

COVID-19: EMERGENCY SEC STAFF ACTION ALLOWS CONDITIONAL SALE TO AFFILIATES OF PORTFOLIO DEBT SECURITIES HELD BY OPEN-END FUNDS

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Investment Management Alert

By: George Zornada, Jon-Luc Dupuy, Lindsay R. Grossman

On March 26, 2020, the staff (the “Staff”) of the Securities and Exchange Commission (the “SEC”) took a substantial step in recognition of the significant securities market disruptions related to COVID-19 and granted no-action relief that temporarily relaxes affiliated transaction rules for open-end investment companies registered under the Investment Company Act of 1940, as amended (the “1940 Act”), that are not exchange-traded funds or money market funds (each, a “Fund”).^[1] The relief broadly allows any Fund holding debt securities to sell such securities, under Rule 17a-9 as slightly modified, to any affiliated person, or an affiliated person of such person, that is not a registered investment company (e.g., an affiliated adviser or private fund but not limited to any particular affiliated person). As such, Funds will have greater flexibility to liquidate positions in debt securities and raise cash during the temporary period.

The relief is effective immediately and will extend until terminated in a public notice issued by the Staff.

SUMMARY OF RELIEF GRANTED

Rule 17a-9 of the 1940 Act provides an exemption from the prohibitions on affiliated transactions under Section 17(a) to permit affiliated persons of a money market fund (or affiliated persons of such persons) to purchase securities from the money market fund. In light of short-term dislocation in the market for a variety of debt securities, the Investment Company Institute requested the Staff’s assurances that it would not recommend enforcement action under Section 17(a) if a Fund sold debt securities to an affiliated purchaser in reliance on Rule 17a-9.^[2] The Staff granted the relief requested, temporarily expanding the application of Rule 17a-9 to Funds other than money market funds.

The SEC has already relaxed interfund lending rules for registered investment companies (see related alert: [Rapid SEC Action on Open-End Fund Borrowing for Liquidity](#)), and the relief granted in the *ICI Letter* represents another significant step by the SEC and its Staff to provide avenues for Funds to enhance liquidity and fund shareholder redemptions in light of significant securities market disruptions related to COVID-19.

CONDITIONS OF RELIEF

In order to rely on the *ICI Letter*, the following conditions must be satisfied:

1. The purchase price for the debt security is paid in cash;

2. The price of the purchased debt security is its fair market value under Section 2(a)(41) of the 1940 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”);
3. If the affiliated purchaser sells the security for a higher price than the Purchase Price, the affiliated purchaser must promptly pay any profit from such sale back to the Fund;^[3] and
4. Within one business day of the purchase of the security, the Fund must post a public notice on its website and send a notification email to the Staff via email at IM-EmergencyRelief@sec.gov, which must state: the name of the Fund, the name of the affiliated purchaser, the security(ies) purchased (including a legal identifier if available), the amount of the security(ies) purchased, and the total price paid.

If you have any questions regarding these matters, please contact any of the authors listed above or one of the K&L Gates attorneys with whom you work.

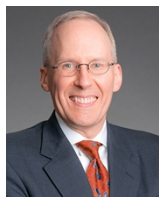
Notes:

[1] Investment Company Institute, SEC No-Action Letter (Mar. 26, 2020) (“*ICI Letter*”).

[2] Request for No-Action Relief for Affiliated Purchases of Debt Securities from Registered Open-End Investment Companies, Investment Company Institute (Mar. 26, 2020), https://www.ici.org/pdf/20_ltr_17a9.pdf.

[3] 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.

KEY CONTACTS



GEORGE ZORNADA
PARTNER

BOSTON
+1.617.261.3231
GEORGE.ZORNADA@KLGATES.COM



JON-LUC DUPUY
PARTNER

BOSTON
+1.617.261.3146
JON-LUC.DUPUY@KLGATES.COM

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