory here. A global pandemic of this scale hasn’t been felt in over a hundred years when the state of the securities industry and capital markets looked much different. The impact of COVID-19 is ongoing and hard to predict, and despite these challenges, many firms and compliance professionals have overseen the successful implementation and execution of their business continuity plans and incident response plans. There will be challenges, and not every part of the rollout may be perfect, but as the onslaught of the coronavirus has already demonstrated, having a robust compliance program and strong leadership in legal and compliance roles is invaluable to the success of the industry. Compliance professionals now have an opportunity in the weeks and months ahead to further highlight this value we provide our respective firms. As you continue to review the successes and gaps in your own compliance programs, use this time as the motivation necessary to make the firm better. It doesn’t have to be perfect. Even small improvements over time can add up to major firm enhancements, and there is no better time than a crisis to showcase the steady hand of a seasoned compliance professional.

At its very core, compliance is about elevating the quality of services our firms provide. Through practical guidance from the NSCP and the additional relief provided by regulators, we will get through this together. And the regulators are here to help. Through the efforts of the SEC, FINRA, CFTC, state regulators, and organizations like the NASAA, there has been continued leadership from the highest levels of our industry and support of market participants during this tumultuous time. Many of these institutions have also provided excellent resources. If you’re looking for good material to help jumpstart the improvements you can make inside your own firms, we’ve outlined a few of these below:

8. <https://www.sec.gov/rules/final/ia-2176.htm>.

9. <https://www.sec.gov/rules/other/2020/ia-5463.pdf>.

10. <https://www.sec.gov/rules/other/2020/ia-5469.pdf>.

## NSCP

NSCP realizes that these are unprecedented times and that our members are facing numerous challenges, both personal and professional. NSCP has responded to the impact of COVID-19 on the compliance profession by providing our members timely resources and up-to-date information to help navigate in these continuously changing times.

NSCP is now offering bi-weekly membership calls on “Navigating the Regulatory Environment in Response to COVID-19,” where leading industry experts provide updates on regulatory relief and developments. Previous calls have included guest panelists from FINRA, the SEC and NASAA.

NSCP recently hosted the webinar, “[Ensuring Business Continuity During the COVID Crisis](#)” and will sponsor the upcoming webinar, “What to Disclose and When: SEC Corporate Filings in the time of COVID-19” presented by Fox Rothschild LLP. NSCP will continue to offer webinars that are timely and relevant to assist our members in meeting regulatory challenges as the coronavirus situation evolves.

With the impending June 30th deadline of Regulation BI and Form CRS, NSCP members seeking guidance and who wish to share notes as to how firms are preparing for the compliance deadline to join NSCP’s Regulation BI Working Group. Information regarding the group is available in [NSCP’s Member Center](#).

The saying, “it takes a village,” is never more important at this time. NSCP encourages its members to assist each other by asking and answering questions via NSCP’s Compliance Forum and Industry Forums. The Forums are safe havens for members to raise issues they may be having with regulatory compliance, business operations and client relations as well as a means to obtain regulatory guidance and resources from fellow members.

NSCP’s Virtual Spring Conference session recordings, which offer comprehensive and practical information relevant to our current and future regulatory obligations, will be available to conference registrants in NSCP’s Member Center.

NSCP stands ready to help its members respond to the changing regulatory landscape due to the impact of the coronavirus. Please do not hesitate to reach out to NSCP Staff at [info@nscp.org](mailto:info@nscp.org).

## SEC

The Staff has provided a summary<sup>11</sup> of operational initiatives, market-focused actions, guidance and targeted assistance and relief, investor protection efforts and other work of the agency in response to the effects of COVID-19. It is not an exhaustive list. Rather, it provides background and more specific context as to how the SEC is continuing to work with investors and other market participants as it executes its mission during this period of collective, national challenge.

## FINRA

FINRA recognizes the significant impacts that the spread of coronavirus disease (COVID-19) may have on member firms, investors and other stakeholders. FINRA is committed to providing guidance, updates and other information to help stakeholders stay informed about the latest developments. New information will be posted on [this page](#) as it becomes available.

## NASAA

The North American Securities Administrators Association (“NASAA”) created an [online repository](#) of regulatory updates issued as a result of the COVID-19 outbreak. According to NASAA, the COVID-19 Update Center collects and displays recent updates from state and provincial securities regulators, such as extended deadlines, temporary relief, and investor advisories.

## CISA (U.S. Department of Homeland Security)

The Cybersecurity and Infrastructure Security Agency (CISA) is working closely with partners to prepare for possible impacts of a COVID-19 outbreak in the United States. CISA has prepared materials to help firms think through physical, supply chain, and cybersecurity issues that may arise from the spread of Novel Coronavirus, or COVID-19.<sup>12</sup>

11. <https://www.sec.gov/sec-coronavirus-covid-19-response>

12. [https://www.cisa.gov/sites/default/files/publications/20\\_0318\\_cisa\\_insights\\_coronavirus.pdf](https://www.cisa.gov/sites/default/files/publications/20_0318_cisa_insights_coronavirus.pdf)