Good Practices for the Termination of Investment Funds

The responses provided aim to maximise unitholder value, avoid unnecessary costs and provide finality to unitholders, funds and service providers. As all Irish domiciled funds must comply with the Central Bank’s requirements in relation to revocation of authorisation of funds and there will be various legal and tax implications following the granting of such revocation.

A. Disclosure at Time of Investment

Good Practice 1

Question 1 - Which items of information concerning the termination should be available at the time of the investment?

The Central Bank of Ireland requires some disclosure around the termination of funds. However, the disclosures are generally at a very high level. We agree that more detail could be provided. A granular description of the termination process and explanations of the difficulties and possible outcomes that may be achieved would be likely to take up too much space in an offering document. Therefore, it should be made available to investors as a separate policy document.

Good Practice 2

Question 2 - Should regulators develop good practices to address issues concerning uncontactable investors and, if so, what particular issues should these cover?

The main issues surrounding whether the fund can be de-authorised while still having uncontactable investors are – who holds the assets, what the costs are of holding those assets and tax treatment of payments.

Fund depositaries will charge funds for holding assets or keeping accounts open. In addition the work undertaken by transfer agents to locate investors after the final NAV has been struck may be charged and paying depositaries/transfer agents indefinitely will deplete any remaining assets that a terminating fund has. The better solution would be to require Central Banks or Member States to establish a fiduciary entity to whom amounts within dormant accounts could be transferred thereby enabling the responsible entity and service providers to close funds. Such an entity could take responsibility for any future unitholder claims and / or the payment of those assets onwards to the Member States after a specified period has elapsed and where they remain unclaimed.

For tax purposes a tax clearance certificate should be obtained prior to beginning the liquidation process. Any payments to the Fund in a windfall following de-authorisation should be treated in the same manner as they would have been prior to the Fund being de-authorised.
Question 3 - What is considered a reasonable time period and/or reasonable efforts to deem an investor “uncontactable”?

A period of two years from when the entitlement arose would be a reasonable timeframe, allowing funds time to try to make contact through their transfer agents/clients sales team but also allowing the fund to close and de-authorise without too much delay thus preserving value for untraced investors, should they contact the fund, its service providers or the fiduciary entity mentioned above.

Question 4 - In the absence of a formal domestic regime, what is the most appropriate way for the responsible entity to deal with the distribution proceeds of investors who cannot be contacted?

A fund termination policy could be adopted by the fund that would include a provision for the payment of residual assets after a specified period to a registered charity nominated by the fund’s board of directors.

Funds could adopt provisions in their constitutional documents which would extinguish the claims of investors once such a payment had been paid. Albeit this would be easier for new funds than for existing funds.

The adoption of an industry standard fund termination policy to that effect would also give fund promoters and their service providers a degree of commercial comfort that there would not be any recourse from investors in the future, albeit that absolute legal comfort that no claim existed would not be possible prior to the statute of limitations becoming applicable.

B. Decision to Terminate

Good Practice 3

The responsible entity’s decision to terminate an investment fund should take due account of the best interest of investors.

No comment

Good Practice 4

Termination plan

With regards to point 45 which refers to service provider fees, one of the key concerns of investors in a fund termination is that the value of the assets in question maybe depleted by the imposition of costs on such funds by service providers. Some service providers impose fees, others do not. Legislation ought to deal with how and when service providers accrue a fee so that there is certainty and consistency in relation to fees.

Question 5 - Do you agree that a termination plan is a useful tool to facilitate the smooth running of the termination process? Please provide information to back up your conclusion.

Yes - A termination policy should be part of the AIFM / UCITS Business Plan; it is a fundamental cornerstone of a successful fund termination proposal. Each fund would, prior to its closure, adopt a fund termination plan which would apply to the fund. The policy should deal with, inter alia, trustee confirmations in relation to disbursement of assets, payments to unitholders and treatment of residual assets. The fund termination policy could be adopted by the board of directors of the fund, or its manager, at any time during the life of the fund but would have to be adopted as part of the decision to terminate the fund if it had not previously been adopted. The policy would include an agreement with the fund’s depositary and transfer agent as to their roles in relation to the fund termination.
Question 6 - In order to promote investor awareness and facilitate investment decision making, what are the key items which should be set out in the termination plan? Furthermore, should investors be provided with the full termination plan or is a summary sufficient with a right to receive a copy of the full termination plan on request?

The report outlines 9 key items which in agreement with, there should be no need to highlight the specifics of valuation of the securities as the fund’s prospectus/documentation should be followed for these in all cases.

It should be sufficient to provide investors with a summary of the termination plan with access provided to the detailed plan on request. In the main, investors will be only be interested in timing and results so it does not make sense to provide all investors with technical detail that they might not want or understand. In addition, if a termination policy is also made available to investors they should have sufficient information in relation to how their fund would be terminated.

Question 7 - What items relating to the investor approval process should be contained within the termination plan?

Where a fund is being terminated with investor approval, there will be legal requirements in relation to the holding of general meetings and what information must be provided to investors to enable them to approve the termination of a fund. Information to be provided to investors in any termination plan in relation to the legal process should be adequate but should not be prescriptive or duplicate information that is required for the process itself having two sources of information (the plan and the process itself) might cause confusion for investors.

Question 8 - How should illiquid securities be treated in the context of investment funds seeking to wind-up and terminate?

We would generally expect the Board of such a fund to assign a nil value to any such securities. If subsequently realised the proceeds should be treated as windfall payments below.

Question 11 - How should windfall payments be treated?

Following the revocation of the fund’s authorisation, a fund may receive windfall payments. We again propose that the fund termination policy would include procedures for the payment of such windfall payments to investors and / or the treatment of any residual assets which are not paid to investors.

In the case of windfall payments the fund is likely to have terminated its administrator and transfer agent and so the issues this creates in terms of contacting investors and performing AML checks will need to be addressed in the fund termination policy.

Any windfall payments should be accorded the same tax treatment as they would have been prior to the liquidation as they arise as a result of the funds activities prior to de-authorisation.

Question 12 - Are service providers entitled to recoup all costs and fees for the services provided to investors for the service of holding and distributing the windfall payment?

The fund’s depositary and administrator should be entitled to such reasonable costs and expenses incurred by them in relation to the provision of services to the relevant fund in connection with its fund termination policy as may be agreed between the depositary, administrator and the fund. Such costs and expenses should be deducted from any payments to unitholders or from the monies standing to the balance of any Residual Assets Account.

Relevant service provider contracts should make provision for resuming their roles as depositary and administrator and should cross reference the fund’s termination policy.
Question 13 - Should the responsible entity or the custodian remain in operation (i.e. prohibited from revoking their authorisation and winding up) until such time as all windfall payments have been realised and distributed to investors?

Where there is no date expected or it is not assured the payments will be received then no. It is unreasonable to prevent a commercial entity from winding up in order to provide for a circumstance that might never happen. Instead the business in question should be transferred to another entity capable of carrying out the role.

Good Practice 5

Question 14 - Does the suspension of dealings adequately address the issue of first mover advantage in cases where investment funds are terminating?

Yes

Question 15 – Are there instances where it would be appropriate to continue accepting subscriptions and/or redemptions during the termination process? If so, please disclose and provide the rationale.

No

Good Practice 6

Who should the termination plan be approved by?

Requiring a termination plan to be approved by the national regulator would be too onerous and could cause delays in implementation due to authorisation turnaround times; alternatively the Programmes of Activity/Business Plans for AIFMs / UCITS ManCos could include a sample termination policy for its funds under management.

C. Decision to Merge

Good Practice 7

Requirement to contact investors

No comment

Good Practice 8

Responsibility to offer investors the option to merge where the receiving fund has similar investment objectives.

No comment

Good Practice 9

Investors right to redeem free of redemption or exit charges.

We find no reason for there to be the right to redeem free of redemption or exit charges before the merger takes place. Waiver of redemption or exit charges would, in any case, be at the discretion of the fund or the manager in accordance with the fund’s offering document

Good Practice 10
Question 16 - In cases where mergers are proposed as alternatives to investment fund terminations, should the responsible entity incur all of the costs of the mergers?

Currently the default position for UCITS is that the Investment Manager is required to pay the costs of mergers. AIFMD does not address fund mergers but, if it did, should probably take a consistent approach.

D. During the Termination Process

Good Practice 11

Question 17 – Should a fund be permitted to deviate from its investment restrictions while engaged in a termination process? If so, at which stage of a termination process should the fund be permitted to deviate from the restrictions?

A fund should be permitted to deviate from its investment restrictions in most cases while engaged in the termination process. It should be able to sell assets at the best price for investors without regard to investment restrictions, taking account of the best interest of investors, while respecting the general concept of risk spreading to the extent applicable.

Question 18 – What other information should be included in the investor communication advising of the decision to terminate?

It would be normal to inform investors that their fund was being terminated. Such a notification should include a reference to the policy document referred to above and the expected duration of the liquidation process.

Good Practice 12

Question 19 - What action should the responsible entity take to address issues concerning conflicts of interest in cases of terminating investment funds which are seeking to wind-up?

Irish funds already are required to have a conflicts of interest policy and disclose conflicts of interest.

E. Specific Types of Investment Funds

Good Practice 13

Redemptions in Specie

It is already the case in Ireland that the fund may offer investors in a terminating investment fund the ability to redeem in specie where the consent of the investor has been obtained, while ensuring the best interests of other investors in the investment fund.

Question 20 - Are redemptions in specie appropriate for retail investors where the investment fund wishes to terminate?

Yes – but there are instances where retail investors would encounter difficulty holding certain investments. Accordingly, redemptions in specie are only appropriate where a retail investor has requested it or consents and is in a position to hold the investment.

Question 21 - To what extent should investor consent be required for redemptions in specie or can reliance be placed on the responsible entity to act in the best interests of all investors?

Irish rules require investor consent. We see no reason to change this position.
Question 22 – Are there situations where difficulties may arise in implementing redemptions in specie?

Assuming the investor requests or consents and is in a position to hold the investment then this should mitigate any potential issues.

Good Practice 14

Question 23 – What are the benefits to permitting the use of side pockets in the termination process?

Side pockets enable live funds with illiquid or hard to value assets to maintain a degree of liquidity in respect of assets which are not illiquid or hard to value. Given our responses to questions 8 and 11 we don’t see benefits to them in relation to terminations.

Question 24 - Should it be possible to terminate an investment fund where side pocket assets exist?

It should not be possible for a fund to be terminated while there is the existence of side pockets.

Question 25 - Who should be responsible for managing and overseeing the side pocket in such circumstances and is this entity entitled to a fee for such services?

N/A

Good Practice 15

Question 26 – Are funds of finite duration renewed or their maturity extended? In such cases, what approval process should be followed?

Irish funds of finite duration may generally extend their duration in order to facilitate an orderly sale of assets for two periods of one year each on the approval of Directors. Shareholder approval is required thereafter. Once the finite duration has lapsed the fund, subject to the approval of shareholders, can continue to the extent the duration of the fund indefinitely until termination.

Question 27 – Are there further matters that need to be considered in relation to specific types of investment funds?

It does not make sense that service providers be obliged to trace each and every beneficiary of a windfall payment in circumstances where a payment would fall beneath an appropriate de minimus level. It might be worth transferring such de minimus payments to the fiduciary entity mentioned above to offset its running costs or payment to a charity.

Over-arching questions

The tax treatment of an authorised fund is different from a fund that is not authorised. As a result it is not possible to de-authorise an Irish authorised fund with remaining assets other than those necessary to pay liquidation expenses. Authorised funds are required to maintain a full authorised fund type infrastructure which can be costly. Therefore no set of recommendations in relation to the termination of funds is going to provide solutions to the problems mentioned in the paper unless tax treatment is addressed. We suggest that funds need to be able to de-authorise to preserve value for clients during fund terminations and that any payments made by funds post termination should be accorded the same tax treatment as they would have had while the funds were authorised.