

COVID-19: GOVERNANCE: LISTED CLOSED-ENDED INVESTMENT FUNDS (UK) - UPDATED 2 APRIL 2020

02 April 2020 | Europe, UK
Legal Briefings

The spread of COVID-19 has unsettled financial markets over the last few weeks. Against this backdrop, it is also important to recognise the differing impact of the pandemic on different sectors and market players.

In the context of listed closed-ended investment funds (Listed Funds), COVID-19 has already likely had an impact on their portfolio and share prices (with potential widening on the share price discount). In addition, when considering the impact of COVID-19, Listed Fund Boards must have regard to the way in which these funds are regulated as listed companies and the nature of the relationship between the Listed Fund and the entities or groups providing investment management services (Investment Managers) or other critical services (such as administrators) to the Listed Funds.

While not seeking to be exhaustive, this briefing seeks to summarise some of the key factors to be considered by Listed Fund Boards at this stage. Where it considers the relationship between Listed Funds and their Investment Managers, the principles will often be of relevance to relationships with other key service providers as well.

AGMS AND OTHER SHAREHOLDER MEETINGS

Each Listed Fund will have different concerns and issues relating to shareholder meetings depending on its circumstances – those Listed Funds with shareholder meetings attended by only a few shareholders will likely approach the issue differently to those with a large shareholder base typically attending meetings.

The UK Business Secretary announced on 27 March that the Government will be introducing emergency legislation to grant relief to companies holding their AGMs during this period of social disruption. Although the draft legislation isn't yet available and, with Parliament now only reconvening on 21 April 2020, it is not clear when this will be implemented – however, the indication is that this proposed legislation will give companies the ability to either postpone or to hold virtual AGMs. It is unclear as yet whether the legislation will also extend the 6 month time limit following a company's year-end for holding the AGM.

In the meanwhile, [industry guidance](#) published on 26 March 2020 recommends that companies should inform shareholders that in light of the Governments "stay at home" measures which took effect on 26 March 2020, anyone seeking to attend the meeting will be refused entry to the meeting and that shareholders should vote by proxy instead. There is a good argument that the common law powers of the chairman of a general meeting are wide enough to permit the turning away of shareholders in these circumstances – however, in the absence of legislation, this is not entirely without risk. As such, factors such as the powers expressly provided under the Articles, the agenda for the relevant shareholder meeting, the ability to adjourn or postpone the meeting, any long stop date for holding the meeting and the measures adopted to enable "virtual" engagement with shareholders (through a Q&A facility or live streaming on the company's website), would be relevant in determining the approach best suited to each company.

Against that backdrop, some of the key issues for Listed Fund Boards to consider in relation to upcoming shareholder meetings are:

Quorum – What is the quorum for the meeting in the Articles of Association? Can this be satisfied by board attendance?

Director attendance – Will directors be able to attend – especially those based in jurisdictions other than where the relevant meeting is being held? What arrangements, if any, will be put in place for them to join the meeting – for example, will they video conference in to the meeting? What arrangements are in place if the Chair cannot attend due to illness or travel restrictions? Similarly, what arrangements are in place if the Company Secretary cannot attend – who will take on that role on the day?

Form and conduct of the meeting – Can audio-visual links be used to allow the meeting to be held in overflow rooms at the same venue? Can shareholders be asked to send questions in advance of the meeting, and to have these responses to on the Listed Fund's website? Can the proceedings be live-streamed on the Listed Fund's website? For Listed Funds which have significant set-piece presentations from the Chair or the Investment Manager, is it advisable to shorten or dispense with these?

Venue – Is there a contingency plan if the meeting venue becomes unavailable? What are the provisions in the Articles of Association around adjournment of the meeting to change the venue?

Adjournment – If the meeting needs to be adjourned, what do the Articles of Association say? Particularly in relation to AGMs, it is important to note that these cannot be cancelled once called. AGM circulars, therefore, cannot be revoked or cancelled and, even if they are postponed (which can be cumbersome exercise) or adjourned on the day, the AGM must be held within 6 months of the Listed Fund’s year-end (unless this is statutorily extended as part of the emergency legislation).

PUBLICATION OF FINANCIAL STATEMENTS

ESMA has [encouraged](#) national competent authorities in the European Union to apply a risk-based approach in the exercise of supervisory powers in their day-to-day enforcement of applicable legislation in the area of the Transparency Directive and the publication deadline of financial reports. This has been reflected in the approach taken in the UK.

In relation to annual financial statements, the FCA announced on 26 March 2020 temporary relief which will permit listed companies which need the extra time to complete their audited financial statements an additional 2 months in which to publish them. Currently, under the Transparency Directive, companies have 4 months from their financial year end in which to publish audited financial statements. Under the temporary relief, the FCA will, among other things, forbear from suspending the listing of companies if they publish financial statements within 6 months of their year-end.

Detailed additional information on the duration, scope and applicability of this temporary relief (including a Q&A document) is available on the [FCA website](#).

The FCA has also [confirmed](#) to the AIC that companies due to publish their half-yearly accounts by 31 March and which are having difficulties getting their auditor to sign these off due to uncertainty caused by Covid-19 should contact the FCA’s emergency helpline on 020 7066 8354. The AIC has indicated that if companies contact the FCA, the FCA has confirmed that it will temporarily relieve companies from the requirement to comply with DTR 4.2.2(2) to publish half-yearly financial reports no later than 3 months after the period end.

In this connection, [guidance](#) published by the FRC on corporate governance and reporting is also relevant for Listed Fund Boards.

BOARD MEETINGS OF OFFSHORE LISTED FUNDS

Listed Funds established in Jersey, Guernsey or other offshore jurisdictions are typically advised to avoid holding board meetings in the UK in order to prevent the risk of UK VAT being payable on services provided to the Listed Fund (although holding Board meetings in the UK should not affect the tax residence of the Listed Fund, since they are AIFs from a regulatory perspective). This includes avoiding having UK-based directors dialling in to offshore board meetings from the UK. UK VAT may become payable if the Listed Fund were to have a “fixed establishment” in the UK for VAT purposes, where VATable services supplied to the Listed Fund would be considered to be received. However, due to the travel restrictions now in place, it may be that Listed Funds have no choice but to hold board meetings by phone from wherever the relevant directors happen to be at the relevant time.

Absent legislative intervention (which is currently not expected), the VAT risk remains – therefore, any offshore Listed Fund holding a Board meeting in the UK during this period would need to consider carefully whether, in light of the agenda of the Board meeting and the services being provided to the Listed Fund, the holding of the Board meeting in the UK would have any adverse VAT consequences for the Listed Fund.

In addition, for any offshore subsidiaries of Listed Funds that are not AIFs, there remains a risk of such subsidiaries becoming UK tax resident if their “central management and control” is exercised in the UK, which generally turns on where the Board meets and where Board-level decisions are taken. To the extent that any Board meetings of such subsidiaries need to take place during this period, care should therefore be taken if any members of the Board are physically based in the UK.

MANAGEMENT ARRANGEMENTS

Quarantine requirements and restrictions on travel may affect the service being provided by Investment Managers to Listed Funds. Most management agreements would typically have some form of force majeure provision – we would expect that a pandemic of the nature of COVID-19 would fall within the definition of a “force majeure event” in most cases. Force majeure provisions would typically provide that if, as a result of a force majeure event, the performance by either party of its obligations is materially affected, these obligations would remain in force but would be suspended. Management agreements may then differ on the impact of such suspension on fees and also in relation to whether a suspension for an extended period enables the unaffected party to terminate the agreement on notice.

Against that backdrop, any Listed Funds or Investment Managers expecting the management of the Listed Fund to be materially impacted by COVID-19 should review the force majeure provision in the relevant management agreement – it may also be advisable to have preliminary conversations between the Listed Fund Board and the Investment Manager to agree their understanding of such provisions and the approach which would be in the best interests of the shareholders of the Listed Fund, rather than having these discussions once the force majeure event has already arisen.

In addition, some Investment Managers may be heavily reliant on specific individuals in relation to the management of certain of their Listed Funds – in these cases, it may be that such individuals are listed as “key persons” in the relevant management agreement. We would expect that Investment Managers will, where appropriate, be considering contingency plans for minimising disruptions and some may already have implemented these in whole or part. Listed Funds, especially those which are heavily reliant on specific individuals within the Investment Manager, should discuss with their Investment Manager what their contingency plans are, when they will be implemented and how they might affect the service provision to the Listed Fund, if at all.

MARKET DISCLOSURES

ESMA has [recommended](#) that “issuers should 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 the Market Abuse Regulation”.

Listed Funds with material exposures to broader equity markets, or sectors such as energy, travel and leisure and transportation, should seek to ensure that their Investment Manager is actively monitoring the impact of COVID-19 on the performance of the Listed Fund’s portfolio and that the information flow from the Investment Manager to the Listed Fund Board enables the Board to determine the materiality of any new developments and their impact on the Listed Fund’s portfolio. Specifically, if any material NAV movements are expected as a result of the wider market movements, ad hoc NAV announcements outside of the usual reporting cycle may need to be considered.

If any Directors of the Listed Fund or key personnel within the Investment Manager are quarantined or are otherwise unable to provide the usual level of service, Listed Fund Boards would also need to consider whether this is a material development which needs to be announced (either as potentially inside information or as a matter of investor relations best practice).

PROSPECTUS AND AIFMD DISCLOSURES

The market volatility resulting from COVID-19 will obviously impact the fundraising environment, making it more difficult for new or existing Listed Funds to raise new money. If any new prospectuses are being published, the key consideration will be to ensure that any specific risks arising from the pandemic and its impact on the financial markets are adequately disclosed in the prospectus. In this context, it is worth noting that under the Prospectus Regulation, the specific impact of risks on the issuer need to be disclosed – any risks relating to COVID-19 would therefore need to specifically draw out how these would impact the operation and prospects of the Listed Fund in question.

Separately, a more complex issue will be the approach to be adopted by Listed Funds with ongoing placing programmes pursuant to a “live” prospectus. The AIC has published [guidance](#) that although it is difficult to provide a definitive view on whether a supplementary prospectus is required, general concerns about the impact of COVID-19 may not be sufficient to trigger a requirement for a supplementary prospectus. However, if recent developments are likely to materially impact the disclosures in an existing prospectus (particularly disclosures relating to target return projections or the expected rate of deployment of amounts subscribed for in a fundraise), Listed Fund Boards, together with the Investment Managers and sponsors / bookrunners, would need to consider whether the impact is material so as to require the publication of a supplementary prospectus.

Listed Funds also need to make certain specific disclosures pursuant to the AIFM Directive, typically contained in the Prospectus or in a separate AIFMD disclosure document. These AIFMD disclosures include, inter alia, a description of the key risks associated with the Listed Fund. These disclosures are required to be updated when “there are material changes” to the information. Although COVID-19 may not result in material changes to the risk disclosures of most Listed Funds, Listed Fund Boards and their Investment Managers should nevertheless consider whether, given the investment strategy of a given Listed Fund, COVID-19 and its impact on the wider economy does constitute a material risk which needs to be disclosed in a revised AIFMD disclosure document.

DISCOUNT CONTROL MECHANISMS

Some Listed Funds put in place discount control mechanisms (such as share buybacks, tender offers or continuation votes) which would or may be triggered by the Listed Fund’s shares trading at a material discount to NAV consistently over a period of time – some Listed Funds may also commit to defend a certain level of discount. The widespread sell-off on equity markets as a result of COVID-19, and the potential consequential widening of Listed Fund discounts, might make it more likely than before that these discount control mechanisms may be triggered for Listed Funds.

Usually, the mechanisms are structured such that the Listed Fund Boards have some discretion over whether the mechanism should be implemented – in these cases, the Listed Fund Board will need to actively consider the level of discount and determine whether implementing the mechanism is in the best interests of shareholders.

However, there may be cases where the Board’s discretion is limited and the mechanism needs to be implemented on the satisfaction of certain objective criteria (usually where the Listed Fund Board has committed to defending a certain level of discount). Boards of Listed Funds with such discount control mechanisms should actively monitor the likelihood that these will be triggered, consider ways of mitigating this risk and also prepare for the potential implementation of the mechanism.

PRIIPS DISCLOSURES

In relation to Listed Funds, there are also certain disclosures required by the PRIIPS Regulation, which are contained in a Key Information Document (KID). KIDs are required to be updated when “there is a change that significantly affects or is likely to significantly affect the information”.

The key point on KIDs is to check if any of the calculations and disclosures on future performance of the Listed Fund will be affected. In addition, KIDs are also required to contain descriptions of the key risks associated with the Listed Fund – although COVID-19 may not result in significant changes to the risk disclosures of most Listed Funds, Listed Fund Boards and their Investment Managers should nevertheless consider this in the context of the specific Listed Fund.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



NIGEL FARR
PARTNER, LONDON

+44 20 7466 2360
nigel.farr@hsf.com



TIM WEST
PARTNER, LONDON

+44 20 7466 2309
Tim.West@hsf.com



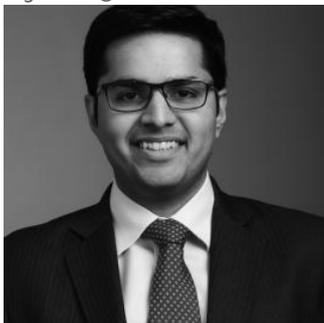
NISH DISSANAYAKE
PARTNER, LONDON

+44 20 7466 2365
Nish.Dissanayake@hsf.com



STEPHEN NEWBY
PARTNER, LONDON

+44 20 7466 2481
Stephen.Newby@hsf.com



**SHANTANU
NARAVANE**
SENIOR ASSOCIATE,
LONDON

+44 20 7466 2077
Shantanu.Naravane@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2022

SUBSCRIBE TO STAY UP-TO-DATE WITH INSIGHTS, LEGAL UPDATES, EVENTS, AND MORE

Close

© HERBERT SMITH FREEHILLS LLP 2022