

# SEC Takes Further Action to Assist Funds in Light of COVID-19 Coronavirus Pandemic: Provides Flexibility for Funds and Insurance Company Separate Accounts to Obtain Short-Term Funding

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March 2020



## SEC Takes Further Action to Assist Funds in Light of COVID-19 Coronavirus Pandemic: Provides Flexibility for Funds and Insurance Company Separate Accounts to Obtain Short-Term Funding

On March 23, 2020, the Securities and Exchange Commission issued an order<sup>1</sup> providing relief to registered open-end funds and insurance company separate accounts (separate accounts) registered as unit investment trusts. The Order follows two previous orders by the SEC, granted on March 13, 2020, which provided relief to funds and investment advisers whose operations may be affected by the COVID-19 coronavirus outbreak.<sup>2</sup>

Designed to provide additional flexibility in obtaining short-term funding, the Order:

- Permits funds (other than money market funds) and separate accounts to borrow from certain affiliates;
- Allows funds to use interfund lending arrangements, and expands relief to funds that already have existing interfund lending exemptive relief; and
- Authorizes funds (other than money market funds) to participate in certain lending arrangements or borrowings that deviate from their fundamental policies.<sup>3</sup>

The exemptive relief is summarized in the following table. The relief will remain in effect at least through June 30, 2020. Its termination date will be specified in a subsequent public notice from the SEC Staff, with at least two weeks advance notice.

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<sup>1</sup> Order Under Sections 6(c), 12(d)(1)(J), 17(b), 17(d) and 38(a) of the Investment Company Act of 1940 and Rule 17d-1 Thereunder Granting Exemptions from Specified Provisions of the Investment Company Act and Certain Rules Thereunder, SEC Rel. No. IC-33821 (Mar. 23, 2020) (Order).

<sup>2</sup> See *Dechert OnPoint*, [SEC Takes Targeted Action to Assist Funds and Advisers in Light of COVID-19 Coronavirus Pandemic: Provides Temporary, Conditional Exemptions from Certain 1940 Act and Advisers Act Requirements](#).

<sup>3</sup> See [Press Release, SEC Provides Temporary Additional Flexibility to Registered Investment Companies Affected by Coronavirus](#) (Mar. 23, 2020).

Exemption	Conditions
<p><b>Borrowing from Certain Affiliates by Funds other than Money Market Funds<sup>4</sup></b></p> <ul style="list-style-type: none"> <li>• Funds and separate accounts are exempt from <b>Section 12(d)(3)<sup>5</sup></b> of the Investment Company Act of 1940 to the extent necessary to permit borrowing money from any affiliated person,<sup>6</sup> or affiliated person of such affiliated person, that is not itself a registered investment company.</li> <li>• An affiliated person of a fund or separate account, or an affiliated person of such affiliated person, is exempt from 1940 Act <b>Section 17(a)<sup>7</sup></b> to the extent necessary to permit making collateralized loans to such fund or separate account.</li> <li>• Funds are exempt from 1940 Act <b>Section 18(f)(1)<sup>8</sup></b> to the extent necessary to permit borrowing money from any affiliated person, or affiliated person of such affiliated person, that is not a bank and is not itself a registered investment company.</li> </ul>	<ul style="list-style-type: none"> <li>• The fund's board, including a majority of the directors who are not interested persons of such fund (Independent Directors), or the insurance company on behalf of the separate account, reasonably determines that such borrowing: <ul style="list-style-type: none"> <li>o is in the best interests of the fund and its shareholders or unit holders; and</li> <li>o will be for the purpose of satisfying shareholder redemptions.</li> </ul> </li> <li>• Prior to first reliance on this relief, the fund or separate account notifies the SEC Staff via email (IM-EmergencyRelief@sec.gov) stating that it is relying on the Order.</li> </ul>

<sup>4</sup> Importantly with respect to insurance company separate accounts, this relief does not address restrictions on affiliated transactions under ERISA (or the corresponding provisions of the Internal Revenue Code). To the extent a separate account constitutes “plan assets” as understood under ERISA (and for purposes of Section 4975 of the Code, these separate restrictions on affiliated transactions would need to be addressed.

Separately, while the Order does not specifically note that it applies to reverse repurchase agreements, which are a form of short-term secured borrowing, the relief from Sections 17(a) and 18(f)(1) would be consistent with permitting funds to borrow by entering into reverse repurchase agreements with affiliated persons (or affiliated persons of such affiliated persons).

<sup>5</sup> Section 12(d)(3) prohibits funds (and companies controlled by them) from purchasing or otherwise acquiring any security issued by, or any other interest in the business of, any person who is a broker, dealer, engaged in the business of underwriting, or an investment adviser of an investment company or otherwise a registered investment adviser (a securities-related business) except in certain enumerated circumstances. *See also* 1940 Act Rule 12d3-1 (permitting the acquisition of securities issued by securities-related businesses up to certain thresholds and subject to certain conditions).

<sup>6</sup> Section 2(a)(3) of the 1940 Act defines “affiliated person” of another person to mean: “(A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.”

<sup>7</sup> Among other things, Section 17(a) makes it unlawful for any affiliated person of a fund (other than those described in Section 12(d)(3)(A) and (B)), and any affiliated person of such person, acting as principal, knowingly to purchase from such fund (or from any company controlled by such fund) any security or other property (except securities of which the seller is the issuer), and to loan money or other property to such fund (or to any company controlled by such fund) in contravention of SEC rules.

<sup>8</sup> Section 18(f)(1) prohibits funds from issuing any class of senior security or selling any senior security of which it is the issuer, except that a fund is permitted to borrow from a bank provided that immediately after any such borrowing there is at least 300% asset coverage for all borrowings of such fund, and provided that certain additional, related conditions are satisfied.

Exemption	Conditions
<p><b>Interfund Lending: Funds without Existing Orders</b></p> <p>A fund not currently able to rely on an SEC order permitting interfund lending and borrowing may establish and participate in such a facility as set forth in an exemptive order permitting such a facility that the SEC has issued within the 12 months preceding the Order (recent IFL precedent).</p>	<ul style="list-style-type: none"> <li>• The fund satisfies the terms and conditions for relief in the recent IFL precedent (including with respect to whether it may participate as a borrower), <i>except</i>:               <ul style="list-style-type: none"> <li>○ it may rely on the relief provided to funds with existing IFL orders, discussed below, subject to its terms and conditions other than the website notice condition;</li> <li>○ it need not satisfy the condition in the recent IFL precedent requiring prior registration statement or shareholder report disclosure; and</li> <li>○ money market funds may not participate as borrowers in the interfund facility;</li> </ul> </li> <li>• Prior to first reliance on this relief, the fund:               <ul style="list-style-type: none"> <li>○ notifies the SEC Staff via email (IM-EmergencyRelief@sec.gov) stating that it is relying on the Order and identifying the recent IFL precedent that it is relying on; and</li> <li>○ discloses on its public website that it is relying on the relief to utilize an interfund lending and borrowing facility; and</li> </ul> </li> <li>• To the extent the fund files a prospectus supplement or a new or amended registration statement or shareholder report while relying on this relief, the fund updates its disclosure regarding the material facts about its participation or intended participation in the facility.</li> </ul>

Exemption	Conditions
<p><b>Interfund Lending: Funds with Existing Orders</b></p> <p>A fund currently able to rely on an SEC order permitting interfund lending and borrowing (existing IFL order) may:</p> <ul style="list-style-type: none"> <li>• Make loans through the facility in an aggregate amount not exceeding 25% of its current net assets at the time of the loan, notwithstanding any lower limitation in the existing IFL order;</li> <li>• Borrow (if permitted in the existing IFL order to be a borrower) or make loans through the facility for any term notwithstanding any conditions limiting such term, <b>subject to the Specific Conditions</b> noted at right; and</li> <li>• Avail itself of the relief in the Order (described below) concerning deviating from a fundamental policy with respect to lending or borrowing, notwithstanding any condition of the existing IFL order that incorporates limits set forth in the fund's fundamental restrictions, limitations or non-fundamental policies.</li> </ul>	<p><b><u>General Conditions</u></b></p> <ul style="list-style-type: none"> <li>• Any loan under the facility is otherwise made in accordance with the terms and conditions of the existing IFL order;</li> <li>• Prior to first reliance on this relief, the fund: <ul style="list-style-type: none"> <li>◦ notifies the SEC Staff via email (IM-EmergencyRelief@sec.gov) stating that it is relying on the Order; and</li> <li>◦ discloses 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.</li> </ul> </li> </ul> <p><b><u>Specific Conditions</u></b></p> <ul style="list-style-type: none"> <li>• The term of any interfund loan made in reliance on the Order does not extend beyond the expiration of the Order;</li> <li>• The fund's board, including a majority of the Independent Directors, reasonably determines that the maximum term for interfund loans to be made in reliance on the Order is appropriate; and</li> <li>• The loans will remain callable and subject to early repayment on the terms described in the existing IFL order.</li> </ul>
<p><b>Deviating from Fundamental Policy with respect to Lending or Borrowing for Funds other than Money Market Funds</b></p> <p>Funds are exempt from 1940 Act <b>Sections 13(a)(2) and 13(a)(3)</b> to the extent necessary to permit entering into otherwise lawful lending and borrowing transactions that deviate from any relevant policy recited in the registration statement without prior shareholder approval.<sup>9</sup></p>	<ul style="list-style-type: none"> <li>• The fund's board, including a majority of the Independent Directors, reasonably determines that such lending or borrowing is in the best interests of the fund and its shareholders;</li> <li>• The fund promptly notifies its shareholders of the deviation by filing a prospectus supplement and including a statement on the fund's public website; and</li> <li>• Prior to first reliance on this relief, the fund notifies the SEC Staff via email (IM-EmergencyRelief@sec.gov) stating that it is relying on the Order.</li> </ul>

<sup>9</sup> Section 13(a)(2) prohibits a fund from, among other things, borrowing money and making loans to other persons unless authorized by shareholder vote, except in accordance with the recitals of policy contained in its registration statement. Among other things, Section 13(a)(3) prohibits a fund, in the absence of a shareholder vote, from deviating from any investment policy changeable only if authorized by shareholder vote. See also 1940 Act Section 8(b) and Form N-1A Item 16(c) (requiring disclosure of fund policy with respect to, among other things, borrowing money and making loans).

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