

COVID-19 NEWS OF INTEREST

SEC Staff Provides No-Action Relief to Registered Investment Companies and BDCs in Connection with Participation in TALF 2020

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On May 27, 2020, the staff of the Division of Investment Management (“Staff”) of the Securities and Exchange Commission (“SEC”) granted conditional no-action relief with respect to certain provisions of the Investment Company Act of 1940 (“Investment Company Act”) to facilitate participation by registered investment companies and business development companies (“BDCs”) in the Federal Reserve Board’s 2020 Term Asset-Backed Securities Loan Facility (“TALF 2020”).¹ The no-action relief (the “2020 Relief”) re-affirms and, with respect to certain aspects, expands the Staff’s no-action positions set out in two letters issued in 2009 in connection with the term asset-backed securities loan facility that was established in response to the 2008 financial crisis (“TALF 2008”). In connection with providing the 2020 Relief, the Staff has determined that the terms and conditions of TALF 2020 are substantially similar to those of TALF 2008 for purposes of the no-action positions taken in the 2009 letters.² The 2020 Relief thus allows funds to rely on the prior no-action positions in connection with their participation in TALF 2020.

TALF 2020 was established by the Federal Reserve Board in March 2020 in response to the impact of COVID-19 on the global financial markets. TALF 2020 is intended to support the flow of credit to consumers and small businesses by facilitating the issuance of asset-backed securities (“ABS”) backed by certain types of loans. Under TALF 2020, the Federal Reserve will provide non-recourse loans to holders of certain high-quality ABS backed by newly and recently

¹ Investment Company Institute and SIFMA AMG, SEC No-Action Letter (May 27, 2020), available [here](#).

² In the 2020 Relief, the Staff acknowledged that certain structural differences exist between TALF 2008 and TALF 2020 and that certain TALF 2020 terms may change following the date of the 2020 Relief. Nonetheless, the Staff expressed that, in its view, these structural differences and other potential changes are not relevant for purposes of the provisions of the Investment Company Act at issue in the 2009 no-action letters.

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originated consumer and small business loans. TALF 2020 loans must be secured by eligible ABS held by the borrower at the time of origination or purchased by the borrower with the proceeds of the TALF 2020 loan (“Eligible Securities”). U.S. investment funds, including registered investment companies and BDCs, whose investment managers have significant operations in and a majority of their employees based in the United States, are eligible borrowers under TALF 2020.³

“Asset Coverage” Relief

Relief issued in connection with TALF 2008

In a June 2009 letter (the “June 2009 Letter”),⁴ the Staff provided no-action relief with respect to Sections 18(a)(1), 18(c) and 18(f)(1) of the Investment Company Act to registered investment companies that sought to participate in TALF 2008 without treating a TALF loan as a senior security representing indebtedness for purposes of compliance with those sections.⁵ The June 2009 Letter also provided relief with respect to Section 17(f) of the Investment Company Act and the rules thereunder in connection with a fund’s participation in the unique custody arrangements necessitated by TALF 2008.⁶

The relief provided in the June 2009 Letter was subject to certain conditions, and required that a participating fund segregate liquid assets in an amount equal to the fund’s outstanding principal and interest on the TALF loan (“Asset Segregation Requirement”) in a manner similar to that set out in Investment Company Act Release No. 10666 (“Release 10666”) for reverse repurchase agreements. Eligible Securities that collateralized the TALF loan were not permitted to be used to meet the Asset Segregation Requirement. In addition, the June 2009 Letter required that the value of the

³ See Federal Reserve Bank of New York, FAQs: Term Asset-Backed Securities Loan Facility (effective May 26, 2020).

⁴ Franklin Templeton Investments, SEC No-Action Letter (June 19, 2009), *available here*.

⁵ Section 18(a)(1) of the Investment Company Act prohibits a registered closed-end investment company from issuing any class of senior security representing indebtedness or selling any senior security representing indebtedness of which it is the issuer, unless (among other things) immediately after such issuance or sale the fund will have asset coverage of at least 300%. Section 18(c) of the Investment Company Act prohibits a registered closed-end investment company from issuing any senior security representing indebtedness if, immediately thereafter, such fund would have outstanding more than one class of senior security representing indebtedness, subject to certain exceptions. Section 18(f)(1) of the Investment Company Act prohibits a registered open-end investment company from issuing any class of senior security or selling any class of senior security of which it is the issuer, except that the fund may borrow from any bank if, immediately after any such borrowing, there is asset coverage of at least 300% for all of the borrowings of the fund.

⁶ Among other things, Section 17(f) of the Investment Company Act and the rules thereunder generally place limitations on the types of custody arrangements into which a registered investment company may enter with respect to its assets.

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segregated assets be marked-to-market daily, such that additional liquid assets would need to be segregated whenever the total value of the segregated assets fell below the amount of the fund's obligation under the TALF loan.⁷

The June 2009 Letter also required that a participating fund's investment in Eligible Securities and borrowing under the TALF 2008 program be consistent with the investment objective, policies and limitations of the participating fund, as stated in its registration statement under the Investment Company Act.

2020 Relief

Under the 2020 Relief, the Staff re-affirmed the no-action position taken in the June 2009 Letter as it applies to a registered investment company's participation in TALF 2020. The Staff also confirmed that the relief provided in the June 2009 Letter is available to BDCs, in addition to registered open-end and closed-end investment companies. Accordingly, a registered investment company or BDC may rely on the June 2009 Letter in connection with its participation in TALF 2020, so long as the registered investment company's or BDC's facts and circumstances are substantially similar to those described in the underlying request of the June 2009 Letter and meet the conditions set out in that letter.⁸

Funds with existing borrowing facilities that seek to rely on the asset coverage relief provided in the 2020 Relief should check the documentation of those facilities to determine whether additional borrowings, such as participation in TALF 2020, are permissible.

Relief to Participate Through an Affiliated Private Fund

Relief issued in connection with TALF 2008

In an October 2009 letter (the "October 2009 Letter"),⁹ the Staff provided no-action relief with respect to Sections 17(a) and 17(d) of the Investment Company Act and Rule 17d-1 thereunder in connection with purchases by certain registered investment companies ("Registered Funds") and institutional separately managed accounts and common trust funds ("Accounts") of interests in a Section 3(c)(1) or Section 3(c)(7) pooled investment vehicle that was organized for the specific purpose of acquiring Eligible Securities and obtaining loans under TALF 2008 (the "Private Fund").¹⁰

⁷ The June 2009 Letter noted that the combination of the Asset Segregation Requirement and the Eligible Securities collateralizing the borrowing would ensure that a fund's borrowing under the TALF 2008 program would, in effect, have asset coverage of at least 200%.

⁸ In the 2020 Relief, the Staff acknowledged that the June 2009 Letter contains references to the asset segregation requirements set forth in Release 10666, and that the SEC's recently re-proposed Rule 18f-4 under the Investment Company Act contemplates rescinding Release 10666.

⁹ T. Rowe Price Associates, Inc., SEC No-Action Letter (Oct. 8, 2009), available [here](#).

¹⁰ Section 17(a)(1) of the Investment Company Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such person, acting as principal, from knowingly selling any security to such investment company, subject to certain exceptions. Section 17(a)(2) of

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As described in the request letter, each of the Registered Funds held or had the ability to acquire Eligible Securities to use as collateral for TALF loans, but potentially would have been unable or unwilling to post the minimum amount of Eligible Securities required for a TALF loan (*i.e.*, \$10 million plus the applicable “haircut” amount for purposes of TALF 2008).¹¹ As a result, the Registered Funds proposed to gain indirect access to the TALF 2008 program by investing in the Private Fund. The Private Fund was managed by the investment adviser to the Registered Funds, and interests in the Private Fund were sold only to eligible Registered Funds and Accounts. The Registered Funds and Accounts wishing to participate in the TALF 2008 program proposed to purchase Private Fund interests for cash or through a contribution in-kind of Eligible Securities held in their respective portfolios or a combination of cash and in-kind contributions. The Private Fund would then, in turn, obtain a TALF loan using the contributed Eligible Securities as collateral for the TALF loan or use the cash investments or TALF loan proceeds to purchase Eligible Securities that would be posted as collateral for the TALF loan.

The no-action relief was subject to a number of conditions set out in the request letter, including the following, among others:

- Except with respect to certain sub-advised Registered Funds, any investment by a Registered Fund in the Private Fund was required to be approved in advance by such Registered Fund’s board of directors/trustees, including a majority of its independent members;
- Except with respect to certain sub-advised Registered Funds, a Registered Fund would be permitted to invest in the Private Fund only if it had an operating policy that restricted it from purchasing additional securities to the extent it had borrowed in excess of 5% of its assets;¹²
- A Registered Fund would not invest more than 5% of its total assets in the Private Fund or more than 10% of its total assets in the Private Fund, any other investment vehicle relying on Section 3(c)(1) or 3(c)(7) and direct investments in TALF loans;

the Investment Company Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such person, acting as principal, from knowingly purchasing any security (other than any security of which the seller is the issuer) from such investment company. Section 17(d) of the Investment Company Act generally prohibits an affiliated person of a registered investment company, or any affiliated person of such a person, acting as principal, from effecting any transaction in which the registered company is a joint or joint and several participant in contravention of SEC rules and regulations. Rule 17d-1, in pertinent part, prohibits any affiliated person of a registered investment company or any affiliated person of such a person from participating in, or effecting any transaction in connection with, a joint arrangement or profit-sharing plan unless the SEC grants an exemptive order authorizing the arrangement or plan.

¹¹ The minimum loan amount for TALF 2020 is \$5 million.

¹² Under the October 2009 Letter, the borrowing of a TALF loan, including indirectly through an investment in the Private Fund, would not be subject to this operating policy.

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- No single investor in the Private Fund (including any Registered Fund) would hold an investment constituting 25% or more of the total value of the outstanding Private Fund interests; and
- The Private Fund would be deemed to be subject to Sections 9, 12, 13, 17(a), 17(d), 17(e), 17(f), 17(h), 21, 23(a), and 36-53 of the Investment Company Act as if it were a registered closed-end investment company.

Due to the very fact specific nature of the request, however, the Staff limited reliance on the October 2009 Letter to the Registered Funds identified in the incoming letter.

2020 Relief

Under the 2020 Relief, the Staff re-affirmed the no-action position taken in the October 2009 Letter as it applies to a registered investment company's participation in TALF 2020. In addition, the 2020 Relief expands the scope of the October 2009 Letter in two notable ways:

- First, the 2020 Relief extends the availability of the relief provided in the October 2009 Letter to third parties, in addition to the recipients of the original letter.
- Second, the 2020 Relief extends the no-action position applicable to registered investment companies with respect to Section 17 to BDCs with respect to Section 57(a) of the Investment Company Act, thus allowing a BDC to rely on the October 2009 Letter if the facts and circumstances of a transaction involving the BDC are substantially similar to those described in the October 2009 Letter.¹³

Accordingly, a registered investment company or BDC may rely on the October 2009 Letter in connection with its participation in TALF 2020, so long as the registered investment company's or BDC's facts and circumstances are substantially similar to those described in the underlying request of the October 2009 Letter and meet the conditions set out in that letter.

¹³ BDCs are subject to Section 57(a) of the Investment Company Act rather than Sections 17(a) and 17(d). Nonetheless, the restrictions on principal transactions and joint transactions in Section 57(a) generally mirror those in Sections 17(a) and 17(d) as they apply in the context of a transaction substantially similar to that described in the October 2009 Letter. Rule 17d-1 applies to both registered investment companies and BDCs.

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