

# Market disruption events and their impact on fund practitioners

*Market or fund disruption events can have a profound impact on the funds industry and funds practitioners need to be aware of how they should deal with such events.*

One of the major challenges facing all participants in the funds industry is how to react to significant market events. Investment markets are typically disrupted by headline-grabbing, one-off events like 9/11, Black Monday or the recent sub-prime/credit crunch crisis, whereas funds can be disrupted by a broad range of incidences such as the resignation of key investment staff, significant regulatory issues and loss of investor confidence in a fund. While these matters will overlap to some degree, their relevance to each fund will vary depending on the type, impact and duration of disruption and the specific characteristics of each fund. But what do industry practitioners need to know when facing a fund or market disruption event?

The first step for industry participants when facing a disruption event is to establish the facts behind the event by gathering as much relevant information as possible. In doing so, there are a number of immediate considerations including: ascertaining the type of disruption and how it impacts on a particular fund as early as possible; documenting all information appropriately; and reviewing all constitutional documents of the fund, material contracts and relevant legislation to see if it provides guidance on dealing with the disruption.

All relevant industry and regulatory websites/guidance papers should also be reviewed, such as e.g. the industry's information note on fund suspensions and the industry information note on extended trading hours. Industry participants can also learn from the regulatory protocol for the suspension of funds in other jurisdictions.

As market disruption events can either have an impact on the whole securities market or just specific funds, it may be necessary to examine each fund on a case by case basis.

Where it is perceived that market events may impact a fund the following points may require consideration:

- » Does the disruption event impact the fund as a whole or does it affect particular investments of the fund? Is the duration of the disruption event short or long term? Liaise with the investment manager to understand their consideration of the event on the portfolio
- » The disruption event needs to be assessed as to its impact on shareholders – is it significant and could it be material? Establish what information is publicly available in the market
- » The constitutional documents of the fund, all material contracts and the relevant legislation should be reviewed to determine if there are specific steps to be taken once a disruption event occurs
- » Has the disruption event caused a loss to the fund? If so, was the loss caused by the action or inaction of a service provider?

Upon identifying the impact of the market disruption event, the manager/directors must come to a decision regarding what parties should be informed. While the ultimate responsibility for deciding how to react to the occurrence of a particular disruption event will typically lie with the directors/manager of the fund, a number of other parties may also need to be involved in discussions and updates on the issue. These parties may include the custodian /trustee; the investment manager, promoter and distributor; administrator; shareholders; regulator; legal advisors; audit and other professional advisors; and stock exchanges if the fund is listed. It is also important to consider if there are any conflicts of interest between the parties advising the fund and the service providers.

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Once relevant parties have been informed of the event, other considerations may require contemplation:

- » How does the prospectus/constitutional documentation wording impact on the issue? Do these documents refer to this type of event and action to be taken and are there any specific communication requirements under the terms of the documents?
- » How will returns to investors be impacted?
- » What types of shareholders are involved?
- » Does communication on the issue need to be sent to the shareholders? If so, continuously assess if further communication is required as the issue unfolds / approaches resolution
- » Are all investors shareholders or are some considered creditors? Considerations may be appropriate where these groups have different rights around the event
- » Are there any lock-up periods or side letters which need to be taken in to account?
- » Should the fund be suspended?

Following a disruption event, communication procedures will be extremely important. Consideration needs to be given regarding what party is best placed to co-ordinate communication on any such issue. This may include who is best placed to draft relevant communication to the parties involved and what reviews need to occur in advance of circulation.

Other issues worth considering include the need to inform all stakeholders of the occurrence of the disruption event as soon as possible; how the information should be distributed; whether or not the event requires possible stock exchange announcements where the fund is listed; how the relevant regulators are informed and who needs to be informed if trading is re-launched.

Once the impact of the disruption event has been assessed, then decisions must be made as to what must be done in the best interests of the shareholders. If it is not possible to correctly provide a fair value of the assets of the fund in accordance with industry practice, consideration should be given to potential actions such as delaying or suspending NAV production, suspending or limiting shareholder dealing or liquidating the fund. The course of action to be

followed in the best interests of the shareholders of a particular fund will be determined by the type, severity and duration of the disruption event in conjunction with the type of fund, category(ies) of shareholders affected and the frequency of NAV production.

The constitutional documents of the fund and any industry or regulatory guidance should also be consulted before taking any of these actions, while the board of directors of the fund or the manager should regularly discuss what decisions should be made. Where necessary and before following a particular course of action, all approvals should be obtained, whether from the trustee or the Financial Regulator or both. Equally the shareholders and the Financial Regulator should be kept informed of all decisions made and actions followed.

Suspension of fund pricing or investor trading is typically only considered in exceptional circumstances to protect the interests of the shareholders. However, if it occurs, additional practical considerations may be required. These considerations include determining exactly what is being suspended - NAV production and/or investor dealing; assessing what is required of the service providers in the implementation of and during the course of the suspension.; deciding whether the investment manager may deal during the period of suspension and determining how to treat deals that are received during the suspension period.

Finally, the importance of good corporate governance and the maintenance of a robust documentation/ audit trail throughout a disruption event cannot be over emphasised. Industry participants should keep in mind that in the worse case scenario, litigation and/or a regulatory investigation could follow a disruption event, particularly a fund-specific disruption event. As such, all decisions and correspondence should be documented and maintained from the beginning, minutes should be taken at all meetings and all electronic communications should be retained for future reference.

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*This article has been prepared from the Industry Trustee Committee's soon to be published Market Disruption Information Note.*