

August 26, 2016

## Asset Management—Termination of Funds

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### IOSCO Issues Consultation Report on Termination of Investment Funds; Seeks Comments on Proposed Good Practices

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#### SUMMARY

On August 18, 2016, the Board of the International Organization of Securities Commissions (“IOSCO”) issued guidance on voluntary termination processes for investment funds.<sup>1</sup> The consultation report, “Good Practices for the Termination of Investment Funds” (the “Report”), solicits feedback on proposed good practices on the voluntary termination process for collective investment schemes (“CIS”) and other fund structures; the list of “Good Practices” is attached hereto as [Annex A](#). Along with the proposed “Good Practices,” the Report features a series of questions addressed to stakeholders soliciting feedback.

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#### IOSCO

IOSCO is an international policy forum for securities regulators, with the organization’s membership regulating more than 95% of the world’s securities markets in more than 115 jurisdictions. The Report states that the “Good Practices” included in the Report “generally reflect approaches to issues currently acknowledged by regulators.” IOSCO notes in the Report that it is mindful that not all of the proposed “Good Practices” will be applicable in all circumstances, given the specific nature of fund terminations. Moreover, the Report does not envision the proposed “Good Practices” as overriding national regulatory regimes, recognizing, rather, that the approaches taken in different jurisdictions may vary.

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#### PROPOSALS

The suggestions in the Report fall into the following categories:

- **Disclosure at Time of Investment:** The Report highlights the importance of disclosure to investors at the time of initial investment as to fund termination procedures, including disclosure of the general

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circumstances in which a fund may be terminated, the extent to which investor approval may be required for termination, the preparation of a termination plan, and an overview of what such a termination plan will cover. The Report also points out that there should be procedures in place for dealing with investors who cannot be contacted at the time a decision to terminate is made.

- **Decision to Terminate:** The Report stresses that any decision to terminate must take account of the best interests of the investors. Once a decision to terminate has been made, the Report urges that a termination plan be issued, setting out the steps which will be undertaken as part of the termination process. The Report goes on to examine a number of issues that any such plan should address, including the rationale for termination, the extent to which investor approval is required, estimated costs of termination and who will bear them, whether a liquidator will be appointed, the duration of the process, the existence of alternative investment opportunities, the asset valuation method to be used and the process for dealing with illiquid investments. The Report states that the plan should be clearly communicated to investors, and proposes that investor subscriptions and redemptions should be suspended during the termination process of an open-ended fund.
- **Decision to Merge:** The Report notes that there are situations where the merger of two investment funds may be advantageous. Such decisions should be clearly communicated to investors, per the Report, and, to the extent possible, the option to merge should only be presented to investors where the acquiring fund has similar investment objectives, policies and risk profile. In addition, investors in the fund to be acquired should have a right to redeem free of any redemption or exit charges prior to the merger. The Report goes on to propose that, when a decision to merge is made for commercial reasons, the responsible entity should bear all costs associated with the merger and, if the responsible entity does not, the rationale for not doing so should be clearly communicated to investors.
- **During the Termination Process:** The Report stresses the need to keep all investors up to date during the termination process with appropriate, adequate and concurrent reporting to them, and highlights specific issues and developments which should be the focus of such communication. Additionally, during the termination process, the Report notes that assets should be fairly valued; to that end, valuation policies should be set out in advance, yet “should be sufficiently robust to permit the investment fund to make adjustments to the valuation policy where it is considered necessary to reflect fair value.” It also notes that the valuation policies should seek to address conflicts of interest, identifying instances in which such conflicts can arise.
- **Specific Types of Investment Funds:** The Report makes several recommendations for more specific types of investment funds. Notably, the Report recommends that the responsible entity in a termination may offer the ability to redeem *in specie* to professional investors where investor consent has been obtained, provided that the best interests of other investors are not negatively affected. Citing an earlier IOSCO report “Principles of Liquidity Risk Management for Collective Investment Schemes,”<sup>2</sup> the Report states that retail investors should not generally be required to accept *in specie* transfers. The Report also notes the desirability, in certain situations, of using side pockets as part of the termination process, particularly in the case of illiquid assets. Lastly, the Report states that, in the case of funds with a finite duration, procedures for effecting an orderly wind-up of the fund should be considered well in advance of termination.

IOSCO seeks comments on or before the 17th of October, 2016. The full text of the Report can be found at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD542.pdf>.

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ENDNOTES

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- <sup>1</sup> See International Organization of Securities Commissions (“IOSCO”), [“Good Practices for the Termination of Investment Funds”](#) (August 18, 2016) (the “Report”).
- <sup>2</sup> See IOSCO, [“Principles of Liquidity Risk Management for Collective Investment Schemes”](#) (March 4, 2013).

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Annex A

<b><i>A. Disclosure at Time of Investment</i></b>	
Good Practice 1	<p>Investors should be provided with information, at the time of investment, relating to the ability to terminate an investment fund as well as the processes for effecting such termination. In this regard, the investment fund documentation, dependent on the legal form of the investment fund, should:</p> <ul style="list-style-type: none"> <li>i. outline the general circumstances in which an investment fund can be terminated;</li> <li>ii. set out the extent to which investor approval or consent is required to effect the termination;</li> <li>iii. 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; and</li> <li>iv. provide a high-level overview of the key items that will be covered in the termination plan.</li> </ul>
Good Practice 2	<p>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.</p>
<b><i>B. Decision to Terminate</i></b>	
Good Practice 3	<p>The responsible entity’s decision to terminate an investment fund should take due account of the best interests of investors in the investment fund.</p>
Good Practice 4	<p>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 at least the following key items:</p> <ul style="list-style-type: none"> <li>i. the rationale for terminating the investment fund;</li> <li>ii. the extent to which investor approval is required to effect the termination, if at all, together with details of relevant processes;</li> <li>iii. details on the estimated costs of the termination and whether investors will bear these;</li> <li>iv. whether another entity will be appointed to effect the termination (e.g., a liquidator);</li> <li>v. the estimated duration of the termination process and how information will be communicated to investors throughout;</li> </ul>

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	<ul style="list-style-type: none"> <li>vi. the existence of alternative investment opportunities (including mergers or transfers to other investment products), if any;</li> <li>vii. investor dealing arrangements (including the necessity for suspension of subscriptions and redemptions) in the investment fund;</li> <li>viii. an indication of the asset valuation method (including illiquid or hard to value assets) of the investment fund; and</li> <li>ix. process for dealing with illiquid assets or addressing any windfall payments due to the fund and its investors after the fund is terminated.</li> </ul>
Good Practice 5	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 termination plan should be approved by the responsible entity of the investment fund. In relevant circumstances, the custodian should also approve the termination plan.
<b><i>C. Decision to Merge</i></b>	
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	Where the decision to merge is for commercial reasons, the responsible entity should incur all costs. 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.
<b><i>D. During the Termination Process</i></b>	
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.

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Good Practice 12	<p>The responsible entity should—during the termination process and in the context of valuing assets of the terminating fund—</p> <ul style="list-style-type: none"><li>i. ensure that fair valuation of the assets will apply; and</li><li>ii. seek to address conflicts of interest arising.</li></ul>
<b><i>E. Specific Types of Investment Funds</i></b>	
Good Practice 13	<p>The responsible entity may offer professional investors in a terminating investment fund the ability to redeem <i>in specie</i> where the consent of the investor has been obtained, while ensuring the best interests of other investors in the investment fund are not jeopardized.</p>
Good Practice 14	<p>The responsible entity may use side pockets as part of the termination process where the ability to side pocket assets is provided for in the investment fund documentation.</p>
Good Practice 15	<p>In the context of a fund of finite duration, the responsible entity should, a reasonable period in advance of the fund's anticipated termination date, consider the procedures that will be required to achieve an orderly wind-up of the fund.</p>