

# Exemption of managers of collective investment schemes from certain requirements relating to the administration of portfolios

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*The FSCA has contemplated that managers of collective investment scheme portfolios may run into liquidity issues due to the volatility currently experienced within financial markets due to the spread of COVID-19. The FSCA has intervened and allowed an exemption for managers to suspend the creation, issue, sale and repurchase of participatory interests in a portfolio under exceptional liquidity risk.*

## 1. Background

The spread of COVID-19 in South Africa has resulted in significant volatility in the domestic bond market and listed property markets which has had an impact on liquidity in certain portfolios of collective investment schemes ("CIS").

The Financial Sector Conduct Authority (the "FSCA") has stated in a notice (the "Notice")<sup>[1]</sup> that the current provisions of the Collective Investment Schemes Control Act<sup>[2]</sup> (the "Act") that regulate illiquidity in portfolios might not be applicable in the current circumstances<sup>[3]</sup> and has, accordingly provided for alternative interventions that may be utilised by managers<sup>[4]</sup> managing portfolios that are under exceptional liquidity risk and/or in stressed market conditions (collectively referred to as "Eligible Portfolios").<sup>[5]</sup> In essence the FSCA has allowed for the obligation to pay redemptions to be suspended.

## 2. Provisions of the Act

The Act requires that every deed<sup>[6]</sup> must set out the requirements for the administration of a portfolio and that the manager must administer the portfolio in accordance with the deed.<sup>[7]</sup> Schedule 1 of the Act stipulates that the deed must, at the very least, contain provisions regarding:

2.1 the frequency of calculation of selling and repurchase prices of participatory interest and the point in time at which such calculations will be performed on a specific day (referred to as the "Valuation Point");<sup>[8]</sup> and

2.2 the manner in which and a point in time at which the Valuation Point will be applied either to the creation, sale, repurchase or cancellation of a participatory interest.<sup>[9]</sup>

In respect of the repurchase of participatory interests in a portfolio of a CIS in securities, a deed must provide for:

2.3 the duty imposed on a manager to repurchase any number of participatory interests offered to it;

2.4 for the purposes of 2.3, the manager must determine a point in time by when repurchase requests must be received for the purpose of determining which Valuation Point will be utilised for the pricing calculation; and

2.5 the time determined (described in 2.4) may not be changed unless 30 days' prior written notice has been given to investors.

<sup>[10]</sup>

## 3. Exemption of managers of collective investment schemes from certain requirements relating to the administration of portfolios

The FSCA has granted an exemption to managers administering Eligible Portfolios from complying with the requirements set out in 2 above (the "Exemption").

The Exemption allows managers to suspend the creation, issue, sale and repurchase of participatory interests in an Eligible Portfolio (the “**Suspension**”). The application of the Exemption is limited to circumstances where a manager is unable to reasonably liquidate sufficient assets held by an Eligible Portfolio, and in a manner that is not prejudicial to investors, in order to meet its ordinary obligation to repurchase participatory interests in that portfolio when offered to it in terms of a daily Valuation Point.

The Exemption is subject to the following conditions:

3.1 The trustee/custodian must provide prior consent to the manager to:

3.1.1 not comply with the requirements contained in the deed as provided for in the Exemption; and

3.1.2 temporarily suspend the creation, issue, sale and repurchase of participatory interests in a particular portfolio.

3.2 The manager must inform the FSCA of the consent provided in 3.1 and must state the reason for the Suspension prior to it taking effect.

3.3 The manager and the trustee/custodian must ensure that the Suspension is only allowed to continue for as long as it is justified having regard to the interests of investors in the Eligible Portfolio.

3.4 When the creation, issue, sale and repurchase of participatory interests in a Eligible Portfolio is suspended, the manager must:

3.4.1 without delay notify investors of the Suspension;

3.4.2 provide each investor with the opportunity to withdraw the repurchase instruction not yet processed; and

3.4.3 as soon as practicable, provide the FSCA with written confirmation of the Suspension and detailed reasons for it.

3.5 The notification to investors in 3.4 must:

3.5.1 be clear, fair and not misleading;

3.5.2 particularly draw investors’ attention to the circumstances which resulted in the Suspension, the necessity and reasons for the suspension; and

3.5.3 inform investors how to obtain the information set out in 3.6.

3.6 manager must keep investors appropriately informed about the Suspension by:

3.6.1 publishing sufficient details about the Suspension, including if known, its likely duration; and

3.6.2 updating this information, when appropriate, at least on its website.

3.7 A manager must continue to perform valuation and pricing as far as it is reasonably and practically possible.

3.8 A manager is not precluded from entering into arrangements to continue meeting standing income demands, including but not limited to annuity requirements, as and when reasonably and practically possible with sufficient available liquidity.

3.9 The Suspension of the creation, issue, sale and redemption of participatory interests must cease as soon as the portfolio ceases to be an Eligible Portfolio.

3.10 The manager and the trustee/custodian must review the Suspension as regularly as the circumstances dictate, but as a minimum, every 48 hours.

3.11 A manager must inform the FSCA and the trustee/custodian as the case may be, of the lifting of the Suspension and immediately after the lifting must confirm this in writing to the FSCA.

#### **4. Commencement and duration**

The Exemption came into operation on 8 May 2020 and will remain effective until amendment or withdrawal by the FSCA by notice on its website.

#### **5. Breach of the notice**

The Act requires managers to administer CISs honestly and fairly, with skill, care and diligence and in the interests of investors and the CIS industry.<sup>[11]</sup> This implies that managers of Eligible Portfolios are obliged to utilise the Exemption or risk being in breach of their statutory obligations.

Non compliance with the conditions attached to the Exemption will result in the Exemption no longer being applicable to that manager. In addition, a failure to comply with any direction under the Act amounts to an offence and is punishable by a fine not exceeding R10 million or to imprisonment for a period not exceeding 10 years or to both such fine and such imprisonment.<sup>[12]</sup>

## 6. Conclusion

The suspension of redemption obligations is important in the context of the general obligation to protect investors. When liquidity is constrained, not only is there a risk that the redemption price (usually the Net Asset Value per share) is potentially inaccurate, but the sell-off of liquid assets to fund redemptions leaves funds with portfolios that are increasingly illiquid thereby compromising the rights of the investors who remain. In times of crisis, it is therefore important to suspend the right to redeem in order to protect the interests of all investors. It follows that subscriptions cannot be allowed for the same reasons – notably that if interests are issued at inflated prices, the incoming investor is compromised and if the interests are issued at deflated prices, the existing investors are compromised. For this reason, a suspension of subscriptions inevitably follows a suspension of redemptions.

The FSCA may, at some point need to consider amendments to the law that allow for the creation of liquidating side pockets. This allows for assets that are compromised over the long-term to be transferred out of the main fund thereby freeing up the main fund to recommence trading.

The broader context of these regulations is discussed in more detail in our note titled, “Funds in crisis – how do funds manage in times of crisis?” – <https://werksmans.com/legal-updates-and-opinions/funds-in-crisis-how-do-funds-manage-in-times-of-crisis-2/>.

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[1] FSCA CIS Notice 2 of 2020 published on 8 May 2020.

[2] Act 45 of 2002.

[3] It is worth noting that the Regulations made under section 27(2) of the Disaster Management Act 57 of 2002 (published by Government Notice No. 459 of 9 April 2020) also do not make provision to assist CIS managers.

[4] “manager” is defined as a manager registered under section 42 of the Act to administer CIS in securities.

[5] Said interventions are supported by the International Organization of Securities Commissions and the Financial Stability Board.

[6] The deed is the agreement between a manager and a trustee/custodian, or the document of incorporation whereby a CIS is established and in terms of which it is administered.

[7] Section 97(1) of Act 45 of 2002.

[8] Section 97(1)(a) read with Schedule 1, item 1(c) of Act 45 of 2002.

[9] Section 97(1)(a) read with Schedule 1, item 1(e) of Act 45 of 2002.

[10] Section 97(1)(a) read with Schedule 1, item 2(a) – (c) of Act 45 of 2002.

[11] Section 2(1) of Act 45 of 2002.

[12] Section 115(c) read with section 116 of Act 45 of 2002.



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