

Is the PPP Just a Loan?

SEC guidance on disclosure of these loans to clients turns on materiality, that is, if it affects them.

One of the federal government's early responses to the COVID-19 global pandemic was to provide funding to help small businesses maintain their operations by retaining their workforce. Thus, the Small Business Administration authorized a forgivable loan through the Paycheck Protection Program (PPP) under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, but without providing meaningful guidance.

The 2020 market crash drastically impacted the profits and revenues of many small businesses, including investment advisors. As the world began to shelter-in-place, many small businesses had to consider the possibility of laying off workers or closing their doors.

Generally, an advisor's revenue and profit are tied to the value of assets under management. But as assets and profits began to decline, many advisors were uncertain as to whether they would be able to maintain their current operations — especially if the market continued its downward trend.

Advisors saw the PPP loan as an opportunity to support their operations, including retaining employees, during what appeared to be a potentially unprecedented historical event. However, there was a catch — small businesses needed to act quickly if they wanted to benefit from the PPP, and they had to do it based on the guidance available at that time.

Finally, on April 27, 2020, a month after the PPP went live, the Securities and Exchange Commission's Division of Investment Management released guidance addressing whether an



advisor must disclose its participation in the PPP.

Specifically, the SEC's guidance regarding an advisor's regulatory reporting obligations provided that, "[a]s 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)." (*emphasis added*).

Whether the application for or receipt of a PPP loan is material, and therefore requires disclosure to clients, is a question of fact. Materiality turns on whether this information rises to the level of "need to know" information for a typical client or prospective client. (The standard of materiality under federal securities laws is whether there is a substantial likelihood that a reasonable investor would have considered the information important.)

If after performing this analysis, the advisor believes that their decision to participate in the PPP is a material fact impacting their advisory relationships, then the advisor should disclose the PPP loan. However, this analysis should not focus on morality or the role of government in our society. Materiality ought to turn on whether the advisor and its personnel remain in an appropriate financial position so that they are able to continue their operations and render investment advice.

In the event an advisor receives a PPP loan and determines that disclosure is unnecessary after performing its analysis, then the advisor should document its rationale in reaching its conclusion. **IA**

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