

ALERTS

Regulated Funds: SEC Provides No-Action Relief for Purchases of Debt Securities from Mutual Funds in Response to COVID-19

April 2, 2020

On March 26, 2020, the staff of the Division of Investment Management of the U.S. Securities and Exchange Commission (“Staff”) issued a no-action letter (“No-Action Letter”) indicating that, for the duration of the COVID-19 national emergency, registered open-end funds that are not exchange-traded funds and do not hold themselves out as money market funds (“mutual funds”) will be able to rely on the provisions of Rule 17a-9 under the Investment Company Act of 1940, as amended (“1940 Act”), to allow for purchases of debt securities by affiliated persons of such funds.[1] Prior to the issuance of the No-Action Letter, Rule 17a-9, which provides an exemption from prohibitions against transactions with affiliated persons under Section 17(a) of the 1940 Act, was only available to money market funds.[2] In reliance on Rule 17a-9, an affiliated person of a money market fund, or an affiliated person of such person, is permitted to purchase securities held by a money market fund, subject to certain conditions.

Recognizing a “short-term dislocation” in the debt securities market resulting from the COVID-19 outbreak, the Investment Company Institute (“ICI”) noted that mutual fund investment advisers (directly or through their affiliates) may wish to purchase debt securities from such funds to enhance the funds’ liquidity and to help fund shareholder redemptions.[3] The Staff agreed to make the Rule 17a-9 exemption temporarily available to enable such purchases of debt securities from mutual funds, subject to the following conditions:

1. The purchase price 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;
3. In the event that the purchaser thereafter sells the purchased security for a higher price than the purchase price paid to the fund, the purchaser shall promptly pay to the fund the amount by which the subsequent sale price exceeds the purchase price paid to the fund. If the 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;
4. Within one business day of the purchase of the security, the fund publicly posts on its website and informs the Staff via email at IM-EmergencyRelief@sec.gov, stating the name of the fund, the name of the purchaser, the security(s) purchased (including a legal identifier if available), the amount purchased and the total price paid; and
5. The relief set forth herein shall be in effect on a temporary basis in response to the national emergency concerning the COVID-19 outbreak, which was proclaimed by the President of the United States on March 13, 2020, and will cease to be in effect upon notice from the Staff.

The No Action Letter states that if the above conditions are met, the Staff will not recommend enforcement action against a mutual fund or any affiliated person of such fund that is not a registered investment company in connection with the purchase of debt securities by the affiliated person.

The No-Action Letter is part of a series of recent efforts by the Staff aimed at enhancing liquidity options for funds impacted by changing market conditions as a result of the COVID-19 outbreak.[4] If you have any questions about the content of this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] Investment Company Institute, SEC No-Action Letter (March 26, 2020), <https://www.sec.gov/investment/investment-company-institute-032620-17a>.

[2] 17 CFR § 270.17a-9

[3] Request for No-Action Relief for Affiliated Purchases of Debt Securities from Registered Open-End Investment Companies (March 26, 2020), <https://www.sec.gov/divisions/investment/noaction/2020/investment-company-institute-032620-17a-incoming.pdf>.

[4] *See SRZ Alert* Regulated Funds: SEC Provides No-Action Relief to Money Market Funds in Response to COVID-19 Outbreak (March 25, 2020), <https://www.srz.com/resources/regulated-funds-sec-provides-no-action-relief-to-money-market.html>; and *SRZ Alert* Regulated Funds: SEC Provides Temporary Exemption for Borrowing and Lending Arrangements in Response to COVID-19 Outbreak (March 31, 2020), <https://www.srz.com/resources/regulated-funds-sec-provides-temporary-exemption-for-borrowing.html>.

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