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Memorandum

SEC Provides Registered Open-End Funds With Temporary Funding Flexibility in Response to Coronavirus Crisis

April 10, 2020

On March 23, 2020, the U.S. Securities and Exchange Commission ("SEC") announced temporary flexibility for registered funds affected by the coronavirus disease 2019 ("COVID-19") to borrow funds from certain affiliates and to enter into certain other lending arrangements.

The SEC's Order was issued under Sections 6(c), 12(d)(1)(J), 17(b), 17(d) and 38(a) of the Investment Company Act of 1940 ("Temporary Exemptive Order"). The Temporary Exemptive Order provides exemptions from certain requirements of the Investment Company Act of 1940 ("Investment Company Act"). The exemptions provide additional flexibility to obtain short-term funding for: (i) registered open-end management investment companies other than money market funds ("open-end funds"); and (ii) insurance company separate accounts registered as unit investment trusts ("separate accounts").

The period of relief provided in the Temporary Exemptive Order applies from March 23, 2020 until at least June 30, 2020, and the final termination date will be specified in a future public notice from the SEC staff.

Additionally, on March 26, 2020, the staff of the SEC's Division of Investment Management announced temporary conditional no-action relief under Section 17(a) of the Investment Company Act ("Temporary No-Action Letter") for registered open-end management investment companies other than money market funds and exchange-traded funds ("mutual funds") from restrictions on affiliated transactions contained in Section 17(a) of the Investment Company Act. The Temporary No-Action Letter is intended to improve the liquidity of certain debt securities, which has been disrupted by COVID-19.

The SEC has emphasized that it will continue to monitor the current situation and may issue other relief as necessary or appropriate. The most useful parts of the relief granted to date do not extend to registered closed-end management investment companies or business development companies ("BDCs").

Key Takeaways

The SEC has provided temporary exemptive relief to allow an open-end fund's investment adviser and other affiliates to enter into secured loans with the open-end fund.

The SEC has provided temporary exemptive relief to expand the scope of existing open-end fund interfund lending programs and, if a fund complex does not currently have an interfund lending exemptive order, to permit registered open-end funds to participate as borrowers in a newly established interfund lending program that complies with the terms and conditions of an existing IFL order (as defined below).

The SEC staff has taken a no-action position that a mutual fund can engage in cross trades with respect to certain debt securities with affiliates based on prices from a reliable third-party pricing service, subject to conditions based on Rule 17a-9 under the Investment Company Act, which is only available for money market funds.

The Temporary Exemptive Order and Temporary No-Action Letter do not provide any relief to assist closed-end funds or BDCs with potential liquidity issues.

Relief Under the Temporary Exemptive Order

FLEXIBILITY FOR OPEN-END FUNDS TO BORROW ON A SECURED BASIS FROM AFFILIATED PERSONS

The Temporary Exemptive Order provides the following conditional exemptions during the period of relief, which have the practical effect of allowing an open-end fund to borrow money on a secured basis from its investment adviser or other affiliated entities:

- An open-end fund is exempt from Section 12(d)(3) of the Investment Company Act to the extent necessary to permit it to borrow money from any affiliated person (a "first-tier affiliate"), or affiliated person of such affiliated person (a "second-tier affiliate") that is not a registered investment company itself;
- A first- or second-tier affiliate of an open-end fund or separate account is exempt from Section 17(a) of the Investment Company Act, to the extent necessary to permit such affiliates to make collateralized loans to an open-end fund or separate account; and
- An open-end fund is exempt from Section 18(f)(1) of the Investment Company Act to the extent necessary to permit it to borrow money from a first- or second-tier affiliate that is not a bank and is not itself a registered investment company.

Each of the exemptions described above is only available if the following conditions are met:

- The board of directors of the open-end fund, or the insurance company on behalf of the separate account, reasonably determines that the proposed borrowing under the Temporary Exemptive Order: (i) is in the best interests of the open-end fund and its shareholders or the separate account and its unit holders; and (ii) will be used to satisfy shareholder redemptions; and
- Before relying on the relief for the first time, the open-end fund or separate account must notify the SEC staff via email (IM-EmergencyRelief@sec.gov) that it is relying on the temporary relief.

The Temporary Exemptive Order does not provide exemptive relief from Section 17(d) of the Investment Company Act or Rule 17d-1 thereunder when an open-end fund borrows on a secured basis from an affiliate in reliance on the Order.

INTERFUND LENDING RELIEF FOR REGISTERED INVESTMENT COMPANIES

During the temporary relief period, any registered investment company that has previously obtained an SEC exemptive order permitting an interfund lending and borrowing facility, or any registered investment company that does not currently have such an order but determines to generally adhere to the conditions of any interfund lending order granted by the SEC in the 12-month period preceding and including March 23, 2020 (any such order, an "existing IFL order"), may:

- Make loans through the facility in an aggregate amount that does not exceed 25% of its current net assets at the time of the loan notwithstanding any lower limitation in the existing IFL order (which typically sets this cap at 15% of the lending fund's current net assets);
- Borrow (if permitted under the existing IFL order to be a borrower)[1] or make loans through the facility for any term notwithstanding any conditions limiting the term of such loans, if:
  - The term of any interfund loan made in reliance on the Temporary Exemptive Order does not extend beyond the expiration of the temporary relief;
  - The board of the registered investment company reasonably determines that the maximum term for interfund loans to be made in reliance on the temporary relief is appropriate; and
  - The loans will remain callable and subject to early repayment on the terms described in the existing IFL order.

During the temporary relief period, any fund previously able to rely on an existing IFL order may deviate from their registration statement policies to lend or borrow (as discussed below under *Open End Funds May Deviate From Their Registration Statement Policies*) notwithstanding any condition of the existing IFL order that incorporates limits set forth in its fundamental restrictions, limitations or non-fundamental policies if, in each case, any loan under the facility is otherwise made in accordance with the terms and conditions of the existing IFL order.

For a fund that has not previously been able to rely on an existing IFL order, during the temporary relief period such fund is exempt from the requirement in the designated existing IFL order to have previously disclosed reliance on the temporary relief in its registration statement or shareholder report, but if the fund files a prospectus supplement (or a new or amended registration statement or shareholder report) while it is relying on

[1] Closed-end funds are not permitted to borrow under existing interfund lending exemptive order precedent. Additionally, money market funds generally do not participate in interfund lending as borrowers under existing precedent and money market funds that were not previously eligible to rely on an existing IFL order are prohibited from acting as a borrower under the Temporary Exemptive Order.

the temporary relief, it must update its disclosure regarding the material facts about its participation or intended participation in the interfund lending facility.

Before relying on the temporary relief for the first time, the registered investment company must:

- Notify the SEC staff via email (IM-EmergencyRelief@sec.gov) that it is relying on the temporary relief (and for a fund not previously eligible to rely on an existing IFL order, identify which existing IFL order the fund is relying on); and
- For a fund that had previously been able to rely on an existing IFL order, disclose on its public website that it is relying on an SEC exemptive order that modifies the terms of its existing IFL order to permit additional flexibility to provide or obtain short-term funding from its interfund lending and borrowing facility.

OPEN-END FUNDS MAY DEVIATE FROM THEIR REGISTRATION STATEMENT POLICIES

During the period of temporary relief, an open-end fund may enter into lending or borrowing transactions that deviate from any relevant policy recited in its registration statement without prior shareholder approval if:

- The open-end fund's board reasonably determines that such lending or borrowing is in the best interests of the registered investment company and its shareholders;
- The open-end fund promptly notifies its shareholders of the deviation by filing a prospectus supplement and includes a statement on the applicable fund's public website; and
- Before relying on the relief for the first time, the registered investment company notifies the SEC staff via email (IM-EmergencyRelief@sec.gov) that it is relying on this temporary relief.

Temporary Relief from Restrictions on Affiliated Transactions

In its March 26, 2020 Temporary No-Action Letter addressed to the Investment Company Institute, the staff of the Division of Investment Management announced temporary no-action relief from restrictions on affiliated transactions contained in Section 17(a) of the Investment Company Act in response to the COVID-19 outbreak. The Temporary No-Action Letter is intended to permit affiliates of mutual funds to purchase debt securities from such mutual funds, as the liquidity of the debt securities market has been disrupted by COVID-19.

The Temporary No-Action Letter announces that the staff of the Division of Investment Management will not recommend enforcement action against any mutual fund or any first- or second-tier affiliate of a mutual fund that is not a registered investment company (each, an "Affiliated Purchaser") that purchases a debt security from a mutual fund.

To rely on this position, all of the following conditions must be met:

- The purchase price of the debt security must be paid in cash.
- The price of the purchased debt security must be its fair market value (as determined under Section

2(a)(41) of the Investment Company Act), provided that this price is not materially different from the fair market value of the security indicated by a reliable third-party pricing service (the "Purchase Price").

- If the Affiliated Purchaser later sells the purchased security for a higher price than the Purchase Price paid to the mutual fund, the Affiliated Purchaser shall promptly pay the difference to the mutual fund.[2]
- Within one business day of the debt security purchase, the mutual fund must publicly post on its website and inform the SEC staff via email (IM-EmergencyRelief@sec.gov) stating the mutual fund's name, the Affiliated Purchaser's name, the security(s) purchased (including a legal identifier if available), the amount purchased, and the Purchase Price.

Rule 17a-9 under the Investment Company Act already permits an Affiliated Purchaser to purchase certain securities from a money market fund, with similar conditions. The Temporary No-Action Letter temporarily expands the relief provided by Rule 17a-9 by allowing Affiliated Purchasers to purchase debt securities from affiliated mutual funds, which could provide mutual funds with an important liquidity option during the current market disruption.

[2] If the Affiliated Purchaser is subject to Sections 23A and 23B of the Federal Reserve Act, this condition does not apply to the extent that it would otherwise conflict with: (i) applicable banking regulations; or (ii) any applicable exemption from such regulations issued by the Board of Governors of the Federal Reserve System.

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