EFAMA response to the IOSCO Consultation On Good Practices for the Termination of Investment Funds

A. Preliminary Remarks

EFAMA[1] welcomes the opportunity to provide its comments on the Good Practices to be adopted by IOSCO for the Termination of Investment Funds. We agree that the decision to terminate a fund can have significant impact on investors in terms of the costs associated with such an action, or the ability for investors to redeem their holdings during the termination process. In this regard, even in the context of a fund's voluntary termination, asset managers must abide by their fiduciary obligation to act in the best interest of their investors.

In this respect, we welcome the efforts of IOSCO towards the development of Good Practices, as presented in the consultation. At the same time, we wish to underline that a large majority of these Good Practices are already reflecting existing regulatory requirements, market standards and best practices in the EU asset management industry. In this sense, we do not anticipate the proposed Good Practices to bring extensive changes to the current EU regulatory framework and to the ongoing practices of European investment funds.

The efforts to further standardise established practices, as welcome as they are, should, however, not result in additional, overly-prescriptive regulatory requirements, likely to turn the existing best practices into an overly bureaucratic process, at odds with timely decision-making. The termination process should always be in the best interest of investors and stream-lined enough for the entity in charge of the liquidation to deliver it over a reasonable time-frame. For instance, an exhaustive list of information to be disclosed in the initial termination plan, or the detailed description of the treatment of different types of assets during the termination process, would not only be overly prescriptive, but might create unfavourable conditions for the liquidation process and reduce the flexibility for the responsible entity to choose the right option at the time of the liquidation. Therefore, EFAMA considers it important that the IOSCO Good Practices focus on the key high-level information to be disclosed to investors, while at the same time allowing sufficient flexibility and discretion for the responsible entity to act in the investors' interest.

Finally, EFAMA would like to draw IOSCO's attention on the definition of the notion of termination process. In this regard, it is important to clarify that the scope of this process covers every action taken once the decision to launch the process is reached. Hence, any actions prior to this, for instance related

[1] EFAMA is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 62 corporate members EUR 21 trillion in assets under management of which EUR 12.6 trillion managed by 56,000 investment funds at end-2015.

to the assessment and consideration prior to taking such a decision, is not part of the termination process. This is particularly important also in terms of selecting the responsible entity in charge of the liquidation process, which in a number of jurisdictions and once the termination process is launched, could be the custodian, another third-party entity, or continue to be the asset management company.

B. RESPONSES TO THE QUESTIONS OF THE CONSULTATION

Good Practice 1

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

EFAMA supports the contents of the proposed Good Practice 1, regarding information on the possibility of a fund's termination to be made available at the time of the investment, the general circumstances and its process for termination. For umbrella fund structures, we recommend that the above elements be spelt out for each of the sub-fund compartments.

Concerning the description of the circumstances for a fund to be terminated, these should be described in general terms, avoiding investors to believe that in the event of their materialisation, the responsible entity would systematically opt to close the fund (especially when this decision would contravene the interests of fund investors). The information regarding the termination process should also be indicative, in such a way as to leave sufficient flexibility and discretion for the responsible entity to act in the investors' best interest[2].

With respect to funds of finite duration, the recommendation of the proposed Good Practice 1 should be adjusted accordingly.

Good Practice 2

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

EFAMA would broadly agree with the proposed Good Practice 2. Delivering on such Good Practice may, however and despite all reasonable efforts, be complicated by extensive distribution networks, particularly for retail fund products marketed and sold outside a vertically-integrated business model, for instance through banks, insurance companies, or online platforms. We would therefore suggest,

[2] As an example, in a letter to shareholders, one asset management company has expressed that "(…) Directors may determine to close a Fund in circumstances where the Net Asset Value of the Fund has fallen below the Euro equivalent of $50m". The same letter states that the same Directors shall therefore determine, in accordance with the fund prospectus and its Articles, that it is in the best interests of shareholders to liquidate the fund's assets and distribute redemption proceeds to shareholders.

with regard to the proposed Good Practice 2, that the responsible entity for the termination process should make all reasonable efforts to contact investors upon the decision to terminate a fund.

Distributors may, however, have an important role to play in the termination process. As for any corporate action that the fund may undertake, distributors will be notified and in principle - depending also on national regulation – will need to transmit the information through the intermediary chain to reach the end-investors. Important is also to consider how securities are held and appear on the fund's register. Where the securities are held in nominee accounts, the distributor is the legal owner as the nominee and consequently the manager's responsibility on distributing proceeds ends at the level of the distributor. In other systems, e.g. in presence of direct holding structures, the duties of locating the end-investor would continue further down the holding chain.

EFAMA would favour a regime where an uncontactable investor's entitlements remained segregated for an indefinite period, or one spanning several decades, appropriately disclosed at the time of investment, including relevant contacts, via a management company's or a distributor's website. Alternatively, were an investor to remain uncontactable beyond a certain period (appropriately disclosed at the moment of sale), the unclaimed proceeds of the fund's liquidations could be invested into a default investment scheme until the moment these are ultimately claimed.

3. What is considered a reasonable time period and/or reasonable efforts to deem an investor "uncontactable"?

The answer to this question, at present, varies considerably by jurisdiction. In general, we would observe that the responsible entity should attempt to use various means at its disposal, from publications of announcements in the financial press or on corporate websites, to emails, and naturally involving fund distributors where funds are offered publicly to myriads of retail investors.

In some jurisdictions, tracing end-investors may even involve specific service providers. For example, in the U.K., after multiple attempts to deliver correspondence followed by returned mail, a manager may decide to use "credit reference agencies" to identify the investor's new address[3]. Differently, if the post has been delivered, but the investor fails to cash a cheque, in some jurisdictions, the cheque may only be valid for a number of months before it is cancelled.

Nevertheless, EFAMA would note that what constitutes a "reasonable time period" remains relative. In fact, given the pace of technological change and innovations brought about by the use of online banking and other fully digitalised financial services for retail users, we would observe that the lapse of time needed to identify and locate the end-investor even in the context of a fund termination, is likely to be reduced significantly over the foreseeable future.

[3] In the U.K., these are independent service providers that hold information about consumers and/or businesses to help organisations (e.g. most typically banks, but also finance companies, mobile phone operators, retailers, etc.) decide whether to grant them credit. These agencies act as reservoirs of credit information and would typically be able to trace an individual back to a postal address and/or bank account.

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?

In the absence of a domestic regime or of a default investment option (as per our response to Question 2 above), the responsible entity could entrust the fund liquidation proceeds to the fund's custodian, to a trustee, or to a similar public body, where these are kept at all times segregated from their own/other clients' assets.

Good Practice 4

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, the termination plan can enhance the timely information to investors and thus, facilitate the smooth running of the termination process in terms of adequate investor protection. At the same time, as in practice important information related to the termination process is not known before the termination process starts, it is not necessarily possible or appropriate to provide full details of the termination plan ex ante to investors. Moreover, and given that the termination plan and process should be tied to the manager's fiduciary duty to act in the best interest of the investor, providing full transparency regarding all terms of the termination process might lead to unfavourable circumstances for investors. For instance, the market may become aware of a fund's liquidation, attracting buyers for its assets at deep discounts and thus potentially worsening the terms of such liquidation (i.e. the determination of the assets' fair value by the responsible entity) for investors. For these reasons, the right flexibility should be ensured so that disclosing of information in the termination plan will not jeopardise the smooth running of the termination process to the benefit of the investors.

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?

As mentioned in our response to Question 5, it is difficult to define ex ante and for all cases of termination an exhaustive list of key items and information to be included in the termination plan. Moreover, the termination plan, especially for public offered funds that will be made available to the public directly or indirectly, should not entail information if this risks making the process detrimental for the investors and create unfavourable market conditions for the fund and its assets.

Having this in mind, any set of Good Practices for the termination plan should include a flexible and high-level list of information, enabling the entity that will be responsible for the termination process to further specify additional information once this becomes available without jeopardising the smooth running of the process. Such items might include the triggering point of the termination process, to the rationale for the decision to terminate, to any third party entity appointed for managing the termination process and the liquidation of remaining assets, to alternative investment options, to the

possibilities of suspension of subscriptions/redemptions once the termination process is triggered and the terms under which this might occur, etc.

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

Any terms related to the investor approval process as part of the termination process are already disclosed in the offering legal documents of a fund, such as the initial prospectus. Therefore, the termination plan should accurately reflect these terms.

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

The initiation of the termination process signifies the disinvestment and disposal of all assets - illiquid or not - of the investment fund. As the final goal is the same, the treatment of all securities and assets and the ways to achieve their disposal remains also in principle the same, i.e. ensuring their disposal in the best interest of investors. We consider, therefore, that no prescriptive and detailed treatment of illiquid securities should be foreseen in the termination plan.

It is true that the sale of illiquid securities and of illiquid assets in general typically requires more effort and time. In practice, the entity in charge of the liquidation may have a number of options available to dispose of illiquid assets, such as their disposal at a fair price when this is feasible, redemptions *in specie*, sale at a discount, transfers into a side pocket, etc. The termination plan should provide information to investors about the different options available to the entity in charge of the liquidation to dispose of illiquid assets, but not necessarily about the actual preferred option or the valuation method. This may indeed unnecessarily limit the alternatives for the entity that will be in charge of the liquidation and risk creating adverse market conditions for the disposal of those assets by informing potential buyers (please also see our response to Questions 5 and 6). The investor would only need to know what the main terms of the process will be. It would be of little use to the investor, if not to his/her detriment, to disclose further details of the termination plan, e.g. the valuation method and preferred options as to the disposal of assets (illiquid or not).

9. Should an investment fund be permitted to revoke its authorisation without liquidating all positions? If yes, what happens to the illiquid assets? If no, should an investment fund be permitted to continue indefinitely until all assets can be valued and sold and the investment fund may then terminate?

EFAMA considers that a funds' termination occurs when all its books are closed, all its positions are liquidated. In this regard, revoking the license of the manager prior to it liquidating the fund's positions, even if possible, is not necessarily always to the best interest of investors.

In principle, it is preferable in terms of the legal protection of investors that the fund cease to exist and its authorisation is revoked only once all its assets are disposed of and all payments are executed to investors. The termination process may be prolonged for assets whose disposal at a fair value may not be possible. In these cases, the right time to terminate the fund has to be ruled on a case-by-case basis (in some jurisdictions investors' involvement is foreseen as to this decision).

Finally, apart from the termination and the cessation of the fund itself, it is critical to ensure that the entity responsible for the termination process (asset manager, the custodian or any other liquidating third-party entity) remains authorised and operational until the termination of the fund. In case the responsible entity ceases to exist during the termination process, responsibilities should be transferred to another adequate entity.

10. Should the custodian of the investment fund hold illiquid securities or securities with nil value until such time as a value can be realised?

The custodian and the responsible entity can decide on a case-by-case basis, in the best interest of investors, to either hold the security with nil value, dispose of it already at a lower value, redeem it via redemptions *in specie*, etc. Such decision could involve the function responsible for the valuation of the fund's assets. Preferably, the custodian should dispose of the assets at the best possible price for the investors. In the event that the value of an asset may not be realised immediately, we would agree that it would be in the investors' interest that the custodian hold illiquid securities for a reasonable period. The disposal of the assets at zero value should be a solution of last resort.

11. How should windfall payments be treated?

In the case of windfall payments occurring after the termination process is finalised and the fund has ceased to exist, the optimal treatment would be their distribution to investors of the fund. This would however require a detailed and up-to-date investor record, which may not always be in place (especially with regard to open-end retail funds). This should be executed by the responsible entity on a best effort basis.

If, however, this is not feasible, due to absence of sufficient data, or due to investors that cannot be reached despite the best efforts of the responsible entity, other options could be foreseen insofar as they do not lead to conflicts of interest (e.g. the entity deciding to keep the payments, unless foreseen in the termination plan).

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?

We believe that service providers are entitled to recover the costs related to the holding and distributing of windfall payments.

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?

Please see our response to Question 9.

Good Practice 5

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

In every case there is an issue of first mover advantage, suspension of dealings and of redemptions of a fund's units should be the adequate way to address this issue.

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.

Related to new subscriptions, their suspension during the termination process appears appropriate to avoid prolonging the termination process (i.e. usually once the termination process is launched, investors prefer to see it complete as soon as possible). However, there are cases where the suspension of subscriptions is not necessary, or might even go to the detriment of investors. For instance, in the case of a termination via a merger, new subscriptions into the new fund entity should not be impeded. Another instance is where investments are made on a regular and continuous basis via an automated process. Here, shareholders of a fund (e.g. as part of a life insurance plan) would typically invest a certain amount every month. Where these individuals make such regular investments, an immediate suspension of subscriptions following the decision to terminate the fund would be disruptive and not in their best interest. In the time between the publication of a notice that the fund will be terminated and the moment where the fund is actually terminated, the investor (through the insurance company) should still be able to invest on last time. This example, we believe, proves there may be conditions where it would be appropriate to still allow redemptions during the termination process.

Related to suspension of redemptions, please see our response to Question 14 above.

Good Practice 10

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?

Where justified by commercial imperatives (e.g. the rationalisation of a fund range, the efficiencies from managing larger funds, etc.), we believe that a merger's associated costs should be borne by the responsible entity.

Good Practice 11

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?

We understand that once the termination process is engaged, i.e. communicated publicly to investors, investment restrictions would still hold, although the priority of the responsible entity/liquidator will be to sell the portfolio's assets while treating all investors fairly. No additional investments should be authorised with the exception of those techniques which may allow a portfolio manager to hedge its exposures until the final liquidation of the assets.

In certain jurisdictions, the entity responsible for the termination process is the custodian. This would aim to expedite the disposal of the assets into the market, regardless of the investment strategy the portfolio manager was pursuing.

Regardless of the type of entity responsible for the termination process, it will still be bound by its duty to obtain best possible price over a given period which is part of the termination planning process. For very liquid assets, this period could be set at a few days, but for harder-to-sell assets, a longer period is appropriate to allow for the best price to be obtained.

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

EFAMA does not see the need for additional information to that contained under paragraph 62 of the consultation report.

Good Practice 12

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?

EFAMA agrees with the wording of the proposed Good Practice 12. The presence of potential conflicts of interest would depend on the nature of the responsible entity. Where the asset management company is such entity, there are overarching conflict of interest rules that individuals need to abide by in all circumstances. Under the EU UCITS and AIFM frameworks, there are specific conduct rules that oblige the management company to identify, prevent, manage or disclose conflicts of interest. These have been more recently reinforced by also requiring the fund custodian (commonly known as the "depositary" under EU rules) to generally carry out the management company's instructions unless these conflict with applicable national law, fund rules or its Articles of incorporation (of which conduct rules form an integral part).

Good Practice 13

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

We believe that redemptions *in specie* should be confined to professional investors only and carried out with the express consent of the latter, where these are able to receive and administer illiquid assets under a suitable custody arrangement. A retail investor base should be excluded as typically too broad to be individually identified over a short period, unable to receive illiquid assets, whose value may also not be reduced to a size reflecting the small pro-rata amounts of the underlying portfolio typically owned by retail clients.

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?

We envisage two situations: (i) where redemptions *in specie* are expressly provided for in the fund documents and agreed upon at the time of investment, or (ii) where at the time of redemption the investor declares its consent to receive assets *in specie*. In both cases, the consent of the investor is required, given the potentially cumbersome nature of such redemptions.

22. Are there situations where difficulties may arise in implementing redemptions in specie?

As per our answer to Question 20 above, redemptions *in specie* may not be always feasible. Additionally, there may be situations where, for example, an independent body required to value a specific asset is unable to do so, or even where certain assets are not suitable to be transferred to a third-party without the prior consent of the issuer (e.g. the issuer could object to certain types of investor directly owning the investment for tax reasons).

Good Practice 14

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

EFAMA deems that the main benefits of side pockets have been well illustrated in the narrative of paragraphs 76 to 78.

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

In principle, this should not be the case, as the purpose of the side-pocket is to wind down only one portion of the overall fund portfolio that may be difficult to value at any one moment, without jeopardising the conduct of the chosen investment strategy and fund objectives. The eventual termination of the entire fund should in our view not derive from the fact that a side-pocket has been activated.

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?

We believe that the management and oversight of the side-pocket should, generally, be entrusted to the asset management company, or the depositary, as the responsible entity. The latter should be allowed to collect fees that are appropriately disclosed and ideally no greater than those charged prior to the creation of the side-pocket.

Good Practice 15

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

Funds with a limited lifetime should foresee in their initial offering documentation the conditions upon which an extension of the lifetime of the fund can be decided. This disclosure is in line with the best interest of investors and could foresee amongst others, the agreement of a certain quota of investors and the quorum necessary for such a vote to be considered valid. If this is not the case and no provisions in the funds rules exist as to the extension of its lifetime, such a decision should be taken on the basis of investors' best interests.

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

Partial payments to investors can be foreseen in the case of liquidation processes that last over a long period of time.

Over-arching questions

28. Are the good practices well formulated to take account of current best practice?

EFAMA wishes to make the following comments with regard to some of the proposed Good Practices foreseen in the consultation report:

- Good Practice 4 is far too detailed and prescriptive, at odds with the best interest of investors. Please see our response to Questions 5 to 12.
- Good Practice 6 should not foresee an approval of the termination plan by the custodian. It could instead foresee that a close collaboration with the custodian should be in place. Moreover, IOSCO's consultation makes reference to approval by the national regulator, where appropriate. However, this prior approval might lead to extensive delays, which is usually to the detriment of investors' interests. What can be foreseen instead of an approval is the need to notify the regulator of the termination of the fund prior to proceeding with the termination process.
- Good Practice 15 should foresee not only an orderly, but also a timely wind-up of the fund.

29. Have all key considerations been captured? If not, please identify further elements that need to be considered in respect of terminating investment funds.

We do not believe there would be further elements to consider.

***

Brussels, 17 October 2016

[16-4064]