

CLIENT ALERT

April 23, 2020

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CROSS BORDER: REGISTRANT ACTIVITIES

DEALING WITH YOUR OBLIGATIONS TO CLIENTS DURING THE COVID-19 PANDEMIC

by *Andre G. Poles, Bradley J. Wyatt, Frank Borger Gilligan, William H. Dorton, and Chantal A. Cipriano*

While securities regulators on both sides of the border have provided some relief to dealers and advisors, the Canadian Securities Administrators (“CSA”) and the Securities and Exchange Commission (“SEC”) have not extended that relief to ease the duties owed by registrants to retail clients. In particular, registrants continue to be required to have sufficient current information about their client’s situation and objectives when making recommendations to buy, sell, or hold securities. Dealers and advisors on both sides of the border should be acting now to assess client information with an eye to ensuring that they keep up with the altered and evolving market and economic conditions affecting us globally.

CANADA

When dealing with clients during the COVID-19 pandemic, registrants must continue to focus on their obligations to know their clients and to take reasonable steps to ensure that any trading is suitable for the client. Typically, registrants collect “know-your-client” (“KYC”) information at the start of the client relationship and periodically thereafter. In particular, registrants have an obligation to update KYC when they become aware of a significant change to a client’s circumstances.

In light of the massive disruption to the economy, workplaces, and financial markets, including the consequential impacts on investor incomes, portfolios, and wealth brought on by the COVID-19 pandemic, it would be unusual for a registrant to take the position that the requirement to update KYC has not been triggered.

Registrants that operate with discretionary authority over a client’s assets should be proactively reaching out to their clients to understand if the client has experienced a change in financial status in light of the pandemic. In circumstances where there has been no significant change to a client’s financial status, the current health crisis and economic conditions may still have resulted in changes to the client’s short-term and long-term investment goals and liquidity needs. All of these changes will need to be understood and considered by the registrant when determining whether to continue to hold, sell, or acquire specific securities for the client’s portfolio.

Similarly, registrants who deal with clients on a transactional basis will need to be aware of changes to the client’s circumstances when accepting trading instructions or making trading recommendations.

In light of the physical distancing requirements imposed across Canada, registrants will need to develop and implement new and flexible measures related to their KYC update process. Firms should update policies and procedures to reflect the “new normal” when it comes to gathering information on a wide scale and communicating with clients whose information may require updating. Even while implementing changes in response to the pandemic, registrants should remain

cognizant of the need for their compliance policies to both meet their regulatory obligations and reflect how they are actually operating. Once implemented, the “new normal” should be reviewed and revised regularly as the pandemic and its impacts evolve.

UNITED STATES

Similarly, in the United States, the SEC has not eased any of the requirements regarding the duties that are owed to retail investors by investment advisers or broker-dealers. In an April 2, 2020 statement, Chairman Jay Clayton reiterated that investors remain the top focus of the SEC and that the uncertainties caused by COVID-19 have not changed their perspective and commitment to protecting investors. Chairman Clayton also stressed that the June 30, 2020 deadline for broker-dealer compliance with Regulation Best Interest (“Reg BI”), Form CRS, and other related requirements remains intact.¹

Broker-dealers and investment advisers must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer in light of that client’s investment profile and the potential risks, rewards, and costs associated with the recommendation. In light of the current pandemic, U.S. broker-dealers and investment advisers need to proactively assess their KYC information – and make appropriate updates as necessary – in order to ensure continuing compliance. In connection with such an assessment, U.S. broker-dealers and investment advisers should consider the following:

Reg BI was adopted on June 5, 2019 with a June 30, 2020 compliance deadline, and is a key component of the SEC’s broader package of rules designed to raise the standard of care required of broker-dealers and to enhance the quality and transparency of retail investors’ relationships with broker-dealers and investment advisers.

Broker-dealers and investment advisers must exercise reasonable diligence, care, and skill when making a recommendation to a retail customer in light of that client’s investment profile and the potential risks, rewards, and costs associated with the recommendation. Both before and after the Reg BI compliance date, broker-dealers and investment advisers need to have sufficient current KYC information to meet their obligations. In light of these obligations and the current pandemic, broker-dealers and investment advisers in the U.S. should consider updating KYC in light of the following:

Changes in Current Financial Status. From the middle of March to the middle of April, approximately 18 million people in the U.S. filed first-time unemployment claims. As it stands now, an estimated 13% of the labor force in the U.S. is unemployed. At the height of the Great Recession, that number was 9.9%. More concerning is that these numbers are likely to continue to rise. Broker-dealers and investment advisers must assess the current financial status of their clients and should adjust investment strategies and recommendations accordingly.

¹ Reg BI was adopted on June 5, 2019 with a June 30, 2020 compliance deadline and is a key component of the SEC’s broader package of rules designed to raise the standard of care required of broker-dealers, and enhance the quality and transparency of retail investors’ relationships with broker-dealers and investment advisers. The SEC’s Office of Compliance Inspections recently issued two risk alerts providing guidance regarding the scope of forthcoming examinations focusing on compliance with Reg BI and Form CRS. The examinations are scheduled to begin after the June 30 deadline. Watch for our upcoming release on this topic.

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Changes in Investment Goals. Regardless of the employment and financial status of the client, the current health crises and economic conditions may have changed the client's short-term and long-term investment goals. Broker-dealers and investment advisers should consider new policies and procedures for reviewing and reassessing their clients' risk tolerances and strategic goals in light of the pandemic.

Need for Liquidity. Brokers and advisers should consider the client's need for liquidity before making recommendations or investment strategies. The ability to easily liquidate assets may be much more important to investors now that it was prior to the start of the pandemic.

Health Care and Insurance. Unfortunately, for most Americans, the loss of employment also means the loss of health care benefits. For those fortunate enough to be able to maintain coverage through COBRA or the private market, such coverage is expensive. Additionally, firms should consider the impact that COVID-19 might have on insurance carriers and stocks, as well as whether certain types of insurance could be sound investments for certain clients.

Please Note: These materials do not constitute legal advice. Government initiatives, announcements, and regulations in response to the COVID-19 situation continue to evolve and change frequently. As such, it is important to ensure you are aware of current information and that you consult with a lawyer before making your business decisions.

If you have any immediate questions or require further information, please reach out to your Dickinson Wright lawyer or contact the dedicated Dickinson Wright COVID-19 email at COVID19info@dickinsonwright.com.

ABOUT THE AUTHORS



Andre G. Poles is a Partner in Dickinson Wright's Toronto office. He can be reached at 416.777.4037 or apoles@dickinsonwright.com.



Bradley J. Wyatt is a Member in Dickinson Wright's Ann Arbor office. He can be reached at 734.623.1905 or bwyatt@dickinsonwright.com.



Frank Berger Gilligan is Of Counsel in Dickinson Wright's Nashville office. He can be reached at 615.780.1106 or fborbergilligan@dickinsonwright.com.



William H. Dorton is Of Counsel in Dickinson Wright's Lexington office. He can be reached at 859.899.8733 or wdorton@dickinsonwright.com.



Chantal A. Cipriano is an Associate in Dickinson Wright's Toronto office. She can be reached at 416.646.6864 or ccipriano@dickinsonwright.com.

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