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Asset Management & Investment Funds

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COPING WITH COVID, A PRESCRIPTION FOR FUND MANAGERS AND FUND BOARDS

The evolving COVID-19 crisis poses a profound set of challenges for all regulated financial service providers including UCITS managers and AIFMs (**Fund Management Companies** or **FMCs**) and their funds under management. In the table below we consider some of those challenges, along with key actions and considerations for FMCs coping with high levels of market volatility, reconfigured governance arrangements and threats to business and operational continuity.

MARKET VOLATILITY

"ESMA's objective is to maintain markets that are open and orderly as they are vital for the functioning of our economy and financial system, especially in the current circumstances. Open markets allow the process of adjusting prices to new information to continue, and they provide liquidity to the benefit of investors by allowing them to rebalance portfolios and meet contractual obligations. ESMA, in coordination with NCAs, continues to monitor developments in financial markets as a result of the COVID-19 outbreak and is prepared to use its powers to ensure the orderly functioning of EU markets so that they benefit investors and support stability."

Steven Maijoor, ESMA Chair, 23 March 2020

CHALLENGES	ACTIONS	CONSIDERATIONS

Fund illiquidity	Illiquidity may necessitate consideration of available liquidity management tools, as permitted by regulatory regime and in line with FMC's liquidity management policy.
	
	Permitted liquidity management tools may, subject to the constitution of the fund, include:
	• **redemption gates** which cap the level of redemptions processed on a given dealing day, the minimum level of the cap depends on the fund type:
	  ◦ UCITS:10% NAV/shares in issue;
	  ◦ open-ended QIAIF (monthly dealing) 10% NAV;
	  ◦ open-ended QIAIF (quarterly dealing 25% NAV;
	  ◦ limited liquidity QIAIF (less than quarterly dealing): no minimum cap,
		Boards and senior management should be deeply and proactively engaged in any decision to implement liquidity management tools. Frequent (possibly daily/intra-day) engagement and exceptional reporting should be considered on matters of portfolio liquidity, the extent and impact of any investor redemptions on the liquidity profile of the fund and other matters impacting fund liquidity.
		
		Fund documentation must be checked prior to implementation to ensure availability of any chosen liquidity management tool.
		
		Imposition of certain of the liquidity management tools (e.g. suspension) may trigger investor, regulatory and stock exchange reporting requirements.

CHALLENGES	ACTIONS	CONSIDERATIONS

	• **anti-dilution adjustments** in the event of net subscriptions or redemptions,
	• **suspension** of NAV calculation and dealing in the fund,
	• **in specie redemptions** (<5% on shareholder consent, >5% @ fund's discretion),
	• **side pocket arrangements/share classes** (applicable for AIFs only) into which illiquid or hard to value assets may be transferred,
	• **reduce dealing days** with notice to, or consent of (depending on amendment) shareholders and the Central Bank (minimum dealing frequency: UCITS - twice a month/ open-ended QIAIFs – quarterly),
	• **redemption fees** @ a maximum of 3% NAV for UCITS and 5% for open-ended QIAIFs, and
	• **extended settlement**
	  • UCITS must settle within ten business days of the relevant dealing deadline,
	  • open-ended QIAIF must settle within 90 (95 in limited circumstances) calendar days of redemption request;
	  • limited liquidity QIAIFs (less than quarterly dealing) are not subject to any settlement time limit.	

Passive/inadvertent breaches of regulatory or self-imposed investment or risk exposure limits	**AIFM** obligation: in the event of actual or anticipated breaches of the risk limits of the AIF, the AIFM must take timely remedial action in the best interest of investors. **UCITS** obligation: Where the limits are exceeded for reasons beyond the control of a UCITS or as a result of the exercise of subscription rights, the UCITS shall adopt as a priority objective for its sales transactions the remedying of that situation, taking due account of the interests of its unit-holders.	**What type of breach is a passive/ inadvertent breach?** No Central Bank definition of passive/ inadvertent breach. Industry guidance classifies an inadvertent breach as a breach caused by factors outside the control of the FMC e.g. caused by the relative movements of security prices or redemption of shares or units in the fund by investors. **Are passive/inadvertent breaches reportable to the Central Bank?** This depends on whether the breach is the result of a material/non-material error. A breach arising from a material error is required to be reported promptly by the FMC and depositary. UCITS depositaries are required to report unresolved breaches arising from non-material errors within 4 weeks of the error.

CHALLENGES	ACTIONS	CONSIDERATIONS
		Central Bank's view of what constitutes material: • errors which have a NAV impact of ≥0.50% (≥0.10% of NAV for MMFs); • if below materiality threshold, error may still be deemed material when account is taken of any relevant surrounding circumstances e.g. the circumstances which resulted in the error (for example, inadequate controls) or the duration of the error. Non-material error breaches are required to be reported on a periodic basis via the Central Bank's ONR system. **Is compensation payable as a result of passive/inadvertent breach?** Central Bank view is that redress should generally not be payable except where otherwise deemed appropriate by the depositary.
Market illiquidity – availability of accurate/ reliable pricing	Review fund valuation rules and valuation policy for use of exceptional valuation measures to ensure proper and accurate valuation of assets.	FMCs should note Irish Funds industry guidance in relation to exceptional valuations and NAV calculation errors: *"where a NAV is dependent upon an estimate or exercise of judgement, if judgment is exercised in a manner that is consistent with the valuation policy and procedures of the fund and the FMC has taken the due care and skill that a diligent FMC would reasonably be expected to take in the circumstances, a subsequent difference upon receipt of additional information in the future would not be considered a NAV pricing error."*
Elevated level of VAR back-testing exceptions	See above on inadvertent/passive breaches.	See above on inadvertent/passive breaches.
Increased overall level of fund risk impacting synthetic risk reward indicator (**SRRI**) in UCITS key investor information document (**KIID**) or summary risk indicator (**SRI**) in PRIIPs key information document (**KID**)	Review risk indicator for any material change requiring an update to the KIID/ KID to ensure the information remains up to date in line with regulatory requirements.	Any material changes to the risk and reward profile of the fund should result in a prompt revision of the KIID/KID. Any revised UCITS KIID should be forwarded by email to the Central Bank at UCITSKIID@centralbank.ie.
Long position losses and EU measures limiting creation or extension of short positions	Review any existing or proposed short positions in-scope of ESMA's approved measures under the Short Selling Regulation (SSR) by the French, Spanish, Italian, Belgian, Greek and Austrian regulatory authorities to ban the creation of any new or further net short positions in shares admitted to trading on trading venues under their respective jurisdictions. See our briefing on this development for further details.	Review and consider investment objective and policy of fund to determine flexibility prior to any short investment.

GOVERNANCE ARRANGEMENTS

"Given the global nature of the COVID19 emergency, interconnections between financial service providers and financial markets, reliance on outsourced service providers and firms' dependence on key staff, the Central Bank expects financial service firms' boards and senior management to actively monitor developments in order to be in the best position to preempt and respond to rapidly changing circumstances."

Central Bank of Ireland, Statement on the essential nature of financial services, 31 March 2020

CHALLENGES	ACTIONS	CONSIDERATIONS
Physical attendance at board meetings	Subject to the FMC's constitution (or that of the fund, where relevant), there is no statutory or regulatory provision preventing the FMC from hosting virtual board meetings e.g. by teleconference, video conference or by other electronic communication. Subject to the FMC's constitution (or that of the fund, where relevant), consider approval by way of written resolution signed by all the directors in separate counterparts in place of a physical board meeting.	Check constitution for facility to hold virtual board meetings and implement approvals by way of written resolution in separate counterparts. Consider constitutive amendment if facility is unavailable.
Remote working impeding access to 'wet ink' signatures	Consider the permissibility of electronic signatures as recognised under Irish law.	See our briefing on the use of electronic signatures for further details.
Key personnel may become unavailable and at very short notice	Preparatory measures should be considered for control functions (CFs) and pre-approval controlled function (PCF) holders e.g. identify suitably experienced and competent successors with bandwidth to take on CF/PCF role at short notice. Key staff should maintain handover notes to ensure a smooth transition of functions.	Subject to its prior approval, the Central Bank permits the appointment of a temporary officer in exceptional circumstances to perform a PCF role. Early engagement with the Central Bank is advised to ensure that this can be achieved promptly in the absence of any express forbearance measures. It should also be noted that the FMC must be satisfied on reasonable grounds that the proposed appointee meets the fitness and probity standards
Holding shareholder meetings	Funds incorporated as public limited companies (PLCs) are required to hold an annual general meeting (**AGM**) of shareholders each year at which the financial statements are considered and not more than 15 months can elapse between AGMs. Subject to the constitution of the FMC (or that of the relevant fund) virtual shareholder meetings may be permissible. Funds established as Irish Collective Asset Management Vehicles (**ICAVs**) may, on written notice to shareholders, dispense with holding the AGM.	FMCs with funds under management that are obliged to hold shareholder meetings should seek advice on applicable statutory requirements, including in respect of time limits, to ensure compliance with relevant governing regimes.

REGULATORY COMPLIANCE

"In response to the COVID-19 outbreak, ESMA has intensified its coordination with NCAs. To help market participants' business continuity, we have clarified the requirements regarding the recording of telephone conversations, have provided relief regarding a number of deadlines, including that regarding SFTR, and have coordinated the implementation of short selling measures in a number of member states. We will continue this strong cooperation with NCAs to respond to the current exceptional circumstances."

Steven Maijoor, ESMA Chair, 23 March 2020

CHALLENGES	ACTIONS	CONSIDERATIONS
Business continuity and continuing regulatory compliance	FMCs are subject to are subject to business continuity obligations under sectoral regulations and regulatory expectations in this area are set out in the Central Bank's Guidance - Fund Management Companies. An important factor to securing a sympathetic response to the FMC's circumstances will be the implementation of a robust, well-tested business continuity plan (**BCP**) and crisis response strategy. With delegation being an integral feature of many FMCs' business models, the FMC's operational resilience will have an external dependency on its delegates and service providers (**SPs**), whether intra-group or third-party providers. FMCs who rely upon BCPs maintained by SPs need to maintain frequent and close communication with SPs on the maintenance of business continuity during the current crisis.	The Central Bank has, in meetings with the industry body Irish Funds, emphasised the need for early and open supervisory engagement by FMCs facing challenges with compliance. FMCs should be better placed in their supervisory engagement if they can demonstrate that all reasonable actions were taken to avoid a breach or otherwise mitigate its impacts, with a clear record of how the FMC has prioritised the interests of investors in the funds under management.
Enhanced regulatory reporting under Short Selling Regulation	FMCs must consider any investments in-scope of ESMA's statement of 16 March 2020, requiring, with immediate effect, all holders of net short positions in shares traded on an EU regulated market (where that EU market is the principal trading venue for the shares) to notify the relevant national competent authority if the position reaches or exceeds 0.1% [*down from 0.2%*] of the issued share capital of the issuing company.	See our briefing on this development for further details.
Upcoming regulatory reporting deadlines	**Securities Financing Transaction Regulation** ESMA has told competent authorities to exercise regulatory forbearance in respect of the deadline of 13 April 2020 for reporting of securities financing transactions (**SFT**) by credit institutions and investment firms under the SFTR. ESMA expects such entities to report by 13 July 2020, the scheduled deadline for reporting by CSDs and CCPs under the SFT Regulation (**SFTR**). FMCs continue to be scheduled to commence reporting under the SFTR by 11 October 2020.	In the absence of mitigating measures (other than as referenced opposite) FMCs have been advised by the Central Bank that they are expected to have appropriate contingency plans in place to be able to deal with regulatory compliance matters in the current crisis. The Central Bank has also noted that it has business continuity plans to ensure that it can continue its work effectively and deliver on its public interest mandate during this period.

	Money Market Fund Regulation On 30 March 2020, ESMA announced that the first reports by Money Market Funds (**MMF**) managers under the MMF Regulation (**MMFR**) should be submitted in September 2020. The original date for submissions was April 2020. The delay to the reporting deadline is to allow MMF Managers adapt to an amended XML schema and reporting instructions which ESMA intends to publish shortly on its website. Reporting entities should use the version v1.1 to submit reports required under Article 37 of MMF regulation. The reference period for the first reporting is still envisaged for Q1 2020. That means that the MMF Managers will have to report in September 2020 quarterly reports for both the Q1 and Q2 reporting periods.	
Preparation of Financial Statements	In the absence of mitigating measures FMCs' must ensure compliance with obligations to prepare and file financial statements.	ESMA has advised issuers to provide transparency on the actual and potential impacts of COVID-19, to the extent possible based on both a qualitative and quantitative assessment on their business activities, financial situation and economic performance in their 2019 year-end financial report if these have not yet been finalised or otherwise in their interim financial reporting disclosures.
Market disclosure obligations under the Market Abuse Regime (**MAR**)	Funds in-scope of MAR must disclose as soon as possible any relevant significant information concerning the impacts of COVID-19 on their fundamentals, prospects or financial situation in accordance with their transparency obligations under MAR.	Funds in-scope of MAR must disclose as soon as possible any relevant significant information concerning the impacts of COVID-19 on their fundamentals, prospects or financial situation in accordance with their transparency obligations under MAR.
Companies Registration Office (CRO) filings	Access to the CRO's electronic filing platform (CORE) should be arranged for any filings it supports following the reduced-services update issued by the CRO on 1 April 2020.	CRO update issued 1 April 2020: *"Due to the restrictions put in place by the Government in response to the COVID-19 pandemic, the CRO Offices are closed. We are offering limited services to the public including company incorporations and receipt of charges. The company search facility www.cro.ie remains operational. The company online filing facility www.core.ie remains operational. Post to the Dublin Office will resume from 02/04/20. All post will be date stamped on receipt and stored for processing when the Office re-opens."*
Legalisation of documents in accordance with host Member State inward marketing requirements	**Apostilling** The timeline for legalisation of documents will need to factor in the necessity to submit documents by post following closure to the public of the Department of Foreign Affairs. **Notarising** Access to notaries may also be impacted and timing should be confirmed in advance. Host Member State authority inward marketing requirements should be checked to ensure compliance is possible in the normal course.	On 30 March 2020, the Consular Division of the Department of Foreign Affairs and Trade confirmed that documents for authentication may only be submitted by registered post and payment made by way or credit/debit card.

Contact Us

The Table is intended as a “ready-reckoner” only and is not a comprehensive list of all implications of the COVID-19 pandemic for all Irish fund management companies.

If you have any queries in relation to this or would like to know more about the services we are offering, please contact any of our Asset Management and Investment Funds partners below or your usual contact at William Fry.

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