A&L Goodbody

COVID-19: *Irish investment funds | business in a pandemic*

Focus on
COVID-19
Coronavirus

Irish public health safety measures to combat the spread of COVID-19 have been in place for over two months now.

Regulated investment funds and regulated financial service providers (RFSPs) established in Ireland have been operating under business continuity measures during that time.

Here we revisit the themes discussed in our COVID-19: Governance, contingency planning and risk briefing and give an overview of how regulated investment funds and RFSPs established in Ireland have been managing some business and practical issues against the backdrop of a now significantly changed global business and operating environment.

Director meetings	Shareholder meetings	e-signatures	Regulatory engagement
PCF availability	Force majeure, frustration, material adverse change	BCP review	Cybersecurity
Liquidity management tools	VaR breaches	SRRI updates	Risk disclosure

Director meetings

Quarterly, scheduled and ad-hoc board meetings continue to take place. Directors and attendees participate by video or teleconference rather than physical meetings taking place.

There have been some issues to deal with where older constitutional documents require physical presence of directors to form a quorum or for a director to be counted in passing a resolution. Some older constitutional documents do not provide for having effective board meetings via audio or videoconference. There are a range of solutions for that, depending on the provisions. Some clients have explored the possibility of setting the quorum at 1 director which would work in practical terms but is not a satisfactory solution for several reasons. Other options used are to:

- ratify the resolutions and other acts of directors at the next quorate board meeting
- hold and minute the meeting by audio or videoconference then extract the resolutions from the minutes, ideally by the next day, and have them signed by all directors to take effect as written resolutions.

Firms can plan to update their constitution at the next opportunity to allow for audio or videoconference director meetings and also check the shareholder meeting provisions and update those too for greater flexibility.

It is a good practice, at the start of the board meeting when quorum formalities are noted, for directors to note why the meeting is not physical and, if relevant, discuss and note the selection and use of a video conference platform.

Remote engagement rather than physical presence in a board room can create different board dynamics. It can be a less natural environment to pursue and resolve a point of inquiry or challenge during an audio or videoconference board meeting. Technical difficulties can delay or disrupt proceedings. This can lead to more communication than usual between board meetings and this is usually by email. There has been an increase generally in communication between board meetings, with performance and liquidity metrics being two areas of focus.

Boards have also been paying attention to tax residency considerations where holding in-person board meetings in Ireland is not possible. The location of board meetings and board of directors' decision making is a key factor in determining "central management and control". The Irish Revenue Commissioners published some helpful guidance on 23 March 2020 on the approach which they will take to situations where company employees, directors, service providers or agents, are unable to travel as a result of the COVID-19 related travel restrictions. You can read the ALG Tax team's briefing on this here.

Shareholder meetings

Some funds are taking a decision to postpone AGMs until a later date. This can be done while complying with the statutory requirements for the period of time within which AGMs must be held. Postponement can create time to make alternative arrangements, such as arranging for investors' participation by audio or videoconference, and communicate those arrangements to investors.

We have advised on including "COVID wording" in meeting notices to remind people of the public health restrictions on physical gatherings, how that affects the meeting and encouraging investors to use proxies to cast their votes.

Electronic signatures

There has been a significant increase in interest in using electronic or e-signature solutions to sign documents. As part of initial discussions at board meetings, we have been encouraging directors to note whether an e-signature provider is already being used or to discuss whether a formal e-signature solution should be put in place. We can assist in that regard.

It is worthwhile engaging with service providers on this issue to understand their policies on the use of e-signatures, compatibility and whether they have a preferred provider. There can be some misunderstanding around the term "e-signature" and you can read this ALG briefing on the different types of electronic signatures and permitted uses. If a company secretary of a fund manager or fund is approached to hold directors' electronic signatures, a procedure to govern this should be agreed and documented.

We have found that many clients are content to use scanned wet-ink signatures.

Regulatory engagement

For the most part, we have seen no change in dealing with the Central Bank of Ireland (CBI) authorisation or post authorisation teams as a consequence of COVID-19 disruption. The CBI is adhering to the review timelines published on their website. For document updates and changes which are COVID-19 or market volatility related, the CBI has expedited reviews where requested.

The CBI has communicated with the funds industry directly. The CBI has asked Irish regulated funds and RFSPs to engage with it at an early stage where issues are identified which have the potential to have an impact on investors. Firms have also been asked to provide a weekly update to the CBI from 30 March on BCP arrangements, delegates, liquidity, valuation and cyber-security. You can read here about the CBI's cross-sectoral COVID-19 statement of 4 March 2020 and read here about the flexibility measures introduced by the CBI which are relevant for funds and RFSPs, for example extended regulatory filing deadlines.

The CBI has queried if there is a need for extra risk disclosure in prospectuses and we discuss this below.

International regulatory engagement for ALG's global fund registration team continues as usual and regulator responsiveness has not been affected.

PCF availability

Replacement of directors or designated persons at short notice has thankfully not been a notable consequence to date of the COVID-19 disruption. In the event that it does happen, the CBI has provided some clarity on the process to be followed in case a PCF needs to be replaced as a matter of urgency which is discussed in this ALG publication.

Force majeure, frustration, material adverse change

Funds and RFSPs may be scrutinising their service provider and other delegate contracts to see what the force majeure provisions are, whether there is a material adverse change clause (**MAC clause**) and if COVID-19 disruption could be interpreted as a force majeure event or material adverse change. At this point there appears to be no widespread application of these contractual provisions by service providers to funds or their delegates. We would expect Irish regulated funds and RFSPs to be in a position to identify in advance whether there is a likely risk of this through discharge of their ongoing delegate supervision obligations. The CBI is likely to expect any such identified risks to be communicated to it in weekly reporting.

There is no general principle of force majeure under common law. Instead, parties must include a specific clause in their contracts if they wish to rely on the concept. Where incorporated into a contract, a force majeure clause generally excuses one or both parties from performing its obligations following the occurrence of particular events. Force majeure clauses would typically be included in contracts where regulated funds or RFSPs appoint service providers and delegates.

In the absence of a force majeure provision, frustration may be applicable. Frustration is a common law doctrine which occurs when it has become impossible or illegal for one or both parties to perform the contract. If the obligation to perform is altered and has changed in such a way to make it into something which was otherwise agreed, then this also amounts to frustration.

Some contracts allocate risk among the contractual parties where circumstances arise such that these could be envisaged to lead to a material adverse change on the business or its financial health. A triggered MAC clause may give one party the right to avoid performance under the contract, or even to terminate it.

BCP review

Business continuity plans are being reviewed and discussed, but on the whole no significant changes are being made. It does not appear that putting in place specific COVID-19 BCPs is a widespread practice.

In the main, the existing UCITS and AIFMD requirements and implementation of the CP86 Fund Management Guidance has meant that Irish regulated fund service providers and funds have sound policies and practices which are standing up to the test.

COVID has been a real test of BCPs and it appears they have stood up remarkably well.

Cybersecurity

The CBI's letter on cybersecurity risk management of 10 March 2020 had to be brought to the attention of boards of regulated funds and RFSPs by 30 April 2020. The focus on cybersecurity risk and the considerations raised in the letter, was more timely than anyone could have predicted. The increase in remote working as a consequence of the COVID-19 health restrictions brings an increased risk of cybersecurity breaches.

Cybersecurity is a topic of discussion at board meetings and within RFSPs. It has been reported that cybersecurity attacks, such as phishing, have increased in the last 2 months and Irish regulated funds and RFSPs will not be immune to the trend. Extra vigilance is required. Security of video conferencing platforms is a topic of discussion. The use of personal web-based email addresses while working out of the office is to be discouraged and best security practices for printing sensitive material, laptop accessibility and other usual business activities should be communicated and applied.

This ALG COVID-19 cybercrime article provides food for thought about increased possibility of threats in the current environment.

Liquidity management tools

Liquidity is a focus, primarily because of market volatility and investor sentiment. The CBI has asked Irish regulated funds and RFSPs to report weekly on whether the use of liquidity management tools (LMT) is being considered. LMT provisions in constitutional and offering documents are being reviewed. The CBI requires a suspensions questionnaire to be completed where the CBI has been notified that a fund has suspended dealing. In that questionnaire, the CBI also requires the suspended fund to follow the requirements of the July 2008 industry letter on suspensions issued by the Central Bank of Ireland.

In the main liquidity is being closely monitored but there are currently no indications of a trend towards gatings, suspensions or deferred redemptions.

There is a tendency to compare the current economic crisis to that of 2007 / 2008 but there is also tentative consensus that the current pandemic-triggered economic crisis is not having the same effect on liquidity.

VaR breaches

Breaching and consistently bumping against VaR limits is a current and material issue due to market volatility. The CBI guidance and limits for VaR usage for UCITS and retail AIFs is clear. For QIAIFs there may be VaR limits disclosed to investors in the prospectus to be observed or breaching VaR limits may affect leverage disclosures or be relevant for financing documents.

For QIAIFs which are close to breaching any VaR or associated leverage limits and which are considering prospectus updates as a consequence, the usual CBI regulatory rules about investor notification prior to or approval for any changes should be considered. Any updated documentation would need to be filed with the CBI for noting.

We have recently seen UCITS switch the risk measure for a number of products from absolute VaR to relative VaR. Where the UCITS VaR limit was being bumped against or breached due to market volatility and not FDI use, the CBI considered and accepted the proposal to switch to relative VaR.

SRRI updates

UCITS have to monitor the synthetic risk and reward indicator (SRRI) included in a UCITS KIID on an ongoing basis. The current market volatility has caused a change to the SRRI for some UCITS leading to questions around the requirements to update the KIID to reflect the new SRRI.

The SRRI in a UCITS KIID must be revised if the relevant volatility of the UCITS has fallen outside its current risk category on each reference point over the preceding 4 months.

For those UCITS affected, generally speaking, if the current market volatility continues into June and the SRRI observations over the previous 4 month period trigger a revision to the published SRRI, then revised KIIDs with the new SRRI will need to be issued and filed with the CBI and any other relevant authorities.

Risk disclosure

While it is not a requirement to update offering documentation to disclose risks to Irish regulated funds because of the COVID-19 pandemic, some funds may choose to do so particularly if updating a prospectus or supplements for other reasons.

The main risks to disclose would be negative impact on NAV, general effect on a fund's investments, challenges in valuation or impact on the performance of service providers or counterparties including the possibility of COVID-19 disruption being classified as a force majeure event.

In reviewing such disclosure the CBI, consistent with its request for weekly reporting and advance disclosure of issues arising, may raise comments on the risks outlined. For example the CBI may enquire what contracts would be affected if a force majeure event was triggered or if any of the risks outlined have taken place to date.

Conclusion

Irish regulated Funds and RFSPs will continue to face challenges while the COVID-19 disruption continues. In our view the governance and risk management practices developed and implemented in the European funds industry since the last economic crisis are working to help manage the effect of this sudden, sharp economic shock. As business adapts, new best practices will continue to emerge.

For more information

For more information in relation to this topic please contact your usual contact on the ALG Asset Management & Investment Funds team.

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