



Good practices for the termination of investment funds. February 2018.

On 23 November 2017, the International Organisation of Securities Commissions (IOSCO) published a document on good practices for the termination of investment funds.

These practices only apply to voluntary termination of investment funds as legislation at a national level in most jurisdictions addresses involuntary terminations. Voluntary terminations occur when an investment fund, although still solvent, is no longer economically viable or can no longer serve its intended objectives. In some cases, funds may need to be terminated if significant redemptions mean they are no longer viable. In addition, these good practices affect both open-ended and closed-ended investment funds aimed at retail investors and professional investors and also include terminations resulting from mergers with other funds.

The main aim of these good practices is to protect investors' interests during the termination process and to reflect the regulatory approaches that are currently being developed in the different jurisdictions so that these practices may serve as useful guidance for regulators and the industry when assessing the scope of their regulation and their usual practices.

Particular emphasis is placed on investment funds with illiquid or hard-to-value securities, such as commodity funds, real estate funds or hedge funds.

Among other aspects, the good practices recommend informing unit-holders when subscribing the units or shares about the following situations: the general circumstances in which an investment fund can be terminated, whether investor consent is required and about who will bear the costs. Once the termination has been decided, a termination plan will have to be drawn up including the reason, the process for informing unit-holders, whether or not their approval is necessary, an estimate of the costs of the process, data on the liquidator, the possible existence of alternatives (such as mergers or transfers to other funds), a description of conflicts of interest and valuation methods. In addition, aspects are included relating to the merger process when this is the method for terminating the investment fund, transparency in communication to investors, and the need to establish criteria for fair valuation of the assets.

In general terms, both legislation and usual practice in termination or merger processes in Spain set out the good practices described in the document. Both Royal Decree 1082/2012 (amended by Royal Decree 83/2015) approving the Regulation implementing Law 35/2003 on Collective Investment Schemes, for the case of investment funds, and the Capital Companies Act, in the case of SICAVs (investment companies), include regulations concerning, *inter alia*, the reasons for winding-up, the termination rules, publicity requirements, the possibility of redemption in kind and the winding-up agreement. With regard to termination, the good practices include the need to draw up a "*termination plan*" which may seem excessive with regard to the amount of information that it includes. However, in the Spanish case, the management company or an entity from its group is often the sole unit-holder remaining at the time that the termination process begins, and this is not therefore a significant aspect.

However, when necessary, as in the case of real estate funds or funds that invest in hedge funds and which have had drawn out disinvestment processes, a periodic report is required for investors describing the progress of the process, and compliance with the winding-up agreement is closely monitored.

When preparing the good practices listed below, IOSCO took into account its own principles relating to collective investment schemes, in particular, Principle 25, which is the most relevant. This Principle establishes that the regulatory system should provide full rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets. Similarly, the methodology to assess the level of implementation of the aforementioned Principle specifically considers whether the regulation relating to this matter adequately provides for orderly termination of a collective investment scheme.

The document establishes 14 good practices divided into five sections depending on the time of their application:

1. Disclosure at time of investment
2. Decision to terminate
3. Decision to merge
4. During the termination process
5. Specific types of investment funds

1. Disclosure at time of investment

Good practice 1

The responsible entity should disclose, at the time of investment, information relating to the ability to terminate an investment firm as well as a process for effecting such termination. In this regard, the investment fund documentation should:

- a) Outline the general circumstances in which an investment fund can be terminated;
- b) Set out the extent to which investor approval or consent is required to effect the termination
- c) Disclose that when a decision to terminate is made, the responsible entity will prepare a termination plan – the key contents of which shall be communicated to investors
- d) Provide a high-level overview of the key items that will be covered in the termination plan
- e) Set out whether investors may bear the costs of the termination

Good practice 2

Investment fund documentation should set out how the responsible entity will deal with investors who are not contactable at the time a responsible entity decides to terminate an investment fund.

2. Decision to terminate

Good practice 3

The responsible entity's decision to terminate an investment fund should take due account of the best interests of investors in the investment fund.

Good practice 4

Following a decision to terminate an investment fund, the responsible entity should issue a termination plan. This should set out the steps to be taken during the termination process and should take into account the best interests of investors. The termination plan should contain, depending on the legal form of the investment fund, information relating to the following key items as appropriate:

- a) The rationale for terminating the investment fund
- b) The process for obtaining investor approval to effect the termination, if required
- c) An estimation of the costs of the termination and whether investors will bear these
- d) Whether another entity will be appointed to effect the termination (e.g. a liquidator)
- e) The estimated duration of the termination process and how information will be communicated to investors throughout
- f) The existence of alternative investment opportunities (including mergers, or transfers to other investment products), if any
- g) Investor dealing arrangements (including the necessity for suspension of subscriptions and redemptions) in the investment fund
- h) An indication of the asset valuation method (including illiquid or hard to value assets) of the investment fund
- i) The process for dealing with illiquid assets or addressing any windfall payments due to the fund and its investors after the fund is terminated

Good practice 5

Taking into account the applicable regulatory framework, the responsible entity should consider suspending investor subscriptions and redemptions during the termination process of an open-ended fund with a view to protecting the interests of investors.

Good practice 6

The responsible entity should approve the termination plan. The board of the investment fund, or, if no such board exists, the third party responsible for independent oversight, should also approve the termination plan.

3. Decision to merge

Good practice 7

The responsible entity should clearly communicate to investors the decision to merge an investment fund with another investment fund.

Good practice 8

To the extent possible, the responsible entity should only offer investors the option to merge where the receiving investment fund has similar investment objectives, policies and risk profile to the terminating investment fund.

Good practice 9

The responsible entity should offer investors the right to redeem free of redemption or exit charges before the merger takes place. Investors should be informed of the available alternatives sufficiently in advance.

Good practice 10

The responsible entity should incur all legal, advisory and administrative costs related to a merger. Where the responsible entity proposes not to incur these costs, this decision should be documented in the investor communication including a rationale for the decision.

4. During the termination process

Good practice 11

The responsible entity should ensure that appropriate/adequate information about the termination process is

communicated to all investors concurrently and in an appropriate and timely manner. Investors should be kept up-to-date as circumstances change.

Good practice 12

In valuing the assets of the terminating investment fund, the responsible entity should:

- a) Ensure that fair valuation of the assets will apply
- b) Seek to address conflicts of interest arising

5. Specific types of investment funds

Good practice 13

The responsible entity may offer institutional investors in a terminating investment fund the ability to redeem in kind where the consent of the investor has been obtained, while ensuring the best interests of other investors in the investment fund are not jeopardised.

Good practice 14

In the context of a fund of finite duration, the responsible entity should, within a reasonable period in advance of the fund's anticipated termination date, consider the procedures that will be required to achieve an orderly and timely wind-up of the fund.

Links of interest:

[Good Practices for the Termination of Investment Funds](#)