



Key considerations as SEC and FINRA provide COVID-19 regulatory relief for investment management firms

The SEC is continuing to advance rulemaking initiatives, conduct inspections, bring enforcement actions, and review and comment on issuer and fund filings.

The US Securities and Exchange Commission (SEC) and the Financial Institution Regulatory Authority (FINRA) have recognized the significant impacts that the spread of coronavirus disease (COVID-19) may have on firms, investors, and other stakeholders. In fact, the SEC was one of the first financial regulators to begin providing significant regulatory relief to affected parties.¹ At the same time, the SEC is continuing to advance rulemaking initiatives, conduct inspections, bring enforcement actions, and review and comment on issuer and fund filings. The SEC is continuing to execute its mission during this challenging time by:

- maintaining the continuity of Commission operations;
- monitoring market functions and system risks;
- providing prompt, targeted regulatory relief and guidance to issuers, exchanges, and other impacted registrants; and
- maintaining enforcement and investor protection efforts, particularly regarding the protection of its critical market systems and most vulnerable investors.²

In light of the SEC's recent guidance, firms should consider the following during a period of rapidly evolving regulatory action.

Reporting challenges

An initial focus of the SEC efforts was on monitoring the real and potential effects of the pandemic on public companies, including potential reporting challenges and the importance of prompt, public disclosures by issuers concerning the effects and risks on their businesses.³ On March 13, 2020, the SEC provided exemptive relief to registered investment companies extending the filing deadlines of Forms N-Port and N-CEN required to be filed during the period from March 13, 2020 through April 30, 2020 by 45 days from its original due date. The relief is limited to those registrants that are unable to make these filings timely due to circumstances related to COVID-19.⁴ The relief is conditional on certain filings with the SEC explaining, among other things, the reasons for the inability to file on time

and any material impact of COVID-19 on its business. On March 25, 2020, the SEC extended this relief to filings due during the period from March 13, 2020 through June 30, 2020.⁵ A similar extension was provided to registered investment advisers with respect to their Form ADV filings. The SEC also provided a 45-day extension to registered investment companies for the transmittal of annual and semi-annual shareholder reports to investors for those report transmittal obligations occurring between March 13, 2020 and June 30, 2020.⁷

For the period from March 13, 2020 through June 30, 2020, the SEC also provided relief exempting closed end funds and business development companies from the requirement to file a notice with the

SEC at least 30 days in advance of their intention to call or redeem securities. Under the relief, the notice can be filed as late as the same business day as the call or redemption of the securities and is subject to certain conditions, such as notifying the SEC of its intent to rely on the order with an explanation why and that the abbreviated notice period is permitted under relevant state law and the fund's governance documents.⁸

Key considerations: Firms should review their fund disclosure documents and assess whether any changes are required due to the current volatility in the market or as a result of availing themselves of some of the regulatory relief discussed above. Possible areas that may require revision include risks or temporary changes in strategy or restrictions.⁹ Firms that avail themselves of the relief for extended time for filing requirements should consider the operational impacts on future filings and the “backlog” that could occur due to having to work on different sets of filings concurrently.

Prospectus delivery requirements

The SEC has also taken a no-enforcement position if a registered investment company does not deliver its current prospectus to investors where the delay is due to circumstances related to COVID-19, is

delivered to investors within 45 days of its original due date and is for a due date occurring during the period from March 13, 2020 to April 30, 2020.¹⁰

Key considerations: Firms should ensure that they are able to track the ultimate delivery of prospectuses to their original delivery due date to confirm that the delivery occurred within the 45-day extension period. Similar steps should be taken with respect to the late filing or transmittal of reports discussed above.

Compliance officers should consider adding this advisement to their testing plans and maintaining a record which should include the original and final delivery or filing dates. Such record can be used to respond to any future SEC exams that request information around late prospectus deliveries, shareholder report transmittals and Form N-Port, N-CEN and ADV filings. In this regard, compliance officers should maintain a master inventory of exemptive relief that has been relied upon to support regulatory requests and responses in a timely fashion.

Relief for in-person board meetings

On March 25, 2020, the Division of Investment Management provided exemptive relief which extended a no-action position expressed in the Independent Directors Council letter with respect to unforeseen or emergency circumstances to cover certain board and independent director approvals by registered investment companies and business development companies for advisory contracts, principal underwriting agreements, auditors and 12b-

1 plans that would otherwise be required to be in person if necessary or appropriate due to circumstances related to COVID-19.¹¹ To rely on the order, these approvals must be made at a meeting through a communication where all directors can hear each other simultaneously and must be ratified at the next in-person meeting of the board.

Key considerations: Firms that take advantage of the relief for in-person board meetings will need to track the approvals approved remotely so they are subsequently approved at in-person board meetings.

Liquidity management

On March 23, 2020, the SEC announced temporary flexibility for registered investment companies affected by the pandemic to borrow funds from certain affiliates and to enter into certain other lending arrangements. The relief is designed to provide funds with additional tools to manage their portfolios for the benefit of

all shareholders as investors may seek to rebalance their investments due to recent market events. This temporary relief will extend until at least June 30, 2020.¹² In addition, on March 19, 2020, the SEC's Division of Investment Management issued a no-action letter to the Investment Company

Institute related to mutual funds that are regulated under Rule 2a-7. The no-action letter allows, on a temporary basis, affiliates of a money market fund to purchase securities held by a fund.¹³

Key considerations: Managing redemptions can be challenging during extreme market volatility and liquidity constraints. The SEC's recent steps to provide relief aimed at easing the challenges around liquidity management for mutual fund sponsors such as those that ease the restrictions on otherwise prohibitive affiliated transactions (e.g., affiliated purchase and sale transactions and lending arrangements). Mutual fund sponsors should also evaluate the effectiveness of the funds' liquidity risk management programs during the current environment. Such evaluation should include an assessment of the current stress testing being applied, overall program administration during this unique period, and determining whether any changes ought to be made. As part of the adoption of the SEC Liquidity Risk Management rule (22e-4), open-end registered investment companies are required to file Form N-LIQUID in accordance with rule 30b1-10 on a non-public basis within 1 business day of when certain liquidity events occur. These events include when more than 15% of a fund's net assets are, or become, illiquid as defined by rule 22e-4, and when a fund's highly liquid investments fall below the fund's highly liquid investment minimum for more than 7 consecutive calendar days.¹⁴

Relief for virtual shareholder meetings

On March 13, 2020, the SEC provided guidance to facilitate the ability of market participants to hold their upcoming annual shareholder meetings virtually, using technology to engage with shareholders while complying with the federal securities laws. These virtual shareholder meetings

would avoid the need for in-person shareholder attendance during the pandemic, while at the same time ensuring that shareholders and other market participants are informed of any changes.¹⁵

Key considerations: Firms that avail themselves of the ability to have virtual shareholders meetings should consider effective communication strategies and access for remote participation at meetings to avoid investors being disenfranchised.

Relief for registered transfer agents

On March 20, 2020, the SEC provided relief to transfer agents related to the processing of securities transfers, safekeeping of investor and issuer funds and securities, and maintaining records of investors. Under Section 17A of the Exchange Act and certain Rules under 17Ad of the Exchange Act

certain processing times are required of transfer agents. The SEC granted relief from these processing requirements, subject to certain conditions being met, through May 30, 2020.

Key considerations: Firms should consider evaluating processing constraints and delays at each fund's transfer agent that may be impacting the timely processing of shareholder transactions and other shareholder servicing activities. In addition to impacting the shareholder servicing experience, processing delays could impact the reliability of key information that is used by portfolio managers to manage liquidity and make other portfolio decisions. Another factor for consideration that may potentially impact funds and transfer agents is the Coronavirus Aid, Relief, and Economic Security Act, the \$2.2 trillion stimulus package enacted on March 27, 2020, which allows for changes to accessing retirement vehicles, including waiving the 10 percent penalty on withdrawals from tax-favored retirement plans up to \$100,000 for individuals affected by the pandemic for the calendar year 2020.¹⁶ Additionally, the bill allows for a temporary waiver of required minimum distribution rules for certain retirement plans.¹⁷

Business continuity planning (BCP) and cybersecurity resiliency

Since early February, SEC officials across divisions and offices have expanded their ongoing outreach efforts with clearing agencies, exchanges, issuers, public accounting firms, investor representatives, credit rating agencies, fund sponsors, and investment advisers, as well as other domestic and foreign regulators. The ongoing communication and information-sharing efforts are to keep abreast of activities and operations of key market participants, including the COVID-19's

impact on BCP as employees in securities firms are ordered to work remotely.

On March 9, 2020, FINRA reminded firms of guidance relating to back-up facilities in the unlikely event of a widespread systems outage with respect to one of the trade-reporting facilities or the Alternative Display Facility. FINRA reminded firms that they must establish, maintain and enforce written policies and procedures that include a predetermined response addressing over-the-counter trading and reporting in

the event that they experience a systems issue in their own systems or in a vendor's systems.¹⁸ In addition, on March 26, 2020, FINRA published a cybersecurity alert to its members focused on considerations resulting from COVID-19. This alert provides firms with measures they may use to help strengthen their cybersecurity controls in areas where risks may increase in the current environment.

Key considerations: Firms must remain vigilant and, in light of significant adoption of work from home operating models, must ensure security of customer and firm data that is increasingly being accessed on personal devices, being transmitted over public networks, and/or being stored on public cloud services. Tactical actions include engaging the workforce on cybersecurity implications of working from home, review and enhancement of security controls governing remote access to sensitive firm assets, re-baselining of security monitoring controls and expected user behaviors, and updates to crisis and incident response procedures. Longer term, firms should evaluate the readiness of their security infrastructure to inherently support and scale to the needs of a mobile workforce while managing cost and security friction.

Relief for compliance with the Custody Rule¹⁹

On March 30, 2020 the SEC staff posted a new Custody Rule FAQ IV.7 regarding the required surprise examination by the independent public accountant. The FAQ clarifies that the Division of Investment Management would not recommend enforcement action for a violation of rule 206(4)-2 against an adviser that reasonably

believed that its accountant would complete its examination by the 120-day deadline, but failed to do so due the current logistical disruptions caused by COVID-19, as long as the accountant files the report as soon as practicable, but not later than 45 days after the original due date.²⁰

Key considerations: While there is no specific Custody Rule FAQ for COVID-19 relief for audited financial statements of pooled investment vehicles and their 120-day distribution deadline, existing FAQ VI.9 provides a similar no-action guidance generally for "unforeseeable circumstances", although it is silent towards any number of days after the deadline is missed. Advisers that are concerned about missing custody rule deadlines should discuss these considerations with their lawyers.

Relief for Business Development Companies (BDCs)

On April 8, 2020, in an effort to support the credit markets, the Commission announced a temporary, conditional relief for BDCs from certain restrictions of the Investment Company Act. BDCs were created to provide capital to small and mid-sized operating companies, their “portfolio companies”. In light of current market conditions, the Commission recognized that BDCs may not be able to fulfill this statutory mandate due to issues with satisfying asset coverage requirements due to temporary mark-downs in the value of their investments or

from the prohibition of certain affiliated funds from participating in additional follow-on investments. Therefore, the relief focused on 1) issuance of senior securities and asset coverage, and 2) expanded relief for BDCs with existing co-investment orders. BDCs can avail themselves of this relief through December 31, 2020.²¹

Key considerations: BDCs electing to rely on the relief regarding the more flexible asset coverage calculation would have to make the election by filing Form 8-K and would also be limited in making any new investments in which the BDC was not already invested in. Furthermore, there are other protections within the relief requirements around board oversight and approval, board reporting, recordkeeping, and compensation that management and chief compliance officers should be aware of before relying on the relief.

Additional key considerations

Firms should consider how the global and expansive nature of the current remote working environment has impacted access to data or the firm's ability to continue its operations. Many firms are challenged because their BCPs did not contemplate the closing of all global sites and an expansive, simultaneous, remote working environment. Firms should consider tracking lessons learned and enhancing their regulatory (including BCP plans), operational, and technology resiliency in the event a future crisis occurs.

Firms should consider evaluating key contracts (at the adviser, fund, and service provider levels) and create a repository of key provisions that could translate into risk during times of crisis. Firms should then assess the need to renegotiate these provisions. Examples of key provisions may include force majeure, default and cross default, business/service interruption, and indemnification provisions.

Conclusion

The crisis has illuminated several actions firms can take to strengthen their organizational processes, governance practices, and technology capabilities. Financial and securities regulators have taken swift and coordinated action in response to the ongoing challenges. These actions noted above speak to the importance of market function during this time of collective commitment by all Americans to ensure the health and safety of the nation. On March 24, 2020 SEC Chairman Jay Clayton said that the “continuing, orderly operation of our markets is an essential component of our national response to, and recovery from, COVID-19.”²² The SEC and other financial regulators believe that “preserving the flows of credit and capital in our economy—to businesses and individuals alike—will help us better fight COVID-19, as well as speed and strengthen our recovery.”²³ As the nation’s financial regulators continue monitoring the evolving public health crisis, firms should be prepared for additional guidance and relief.

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COVID-19 impact on bank liquidity risk management and response

Endnotes

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