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

13 October 2016

RE: Public Comment on Good Practices for the Termination of Investment Funds

Dear Mr. Worner:

ICI Global¹ appreciates the opportunity to provide feedback on IOSCO's consultation on good practices for the termination of investment funds. ICI Global's members – regulated investment funds² in jurisdictions worldwide – provide important advantages to investors including professional management, diversification, and reasonable cost, as well as the benefit of substantive government regulation and oversight.

We support IOSCO issuing good practices on fund terminations and mergers and feel the proposed good practices, as a whole, provide a useful framework for ensuring that fund terminations and mergers are effectuated in a manner that protects the interests of investors. Our

¹ The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated investment funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$18.5 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

² For purposes of this letter, the term “regulated investment fund” means any collective investment vehicle that (1) primarily invests in securities, (2) is substantively regulated, and (3) is eligible for public sale. Generally, such funds are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors. Such funds typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or “eligible assets,” concentration limits and/or diversification standards). Examples of such funds include: US investment companies regulated under the Investment Company Act of 1940 (“Investment Company Act”); “Undertakings for Collective Investment in Transferable Securities,” or UCITS, in the European Union; Canadian mutual funds; and Japanese investment trusts.

support, however, is predicated upon IOSCO's statement that not all of the listed good practices will be applicable in all circumstances given the individual nature of investment fund terminations.³ We underscore the importance of IOSCO maintaining this position and recognizing the need for both individual funds and national regulators to have flexibility when considering adherence to the good practices. Further, we reiterate IOSCO's statement that these good practices do not override national or regional legal or regulatory requirements regarding fund termination and/or insolvency regimes.

As IOSCO proceeds with its work, we emphasize that in many jurisdictions regulated investment funds are already subject to regulatory requirements that provide for an orderly process for liquidating or merging that takes into account the interests of investors. For example, when a US mutual fund needs to liquidate, there is an established and orderly process by which the fund liquidates its assets, distributes the proceeds pro rata to investors and winds up its affairs. This process adheres to requirements in the Investment Company Act of 1940 ("Investment Company Act") and state or other relevant laws based on the domicile of the fund, including consideration and approval by the mutual fund's board of directors, including independent directors. Furthermore, all actions by the fund manager and the fund directors are undertaken in accordance with their fiduciary obligations to the fund.⁴

Similarly, UCITS have orderly liquidation procedures as prescribed in their fund rules and the laws of the UCITS home Member State.⁵ Liquidations are subject to the fiduciary responsibilities of the UCITS/management company and/or directors, requiring the liquidation to be conducted in an orderly manner and in the best interests of investors. Upon liquidation, investors may be permitted to continue to place redemption orders and, as a result, regulators generally recognize that a UCITS may deviate from its investment strategy in order to maintain the liquidity necessary for redemptions. On the liquidation date, remaining investors receive a liquidation distribution in respect of their shares which reflects their pro rata share in the assets of the UCITS following the allocation of expenses. If the allocation of expenses results in excess cash being retained by the UCITS on the liquidation date, such excess amounts will be distributed to the final shareholders after settlement of all the UCITS's debts.⁶

³ See Section Part I, A.6 at 2.

⁴ For detailed information on the step by step process for terminations, see Jack Murphy, Julien Bourgeois and Lisa Price, How a Fund Dies, Review of Securities & Commodities Regulation, Vol. 43 No. 21 (Dec. 1, 2010).

⁵ See, e.g. UCITS Directive Article 19 (management company and complying with rules of UCITS home Member State, including rules related to liquidation and winding up.)

⁶ The liquidation procedure usually involves the appointment of an official liquidator with statutory powers and responsibilities regarding the accumulation, realization and distribution of assets. The party in control of the UCITS liquidation, whether that is the management company, liquidator or board, has the ability to apply to the courts for directions. Investors have the right to be notified of the termination of the UCITS and may have the right to appoint a liquidator. The depositary continues to be responsible for the safekeeping of assets during the liquidation of a UCITS and has oversight in relation to the payment of the proceeds from the realization of assets to investors. In addition, it is

Although we generally support the good practices, we have concerns with how certain principles are phrased or how they may be interpreted. We describe below our suggestions with respect to good practice numbers 4, 5, 6, 8 and 10.

As IOSCO considers the finalization of this work, which sets out good practices for funds and the responsible entities that operate them, we raise for IOSCO's further consideration the importance of cooperation and collaboration among regulators involved in terminations or mergers that affect funds or shareholders in multiple jurisdictions. As funds continue to be distributed on a cross-border basis, and as passporting regimes continue to grow, the interests of investors – wherever located – will be best served if regulators work collaboratively, efficiently, and expeditiously to effectuate terminations or mergers. In particular, we suggest that, where funds are distributed and/or shareholders are located in multiple jurisdictions, regulators in the host jurisdiction should rely predominantly on the home country's regulations to ensure the fair and equal treatment of investors.

Good Practice 4 – Questions 10 and 13

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 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 4 provides that, following a decision to terminate an investment fund, the responsible entity should issue a termination plan. The termination plan should specify, in reasonable detail, each of the steps that will be required in order to terminate the investment fund, and lists certain key items that should be included.

While we generally support the need for a reasonably detailed termination plan, we urge IOSCO not to impose upon custodians the obligations that are contemplated in Questions 10 and 13. Question 10 raises the prospect that the custodian may be required to hold assets indefinitely without being paid, despite the ongoing cost to the custodian. And Question 13 raises the prospect that the custodian may not be able to exit the market, which could impact the custodian's ability to restructure or make other business decisions.

The custodian of an investment fund should not be required to hold illiquid securities or securities with nil value. If such an approach were adopted, the custodian could be required to hold such securities indefinitely, with ongoing costs, and without payment for such costs. It is not the role of the custodian to bear the economic risks or the liquidity risks of investment funds, including

possible to merge a UCITS with another UCITS, either within the same Member State or on a cross border basis. The merger of UCITS can be done on a voluntary basis, whether on a redemption and subscription basis or by a share exchange whereby assets of the migrating UCITS are transferred to the receiving UCITS in exchange for the issue of shares in the receiving UCITS.

the risks of the termination of funds. Further, imposing such obligations on custodians may impact the pricing of their services.

Good Practice 5 – Questions 14 and 15

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 5 provides that “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.”

We agree with IOSCO that the timing of the decision to terminate an open-end fund and a determination to suspend subscriptions and redemptions should be considered by the responsible entity to ensure that it does not create opportunities that would facilitate first mover advantages (to the extent they may exist). The language in Good Practice 5, however, too strongly implies that suspending investor subscriptions and redemptions during the termination process is the best or most appropriate way to proceed and may lead to the conclusion that funds that do not make this decision are not acting in the best interest of investors.

In many cases, suspending subscriptions during the termination process – either upon notice of termination or at a later point – may be the most appropriate course of action, and this is reflected in many fund regimes. However, in many circumstances, suspension of redemptions is problematic as it limits an investor’s ability to access his or her money and may impact a fund’s ability to meet its liquidity requirements. In making a determination, responsible entities must consider the circumstances applicable to the particular fund, including the composition of its portfolio and the regulatory framework in which it operates, to address any potential first mover advantages for investors. In certain jurisdictions, for instance, funds are required or permitted to use swing pricing to mitigate the impact of subscriptions and redemptions on remaining fund investors.⁷

Finally, we underscore the importance of regulatory frameworks promoting an orderly process for reaching out to distribution partners to notify investors of changes. Investors often invest in funds through automatic savings plans or insurance linked plans; this requires that decisions regarding suspension of subscriptions and/or redemptions provide ample time for a fund’s business partners to make operational changes and manage communications to underlying investors. Rather than a requirement that certain transactions cease upon the date of notification of

⁷ For a discussion of swing pricing, see Letter from David W. Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, Securities and Exchange Commission, dated January 13, 2016, available at https://www.ici.org/pdf/16_ici_sec_lrm_rule_comment.pdf, Section III.

a corporate event, it may be more appropriate to have a minimum time period (*e.g.*, 30 days) from which such activities should cease based on the date of the relevant event. This would allow funds and fund management companies adequate time to communicate such decisions with their business parties in an orderly fashion.

We therefore recommend that either Good Practice 5 be deleted, or that it be amended to read as follows: “The responsible entity should consider a full range of options (*e.g.*, levies, swing pricing) in order to appropriately balance the interests of redeeming and remaining shareholders.” IOSCO may further consider including in the final report commentary stating that funds should include in their subscription and redemption policies and procedures how subscriptions and redemptions will be treated during the termination process.

Good Practice 6

Good Practice 6 provides that “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.”⁸ The term “custodian” means different things in different jurisdictions, and the responsibilities of such entities vary significantly depending on the jurisdiction. Generally, decisions with respect to the corporate governance and strategy of a fund, including a decision to liquidate, are made by the manager. As a result, in countries where the manager is responsible for corporate and strategic decisions and the custodian is responsible solely for holding assets, it is inappropriate to suggest that the termination plan be approved by the custodian.

For this reason, including approval of the custodian, even “in relevant circumstances,” is not appropriate. While we recognize that fund custodians perform certain functions critical to the operation of a fund, making a determination to terminate a fund is not within the custodial function. Such a decision should not be subject to the approval of the fund’s custodian. We therefore recommend that the second sentence of Good Practice 6 be deleted.

Good Practice 8

Good Practice 8 provides that, “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.”

We urge ISOCO to delete Good Practice 8 as compliance with this good practice may, in certain circumstances, not be in the best interest of investors. Fund mergers can occur for a variety of reasons, and there are a number of factors that may be considered in a merger transaction – a point that is recognized in many regulatory frameworks. The policymakers and regulators in such jurisdictions understand that a range of factors needs to be taken into account when considering a fund merger and that, while similarity of funds may be a factor in the consideration, it should not be determinative.

⁸ IOSCO notes in the consultation that the term “depository/custodian” may be used interchangeably throughout the paper and has the same meaning for purposes of the paper. *See* Consultation, footnote 2.

Neither the Investment Company Act nor the UCITS Directive requires regulated investment funds to merge only with similar funds or otherwise restricts them from merging with a fund that does not have similar investment objectives, policies and risk profile. Under US law, directors generally have a responsibility under state law to evaluate a proposed merger of any funds they oversee to determine whether, in their business judgement, the proposed merger is in the best interest of those funds. For a merger of affiliated funds, the Investment Company Act requires the board of directors, including a majority of independent directors, to consider the relevant facts and circumstances with respect to the merger and determine that the merger is in the best interests of each of the merging funds and that the interests of the shareholders of both funds are not being diluted.⁹ Directors must request and evaluate necessary information and consider and give appropriate weight to all pertinent factors. No single fact or circumstance is suggested to be a priority.

Similarly, UCITS mergers are not restricted based on similarity of funds; they are, however, subject to regulatory authorization. Under the UCITS Directive, UCITS are required to provide appropriate and accurate information on a proposed merger to shareholders to enable them to make an informed judgement. This flexible approach recognizes that mergers can benefit fund shareholders in a number of ways, including by, for example, lowering expenses, creating efficiencies due to economies of scale by spreading fixed costs over a larger asset base, or providing shareholders with enhanced services, and that merger options should not be unnecessarily restricted.

Further, in certain jurisdictions the responsible entity is able to change a fund's investment strategy by providing prior notice to fund shareholders, without shareholder approval. Consequently, Good Practice 8 seems out of step with what funds may otherwise be permitted to do separate and apart from a merger.

Good Practice 10

Good Practice 10 provides that: "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."

As drafted, Good Practice 10 is problematic. First, the term "commercial reasons" is undefined and unclear, and could be used to explain the rationale for almost any merger. Further, national regulatory frameworks may prescribe how costs are permitted to be allocated, and such allocation may not be based solely on whether the merger is undertaken for "commercial reasons."

⁹ See Rule 17a-8 under the Investment Company Act. See also Board Consideration of Fund Mergers, Independent Directors Council, Task Force Report, June 2006, available at https://www.google.com/url?sa=t&crct=j&q=&esrc=s&source=web&cd=1&ved=0ahUKFwj-pseOwdDPAhVMKB4KHaOjATcQFggcMAA&url=https%3A%2F%2Fwww.idc.org%2Fpdf%2Fppr_idc_fund_mergers.pdf&usq=AFOjCNHd4tuJCI1yfe0bPOQzIJN1rvSS1A&sig2=OC2CXksk7dY0DSzH91PLfg&xbvm=bv.135258522.d.dmo.

It is likewise not totally clear what is referenced by the term “costs.” We recommend that this be clarified to reference “merger expenses.” Transaction costs and taxes are generally not borne by the responsible entities; any global standard for allocation of costs should take note of this.

Adherence to this Good Practice as drafted may create tension with considerations under, and compliance with, national regulation. We therefore recommend instead that the Good Practice be revised as follows: “The responsible entity must carefully consider the allocation of costs in connection with the merger. Where the relevant funds will bear merger expenses, this decision should be documented in the investor communication, including a rationale for the decision.”

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If you have any questions about our comments or would like additional information, please contact Susan Olson, Chief Counsel (1-202-326-5813 or solson@ici.org) or Eva Mykolenko, Associate Chief Counsel – Securities Regulation (1-202-326-5837 or emykolenko@ici.org).

Sincerely,

/s/ Dan Waters

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