Blogs
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Asset Management ADVocate

SEC Provides No-Action Relief Extending Rule 17a-9 to Non-Money Market Funds

In response to the ongoing COVID-19 pandemic and resulting market liquidity issues impacting regulated investment companies, the Securities and Exchange Commission's Division of Investment Management (the "Division") recently issued a no-action letter (the "No-Action Letter") providing temporary relief from the prohibitions of Section 17(a) of the Investment Company Act of 1940 (the "1940 Act") to open-end funds that are not exchange-traded funds or money market funds ("mutual funds"). The Division issued the No-Action Letter to address concerns of short term "market dislocation" involving debt securities and mutual funds' need to increase liquidity to satisfy shareholder redemption requests. This post summarizes the conditions to this relief.

Prohibition of Affiliated Transactions with Mutual Funds

Ordinarily, Section 17(a) would prohibit an "affiliated person" of a mutual fund, or an affiliated person of such an affiliated person, from purchasing assets from the mutual fund. The definition of "affiliated person" is very broad.

> Affiliated person" of another person means (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.

Section 17(a) also prohibits purchases by the mutual fund's principal underwriter, promoter and their affiliated persons. We refer to the persons subject to Section17(a) as "fund affiliates."

Rule 17a-9 and Money Market Funds

Since 2010, Rule 17a-9(b) has permitted fund affiliates to purchase securities from money market funds in order to provide liquidity to the fund. Rule 17a-9(b) has three conditions:

1. The fund affiliate must purchase the security for cash;
2. The purchase price must be the greater of the security's amortized cost or market price (including accrued interest); and
3. If the fund affiliate subsequently sells the security at a price higher than the purchase price, it must pay the excess to the fund.

Extension of Rule 17a-9 to Other Mutual Funds

The No-Action Letter states that the Division will not recommend an enforcement action under Section 17(a) if a mutual fund sells debt securities to a fund affiliate in reliance on Rule 17a?9. "Debt securities" include (without limitation): "commercial paper, corporate debt securities, certificates of deposit, asset-backed debt securities and municipal obligations." Because mutual funds do not generally value their debt securities at amortized cost, the No-Action Letter modifies the second condition of Rule 17a-9 to require the purchase price to equal the debt security's fair market value (determined in compliance with Section 2(a)(41) of the 1940 Act), provided that the price "is not materially different" from the price indicated by a "reliable third-party pricing service." A mutual fund that relies on the No-Action Letter must, within one day of the purchase, post on its public website, and email the staff at IM-EmergencyRelief@sec.gov, information identifying the mutual fund, purchaser, purchase price and amount, and security (including LEI, if available). The temporary relief will terminate upon notice from the Division.

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