



Ukraine Crisis: FAQs on the application of LMTs by investment funds

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Preliminary remark:

Please note that the segregation options referred to under point 3. of the present FAQs are **only** applicable for illiquid assets resulting from the Ukraine crisis and should **under no circumstance** be interpreted such as creating a precedent by the CSSF for any other or future situations.

Introduction

In the context of the impact of the Ukraine crisis on financial markets, investment fund managers (IFMs) are currently facing the challenge of how to deal with Russian and Belarussian assets in their managed investment funds that have become illiquid/ non-tradeable as a consequence of this crisis as well as due to the restrictive measures taken by the EU and other countries in this context.

The CSSF received questions from market participants regarding temporary as well as more structural measures for the situation, including the usage of Liquidity Management Tools (LMTs) by investment funds as well as the valuation of the affected assets.

The CSSF hereby would like to provide additional information and clarification, taking into account also the previously published FAQs on swing pricing ([FAQ Swing Pricing](#)) and COVID-19 ([FAQ Covid 19](#)).

The CSSF would like to emphasize that the approach, including the choice of the respective LMTs as well as the valuation to be applied to affected assets, is the responsibility of the governing body¹ of the respective investment fund (hereafter referred to as "governing body of the fund").

The CSSF expects that the governing body of the fund, while always safeguarding the interests of **all** investors (existing and future) in such funds, considers the following elements (non-exhaustive list) when deciding about the application of temporary or more structural measures for the respective investment fund(s):

¹ as defined in Article 1(26a) of the 2010 Law, namely: a) as regards *sociétés anonymes* (public limited companies), the board of directors or the management board, as the case may be; b) as regards other types of companies, the body that represents the management company or the UCITS pursuant to the law and the instruments of incorporation

- Specific fund documentation (prospectus, articles of incorporation, management regulation)
- Investment policy and strategy (country-focused or wider investment focus)
- Overall size of exposure to illiquid/ non-tradeable assets in absolute size and in relation to total net assets.
- Restrictions due to the current sanction's regime.

As most of the affected investment funds are UCITS and governed by the local [Law of 17 December 2010](#), the FAQs below mainly relate to these fund structures, while they might also be applicable to alternative investment funds.

The following FAQs aims at providing further guidance to the governing body of the fund in their own assessment of each investment fund's individual situation, to provide further insights on the different options available to the governing body of the fund and to decide on the best way forward.

1. What are the LMTs to be considered by the governing body of the fund when addressing the issue of illiquid assets in the context of the Ukraine crisis?

The CSSF considers that a distinction has to be made between funds having a limited exposure to illiquid assets and funds having higher exposure to such assets, thereby also taking due account of their investment policy and strategy.

A **limited exposure** to illiquid assets might leave the governing body of the fund with more straightforward and temporary options to deal with the situation, including fair valuation adjustments (taking into consideration the specifics of the concerned assets such as nature, currency and place of listing, e.g. by applying appropriate haircuts to the affected assets that could go up to 100%) or the closure of funds to subscriptions for new investors. In a further step and depending on the size of exposure to those assets by the fund, a segregation of these assets could also be considered by the governing body of the fund as further specified below.

For investment funds with a **higher exposure** to illiquid assets, the CSSF would expect the governing body of the fund to suspend the fund as a first immediate measure to protect the interests of the investors, before then in a second step (after having duly established a continuing structural issue regarding the liquidity of affected assets for the investment fund) decide on how to deal with these illiquid assets across time. Such a structural measure could, for instance, consist in segregating illiquid assets from liquid assets in order to try to reopen the investment fund with only the liquid assets remaining, or even to liquidate the fund, if no solution in the best interest of investors can be attained for these illiquid assets and/or the overall fund structure.

Hence, measures vary depending on whether the fund has a limited exposure that allows the fund to continue its operations with certain approaches or a higher exposure which causes problems for a normal functioning of the fund.

As regards more specifically the segregation of assets, commonly called “*side-pockets*”, whereby part of the assets in a UCITS portfolio that have become illiquid would be segregated, it is important to note that this tool is not explicitly envisaged in the UCITS legal framework, so that “side-pockets” mainly fall in the non-harmonised field. The Luxembourg legislation does not further provide for rules on the conditions for the use of side-pockets in UCITS. As a matter of consequence, it remains the responsibility of the governing body of the fund to ascertain, on basis of the constitutional documents of the UCITS, whether a side-pocket is a tool that could be implemented and under what circumstances and conditions, considering, besides others, also the provisions of article 1(5) of the UCITS Directive (article 2(5) of the local Law of 17 December 2010).

2. What are the LMTs that are available to funds with a limited exposure to assets that have become illiquid as a result of the crisis and restrictive measures in the context of the Ukraine crisis?

The CSSF considers that investment funds with limited exposure to illiquid assets and that, as a result, would continue to operate normally (i.e. by not suspending the fund), have to ensure a fair valuation of the affected assets by considering the specifics of the concerned assets such as nature, currency and place of listing and by applying appropriate haircuts that could go up to 100%. In addition, the governing body of a fund might consider taking a decision with respect to a possible suspension of subscriptions in the impacted sub-fund.

As mentioned, the decision to implement a suspension of new subscriptions or taking no further action other than assigning a fair value to illiquid assets as a result of the limited exposure should be based on consideration of available approaches as foreseen in the respective fund documentation. Should the fund documentation not allow this measure, the governing body of the fund should contact the CSSF accordingly. If the governing body resolves to suspend new subscriptions, then the CSSF should be informed via the usual notification process.

In addition, the governing body of a fund might want to segregate illiquid assets from the still liquid part of the assets by applying one of the available different segregation options as further explained in the next question.

3. When implementing segregation of assets for higher as well as limited exposures in assets that have become illiquid as a result of the crisis and the restrictive measures, what are the options with the related requirements that are available to affected investment funds?

a) Segregation options available to funds

Several options may apply. If and what option to choose is to be assessed by the governing body of the fund, on the basis notably that the fund cannot continue normal operations and has structural liquidity issues persisting for a longer timeframe.

The CSSF would expect that funds with higher exposure to illiquid assets would in a first step decide to suspend subscription and redemption activities, before they then in a second step apply one of the following options to segregate structurally illiquid assets from the still liquid part of the assets, or, as a measure of last resort, put the fund into liquidation.

The following segregation approaches could be considered by the governing body of the fund in this context:

Option 1

The governing body of the fund decides to apply an accounting segregation of the illiquid assets of the impacted fund by allocating the illiquid assets to a new share class with the aim to realize them in the best interest of the investors.

The new share class shall be closed to new subscriptions and suspended for redemptions.

It remains under the responsibility of the governing body of the fund to ascertain, whether a new share class for the illiquid assets is a tool that could be implemented and under what circumstances and conditions.

The CSSF considers that the ESMA opinion on share classes of UCITS (ESMA 34-43-296) would not oppose to the above-mentioned segregation option as the Opinion does not deal directly with the situation of segregating illiquid assets under exceptional circumstances.

Option 2

The governing body of the fund decides to split the impacted sub-fund in two sub-funds, the initial sub-fund retaining the illiquid assets, and the liquid assets being transferred to a new sub-fund to be created.

After the split, the existing investors will be investors in the initial sub-fund and in the new sub-fund in a proportionate manner.

The initial sub-fund with the illiquid assets shall be closed to subscriptions and redemptions.

To be noted that the CSSF deems this solution to be in line with Art. 1 (5) of the UCITS Directive as the new sub-fund would be another UCITS.

The split of the fund in two separate funds (rather than sub-funds) may also be considered, the initial fund retaining the illiquid assets and the liquid assets being transferred to a new fund to be created. The split of a fund organised in a corporate form will have to follow the general rules laid down in the Luxembourg law of 10 August 1915 on commercial companies.

Option 3

The governing body of the fund decides to split the impacted sub-fund in two sub-funds, the initial sub-fund retaining the liquid assets, and the illiquid assets being transferred to a new sub-fund to be created.

After the split, the existing investors will be investors in the initial sub-fund and in the new sub-fund in a proportionate manner.

The new sub-fund with the illiquid assets shall be put into immediate liquidation.

It remains under the responsibility of the governing body to ascertain whether a transfer of the illiquid assets to a new sub-fund to be created is a tool that could be implemented and under what circumstances and conditions, considering beside others the requirement in article 1(5) of the UCITS Directive (article 2(5) of the Law of 17 December 2010) prohibiting UCITS from converting themselves into collective investment undertakings that are not UCITS.

On the basis of a prior analysis, it needs also to be assessed on a case-by-case basis if such re-attribution between different sub-funds of a given umbrella would potentially be in breach of any of the applicable sanctions in the context of the Ukraine crisis.

The split of the fund in two separate funds (rather than sub-funds) may also be considered, the initial fund retaining the liquid assets and the illiquid assets being transferred to a new fund to be created. The split of a fund organised in a corporate form will have to follow the general rules laid down in the Luxembourg law of 10 August 1915 on commercial companies. When choosing this option, the governing body will also have to check the issues raised by article 1(5) of the UCITS Directive (article 2(5) of the Law of 17 December 2010) respectively by the restrictions due to the current sanction regime.

Other options

Other options may be assessed by the governing body of the fund on a case-by-case basis, which will need to be discussed with the CSSF.

b) Necessary analysis before choosing an option

Before determining the adequate option to deal with the assets that became illiquid as a result of the restrictive measures in the context of the Ukraine crisis, the governing body of the fund should conduct a thorough analysis.

Any such analysis shall at least cover the following aspects:

- The governing body must be able to justify why the selected tool is the only possible/adequate tool to be implemented taking into consideration the best interest of the investors.

- The analysis has to cover legal aspects (e.g. assessment of potential breaches with respect to the UCITS regulation) as well as fiscal and accounting aspects related to the proposed operation.
- It should be ascertained that the model is compliant with the sanction regime in the context of the Ukraine crisis.
- It should be ascertained that the implementation of the selected tool is not contrary to the constitutional documents of the UCITS.
- It has to be checked to what extent and under what conditions the approval of investors is required.
- The costs of the selected model have to be assessed (e.g. avoidance of fees that are disproportionate for the investors or any duplication of fees due to an asset splitting).

This analysis shall be carried out under the responsibility of the governing body of the fund.

c) Necessary information to investors

Impacted investors should be informed about the implemented option in accordance with the provisions set forth in the prospectus.

Where the prospectus does not provide for specific provisions with respect to a specific scenario, it is the responsibility of the governing body of the fund to decide on the appropriate means of communication taking into consideration the best interests of the investors and the usual communication channels with the investors, including the use of the fund's or the IFM's internet website to make the information available for a longer period of time.

In addition it is the responsibility of the governing body of the fund to assess to what extent the mechanism to be implemented can be considered as a significant change that may result in the application of the provisions of CSSF circular 14/591.

d) Prior notification to the CSSF with a view to authorisation

The implementation of the options mentioned before requires prior notification with a view to authorisation by the CSSF, providing the necessary information to the CSSF. The application file submitted for authorisation must comprise at least the following information:

- Information on the illiquid assets (e.g. percentage of assets concerned, reason why these assets are illiquid)
- Description of the segregation option the governing body contemplates implementing including the reason for selecting this specific option
- Description of the additional fees to be charged in relation to the contemplated option
- Information on measures taken to avoid unfair treatment of remaining investors
- Information on the way the governing body will communicate to investors
- Where applicable, information on the approval process of the operation by investors
- Necessary update of the prospectus in case the investment strategy changes (to be assessed on a case-by-case basis, e.g. by the segregation of certain assets)
- List of countries where the UCITS is registered for marketing. Confirmation whether the supervisory authorities of such countries have been/will be informed and, if not, why such information procedure is not necessary
- A statement from the governing body confirming the assessment of the legal and fiscal issues related to the proposed operation. That statement has to be documented by a legal assessment/opinion duly endorsed by the governing body.

The application file must be sent to the CSSF via email at opc@cssf.lu.

Final remark:

This document might be updated from time to time and the CSSF reserves the right to alter its approach to any matter covered by the FAQs at any time according to potential developments at European level or in the context of a change of the situation leading to a renewed start of trading of the impacted assets from the Ukraine crisis. You are advised to regularly check the website of the CSSF to see if questions have been added and/or positions have been altered.



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