

MEMO# 32314

March 24, 2020

SEC Provides Temporary Interfund Lending Relief to Funds

[32314]

March 24, 2020 TO: ICI Members

Investment Company Directors SUBJECTS: Compliance

Disclosure

Fund Accounting & Financial Reporting

Fund Governance

Investment Advisers

Operations

Portfolio Oversight

Risk Oversight

Transfer Agency RE: SEC Provides Temporary Interfund Lending Relief to Funds

On March 23, the SEC provided conditional relief to permit registered open-end funds^[1] and insurance company separate accounts^[2] to borrow money from certain affiliates in order “to assist financial market participants in addressing the impacts of the coronavirus.”^[3]

As discussed in more detail below, the relief conditionally permits:

- An open-end fund or separate account to borrow from certain affiliates;
- A registered investment company that already has interfund lending exemptive relief, regardless of any lower limits in that relief, to:
 - lend up to 25 percent of its current net assets, or
 - borrow or lend for any term not extending beyond the length of this temporary relief;
- A registered management investment company that does not already have interfund lending exemptive relief to establish and participate in a lending facility as set forth in an exemptive order that the SEC has issued within the past twelve months; and
- An open-end fund to enter into lending or borrowing arrangements that deviate from any relevant policy recited in its registration statement without prior shareholder approval.

The relief is temporary but will remain in place at least until June 30, 2020.

Background

Many—but not all—fund complexes have SEC exemptive orders that permit their funds to borrow from and lend to one another, subject to numerous conditions.^[4] This arrangement provides a borrowing fund with a source of liquidity at a rate lower than the bank borrowing rate at times when the borrowing fund may have a short-term cash need. And a lending fund could earn interest at a rate higher than it otherwise could obtain from certain short-term money market instruments. Thus, these arrangements can benefit both borrowing and lending funds.

Relief Permitting Open-End Funds and Separate Accounts to Borrow from Affiliates

Temporarily, an open-end fund or a separate account may borrow money from certain affiliated entities, and certain affiliated entities of an open-end fund or separate account may make collateralized loans to such open-end fund or separate account, provided that:

- The board of directors of the open-end fund (including a majority of the directors who are not interested persons of the fund) or the insurance company on behalf of the separate account, reasonably determines that such borrowing:
 - is in the best interests of the fund and its shareholders or unit holders; and
 - will be for the purpose of satisfying shareholder redemptions.
- Prior to relying on the relief for the first time, the fund or separate account notifies the SEC staff via email at IM-EmergencyRelief@sec.gov stating that it is relying on the Order.

Expanded Relief for Fund Complexes with Existing Interfund Lending Orders

For fund complexes that currently have SEC orders permitting interfund lending, this Order provides additional flexibility. Temporarily, any registered investment company currently able to rely on such an order (“existing IFL order”) may:

- Make loans through its facility in an aggregate amount that does not exceed 25 percent of its current net assets at the time of the loan, notwithstanding any lower limitation in the existing IFL order;^[5]
- Borrow (if permitted under the existing IFL order to be a borrower) or make loans through the facility for any term, notwithstanding conditions in the existing IFL order limiting the term of such loans,^[6] provided that:
 - the term of any interfund loan made in reliance on the Order does not extend beyond the expiration of the temporary relief,
 - the fund board (including a majority of the directors who are not interested persons of the fund) reasonably determines that the maximum term for interfund loans to be made in reliance on the Order is appropriate, and
 - the loans will remain callable and subject to early repayment on the terms described in the existing IFL order; and
- Avail itself of the relief related to deviations from certain fundamental investment policies (described below), notwithstanding any condition of the existing IFL order that incorporates limits set forth in its fundamental restrictions, limitations, or non-fundamental policies;

This expanded relief is conditioned on the following:

- Any loan is otherwise made in accordance with the terms and conditions of the existing IFL order;
- Prior to relying on the relief for the first time, the fund notifies the SEC staff via email at IM-EmergencyRelief@sec.gov stating that it is relying on the Order; and
- Prior to relying on the relief for the first time, the fund 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.

Relief for Fund Complexes without Existing Interfund Lending Orders

Temporarily, any registered management investment company that is not currently able to rely on an SEC interfund lending order may establish and participate in such a lending facility as set forth in an exemptive order that the SEC has issued within the twelve months preceding the date of the Order (“recent IFL precedent”), provided that:

- The fund must satisfy the terms and conditions for relief in the recent IFL precedent, except:
 - It may rely on the additional relief described in the sub-section above, subject to its terms and conditions (other than the website notice requirement);
 - It need not satisfy the condition in the recent IFL precedent requiring prior disclosure in its registration statement or shareholder report; and
 - Money market funds may not participate as borrowers in the interfund facility;
- Prior to relying on the relief for the first time, the fund notifies the SEC staff via email at IM-EmergencyRelief@sec.gov stating that it is relying on the Order and identifying the recent IFL precedent that it is relying on; and
- The fund:
 - Discloses on its public website, prior to relying on the relief for the first time, that it is relying on the relief to utilize an interfund lending and borrowing facility.
 - To the extent it files a prospectus supplement (or a new or amended registration statement or shareholder report) while it is relying on this relief, updates its disclosure regarding the material facts about its participation or intended participation in the facility.

Relief from Certain Fundamental Policy Restrictions (If Applicable)

Some funds have fundamental policies (e.g., related to their ability to lend or borrow) that preclude them from participating in interfund lending arrangements, even if they are part of a fund complex with exemptive relief. Temporarily, 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,^[7] provided that:

- The fund board (including a majority of the directors who are not interested persons of the fund) reasonably determines that such lending or borrowing is in the best interests of the fund and its shareholders;
- The fund promptly notifies its shareholders of the deviation by filing a prospectus supplement and including a statement on the applicable fund’s public website; and
- Prior to relying on the relief for the first time, the fund notifies the SEC staff via email at IM-EmergencyRelief@sec.gov stating that it is relying on the Order.

Duration of the Temporary Relief

The Order's relief is limited to the period from (and including) March 23, 2020 to (and including) the date to be specified in a public notice from SEC staff stating that the relief will terminate, which date will be no earlier than June 30, 2020.

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endnotes

[1] Specifically, registered open-end management investment companies other than money market funds.

[2] Specifically, insurance company separate accounts registered as unit investment trusts.

[3] *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 Release No. IC-33821 (March 23, 2020) (the "Order"), available at www.sec.gov/rules/other/2020/ic-33821.pdf.

[4] Exemptive relief is needed because of the 1940 Act's prohibitions or restrictions on affiliated transactions, joint transactions, and borrowing, among other things. See, e.g., *Diamond Hill Funds and Diamond Hill Capital Management, Inc.*, SEC Release Nos. IC-33616 (Sept. 4, 2019) (Notice of Application) (available at www.sec.gov/rules/ic/2019/ic-33616.pdf) and 33652 (Oct. 2, 2019) (Order) (available at www.sec.gov/rules/ic/2019/ic-33652.pdf).

[5] Under existing orders, lending funds are commonly subject to certain limits. For example, a fund may be prohibited from lending to another fund if the loan would cause its aggregate outstanding loans through the facility to exceed 15 percent of the lending fund's current net assets at the time of the loan, and a fund's interfund loans to any one fund may not exceed 5 percent of the lending fund's net assets.

[6] Under existing orders, it is common for the duration of these loans to be limited to seven days.

[7] Ordinarily, a change to a fund's fundamental policy (e.g., related to its ability to lend or borrow) would require shareholder approval.