



ALERTS

U.S. Securities And Exchange Commission Launches Investigations Into PPP Loans

May 17, 2020

Highlights

The SEC has begun investigating recipients of federal PPP loans

The SEC's initiative is of concern to registered entities and public companies that may have additional disclosure obligations related to their PPP loans

SEC registrants and public companies receiving PPP funds should carefully scrutinize all proposed public disclosures to ensure that they completely and accurately reflect the impact of a PPP loan on an entity's operations

The U.S. Securities and Exchange Commission (SEC) has begun sending requests for documents to recipients of loans provided under the federal government's Paycheck Protection Program (PPP) and is looking into how the funds are being used. The U.S. Small Business Administration (SBA) established the PPP to assist small businesses affected by the COVID-19 pandemic. The SEC's increased scrutiny suggests that it has concerns about the use of these loan proceeds and the legitimacy of loan recipients' need for federal assistance.

On April 27, the [SEC provided public guidance](#) addressing new regulatory

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reporting obligations of registered investment advisers (RIAs) that could result if an RIA receives a PPP loan. The guidance reminds RIAs that

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).

Although this guidance was directed at RIAs, it applies generally to any recipient of a PPP loan that is obligated, in the normal course of its business, to disclose material financial information pursuant to the federal securities laws. For example, a public company that "require[s] such [PPP] assistance to pay the salaries of [its] employees," or "is experiencing conditions that are reasonably likely to impair its ability to meet contractual commitments," may have experienced a material change in its operations that triggers an obligation under the Securities Act of 1930 and the Securities Exchange Act of 1934 to make disclosures to the company's shareholders.

Particularly relevant in this connection is Item 303 of Regulation S-K, which requires management to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."

Similarly, public statements related to a business's need for PPP funds may also give rise to securities laws disclosure issues. On May 13, the SBA [updated its public PPP guidance](#) to address borrower and lender questions concerning the rollout of the PPP, reminding borrowers that they

still must certify in good faith that their PPP loan request is necessary. . . . 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. For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.

In other words, a PPP loan recipient is not only required to disclose any adverse material information that required it to seek PPP funds in the first place, but financially stable loan recipients may not falsely represent that a PPP loan is "necessary" when the recipient's actual financial circumstances make the loan unnecessary. The SBA provided a "safe-harbor" period during which PPP loan recipients could return PPP funds,

which was extended to May 18, 2020.

Ensuring The Integrity of Securities Markets

Since the COVID-19 outbreak began, the SEC has acted in various ways to ensure the integrity of the nation's securities markets, including halting trading in the securities of companies that have made dubious public claims about COVID-19 drugs and screening methods. But the SEC's recent information requests are apparently aimed at legitimate companies, not scammers.

The information now being sought by the SEC's Division of Enforcement concerns applicants' qualification to receive PPP funds, and consistent with the SEC's April 27 guidance, the impact of the COVID-19 pandemic on the legitimate business operations of the borrower, including its ability to continue as a going concern. While the SEC's recent guidance was directed at RIAs, it does not appear that the SEC has limited its recent information requests to RIAs, as other SEC registrants and securities markets participants with disclosure obligations under the federal securities laws are also being asked to produce such information.

In a [public statement](#) made at the beginning of the COVID-19 outbreak, the co-directors of the SEC's Division of Enforcement "urge[d] public companies to be mindful of their established disclosure controls and procedures . . . to ensure to the greatest extent possible that they protect against the improper dissemination and use of material nonpublic information." The new requests show that the Division of Enforcement has begun to follow up on this advice, and it seems likely that formal SEC enforcement actions against PPP recipients who have misrepresented their financial condition will follow.

SEC registrants and public companies receiving PPP funds should carefully scrutinize all proposed public disclosures to ensure that they completely and accurately reflect the entity's financial condition, including the impact of PPP loan proceeds on the entity's operations and the circumstances that necessitated the loan in the first place.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work or David Slovick at 646-746-2019 or dslovick@btlaw.com, or Trace Schmeltz at 312-214-4830 or tschmeltz@btlaw.com.

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