

# **Good Practices for the Termination of Investment Funds**

## **Consultation Report**



**IOSCO**

**The Board  
OF THE  
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

**CR04/2016**

**AUGUST 2016**

This paper is for public consultation purposes only. It has not been approved for any other purpose by the IOSCO Board or any of its members.

Copies of publications are available from:  
The International Organization of Securities Commissions website [www.iosco.org](http://www.iosco.org)

© *International Organization of Securities Commissions 2016. All rights reserved. Brief excerpts may be reproduced or translated provided the source is stated.*

## Foreword

The Board of the International Organization of Securities Commissions (IOSCO) has published this Consultation Report with the aim of obtaining feedback from stakeholders on a proposed set of good practices on the voluntary termination process for collective investment schemes ('CIS') and other fund structures such as commodity, real estate and hedge funds (collectively referred to as 'investment funds' in the report). The scope is not limited to retail investment funds as it also addresses issues of relevance to investment funds for professional investors.

### How to Submit Comments

Comments may be submitted by one of the three following methods **on or before 17<sup>th</sup> October 2016**. To help us process and review your comments more efficiently, please use only one method.

**Important:** All comments will be made available publicly, unless anonymity is specifically requested. Comments will be converted to PDF format and posted on the IOSCO website. Personal identifying information will not be edited from submissions.

#### 1. Email

- Send comments to [consultation-2016-04@iosco.org](mailto:consultation-2016-04@iosco.org)
- The subject line of your message must indicate '*Good Practices for the Termination of Investment Funds.*'
- If you attach a document, indicate the software used (e.g., WordPerfect, Microsoft WORD, ASCII text, etc) to create the attachment.
- Do not submit attachments as HTML, PDF, GIFG, TIFF, PIF, ZIP or EXE files.

#### 2. Facsimile Transmission

Send by facsimile transmission using the following fax number: + 34 (91) 555 93 68.

#### 3. Paper

Send 3 copies of your paper comment letter to:

**Shane Worner**

International Organization of Securities Commissions (IOSCO)  
Calle Oquendo 12  
28006 Madrid  
Spain

Your comment letter should indicate prominently that it is a '*Public Comment on Good Practices for the Termination of Investment Funds.*'

## Table of Contents

<b>Chapter</b>	<b>Page</b>
<b>Part 1 Introduction and Scope</b>	<b>1</b>
<b>A. Purpose</b>	<b>1</b>
<b>B. Scope</b>	<b>3</b>
<b>C. Application of Existing IOSCO Principles</b>	<b>3</b>
<b>Part 2 Good Practices for the Termination of Investor Funds</b>	<b>4</b>
<b>A. Disclosure at Time of Investment</b>	<b>4</b>
<b>B. Decision to Terminate</b>	<b>6</b>
<b>C. Decision to Merge</b>	<b>12</b>
<b>D. During the Termination Process</b>	<b>14</b>
<b>E. Specific Types of Investment Funds</b>	<b>16</b>
<b>Appendix 1 Consolidated list of consultation questions</b>	<b>20</b>
<b>Appendix 2 List of Good Practices</b>	<b>23</b>

## Part I INTRODUCTION AND SCOPE

### A. Purpose

1. The purpose of this Consultation Paper is to obtain feedback from stakeholders on a proposed set of good practices on the voluntary termination process for collective investment schemes ('CIS') and other fund structures such as commodity, real estate and hedge funds (hereinafter collectively referred to as 'investment funds').
2. The termination of an investment fund is part of its natural life span. Investment funds terminate for many different reasons, including weak investor demand, unfavourable economic conditions or commercial decisions by the entity responsible for the overall operation of the investment fund ('responsible entity')<sup>1</sup> to restructure. In some cases, funds may also need to terminate if significant redemptions make the fund no longer viable.
3. The ability to terminate an investment fund and the circumstances when the termination may occur are typically prescribed in law or in the constitutional documents of an investment fund, or both. In practice, terminations may require the execution of a specific plan in coordination with key stakeholders, such as the investors, the board of the investment fund, the responsible entity, the depository and/or custodian,<sup>2</sup> the regulator (and possibly a liquidator in some circumstances), followed by a range of other service providers (e.g. auditors, legal counsel, brokers, transfer agents, distributors, etc.).
4. The decision to terminate an investment fund can have significant impact on investors in terms of the cost associated with such an action or the ability of investors to redeem their holdings during the termination process. Throughout this process investors, whether retail or professional, have an important stake linked to the ultimate value of their investment in a fund at the time of termination and their ability to withdraw their investment from the fund in a timely manner.
5. Most regulatory regimes have certain criteria for the termination of investment funds in their jurisdiction, ranging in detail from the overarching obligation to act in the best interests of investors to prescriptive requirements for liquidating the portfolio and the payment of final distribution proceeds. IOSCO recognises the importance for investment funds to have termination procedures in place from an investor protection perspective. For this reason, IOSCO

---

<sup>1</sup> The 'responsible entity' shall be taken as meaning the entity/entities responsible for the overall operation of the investment fund and in particular its compliance with the legal/regulatory framework in the respective jurisdiction. The identification of the responsible entity may vary among jurisdictions and types of investment funds. In some jurisdictions, the responsible entity could be the management company, CIS operator or the investment fund itself. In others, the management company may play a role in carrying out the principles, but may be overseen by an independent body (e.g. board of directors).

<sup>2</sup> The term depository /custodian may be used interchangeably throughout and have the same meaning for the purposes of this paper. In jurisdictions where an investment fund is structured as a trust, the custody function may be undertaken by the trustee.

is developing a set of good practices for the termination of investment funds which take into account investors' interests during this process.

6. The decision to terminate is specific to the investment fund in question and takes into account a number of different factors and circumstances relevant to the investment fund at a particular point in time. In finalising its work, IOSCO will be mindful that not all of the good practices mentioned throughout will be applicable in all circumstances given the individual nature of investment fund terminations.
7. The work of IOSCO will address voluntary terminations, as legislation at a national level in most jurisdictions addresses involuntary terminations (for example, in the case of insolvency of an investment fund). Voluntary terminations typically occur because an investment fund, although still solvent, is no longer economically viable or can no longer serve its intended objectives. The decision to terminate in these cases is taken by the responsible entity although this decision may be based on factors outside its direct control (for example, in cases where the fund service provider (e.g. the custodian or investment manager) has resigned but it is not possible to appoint a suitable replacement). The investment fund is typically terminated in accordance with the provisions in its constitutional document and/or prospectus in conjunction with the legal/regulatory processes in place for the orderly termination of investment funds in that jurisdiction.
8. IOSCO does not intend that the good practices would override national or regional legal or regulatory requirements and/or insolvency regimes. The regulatory steps taken in different jurisdictions may include general principles, prohibited practices and precise rules in relation to conduct and disclosure requirements. The approach varies among jurisdictions depending on their regulatory framework, the structure of their national asset management landscape and the regulator's assessment of the risks and problems facing investors. Generally, they reflect approaches to issues currently acknowledged by regulators. Moreover, while relevant in some cases, the good practices prescribed in this document may not be applicable to involuntary terminations.
9. In a number of jurisdictions, an investment fund may elect not to terminate by liquidating its assets and repaying investors, and instead will seek to merge its assets with another investment fund often managed by the same responsible entity. In this regard, IOSCO is considering whether the issues arising from investment fund mergers generally, as identified by IOSCO in 2004,<sup>3</sup> would have a particular impact on the termination process.

---

<sup>3</sup> IOSCO Final Report – [An Examination of the Regulatory Issues Arising from CIS Mergers](#), published November 2004

## **B. Scope**

10. This Consultation Paper sets out proposed good practices for the voluntary terminations of open-ended and closed-ended investment funds. The scope is not limited to retail investment funds as it also addresses issues of relevance to investment funds for professional investors.
11. Illiquid or hard to value securities can have a direct impact on the voluntary termination of investment funds, particularly for funds established as commodity funds, real estate funds or hedge funds. This Consultation Paper sets out additional good practices specific to the termination of these types of investment funds.

## **C. Application of Existing IOSCO Principles**

12. Various aspects of the IOSCO Objectives and Principles of Securities Regulation<sup>4</sup> have a bearing on the subject of investment fund terminations; however, Principle 25 is of most relevance.
13. Principle 25 states that "*the regulatory system should provide for rules governing the legal form and structure of CIS and the segregation and protection of client assets*". The methodology for assessing compliance with Principle 25 specifically questions whether the regulatory system adequately provides for the orderly winding up of a CIS.
14. Noting that the legal form and structure of investment funds vary among jurisdictions, the methodology stresses the importance of protecting investors as the structure affects the interests and rights of the participants in the investment fund and enables the pool of investors' funds to be distinguished and segregated from the assets of other entities and of the responsible entity. The methodology further notes the importance of *inter alia*, protecting the interests of investment fund investors not only while the investment fund is a going concern, but also when its continuity is affected by circumstances which require it to be terminated. To comply with this principle, the methodology provides that the regulatory system should require the rights of investors in investment funds, or impediments to investors exercising their rights, to be clearly spelled out.

---

<sup>4</sup> [IOSCO Objectives and Principles of Securities Regulation](#), published June 2010

## **PART II GOOD PRACTICES FOR THE TERMINATION OF INVESTMENT FUNDS**

### **A. Disclosure at Time of Investment**

#### **Good Practice 1**

**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:**

- i. outline the general circumstances in which an investment fund can be terminated;**
- ii. set out the extent to which investor approval or consent is required to effect the termination;**
- 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**
- iv. provide a high level overview of the key items that will be covered in the termination plan.**

15. As part of the normal course of business the decision to terminate lies with the responsible entity. The circumstances in which an investment fund may be terminated voluntarily should be disclosed clearly in the constitutional documentation and/or the prospectus/offering documents of the investment fund. The list of possible reasons for terminating the investment fund does not need to be exhaustive as circumstances will change over time. This should include circumstances where the responsible entity might decide to terminate the investment fund based on factors outside of its direct control. It should also outline the extent to which investor approval or consent will be required to effect termination. Disclosure in the investment fund documentation should seek to address at a high level, the main reasons why the responsible entity might decide to terminate.
16. It is important that, as part of that disclosure, the investor is also made aware of the process surrounding the termination of the investment fund as the termination process may limit the investor's ability to exit the investment fund in the normal manner at some future point in time. In particular, the investor should be made aware that a process will exist at the time a decision to terminate is made (as the exact process may depend on the circumstances leading up to the termination).



17. As terminations are generally outside the control of the investment fund investors, it is considered good practice that the responsible entity prepares a termination plan when the decision to terminate the investment fund is taken. The plan should address the different stages of and the practical issues that may arise as part of the termination process. The termination plan should be prepared by the responsible entity when the decision to terminate the investment fund is taken and the contents communicated to investors. Where there is a likelihood that certain factors may impact an investment fund's ability to terminate in an orderly manner, these factors should be clearly disclosed to investors as a risk warning.
18. Investment fund terminations can be lengthy processes, particularly where there are issues surrounding illiquid securities, suspensions or an inability to make contact with investors. Disclosing a high level overview of the key items that will be covered in the termination plan in the investment fund documentation will inform investors about the various stages of the termination process and assist in managing investor expectations during the termination process.

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

**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.**

19. Uncontactable investors present challenges for terminating investment funds. The inability to contact investors can arise when investors fail to notify the investment fund or its service providers of changes to their contact details, address, or bank account details. Having out-of-date investor information leading to an inability to contact the investor results in the investment fund, which would otherwise have terminated, continuing for an extended period of time as it has no way of remitting monies due to that investor.
20. The responsible entity's inability to contact an investor should not, after a reasonable period of time, further delay the termination process. It is considered good practice for the responsible entity to inform investors, at the time of their initial investment, of the problems and consequences of absence of contact over the life-cycle of their investment. The responsible entity should outline what will happen if it is unable to contact an investor during the termination process. While the obligation should be placed on the investor to ensure they avoid loss of contact, investment fund documentation should detail the procedure to be applied by the responsible entity for attempting to make contact with investors (and who will bear the cost of this), for the treatment of unclaimed amounts including details of the duration for holding these monies, and the procedure to be followed once this period has lapsed.
21. Very often the responsible entity will have arrangements in place for the holding of investor's unclaimed monies until they are able to be allocated, and also have procedures in respect of trying to contact the investors. National legal or regulatory regimes in some jurisdictions contain

prescriptive rules for the treatment of unclaimed redemption or distribution proceeds, whereby the proceeds are held in dormant or unclaimed accounts or alternatively referred to the courts or the regulator. When all reasonable efforts have been exhausted, the responsible entity may transfer all unclaimed amounts to the courts, or other national arrangement for addressing these issues. It is not considered good practice for unclaimed amounts to be dealt with in a manner that means they cannot be returned to the investor if he or she subsequently appears within a reasonable time period, unless such transfers are required by law.

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

***Question 3** - What is considered a reasonable time period and/or reasonable efforts to deem an investor “uncontactable”?*

***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?*

## **B. 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.**

22. The responsible entity has a duty to act in the best interests of investment fund investors, throughout the life of the investment fund.
23. Responsible entities decide to terminate investment funds for many different commercial reasons; some investment funds fail to attract significant assets at the outset and cease operations and terminate within a relatively short period of time of initial launch. In other cases, the responsible entity may seek to terminate the investment fund as taking factors such as costs into account, to continue in existence would not be acting in the best interests of investors. In the main, however, poor track record over a prolonged period of time is the primary reason for investment fund terminations.
24. For closed-ended investment funds, in particular, terminations also arise where the investment fund has reached the end of its natural life and seeks to wind-up and distribute redemption proceeds to investors in line with its investment objective. Once final distributions have been made, the closed-ended investment fund will terminate.
25. Conflicts may arise for the responsible entity in managing the commercial motivations for investment fund terminations on the one hand and interests of investors on the other. Similar to

all other actions of the responsible entity, any decision to terminate must be justifiable. The responsible entity must be able to demonstrate that the decision to terminate has taken due account of the 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 at least the following key items:**

- i. the rationale for terminating the investment fund;**
- ii. the extent to which investor approval is required to effect the termination, if at all, together with details of relevant processes;**
- iii. details on the estimated costs of the termination and whether investors will bear these;**
- iv. whether another entity will be appointed to effect the termination (e.g. a liquidator);**
- v. the estimated duration of the termination process and how information will be communicated to investors throughout;**
- vi. the existence of alternative investment opportunities (including mergers, or transfers to other investment products), if any;**
- vii. investor dealing arrangements (including the necessity for suspension of subscriptions and redemptions) in the investment fund;**
- viii. an indication of the asset valuation method (including illiquid or hard to value assets) of the investment fund;**
- ix. process for dealing with illiquid assets or addressing any windfall payments due to the fund and its investors after the fund is terminated.**

26. The termination plan should specify in reasonable detail each of the steps that will be required in order to terminate the investment fund. The termination plan is an important tool that enhances investor understanding and knowledge of the termination process and facilitates a smooth and orderly termination. It will not seek to replace or circumvent the provisions of national law or regulation.
27. The termination plan should identify the rationale for terminating the investment fund. It should also identify the key steps that will be taken as part of the termination process.
28. In the majority of cases, the decision to terminate is that of the responsible entity. However, in some jurisdictions national law or regulatory requirements will mandate that the decision of the responsible entity is approved by investors, or the custodian in some cases. The first step in preparing for the voluntary termination of an investment fund is to determine whether investor approval is required. This may depend on the legal structure of the investment fund and whether voting rights are attributed to shares / units.

29. Investment in an investment fund usually carries with it the right to vote on certain matters and the voting requirements for the approval of investors on, inter alia, liquidations and terminations are generally prescribed in the constitutional documents and the prospectus / offering document of the investment fund, or legal and regulatory regime of the national regulator, or both. The termination plan should set out the process for obtaining investor approval, where required.
30. Where investor approval is required and investors are asked to vote on the decision to terminate with the outcome achieving the minimum voting requirements for approval, the decision is binding on all, including those who do not vote. Where investor approval is required, the rights of investors should be clear from the termination plan. In particular, the termination plan should document how the interests of dissenting investors will be treated.
31. In the majority of cases for voluntary terminations, the cost of termination will be borne by the investment fund, and ultimately the investors. The responsible entity should communicate to investors an estimate of the costs involved in terminating the fund and who will pay these. The estimated costs should take into account all costs associated with the appointment of a liquidator or other agent. In the context of open-ended investment funds, the costs of the termination should be estimated as soon as possible to ensure they are reflected in the net asset value of the investment fund.
32. While the termination process is the responsibility of the responsible entity, it may employ the services of a liquidator to realise the value of assets and facilitate the termination process. The responsibilities of the liquidator also include the coordination, communication and management of the interests of all investment fund investors. The termination plan should state whether another entity will be appointed (e.g. a liquidator) to the investment fund to complete the termination process and in what circumstances such entity would be appointed.
33. The termination plan should provide an estimated duration for the termination process.
34. The responsible entity should ensure that the termination plan sets out how it will communicate with investors during the termination process. Moreover, the termination plan should disclose whether the responsible entity will be in a position to provide regular updates to investors (for example, due to the appointment of a liquidator). If this is not possible, the termination plan should detail the form and frequency of investor communication to be expected from the liquidator.
35. The termination plan should provide that the responsible entity will consider whether it is appropriate to offer investors alternative investment opportunities such as mergers, or transfers into other investment products or other investment fund with similar investment strategies. Where the responsible entity is offering investors alternative investment opportunities such as mergers, or transfers into other investment products or other investment funds with similar investment strategies, this should also be clearly disclosed.
36. The termination plan should detail whether investors may redeem their interest in the investment fund in advance of the formal commencement of the termination process.

37. In the majority of cases, the termination process should be a straight forward matter and facilitated in a reasonably short period of time. Some jurisdictions prescribe timeframes for the orderly wind-up and termination of an investment fund. However, issues concerning illiquid or hard to value assets, suspensions, delays by external service providers, etc., can impact on the ability of an investment fund to terminate in a timely or orderly fashion.
38. While it is difficult to ascertain to any degree of accuracy when illiquid securities will recover in value, for example, or when the portfolio has been liquidated in full and suspensions can be lifted, it is important to manage investor expectations and is considered good practice to keep investors informed of the progress on these matters.
39. Illiquid securities tend to be hard to value with limited or no active secondary market. Illiquid securities can have a direct impact on the liquidation of assets and can significantly delay the termination of the investment fund.
40. Where the illiquid assets cannot be disposed of at fair value, in some jurisdictions investment funds are permitted to value these assets at nil; the proceeds from the sale of all other assets within the portfolio will then be distributed among investors. The investment fund is then terminated. In some cases, the investment fund custodian is responsible for holding the illiquid assets until such time as a value is realised. In other cases, the responsible entity may side-pocket relevant assets or may be required to realise the value of the asset on the termination day, either by purchasing the asset itself or for the benefit of other investment fund under its management. In the main, however, the termination process is typically delayed until such time as all assets can be valued and liquidated.
41. While it is acknowledged that all investment funds must provide for fair value in accordance with their valuation policies, there could be an incentive for the responsible entity to expedite the termination process and sell illiquid or hard to value assets at a price less than the last known market price or fair value price. In some jurisdictions, the responsible entity may apply a discount on the sale of securities in the case of stressed markets. Where this is possible the responsible entity should provide proper disclosure in the investment fund documentation on the ability to apply a discount and the circumstances in which this practice is permitted.
42. The responsible entity should have procedures in place for the valuation of illiquid securities and these procedures should be disclosed to investors as part of the valuation policy in the investment fund documentation or alternatively disclosed in the termination plan. The responsible entity should take all reasonable steps to obtain the best possible outcome for the investment fund investors, taking into account price, costs, likelihood of execution and size amongst other factors. Ultimately it is a matter for the responsible entity to manage appropriately as the circumstances for termination are not identical in all cases.
43. The responsible entity must determine the appropriate time and price to sell a security, while ensuring at all times that it acts in the best interest of investors. In cases where the shareholder base of the investment fund comprises retail and professional investors, there may be conflicting views as to the perceived best interests of all investors. Such decisions can be difficult to resolve

and are generally matters for the responsible entity to determine, unless local laws require otherwise.

44. When considering the matter of illiquid securities, it is also necessary to take into account the appropriate treatment of proceeds recovered from the sale of securities which were once deemed illiquid i.e. windfall payments or delayed reclaims of foreign withholding tax. While most legal or regulatory regimes do not have specific rules for the treatment of windfall payments, it is the expectation that the proceeds from windfall payments would be attributed on a pro rata basis to the investors in the investment fund at the time of termination.
45. The treatment of windfall payments can present administrative challenges as it requires proper records to be maintained indefinitely by the responsible entity or the CIS custodian. In most cases these service providers would not be accruing a fee for this service; moreover, it binds them to holding the asset and the records of the investment fund for an indefinite period of time.
46. Noting the difficulties surrounding this process, it is considered good practice for the responsible entity to document how it proposes to address windfall payments and the process of the responsible entity should be disclosed to investors.

***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.*

***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?*

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

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

***Question 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?*

***Question 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?*

***Question 11*** - *How should windfall payments be treated?*

***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?*

***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?*

**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.**

47. Upon approval of the termination, open-ended investment funds frequently suspend subscription and redemptions to facilitate an orderly wind-up. The criteria governing the suspension of dealings of an investment fund are prescribed in the constitutional documents and prospectus or offering document of the investment fund.
48. The responsible entity may also suspend dealing following the decision to terminate, to eliminate the risk of first mover advantage. Very often where investment funds are terminating, early redeemers will seek to redeem their interests in advance of the formal termination process in order to profit from the most favourable liquidity conditions, thus passing the liquidity cost to remaining investors (i.e. a 'first mover advantage'). By suspending dealing, the responsible entity seeks to minimise the risk of liquid assets being sold at the outset before being obliged to dispose of less liquid assets, and thereby incurring higher liquidity costs for remaining investors later on in the process.
49. The termination plan should disclose whether the responsible entity will suspend dealing after deciding to terminate. Where the responsible entity may opt not to suspend dealings, the termination plan should outline the reasons and the rationale behind such instances. While it may be possible in some jurisdictions to continue to facilitate redemption requests, the responsible entity should ensure the fair treatment of all investors (for example, by making adequate provisions for the termination costs in calculating the pay-outs to the redeeming investors). The timing of the decision to terminate and the decision to suspend should be considered by the responsible entity to ensure that it does not, inadvertently or otherwise, create opportunities which facilitate first mover advantages for investors. In order to suspend dealing, the responsible entity should determine that it is in the best interests of investors to do so. The termination plan should clearly document the policy of the responsible entity and the measures taken to address the issue in relation to first mover advantage and the sale of liquid assets to meet early redemption requests.

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

***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.*

### **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.**

50. The termination plan should be subject to appropriate governance to ensure the best interests of investors have been properly considered. This might involve approval by the board of the investment fund or, if no such board exists, by the custodian. In some cases it may be appropriate for the national regulator to approve the termination plan or at least to be given prior notice of the intended termination and an opportunity to request further information before the responsible entity proceeds.

## **C. 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.**

51. There are many advantages for the responsible entity when a merger of two investment funds occurs. Investment fund mergers allow responsible entities to rationalise their range of investment funds, particularly where the merger involves investment funds with similar investment objectives and policies. There are also benefits for investors when investment funds merge as they can often result in a reduction of costs and/or better performance due to greater economies of scale. Investment fund mergers may also occur when the investment fund is not economically viable on its own and has failed to accumulate sufficient asset size.
52. The responsible entity wishing to merge two investment funds should provide investors in the discontinuing fund with sufficient information to enable them to evaluate the merger proposal and make an informed decision as to whether they wish to proceed with this option.
53. The responsible entity should provide investors with information on the background and rationale for the proposed merger, the investment objective and risk profile of the receiving investment fund, details of the service providers, details of entry and exit fees (those fees not associated with the merger itself) along with an indication of all ongoing costs/charges associated with investment.
54. Disclosure to investors should also include details of how the merger will be effected, i.e. whether investors are required to vote on the proposal, the timeframe and minimum voting requirements to approve the merger and the proposed treatment of dissenting or non-voting investors. This communication should also include information on the procedure for the transfer of assets and exchange of shares/units. Any information provided to investors must be accurate, well balanced and not misleading.



### **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.**

55. Investment fund mergers should ideally involve the amalgamation of investment funds with similar investment objectives. This may not always be the case, however, and there are cases where the receiving investment fund has very different investment and risk strategies. Where this is permitted by national regulation, it is necessary for investors to re-evaluate whether the merged product fits their investment objective and risk appetite. Moreover, it is the responsible entity's role to ensure that the merger is and will be undertaken at all times in accordance with the best interests of investors.

### **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.**

56. In the majority of cases, merger proposals are presented to investors for their approval by way of a vote. Investors must be informed of the terms and conditions of the mergers and afforded a specified period of time to consider the proposal in advance of the vote. It is considered good practice, before a merger becomes effective, for the responsible entity to offer investors the possibility to redeem their shares without redemption or exit charges (except where any anti-dilution mechanism is applied to the dealing price).

### **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.**

57. In addition to the cost of asset transfers, mergers typically result in legal and accounting fees and expenses. In some cases, the merging investment fund will incur some or all of these expenses as it can be argued that this investment fund was not economically viable on its own.
58. Where the proposal to merge is driven by the economies of scale of the responsible entity, all costs associated with mergers should be borne by the responsible entity. In cases where the responsible entity does not intend to incur these costs, this decision should be clearly disclosed in the investor communication and include details of the rationale for the non-payment by the responsible entity.

***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?***

## D. 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.**

59. Investor communication is very important throughout the termination process. In many cases investment fund terminations are prolonged processes spanning in excess of one year.
60. Information should be communicated simultaneously to all direct investors in an appropriate manner to ensure their fair treatment. The responsible entity should also consider the information needs of intermediate or indirect investors.
61. Where a liquidator is being appointed, the responsible entity should, to the extent known, communicate to investors whether it will be in a position to provide regular updates to investors and/or the form and frequency of investor communication to be expected from the liquidator.
62. Investor communication should include, *inter alia*, the following:
  - The outcome of any investor approval process, i.e. whether the termination will proceed or not;
  - Whether the investment fund will facilitate redemptions up to the commencement of the termination process and whether a redemption cost will be levied on such transactions;
  - Whether dealing will be suspended after termination commences, with an indication of the duration of any such suspension;
  - When investors can expect to receive updates on the progress of the termination process;
  - Expected date of termination;
  - The process for liquidation of portfolio securities;
  - The expected timeframe for payment of final distribution proceeds from the sale of investment fund assets to investors.
63. The requirement to appoint a liquidator may depend on the legal structure of the investment fund e.g. corporate investment funds may require liquidators whereas investment funds structured under trust law may not. In general, once a liquidator has been appointed, the investment fund and its responsible entity will have little involvement or discretion in relation to the management of the investment fund. Moreover, the investment fund and its responsible entity will have limited or no access to information on the financial standing of the investment fund, the composition of the portfolio or the current asset valuation of the investment fund. It may be difficult therefore, for the investment fund or its responsible entity to comply with normal communication requirements to investors during this time.
64. National laws in some jurisdictions exempt liquidators from the requirement to provide information to investors in an investment fund. In other jurisdictions, while no regulatory

requirements exist for liquidators to provide information to investors, company/corporate laws in the relevant jurisdictions require the liquidator to provide information to investors on the status of the liquidation process. Typically, the liquidator must present to investors on an annual basis why the liquidation has not been completed.

**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?*

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

#### **Good Practice 12**

**The responsible entity should - during the termination process and in the context of valuing assets of the terminating fund -**

- i. ensure that fair valuation of the assets will apply, and**
- ii. seek to address conflicts of interest arising.**

65. Assets should be valued according to current market prices and in a manner consistent with the local laws, constitutional documentation and prospectus / offering document of the fund, provided that those prices are available, reliable and frequently updated. It is critically important that an investment fund values all assets in its portfolio, including those assets for which market quotations are not readily available.
66. All investment funds and their responsible entities should have written policies and procedures setting out the methodology to be used for valuing each type of asset within the portfolio in normal and exceptional circumstances including cases of termination. The valuation policies 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. The rationale for adjusting the value should be clearly disclosed.
67. In accordance with the IOSCO *Principles for the Valuation of Collective Investment Schemes*,<sup>5</sup> Principle 3 requires that “The valuation policies and procedures should seek to address conflicts of interests”.
68. The potential for conflicts of interest regarding the valuation of an investment fund’s portfolio assets can arise in a number of ways. The potential for conflicts of interest could be seen as higher in the context of illiquid or hard to value assets where the responsible entity is, in practice, the most reliable or only source of information about the pricing of particular assets. The responsible entity may be inherently conflicted with regard to the valuation process as its fees are calculated on the basis of the value of the investment fund assets. The responsible entity may also be conflicted regarding the other funds it manages in comparison with the one being

---

<sup>5</sup> IOSCO Final Report – Principles for the Valuation of Collective Investment Schemes, published May 2013

terminated. A responsible entity might consider terminating a fund in order to favour one of the other funds it manages. In all cases, managing conflicts of interests passes through to the responsible entity to ensure that the decision to terminate a fund is based on legitimate reasons and that the valuation process does not favour one fund at the expense of another.

69. While the investment fund operator must act in the best interests of investors at all times, in the case of an investment fund that is winding up or seeking to terminate, there may be a further incentive for the investment fund operator to delay the sale of an asset in anticipation of a higher realised value at some future stage. This could give rise to possible conflicts of interest.

**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?*

## E. Specific Types of Investment Funds

70. This section seeks to address specific issues for commodity, real estate, hedge funds and private equity funds where these funds would typically be offered for sale to professional investors and are more likely to hold illiquid or hard to value assets.

### **Good Practice 13**

**The responsible entity may offer professional 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 are not jeopardised.**

71. Principle 4 of IOSCO *Principles on Liquidity Risk Management in Collective Investment Schemes*<sup>6</sup> states "Where permissible and appropriate for a particular investment fund, and in the interests of investors, the responsible entity should include in the investment fund's constitutional documents the ability to use specific tools or exceptional measures which could affect redemption rights".
72. The explanatory text for this principle refers to *in specie* redemptions as an example of one such tool which may be used. *In specie* transfers may be used to pay wholly or in part investor redemption proceeds. *In specie* transfers involve transferring ownership of a proportionate share of the underlying assets directly to redeeming investors, usually so that the investor receives a pro-rata share of each asset comprising the portfolio although this may be impractical in some cases, such as debt instruments with large values. In accordance with IOSCO *Principles on Liquidity Risk Management for Collective Investment Schemes*, retail investors should not generally be required to accept *in specie* transfer when they wish to redeem part or all of their investments.

---

<sup>6</sup> IOSCO Final Report – Principles of Liquidity Risk Management for Collective Investment Schemes, published March 2013

73. There are a number of advantages for the responsible entity to using in specie transfers to progress the wind-up and termination of an investment fund holding illiquid securities:
- the investment fund will not be required to hold the illiquid security for an indefinite period;
  - the investment fund can terminate, thus eliminating the need to comply with its legal or regulatory obligations during the winding up phase;
  - the investment fund and its investors are not incurring the cost of the service providers mandated to hold and manage the illiquid security.
74. However, concerns could be raised regarding the appropriateness of transferring ownership of an illiquid security to the underlying investor where the investor then assumes responsibility for managing the sale of the asset and also assumes the risk of not realising its investment.
75. As a good practice, the responsible entity should only offer professional investors redemptions in specie where the investor has consented to this arrangement. The responsible entity should consider whether it could arrange the sale of the asset on behalf of the investor if requested.

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

***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?*

***Question 22** – Are there situations where difficulties may arise in implementing redemptions in specie?*

**Good Practice 14**

**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.**

76. A side pocket is created when specific assets in the investment fund portfolio are segregated and ring-fenced from the rest of the investment fund portfolio. Side pockets are used by investment fund to separate illiquid assets from more liquid assets in an investment fund portfolio. Side pockets are commonly used by hedge funds but some jurisdictions permit the use of side pockets in open-ended mutual funds. Only investors in the investment fund at the time the illiquid asset transferred to the side pocket are entitled to share in any proceeds generated from the realisation of the sale of the asset at some future stage.
77. The side pocket is in general not subject to full management activities as the purpose of its management is to liquidate the assets held in the best interests of investors.

78. The creation of a side pocket might be reasonable for an investment fund seeking to terminate as the factors which prevent the sale of assets are likely to persist over time and are not temporary. However, regulators should treat the creation of side pockets carefully, since this possibility creates an incentive to hide poorly performing assets via side pockets or poor liquidity management by the responsible entity. This is of particular relevance where the investment fund is winding up as it may be possible for the investment fund to be terminated thereby breaking the link with the responsible entity.

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

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

**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?*

**Good Practice 15**

**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.**

79. Funds of finite duration are typically of a closed-ended nature with a defined termination date, although some structures may permit an extension (for example, upon receipt of shareholder approval).
80. At the inception of a fund of finite duration, the responsible entity will have a relatively precise knowledge of the date on which it expects the fund to terminate. With this in mind, it would be expected that the responsible entity should, a reasonable period in advance of the termination date, be in a position to consider and document its approach to liquidating the open positions of the fund and distributing the proceeds to investors. This should be done while ensuring that the over-arching obligation of maintaining the best interests of investors is considered throughout.

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

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

**Over-arching Questions**

**Question 28** – *Are the good practices well formulated to take account of current best practice?*

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

## Appendix 1

### Consolidated list of consultation questions

Good Practices	Questions
GP 1	<p><i>1. Which items of information concerning the termination should be available at the time of the investment?</i></p>
GP 2	<p><i>2. Should regulators develop good practices to address issues concerning uncontactable investors and, if so, what particular issues should these cover?</i></p> <p><i>3. What is considered a reasonable time period and/or reasonable efforts to deem an investor “uncontactable”?</i></p> <p><i>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?</i></p>
GP 4	<p><i>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.</i></p> <p><i>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?</i></p> <p><i>7. What items relating to the investor approval process should be contained within the termination plan?</i></p> <p><i>8. How should illiquid securities be treated in the context of investment funds seeking to wind-up and terminate?</i></p> <p><i>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?</i></p> <p><i>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?</i></p> <p><i>11. How should windfall payments be treated?</i></p> <p><i>12. Are service providers entitled to recoup all costs and fees for the services</i></p>



	<p><i>provided to investors for the service of holding and distributing the windfall payment?</i></p> <p><i>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?</i></p>
GP 5	<p><i>14. Does the suspension of dealings adequately address the issue of first mover advantage in cases where investment funds are terminating?</i></p> <p><i>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.</i></p>
GP 10	<p><i>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?</i></p>
GP 11	<p><i>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?</i></p> <p><i>18. What other information should be included in the investor communication advising of the decision to terminate?</i></p>
GP 12	<p><i>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?</i></p>
GP 13	<p><i>20. Are redemptions in specie appropriate for retail investors where the investment fund wishes to terminate?</i></p> <p><i>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?</i></p> <p><i>22. Are there situations where difficulties may arise in implementing redemptions in specie?</i></p>
GP 14	<p><i>23. What are the benefits to permitting the use of side pockets in the termination process?</i></p> <p><i>24. Should it be possible to terminate an investment fund where side pocket assets exist?</i></p> <p><i>25. Who should be responsible for managing and overseeing the side pocket in</i></p>

	<i>such circumstances and is this entity entitled to a fee for such services?</i>
GP 15	<p><i>26. Are funds of finite duration renewed or their maturity extended? In such cases, what approval process should be followed?</i></p> <p><i>27. Are there further matters that need to be considered in relation to specific types of investment funds?</i></p>
GENERAL	<p><i>28. Are the good practices well formulated to take account of current best practice?</i></p> <p><i>29. Have all key considerations been captured? If not, please identify further elements that need to be considered in respect of terminating investment funds.</i></p>

## Appendix 2

### List of Good Practices

<b>A. Disclosure at Time of Investment</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> <ol 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> </ol>
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.
<b>B. Decision to Terminate</b>	
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	<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> <ol 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> <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> </ol>

	<ul style="list-style-type: none"> <li>viii. an indication of the asset valuation method (including illiquid or hard to value assets) of the investment fund;</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>C. Decision to Merge</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>D. During the Termination Process</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.
Good Practice 12	The responsible entity should - during the termination process and in the context of valuing assets of the terminating fund – <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>E. Specific Types of Investment Funds</b>	
Good Practice 13	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 jeopardised.
Good Practice 14	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.

Good Practice 15	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.