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SEC Adopts Expedited Exemptive Relief Process for Registered Funds and BDCs

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On July 6, 2020, the Securities and Exchange Commission (the "Commission") adopted rule amendments (the "Amendments") to the exemptive relief application process under the Investment Company Act of 1940, as amended (the "1940 Act"), which establish expedited review procedures for applications that are substantially identical to recent precedent and create a timeframe for standard review of applications outside of the new expedited review procedures.[1] In addition, the Amendments adopt a new rule providing circumstances where an application under standard review will be deemed withdrawn.

The Commission adopted the Amendments largely as they had been proposed, and the Amendments will be effective 270 days after their publication in the Federal Register (which has not occurred as of the date of this Client Alert).[2]

Expedited Review

Rule 0-5 under the 1940 Act prescribes the process for registered funds and business development companies ("BDCs") to apply for an order from the Commission for exemptive or other relief under the 1940 Act. These exemptive orders historically have been required for certain funds to operate (e.g., exchange-traded funds or interval funds that seek to offer multiple share classes similar to an open-end fund operating in accordance with Rule 18f-3 under the 1940 Act) and to permit certain activities and transactions that would otherwise be prohibited by the 1940 Act (e.g., interfund lending arrangements or the ability of registered funds and BDCs to participate in certain negotiated co-investment transactions). The Amendments principally amend Rule 0-5 to establish an expedited review procedure for qualifying applications.

Expedited review will be available for an exemptive relief application that is "substantially identical" to two other applications for which an order granting the requested relief has been issued by the Commission within three years of the date of the application's initial filing. New Rule 0-5(d)(2) defines "substantially identical" applications as applications that request relief from the same sections of the 1940 Act and rules thereunder, contain identical terms and conditions and differ only with respect to factual differences that are not material to the relief requested.[3] The three-year lookback period for precedent applications is an increase from the two-year period proposed in the Proposing Release. In connection with this expansion, however, the Amendments add a requirement that applicants explain in a cover letter why the applicant chose the particular precedents used and, if applicable, why it is appropriate to use the chosen precedents rather than more recent applications of the same type for which orders have been issued.

Consistent with the Proposing Release, applicants will not be permitted to "mix and match" precedent relief for submission under the expedited review process, and applications that combine portions or sections of prior different applications will need to be submitted through the standard review process. Furthermore, applications that are highly fact-specific or include different terms and conditions than those of precedent applications generally will not meet the substantially identical standard and therefore will not qualify for expedited review.[4] In response to requests for comments in the Proposing Release, the Commission declined to explicitly exclude any particular type of application from expedited review, including applications to participate in certain negotiated co-investments. The Adopting Release states, however, that applications that are too fact-specific or include even small changes to the terms and conditions of an application may raise a novel issue or require the staff of the Division of Investment Management (the "Staff") to expend significant time to determine whether a novel issue is raised. Such applications would not be eligible for the expedited review process and would need to be submitted under the standard review process.

Under the expedited review process, the Commission will have 45 days from the date of filing of an application to either (i) notice the application or (ii) notify the applicant that (a) the application is ineligible for expedited review or (b) additional review time is necessary.[5] If the Staff notifies the applicant that its application is not eligible for expedited review, the applicant will be asked to either withdraw the application or amend it to make changes to facilitate the application being considered under the standard review process.

As amended, Rule 0-5 will also include certain disclosure, procedural and information requirements for applications seeking expedited review, as well as rules regarding the calculation of the 45-day review period, including “pauses” in the event of amendment by the applicant or comments on the application from the Staff as well as for any irregular closure of the Commission's office in Washington, D.C. to the public for normal business. Under the Amendments, failure to appropriately respond to a request for modification within 30 days of such request will result in the application being deemed withdrawn without prejudice.

Standard Review

In addition to establishing the expedited review process, the Amendments adopt new Rule 13 under the Commission’s Informal and Other Procedures to provide a timeframe for standard review applications that do not qualify for expedited review. The new rule requires the Staff to take action on all standard review applications within 90 days of the initial filing and each of the first three amendments thereto, and within 60 days of any subsequent amendment, subject to 60-day extensions at the Staff’s discretion. Rule 13 represents a modest reduction in the timeframe proposed in the Proposing Release, which would have formalized the Staff’s current internal performance timeline to take action within 90 days of all initial filings and amendments and would have allowed the Staff to grant 90-day extensions. Action may consist of noticing the application, providing requests for clarification or modification of the application or forwarding the application to the Commission for consideration.[6] As with the expedited review process, the standard review period also will "pause" upon any irregular closure of the Commission's Washington, D.C. office to the public for normal business.

Furthermore, the Amendments adopt new Rule 0-5(g), which provides that a standard review application will be deemed to have been withdrawn without prejudice if an applicant does not respond in writing to comments within 120 days of receipt.[7]

Public Dissemination of Staff Comments and Responses

Notably, in the Proposing Release, the Commission stated that it intended to have the Staff publicly disseminate comments and responses on all exemptive relief applications no later than 120 days after the final disposition of such application (regardless of whether the application was submitted under the expedited or standard review process). In response to opposition by most commenters, the Commission declined to adopt this proposal in the Amendments, but the Commission noted that it plans to continue to consider public dissemination of Staff comments and responses.[8]

Analysis

Due to the high bar of the substantially identical standard, applicants will need to weigh the appeal of seeking faster (and more certain) exemptive relief through the expedited review process against what may otherwise be a preference to seek modified (and less certain) relief through the standard review process. This may be especially true for applicants seeking co-investment relief, where the fact-specific nature of a particular application may suggest that it should be filed through the standard review process, even if the applicant otherwise is seeking to comply with identical terms and conditions of two qualifying precedent applications. Moreover, under both expedited and standard review processes, the Staff will continue to have broad discretion to extend the applicable review period, and there are no apparent consequences for failure to meet the associated deadlines.

Overall, the Amendments are a well-conceived effort to improve the efficiency and transparency of the exemptive relief application process, saving applicants both time and costs, which may result in new products coming to the market or new market entrants as a result of lower cost barriers and less uncertainty around the timing for obtaining exemptive relief. The Amendments also should free up Staff resources and allow the Staff to devote more time to review non-routine applications as needed.

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[1] The Amendments are available at https://www.sec.gov/rules/final/2020/ic-33921.pdf (the "Adopting Release"). The Amendments do not affect applications submitted to the Commission under the Investment Advisers Act of 1940, as amended, and the Commission declined to amend the notice process with respect to the issuance of exemptive orders.

[2] The proposed amendments are available at https://www.sec.gov/rules/proposed/2019/ic-33658.pdf (the "Proposing Release"). For a discussion of the Proposing Release, please see our Client Alert at https://www.proskauer.com/alert/sec-proposes-expedited-exemptive-relief-process-and-sec-staff-issues-guidance-on-repurchase-offers-by-non-traded-bdcs.

[3] Examples of factual differences not material to the relief requested include the applicants' identities, the jurisdiction of organization of a fund or the constitution of the fund's board of directors. Adopting Release at n. 40. Applicants will be required to provide, as exhibits to the exemptive application, marked copies of the application showing changes from the qualifying precedent applications.

[4] The Commission cited certain kinds of applications that it believes are unlikely to be suitable for expedited review, including applications filed under Section 2(a)(9) (determinations of control), Section 3(b)(2) (inadvertent investment companies), Section 6(b) (employee securities companies), Section 8(f) (investment company deregistration), Section 9(c) (disqualification/ineligibility) and Section 26(c) (substitution of securities by unit investment trusts). Adopting Release at 21-24 and n. 75.

[5] The Commission has granted the Director of the Division of Investment Management delegated authority to issue notices of applications and orders generally where the matter does not appear to the Director to present significant issues that have not been previously settled by the Commission or to raise questions of fact or policy indicating that the public interest or the interest of investors warrants the Commission consider the matter. The Amendments amend Rule 30-5 of the Commission's Rules of Organization and Program Management to delegate to the Director the authority to notify an applicant that an application is not eligible for expedited review. Consistent with this delegated authority, the Staff will issue notices for applications reviewed under the expedited review process.

[6] If forwarded to the Commission, the Commission will not be subject to the timeline provided by the new rule.

[7] Applicants also could request to withdraw applications with a letter filed as Form APP-WD through the Commission's EDGAR system. Under the Amendments, a deemed withdrawal of an application under either expedited review or standard review will happen automatically and be reflected by the Staff's uploading of a Form APP-WDG to EDGAR, without the need for any action by the applicant.

[8] Commenters expressed a number of concerns, including that the proposed dissemination would discourage innovation and the sharing of proprietary information, increase confidential information requests for materials filed in connection with applications, discourage written communications in favor of oral communications and be of limited utility to investors.