Investment vehicle liquidator: a sought-after expertise

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Voluntary liquidation is a common business management decision concerning various types of investment vehicles at the end of an investment lifecycle. This phase is very often a challenge for management who are typically operating vehicles as a going concern and who are also more geared towards launching new products. During this phase, specific legal, operational, and financial aspects must be considered, as well as their timing.

The voluntary—or solvent—liquidation process is governed by Articles 1100-1 to 1100-15 of the amended and renumbered Law of 10 August 1915 on commercial companies and by the laws applicable to each type of investment vehicle (UCITS[1], funds of Part II of the Law of 17 December 2010, SIF, RAIF, SICAR, etc.). For a *fonds commun de placement* (FCP), which has no legal personality, its management company automatically assumes the role of liquidator. However, the latter can contractually transfer its responsibilities by appointing a professional liquidator. By analogy with funds established in a corporate form, the liquidation will be guided by the Law of 10 August 1915 and the relevant investment vehicle laws aforementioned.

According to the provisions of the law, the shareholders must vote for liquidation during a general meeting held before a Luxembourg notary. Should it be required, the same shareholder's meeting may also appoint a CSSF-accredited liquidator. The liquidator may be a company, in which case the physical representative of the company for the liquidation purpose will need to be accredited as well.

Depending on the degree of regulation, a supervisory authority may accept that only a well-seasoned and reputable liquidator be appointed. Unregulated entities can appoint any person or company, which, in the case of an investment vehicle, may be a shareholder, a director, or the management company.

There are multiple reasons for management to require a third-party specialist to be appointed as liquidator—but which situations merit the need to rely on a professional?

Concurrently, the motivation for voluntary liquidation can depend on a wealth of different factors, from liquidity to complexity. So what should management of an investment vehicle ask themselves when submitting their liquidation proposal to the approval of the shareholder(s)? Initial steps could be answering the following:

- How liquid are the assets in the portfolio to be disposed of?
Typically, selling illiquid assets is a lengthy process which requires time and enhanced due diligence. The liquidator must formalize that the sale is made in the best interest of the shareholders while keeping in mind the running operating costs of the structure. Those sales are sometimes over the counter, therefore AML/KYT(2) and solvency checks are required. Also, a full legal review of the sales agreement should be carried out to protect the shareholders of the investment structure. The liquidator must also be able to demonstrate due care in this process in case of shareholders' complaints.

- How complex is the structure of the holding company?
The complexity of the holding structure and the localization of the portfolio investments can affect the time, resources, and specific knowledge needed to complete the liquidation. Sometimes the structure is such that, between the top investment structure and the concerned asset, there are intermediate legal entities (SPVs, HoldCo, LLPs) that must be liquidated in order to distribute the proceeds up to the top investment structure and pay back the shareholders. As these situations often concern multiple jurisdictions, it can, in turn, raise cross-border tax topics and bring additional complexity to the liquidation process.

- What time and/or resources does the management company (ManCo) or director have available to handle the liquidation?
In some instances, the liquidation of a UCITS with a liquid investment portfolio can be straightforward, providing that all compliance and legal duties have been carried out adequately during the lifecycle of the investment vehicle. Yet, producing the liquidator's report, paying creditors, terminating contracts, ensuring last filings, communicating with the regulator (CSSF), notifying the Trade and Companies Register, organizing the general assembly of shareholders, and following up with all stakeholders can be time-consuming. It is a different experience from running the investment strategy during the UCITS' "active" life.

Management should consider whether they want to invest the time into the end-of-life of an investment vehicle while still focusing on their core business and future projects.

- Is the ManCo or director willing to take on the responsibilities of the liquidation for a long period of time?
The liquidator remains liable for a period of five years after the closure of the liquidation. In addition, the process itself can sometimes last for a longer period than initially anticipated for different reasons, including:
- Difficulty to dispose of illiquid assets or recover the proceeds from an underlying investment structure;
- Undisclosed information uncovered after the appointment of the liquidator (e.g. litigation or guarantees issued by the fund);
- Non-compliant regulatory (FATCA, Common Reporting Standard, etc.) or tax filings (cross-border, VAT, etc.), requiring amendments or corrective actions; and/or
- Blocked accounts in the shareholders' register holding back the payment of the liquidation bonus distribution.

Finally, cash management risks bearing primary responsibility and can be time-consuming. Every invoice received by the investment vehicle requires validation by the liquidator to ensure adequate use of the financial resources.

In addition, should the provision for creditors be under-estimated, excessive distributions could be made to the shareholders. If this situation leads to a lack of liquidity preventing the investment vehicle from paying its creditors, the liquidator will bear primary responsibility to cover the costs for whichever legitimate invoice being received even after the completion of the liquidation.

- In what situation is it advisable to appoint a director or the ManCo of the investment vehicle?
If the investment vehicle is unregulated (SPVs, HoldCos, etc.), the due diligence typically required by an incoming liquidator will often render the appointment of a professional too expensive. However, the professional liquidator can be appointed as an advisor to assist incumbent management in the process, with all formal responsibilities then borne by the ManCo or director.

In conclusion, the voluntary liquidation of an investment vehicle can be a smooth process if a series of steps are carefully planned and anticipated, and the right skillset is on-boarded. However, hiring a professional liquidator will give peace of mind to management. They can be assured that every angle of the liquidation process has been duly analyzed with a proper follow-up of the day-to-day operations by an experienced team.

Deloitte's liquidation services offering includes a dedicated team experienced in handling the process, leaving management to focus on day-to-day business. Our team are able to exercise the voluntary liquidation thanks to:
- Our successful completion of more than 100 solvent voluntary liquidation mandates of regulated entities with assets under management exceeding 600 million;
- The winding-down of several complex investment structures operating through multinational jurisdictions;
- Our significant liquidation experience in the banking, fund, private equity, and insurance industries for companies that are still supervised by regulators during the liquidation phase;
- Our substantial track record of realizing assets of all sizes and types, including expertise in the sale of illiquid assets;
- Our expertise in coordinating legal proceedings for asset recovery purposes; and
- Our international Deloitte network which we can used to quickly address cross-border issues.

From your first thoughts surrounding an exit through to completion, we can offer our assistance by creating a detailed step-by-step plan that considers all organizational aspects and addresses the relevant challenges and risks beforehand. By considering current market changes, regulatory transformations, and the globalization of the market, we can help you navigate the liquidation of your company.

1) Undertakings for Collective Investment in Transferable Securities as per EU Directive 2009/65/EC
2) Anti-money laundering/know your transaction

ESG vs non ESG portfolios:

Sector rotation hurts, but green investors hold their breath for COP26

After winning fame for "Most Underperforming Asset" over the last few years, commodities are now putting a smile on the face of fossil fuel investors. After months of frustration from lockdowns, the reopening of the economy unleashed a hoard of heavy pocketed avid buyers. Industrial activity also resumed at full throttle.

So much so that the imbalance in supply and demand, amplified by supply chain bottlenecks, naturally drove prices higher in everything from furniture and food to cars and particularly energy. China and India are already experiencing power outages since coal reserves are depleting and domestic utilities are reluctant to import overpriced combustible.

One could have thought that renewables would have benefited from the trend amid ESG bashing and massive green bills in the pipeline, but the chart below tells another story. The iShares Global Clean Energy ETF is down 22.91% YTD, while the S&P Oil & Gas Exploration & Production ETF is up by 67.35% and natural gas futures twice as much.

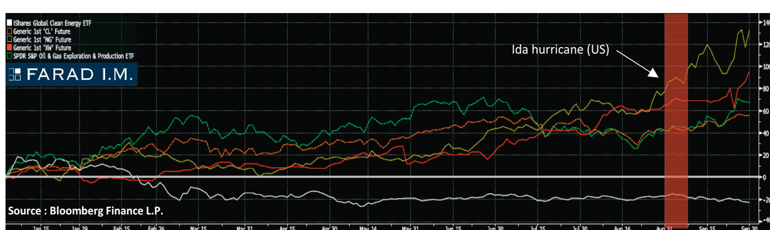

Figure 1 : Investors give prominence to dirty energy – oil (orange), gas (yellow) and coal (red) – over renewables (white)

After taking profit from an amazing rally last year, investors swapped renewable for dirty energy as reflation narratives outweighed environmental awareness. Ironically, other contributing factors to the surge in dirty energy price rally were depleted reserves from hot summer months and Ida hurricane disturbing the supply chain in the United States. As highlighted in the Intergovernmental Panel on Climate Change (IPCC) from the United Nations, anthropogenic carbon emissions are fueling a vicious circle where more pollution yields more intense weather conditions, which yields more energy consumption to cool down or stay warm, which yields more pollution… Nature is not helping nature to recover, but maybe we could.

Who knows, another warning from COP26 on the greatest challenge of our times may just be the inflection point? From October 31st to November 12th, eminent officials will meet at COP26 in Glasgow to discuss technical issues including: carbon market mechanisms, financial help policies for vulnerable countries, nature-based solutions to tackle climate change and other items of the "Paris rulebook". Governments have targets, but what they need are action plans. There is no doubt that achieving carbon neutrality will be a tortuous journey, but COP26 may well be a first step on that path. It is also worth noting that ESG investing has been channeling money to reduce supply from coal mine and oil wells, but demand is slower to react. If rising dirty energy price is a short-term negative for companies' margins and consumers' purchasing power, it is a long-term net positive because it will naturally incentivize demand to look for a cheaper and cleaner alternative - name it solar, wind or hydro energy. We have seen earlier that recently dirty energy has outperformed green energy, a legitimate question would thus be : do ESG labeled stocks perform better than their non sustainability friendly peers? A meta-study of 1,000 research papers published between 2015 and 2020 showed a positive relationship between ESG and financial performance - measured as ROE, ROA and stock price - for 58% of the "corporate" studies. The conclusion is essentially the same for corporations involved in mitigating climate change. On the other hand, "investment" studies focused on risk-adjusted attributes showed that only 33% of ESG-friendly investments delivered better performances than their conventional counterparts, but this relationship rises to 43% for investment in firms particularly engaged in reducing carbon emissions.

In other words, over the past five years, empirical evidence have showed that sustainability initiatives at corporate level tended to improve financial performance thanks to improved risk management and innovative spirit. Therefore, ESG integration, as an investment strategy, has produced relatively higher return than simple negative screening approaches. However, these findings need to be considered cautiously given ESG data shortcomings. The implementation of Sustainable Finance Disclosure Regulation (SFDR) will be key to harmonise ESG terminology. Going forward, as Sustainable Investment becomes the new norm, more stringent processes will be required to sort the wheat from the chaff (T. Whelan et al, "ESG and financial performance", 2021).

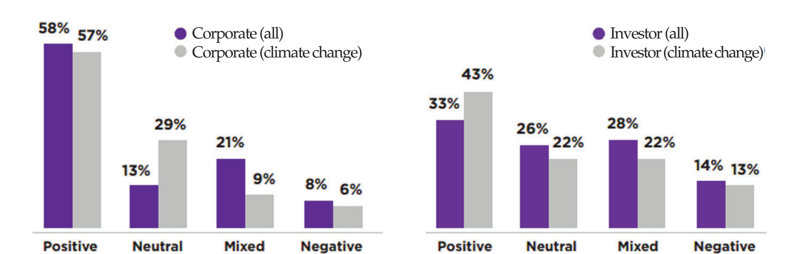

Figure 2 : Relationship between performance of firms/investors integrating ESG factors based on 245 studies from 2016 to 2020 (T. Whelan et al, "ESG and financial performance", 2021).

Generally speaking, over the last three years, the main ESG global equity indexes continue to outperform their non-EGS peers. For instance, the MSCI World ESG Leaders index (white) has outperformed the traditional MSCI World index (dotted orange) by 453 bps (135 bps YTD). As far as fixed income is concerned, we can reiterate our observation made three months ago, the relationship is blurrier over the same timeframe. Indeed, there is a slight over performance of non-ESG corporate bonds if we compare the Bloomberg Barclays Green Bond Index (13.36%) and the Bloomberg Barclays MSCI Global Aggregate ESG (+13.83%) to their non-ESG equivalent (14.46%). However, the relationship is reversed if we consider another benchmark, because the JP Morgan ESG EMBI Global Diversified index outperforms its non-ESG homonym by 121 bps. A possible explanation is that ESG fixed income strategies tend to include more growth firms' corporate bonds, which have underperformed value firm's this year in anticipation of a more hawkish monetary policy globally. Let us recall, however that performance showed can differ dramatically depending on the reference date and the benchmark selected (*Source: Bloomberg Finance L.P., 30/09/2021*).

With a view to assessing and fostering clients' commitment to sustainable investing, FARAD Investment Management has developed an internal proprietary ESG scoring system, called GreenEthica Sustainable Scoring System (GSSS). This report aims to provide a reliable and objective way to assess the main ESG portfolio metrics with a comprehensive focus on its alignment to the 17 Sustainable Development Goals ("SDGs"). Thanks to GSSS, FARAD IM can produce a synthetic sustainability report with selected key ESG metrics to unveil the real sustainability profile of a portfolio and to compare it in relative terms with a benchmark. Thanks to this easy-to-read ESG dashboard, investors can visualise their quantified contribution to the achievement of the 2030 Agenda for Sustainable Investments of the United Nations.

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