



FINANTSINSPEKTSIOON

## **ASSESSMENT OF THE SIGNIFICANCE OF THE AMENDMENT OF RULES OF AN INVESTMENT FUND**

The advisory guidelines have been established by resolution No 1.1-7/56 of the management board of the Financial Supervision Authority of 16 December 2009, on the basis of subsection 57 (1) of the Financial Supervision Act.

### **1. Competence**

In accordance with subsection 3 of the Financial Supervision Act (hereinafter: FSA), financial supervision is conducted in order to enhance the stability, reliability, transparency and efficiency of the financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes, with a view to protecting the interests of clients and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system.

Pursuant to FSA subsection 57 (1), the Supervision Authority has the right to issue advisory guidelines to explain legislation regulating the activities of the financial sector and to provide guidance to subjects of financial supervision.

### **2. Scope of application, purpose and implementation**

#### **2.1. Scope of application**

These advisory guidelines have been established to specify and to give explanatory guidelines of the obligation of a management company provided in the first sentence of subsection 117 (2) of the Investment Funds Act (hereinafter: IFA).

#### **2.2. Purpose**

- 2.2.1. The purpose of the guidelines is to ensure unambiguous understanding of the provision of sentence 1 of IFA subsection 117 (2), and to establish a good tradition that would ensure assessment of significance of amendments of the rules of an investment fund. The guidelines create good preconditions for due performance of the obligations of a management company.

- 2.2.2. The obligation of a management company to assess the significance of amendments serves the interest of unit-holders, because upon entering into authorisation-like debt relationship with a management company, a unit-holder may assume that the other party to the debt relationship does not have unlimited unilateral right of design.
- 2.2.3. A unit-holder may fail to notice a difference specified in the IFA or also in the fund rules which gives a management company the right to unilaterally amend the fund rules and impose on the unit-holder additional obligations before the management company. It may lead to misunderstandings between the management company and unit-holder, and cause potential disputes and result in mistrust towards investment funds.

### **2.3. Scope of application**

- 2.3.1. The guidelines shall apply to all investment funds in the meaning of IFA subsection 1, unless it arises otherwise from law.
- 2.3.2. The guidelines shall apply to amendments to the fund rules, with the obligation for a management company to assess significance of the amendment based on the interests of unit-holders.
- 2.3.3. In the case of any problems regarding implementation and interpretation which may arise upon implementation of the guidelines, it is required to proceed from the principle of reasonability and good faith, considering the purpose of these guidelines.

## **3. Notification obligation of management company**

### **3.1. Obligation of management company to notify Financial Supervision Authority**

- 3.1.1. Upon amending the fund rules, a management company has the obligation to assess in each specific case the significance of amendments of the fund rules, based on legitimate interests of unit-holders (first sentence of IFA subsection 117 (2<sup>1</sup>)). In the circumstances the management company and unit-holders are in a debt relationship that is subject to regulation under private law, it is required to strengthen awareness of unit-holders of the existence of the unilateral right of design of the management company and the amendments to be made.
- 3.1.2. The first sentence of IFA subsection 117 (2<sup>1</sup>) in interaction with IFA subsection 117 (3) 6), provides for the obligation of a management company to submit to the Financial Supervision Authority, upon registration of the fund rules, *inter alia*:
- substantiation of amendments;
  - analysis of the impact on the interests of the fund and unit-holders.

- 3.1.3. Substantiation of amendments shall include assessment as to on which basis and which motives the council of the fund decided to amend the fund rules.
- 3.1.4. Analysis of the impact on the interests of unit-holders involves the obligation of a management company to present the assessment arising from the first sentence of IFA subsection 117 (2<sup>1</sup>), which must include an analysis of significance of amendments for unit-holders. It is recommended to structure the analysis as follows and it must comprise at least the following elements:
- explanation of difference of amendments of the fund rules as compared to the regulation previously in force;
  - reasoned assessment as to whether the unit-holders will be significantly deprived of the gains for which they had legitimate expectations as a result of the amendment, including any potential risks related to the amendment;
  - reasoned assessment as to whether the debt relationship between the fund and unit-holder will change so as a result of the amendment that the unit-holder may lose interest in further performance of the contract;
  - conclusion as to whether the amendment of the fund rules was significant or not for the unit-holders.

### **3.2. Obligation of management company to submit explanations to unit-holders**

- 3.2.1. Upon the request of a unit-holder, a management company is required to submit to unit-holders its explanations on the significance of the amendment of conditions. If so requested by the unit-holder, the explanations shall be submitted, irrespective of whether the management company, according to analysis, considers the amendment of fund rules to be significant or not.
- 3.2.2. A management company shall notify unit-holders of the possibility to obtain the explanation specified in clause 3.2.1 together with submission of information on amendments of the fund rules pursuant to the procedure specified in IFA subsection 119.

## **4. Significant amendments**

- 4.1. IFA subsection 117 (2<sup>1</sup>) provides for the obligation to assess the significance of amendments to the investment policy or rights related to units, specifying it in provisions of IFA subsection 112 (1) 3), 4), 6), 8), 13)-17), 21) and 23). At the same time, in accordance with the wording of the provision: “/.../ *taking primarily account of subsection 112 /.../*”, the list has remained open.

- 4.2. An open list imposes on a management company an additional diligence obligation to assess in each specific case the significance of amendment. The management company has the obligation to assess, inter alia, whether individual insignificant amendments in aggregate constitute a significant amendment for unit-holders.
- 4.3. Presented below is an illustrative and non-exhaustive list of additional amendments of fund rules which are significant from the viewpoint of the Financial Supervision Authority. The purpose of the list is advisory in order to facilitate a management company to make a decision on whether amendments of the fund rules are significant or not. Such amendments may be considered to be significant amendments of the fund rules which arise from resolutions of a management company (except for compulsory amendments arising from legislation) to amend the fund rules and which:
- change the purpose or nature of the investment fund (e.g., the type of the fund changes in the meaning of IFA subsection 2);
  - change to a significant extent the investment policy and investment restrictions of an investment fund, including the investment area of the fund, list of allowed assets, requirements for risk diversification, etc;
  - cause a change in the risk profile of an investment fund and thereby also that of a standard investor of the investment fund;
  - change to a significant extent the bases (methods) for assessment of assets of an investment fund;
  - establish additional restrictions on redemption of units;
  - abolish a general meeting of unit-holders;
  - change the bases for creation of income pursued on investments (e.g., changes in the bases for disbursements made from a fund);
  - cause an increase in the total upper limit fee or fees and expenses to be paid out of an investment fund or also an expansion of the list of fees and expenses to be paid on account of the fund;
  - cause an increase in the issue price and redemption price to be paid on account of unit-holders.

## **5. Entry into force**

These guidelines shall enter into force on 1 February 2010.

