Blogs
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SEC Grants Mutual Funds Short-Term Borrowing/Lending Relief in Response to COVID-19

On March 23, 2020, the Securities and Exchange Commission ("SEC") issued a relief order (the "Order") granting temporary short-term lending and borrowing flexibility to open-end funds and insurance company separate accounts (each, a "fund") to assist such funds in dealing with market disruptions caused by the COVID-19 pandemic. The Order temporarily permits a fund to borrow from its affiliated persons. It also expands such fund's flexibility for lending or borrowing under an existing interfund lending exemptive order ("IFL Order"); a fund without an IFL Order will be permitted to participate in an interfund lending arrangement under similar conditions. Lastly, a fund may temporarily engage in borrowing or lending arrangements that may deviate from its fundamental investment policies. The Order covers transactions involving second-tier affiliated persons as well (first and second tier affiliated persons are referred to as "fund affiliates"). This temporary relief is in effect until at least June 30, 2020. After the effective period, funds will have two weeks to cease activities carried out in reliance on the Order, once the SEC issues a public notice terminating the Order. Before relying on this temporary relief, a fund will need to comply with the various conditions in the Order.

Borrowing from Fund Affiliates

Section 18(f)(1) of the Investment Company Act of 1940 (the "1940 Act") prohibits a mutual fund from borrowing from any entity other than a bank. In addition, Section 17(a) prohibits a mutual fund from selling assets to a fund affiliate, which might include the transfer of collateral for a loan. Finally, Section 12(d)(3) generally prohibits a fund from acquiring securities (or other interests) of a company engaged in a securities-related business (i.e., a broker dealer, an underwriter, or an investment adviser). The Order temporarily relaxes these restrictions (although it is not clear to us why Section 12(d)(3) would apply to borrowings) by allowing a mutual fund to borrow from a fund affiliate if it complies with the following conditions:

- The board of directors (including a majority of the independent directors, the "Board") "reasonably determines" such borrowing is in the best interests of the fund/shareholders;
- The Board "reasonably determines" such borrowing will be for shareholder redemption purposes; and
- Prior to relying on the relief for the first time, the mutual fund notifies the SEC at IM?EmergencyRelief@sec.gov.

Interfund Lending

Mutual funds in an investment company complex are typically affiliated persons of one another, so funds ordinarily must obtain an IFL Order to engage in interfund lending arrangements. Under the temporary relief, a fund with an IFL Order may exceed limitations on the amount of net assets lent and the term of the loan if the fund complies with the conditions in Table I below. Funds without an existing IFL Order may also establish an interfund lending facility without first obtaining shareholder approval as long as they comply with an IFL Order issued within the last 12 months ("Precedent IFL Order"), as modified by the Order. To take advantage of this relief, such funds must comply with the conditions noted in Table I below.

Table I

Borrowing/Lending in Deviation from Fundamental Investment Policies

Funds typically have fundamental investment policy restrictions on such fund's borrowing or lending ability. The Order allows an open-end fund to temporarily engage in such transactions in deviation from its fundamental investment policy without shareholder approval, subject to compliance with the following conditions:

- The Board "reasonably determines" borrowing or lending is in the best interests of the fund/shareholders;
- The fund notifies shareholders through a prospectus supplement filing;
- Public website disclosure of reliance on the relief; and
- Prior to relying on the relief for the first time, notify the SEC at IM?EmergencyRelief@sec.gov.

Money Market Funds

Money market funds may make loans in reliance on the Order but may not borrow from other funds or fund affiliates.

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