

Investment Funds in Luxembourg

A technical guide -
September 2020



Building a better
working world



It's my great pleasure to welcome you to the 2020 edition of our Investment Funds in Luxembourg publication.

This year has been like no other year in our collective living memory. Everything we do in our personal and professional lives for the last 6 months has been influenced by the shadow of the on-going COVID-19 pandemic. Many are predicting a very deep recession with the more optimistic hopes of the so-called V-shaped recovery fading fast. The potential economic impact of the pandemic is further heightened by ever-increasing geopolitical tensions between the two global powers. At the same time, the EU struggled to come up with a cohesive response with splits and divisions between the so-called frugal members and the most impacted southern members.

So, what does this all mean for the asset management industry?

The immediate focus was on employee welfare and safety, maintenance of operations through remote working strategies, dealing with market volatility and liquidity management challenges and enhanced communication with all key stakeholders including investors and regulators. From a financial point of view, there was an immediate significant fall in assets under management with a follow-on impact on fees and margins. Notwithstanding all the initial uncertainty and concern and acknowledging that there were certain fund suspensions and closures, the industry continued to function in a remarkably robust manner.

Once things had stabilized, there was further focus on how to reinforce the initial measures taken. This included steps to further enhance remote operational platforms, including formalizing work from home practices, renewed focus on liquidity management tools including updating communication with investors and industry supervisors, reviewing and updating valuation policies for asset valuations and developing alternative strategies to engage with clients and staff through a range of social media and other internal platforms.

So, given the background of COVID 19 and its impending fall-out expected to last several years, what is the likely longer-term impact for the asset management industry and, more importantly, what future role will the industry be required to play in the recovery of the World economy?

Provision and allocation of capital: given the severe impact arising from the pandemic, many good businesses are challenged and will be under severe financial pressure for several years to come. The industry has both the challenge and opportunity to identify and support these businesses so that in the first instance, they can survive, restructure and thereafter grow in a post pandemic era.

Meeting investors' needs; obviously not new, as it should be the overriding reason why asset managers exist in the first place, however the need is never greater than now, in an era of negative interest rates coupled with an impending pandemic-generated recession. Investors are looking for solutions that will generate a real rate of return while at the same time managing capital risk; all this being achieved in compliance with societal and environmental objectives.

Operations; over the last six months we have all developed new ways of working, including interacting with our colleagues and clients. These new ways of working are unlikely to be temporary, for many reasons. This will be driven by the on-going reflections on what has worked well over the last six months, for our clients? for our staff? but also the ever real need to manage costs given the pressure on fees and margins exacerbated by the pandemic crisis. What will this mean in practice? a significant speeding-up of the much heralded investment in technology and digital solutions? regional offices rather than one-stop mega head offices? formalization of working from home as standard work practice?

Governance and engagement with investee companies; much has been written over the last 5 years on sustainability and how ESG principles should be incorporated into the design and creation of investment fund products. The regulators have been busy over the last few years in creating and building a framework to further facilitate this. The pandemic has given a real impetus and focus to this. ESG considerations are no longer viewed as a "nice-to-have" or a branding exercise, but something very real that needs to be truly embedded in the design and creation of investment fund products. On the other side of this discussion, those investee firms that don't engage in addressing their ESG responsibilities will be severely punished through lack of further capital allocation.

Distribution and engagement with investors - much again has been written and spoken about over several years on the need to enhance technology and ensure clients and other key stakeholders are getting a digital experience. The pandemic has accelerated the focus on this as there is little or no alternative in this non-personal contact environment but to further develop these technologies.

Consolidation - over the last number of years, some consolidation has happened, with very mixed results. The pandemic will again renew focus and speed this up with the likely consequence of the "Big" getting bigger, and the survival of those select managers who can distinguish themselves by providing their clients with real capital appreciation.

I thank you all for your support over the last year and look forward to our continued discussions over the coming year.

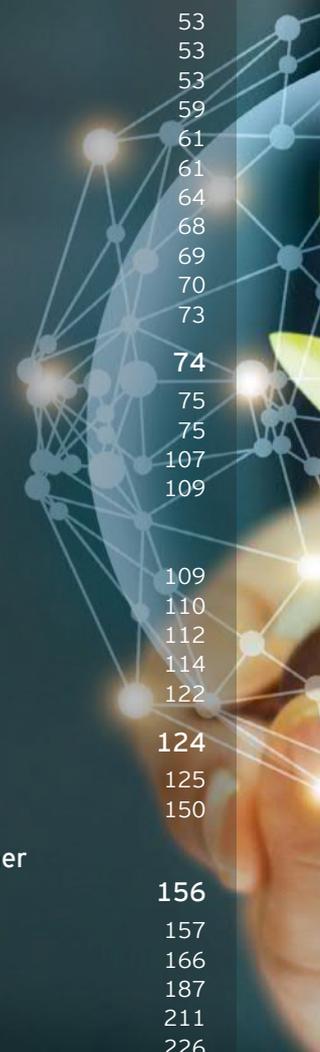


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A handwritten signature in black ink that reads "M. Ferguson". The signature is fluid and cursive, written over a white background.

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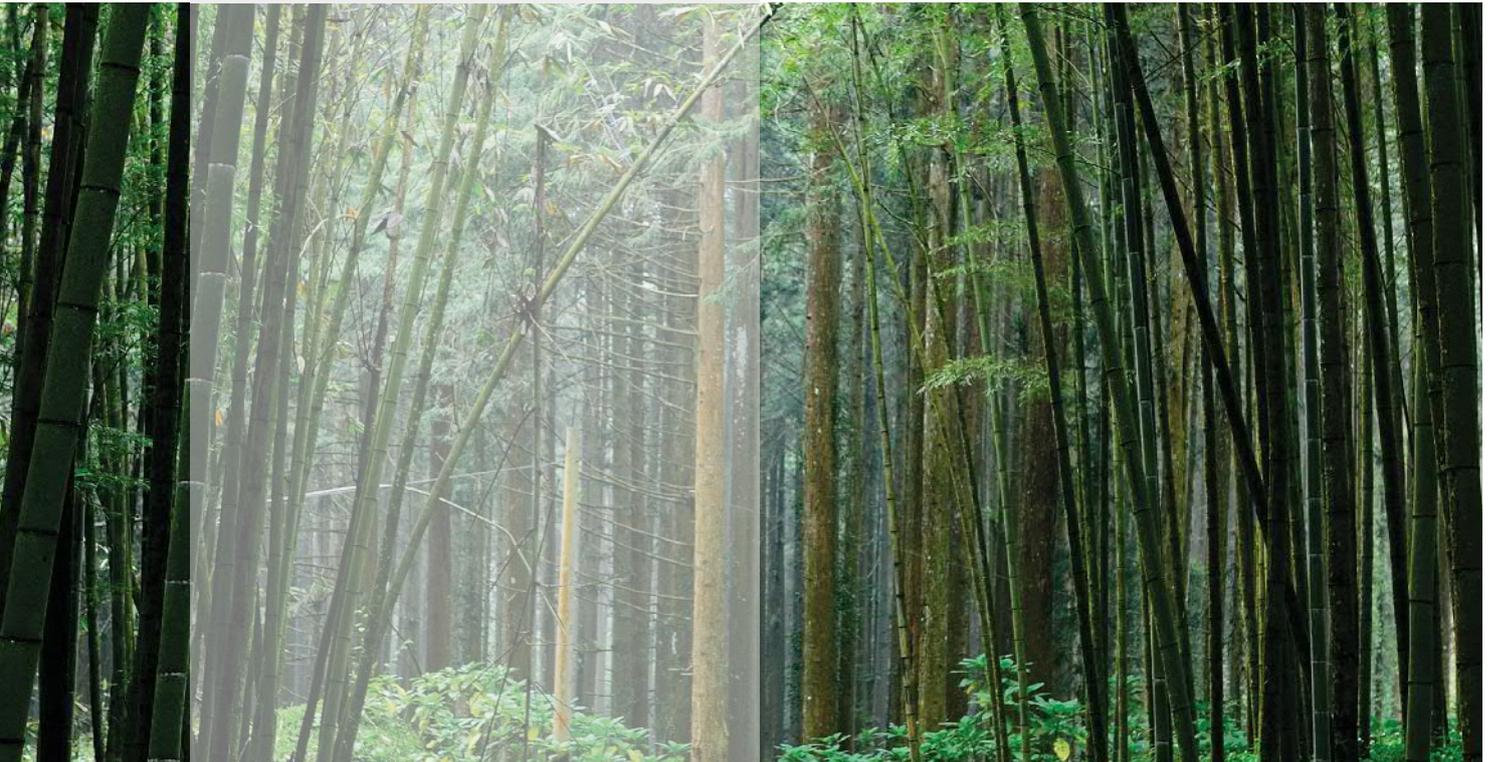
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EY supports asset managers, traditional and alternative investment fund houses through the choice of fund vehicle, the analysis of target markets, the definition of an efficient operating model and distribution strategy, and the selection of service providers.

Choosing an appropriate fund vehicle and operating model



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1.1. Introduction

This Chapter introduces Luxembourg's investment fund industry and outlines Luxembourg's solutions for investment funds.

1.1.1. What is an investment fund?

An investment fund (often referred to as an undertaking for collective investment – UCI – collective investment undertaking – CIU; UCI is the term used in this *Technical Guide*) has the following characteristics:

- ▶ There is collective investment of funds
- ▶ The capital is raised from a number of investors
- ▶ The capital is invested in accordance with a defined investment policy for the benefit of those investors, generally in accordance with the principle of risk spreading

The shares or units of some UCIs may be distributed to the general public while others are reserved for certain circles of investors, such as informed, qualified or institutional investors. Depending on the structure of the UCI, these shares or units may be obtained through private placement, direct distribution, distributors, or through stock exchanges.

The portfolio of collective investments may consist of transferable securities and/or other assets. Risk spreading is required to prevent excessive concentration of investments.

1.1.2. Why set up a UCI?

An investment fund, or UCI, can offer investors the possibility to:

- ▶ Generate current income or capital appreciation, or both
- ▶ Access a diversified portfolio of investments
- ▶ Benefit from professional management of the portfolio
- ▶ Share the associated costs
- ▶ Gain exposure to specific investments in the case of investors who are not able to access the investment directly, for example due to investor qualification requirements

1.2. Luxembourg's investment fund industry

1.2.1. Why Luxembourg?

The success of Luxembourg in attracting investment funds, and becoming a major financial center, is based above all on investor preference which may be attributed to a number of factors such as:

- ▶ A long established outstanding international financial services reputation
- ▶ An unrivaled range of investment fund solutions
- ▶ A strong regulatory environment including accessibility, knowledge and responsiveness of the regulator
- ▶ Political, economic, social, legal and tax stability
- ▶ An ability to provide tax neutral efficiency solutions for all types of investment fund products
- ▶ Access to a unique multicultural, multilingual international workforce
- ▶ An integrated eco-system of service providers with deep expertise and ability to meet specific local and international markets
- ▶ Location and connectivity: at the heart of Europe with deep connectivity and easy access to the key international financial centers throughout Europe, Asia, the Middle-East and the Americas

UCIs, except for Reserved Alternative Investment Funds (RAIFs), are authorized and supervised by the Commission for the Supervision of the Financial Sector (*Commission de Surveillance du Secteur Financier* – CSSF)

The Luxembourg fund industry has, since 1988, been successfully represented and promoted by the Association of the Luxembourg Fund Industry (*Association Luxembourgeoise des Fonds d'Investissement* – ALFI). Since 2008, *Luxembourg for Finance*, the agency for the development of the financial center, has also been promoting the Luxembourg fund industry.

1.2.2. Key figures

Luxembourg is the leading global center for UCIs. The first Luxembourg fund was established in 1959. By May 2020, there were 3,686 UCIs (excluding RAIFs), comprising 14,727 compartments (often referred to as sub-funds)¹, with net assets of approximately EUR 4.48 trillion (US\$ 5,06 trillion), analyzed as follows:

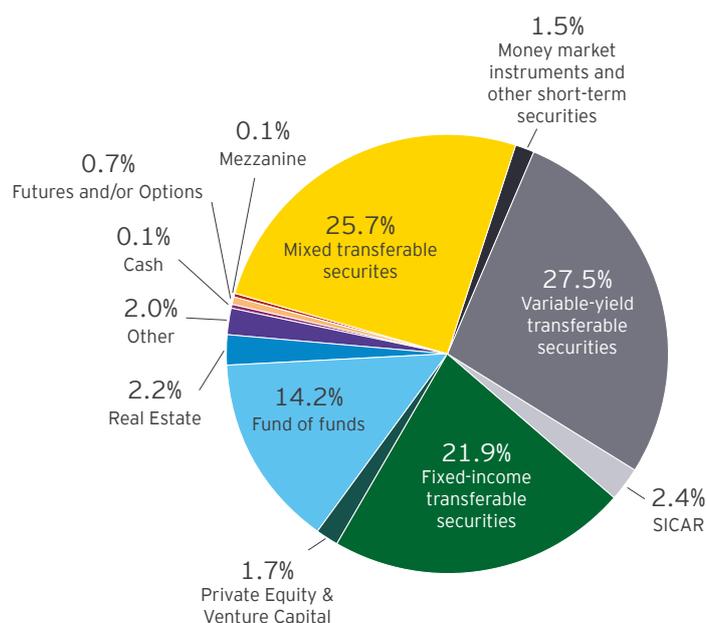
Luxembourg UCIs										
Number and net assets by regime and basic structure (May 2020)										
	Number of UCIs				Total	Net assets in € billion				Total
	Common funds		Investment companies			Common funds		Investment companies		
	(FCP)	Variable capital (SICAV)	Other/ Fixed capital (SICAF)	SICARs		(FCP)	Variable capital (SICAV)	Other/ Fixed capital (SICAF)	SICARs	
2010 Law										
Part I (UCITS ²)	900	842	0	0	1,742	585.788	3,098.596	0	0	3,684.384
Part II	129	130	2	0	261	48.552	97.648	0.467	0	146.667
SIF Law (SIFs)	298	1,104	42	0	1,444	189.402	374.512	30.490	0	594.404
SICAR	0	0	0	239	239	0	0	0	57.778	57.778
Total	1,327	2,076	44	239	3,686	823.742	3,570.756	30.957	57.778	4,483.233

Source: Commission for the Supervision of the Financial Sector (*Commission de Surveillance du Secteur Financier – CSSF*)

In addition to the above, 1,056 RAIFs had been launched at 15 July 2020.

The following chart illustrates the investment policies of Luxembourg UCIs by number of compartments at the end of May 2020:

Investment policies of Luxembourg UCIs by number of compartments (May 2020)



Source: CSSF

¹ Multiple compartment UCIs are covered in Section 2.3.2.

² Undertakings for Collective Investment in Transferable Securities.

1.3. Luxembourg's investment fund solutions

1.3.1. Fund regimes and passports

A. Introduction

Luxembourg offers an attractive range of solutions for the creation of UCIs. Luxembourg UCIs can be established under either of the following regimes:

Fund category	Product Regime	Common name of UCI
UCITS – Undertakings for Collective Investment in Transferable Securities	Part I of the Law of 17 December 2010, as amended (the 2010 Law) on UCIs	UCITS
AIF – Alternative Investment Funds	Part II of the 2010 Law on UCIs	2010 Law Part II UCI
	The Specialized Investment Fund Law (the SIF Law) of 13 February 2007, as amended	SIF
	The Reserved Alternative Investment Fund Law (the RAIF Law) of 23 July 2016	RAIF
	The Investment Company in Risk Capital Law (the SICAR Law ³) of 15 June 2004, as amended	SICAR ⁴

B. Marketing passports

Most Luxembourg UCIs are marketed to investors in a number of countries.

Many Luxembourg UCIs – UCITS and Alternative Investment Funds (AIFs) – benefit from a “Product” passport enabling them to be marketed to investors in the European Union (EU)/European Economic Area (EEA)⁵, following a notification procedure. Marketing of Luxembourg UCIs which do not benefit from a “Product” passport is subject to the national regimes of the country where the marketing takes place.

UCITS can be marketed to all investors in the EU/EEA⁶. The UCITS passport means that the shares or units of UCITS can be marketed to all types of investors, both retail and professional, throughout the EEA, following a notification procedure.

The marketing of AIFs depends on whether or not they are managed in accordance with, and subject to, the full Alternative Investment Fund Managers (AIFM) requirements (“Full AIFM regime AIFs”). Full AIFM regime AIFs are AIFs which are managed by an authorized AIFM or authorized internally managed AIF. Authorized AIFM, and authorized internally managed AIF, must meet the full requirements of the AIFM Directive (AIFMD), which is transposed in Luxembourg by the AIFM Law. AIFM compliance is required when the assets of all the AIFs under management exceed certain thresholds. Other AIFs are subject to a simplified AIFM registration regime (“Simplified AIFM registration regime AIF”). Chapter 6 covers AIFM requirements in more detail.

³ Not covered by this publication.

⁴ Idem.

⁵ The EEA includes European Union (EU) Member States plus Iceland, Liechtenstein and Norway. The EEA Agreement establishes freedom to provide services across the EEA, and any specific provisions.

⁶ The EEA Agreement implements the UCITS Directive passports across the EEA by including reference to it in Annex, without any specific limitations.

The marketing of AIFs may be summarized as follows:

- Full AIFM regime AIFs can be marketed to:
 - Professional investors in the EU/EEA⁷: authorized AIFM, and authorized internally managed AIFs benefit from a passport permitting them to market the shares or units of the AIFs they manage to professional investors throughout the EU/EEA
 - Retail investors in the EU/EEA under stricter national rules: each EU/EEA Member State may permit authorized AIFM, and authorized internally managed AIFs to market the shares or units of the AIFs they manage to retail investors in the Member State. The Member State may also apply stricter requirements than those applicable to marketing to professional investors
- Simplified AIFM registration regime AIFs can be marketed to professional investors in the EU/EEA under national private placement regimes (i.e., subject to national requirements), where such regimes exist. The passport is not applicable. However, a specific regime exists for the managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) which meet the requirements of the simplified EU/EEA regulatory regimes. Such managers can benefit from a “passport” permitting them to market the shares or units of the qualifying European funds they manage to suitably qualified investors throughout the EU/EEA (see Section 2.4.4.3.)
- EU/EEA professional investors may, on their own initiative, purchase the shares or units of any AIFs, irrespective of the domicile of the AIFs or AIFM, provided that there is no marketing (also referred to as “reverse solicitation”)
- In addition to the rules applicable to AIFs, SIFs and RAIFs can only be distributed to “well-informed investors” (see Section 2.4.3.2.)

Summary of marketing of Luxembourg UCIs in the EU/EEA

Products	Regulatory framework	Marketing regime	Investors
UCITS	UCITS	EU/EEA “passport”	Retail and professional
AIF	Full AIFM regime AIF	EU/EEA “passport”	Professional
	EuVECA and EuSEF	EU/EEA “passport”	Qualified
	Simplified AIFM registration regime AIF	National private placement regimes (NPPRs)	Professional
	Full AIFM regime AIF and, if relevant, simplified AIFM registration regime AIF	National retail distribution regimes, where applicable	Retail
	Any AIF (Full AIFM regime or simplified AIFM registration regime)	Reverse solicitation	Professional

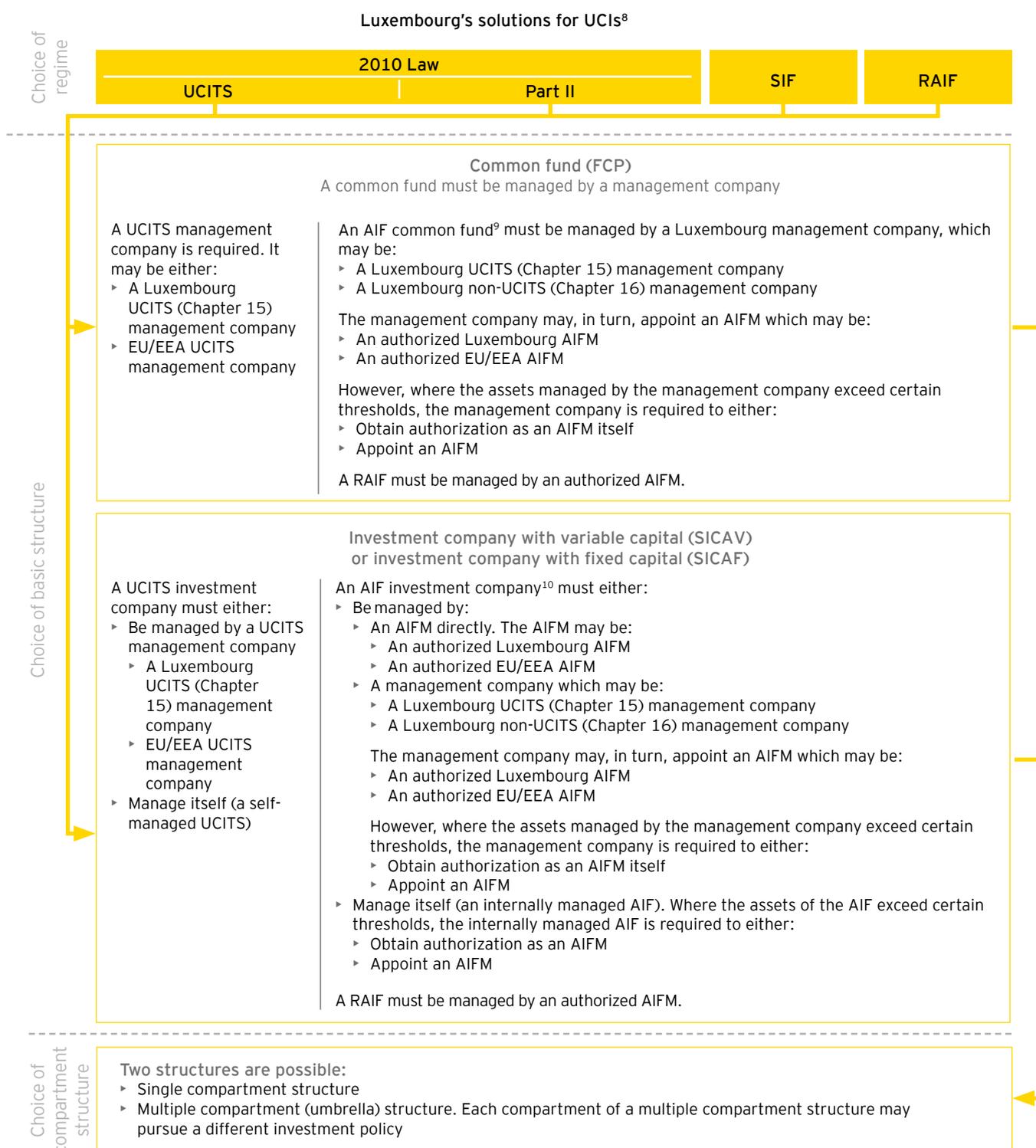
Marketing outside the EEA is subject to each country’s national requirements.

Chapter 12 covers the marketing of UCIs.

⁷ The EEA Agreement did not list the AIFM Directive in Annex at the time of writing, but the AIFM Directive is identified as a “text with EEA relevance”.

C. Overview of fund regimes and basic structures

The choice of regime and basic structure is presented in schematic form below:



⁸ Section 2.3.1. covers basic structures, Section 2.4.4. covers the requirements applicable to AIF, and Section 6.1. introduces management companies and AIFM.

⁹ This general outline does not cover the specific cases of certain partnerships; for further information, see Section 2.3.1.

¹⁰ Idem.

The following table outlines the main characteristics of Luxembourg's investment fund regimes:

	Regimes			
	UCITS	2010 Law Part II	SIF	RAIF
Regulation	Regulated	Regulated	Regulated	Under the AIFMD - however see footnote below ¹¹
Regulator	CSSF	CSSF	CSSF	Under the AIFMD - however see footnote below ¹²
Authorization procedure (see Chapter 3)	Prior to set-up	Prior to set-up	Prior to set-up	Not required
Structures available (see Chapter 2)	Common fund: FCP Investment company: SICAV or SICAF	Common fund: FCP Investment company: SICAV or SICAF	Common fund: FCP Investment company: SICAV or SICAF	Common fund: FCP Investment company: SICAV or SICAF
Eligible investors ¹³ (see Section 1.3.1.B. and Chapter 2)	All	All	Well-informed investors ¹⁴	Well-informed investors ¹⁵
Distribution in European Union (EU)/European Economic Area (EEA) ¹⁶ (see Section 1.3.1.B. and Chapter 12) to:				
▶ Retail investors	EU/EEA passport	National retail distribution requirements	National retail distribution requirements	National retail distribution requirements
▶ Professional investors	EU/EEA passport	EU/EEA passport if managed by an authorized AIFM ¹⁷ , otherwise national private placement regimes (NPPRs)	EU/EEA passport if managed by an authorized AIFM ¹⁸ , otherwise national private placement regimes (NPPRs)	EU/EEA passport of the authorized AIFM ¹⁹
Maximum number of shareholders or unitholders (see Section 2.3.)	No limit	No limit	No limit ²⁰	No limit ²¹
Minimum number of shareholders or unitholders (see Section 2.3.)	No minimum	No minimum	No minimum	No minimum
Minimum investment by a shareholder or unitholder (see Chapter 2)	None	None	EUR 125,000; less if certification	EUR 125,000; less if certification
Use of compartments (sub-funds) (see Section 2.3.2.)	Yes	Yes	Yes	Yes
Cross-investment between compartments (see Section 2.3.5.)	Yes, subject to conditions	Yes, subject to conditions	Yes, subject to conditions	Yes, subject to conditions

¹¹ The RAIF must be managed by an authorized AIFM which is supervised by the competent authority of its country of domicile. A RAIF is not however directly supervised by the CSSF.

¹² Idem.

¹³ Additional restrictions may be included in the constitutional document or prospectus.

¹⁴ See Section 2.4.2.1.B.

¹⁵ See Section 2.4.3.2.

¹⁶ European Union (EU) Member States plus Iceland, Liechtenstein and Norway.

¹⁷ See Chapter 6.

¹⁸ Idem.

¹⁹ Idem.

²⁰ Except in the case of a SIF or RAIF set up as a private limited liability company (S.à r.l.), in which case the maximum number of investors is 100.

²¹ Idem.

	Regimes			
	UCITS	2010 Law Part II	SIF	RAIF
Multiple share or unit classes (see Section 2.3.3.)	Yes	Yes	Yes	Yes
Eligible investments/strategy (see Chapter 4)	Transferable securities such as equities, bonds, money market instruments (MMI), investment funds and certain derivatives Techniques and instruments related to transferable securities Detailed restrictions apply	Some restrictions	No restrictions	No restrictions
Diversification (see Chapter 4)	Detailed requirements	General requirements	General requirements	General requirements
Risk management (see Chapter 7)	Detailed requirements	General requirements, and AIFM requirements (where applicable)	General requirements on risk management system, and AIFM requirements (where applicable)	AIFM requirements
Fees/expenses including performance and advisory fees	No detailed restrictions Must be disclosed	No detailed restrictions Must be disclosed	No detailed restrictions Must be disclosed	No detailed restrictions Must be disclosed
Transferability of shares or units (see Chapter 2)	Generally freely transferable	Generally freely transferable	May or may not be freely transferable Subject to informed investor qualification	May or may not be freely transferable Subject to informed investor qualification
Information for investors (see Chapter 10)	Prospectus Key Investor Information (KII) Financial statements ²² Periodic disclosures ²³	Prospectus ²⁴ Financial statements ²⁵ Periodic disclosures ²⁶	Prospectus or offering document ²⁷ Financial statements ²⁸ Periodic disclosures ²⁹	Offering document ³⁰ Financial statements ³¹ Periodic disclosures ³²
Required service providers (see Chapter 6) ³³ (see Chapter 9) (see Chapter 8) (see Section 10.5.10.)	UCITS management company (common fund) Luxembourg depositary Administration, registrar and transfer agent which must be in Luxembourg if the management company is in Luxembourg Luxembourg auditor	Luxembourg management company (common fund) Luxembourg depositary Luxembourg administration, registrar and transfer agent Luxembourg auditor	Luxembourg management company (common fund) Luxembourg depositary Luxembourg administration, registrar and transfer agent Luxembourg auditor	Luxembourg management company (common fund) Luxembourg depositary Luxembourg administration, registrar and transfer agent Luxembourg auditor

²² At least audited annual and unaudited semi-annual financial statements.

²³ See Section 10.4.1.

²⁴ For full AIFM regime AIF, information to be disclosed in the prospectus or separately (see Section 10.3.3.).

²⁵ At least audited annual and unaudited semi-annual financial statements.

²⁶ For full AIFM regime AIF (see Section 10.4.2.).

²⁷ For full AIFM regime AIF, information to be disclosed in the prospectus or separately (see Section 10.3.3.).

²⁸ At least audited annual financial statements.

²⁹ For full AIFM regime AIF (see Section 10.4.2.).

³⁰ Information to be disclosed in the prospectus or separately (see Section 10.3.3.).

³¹ At least audited annual financial statements.

³² For full AIFM regime AIF (see Section 10.4.2.).

³³ Main service providers only listed here; see Section 1.4.

	Regimes			
	UCITS	2010 Law Part II	SIF	RAIF
Regulator reputational checks (see Chapter 5) (see Chapter 9)	Portfolio manager and/or adviser Directors of UCI, or of management company ³⁶ Depository	Promoter ³⁴ Portfolio manager and/or adviser Directors of UCI, or of management company ³⁷ Depository	Directors of SIF, or of management company ^{38, 39} Depository	Please see footnote below ³⁵
Listing possible (see Chapter 13)	Yes	Yes	Yes	Yes
Net asset value (NAV) calculation and redemption frequency (see Section 8.6.)	Minimum twice a month	Minimum monthly and, if managed by an authorized AIFM, the NAV must be calculated on the occasion of each issue	If managed by an authorized AIFM, on the occasion of each issue or subscription or redemption or cancellation of shares or units, and at least once a year. In any case, NAV required for reporting purposes	On the occasion of each issue or subscription or redemption or cancellation of shares or units, and at least once a year. In any case, NAV required for reporting purposes
Subscription and redemption price (see Section 8.6.2.)	NAV ⁴⁰	NAV ⁴¹	Subscription and redemption conditions laid down in the constitutional document	Subscription and redemption conditions laid down in the constitutional document
Tax treatment in Luxembourg (see Section 11.3.)	No tax, except for annual subscription tax of 0.05% on the NAV unless a reduced rate of 0.01% or exemption applies No withholding tax (WHT) on dividends paid	No tax, except for annual subscription tax of 0.05% on the NAV unless a reduced rate of 0.01% or exemption applies No withholding tax (WHT) on dividends paid	No tax, except for annual subscription tax of 0.01% on the NAV unless an exemption applies No withholding tax (WHT) on dividends paid	No tax, except for annual subscription tax of 0.01% on the NAV unless an exemption applies RAIFs investing entirely in risk capital are subject to the tax regime applicable to SICARs No withholding tax (WHT) on dividends paid

³⁴ Where the 2010 Law Part II UCI is not managed by a UCITS (Chapter 15) management company.

³⁵ RAIFs are not supervised by the CSSF. The AIFM is responsible for ensuring that the AIFs it manages comply with the AIFMD product rules.

³⁶ For self-managed UCITS, see Section 2.4.1.5.

³⁷ For internally managed AIF, see Section 2.4.4.

³⁸ "Directors" means, in the case of public limited companies and in the case of cooperatives in the form of a public limited company, the members of the Board of Directors, in the case of partnerships, the managers or general partner, in the case of private limited liability companies, the manager(s) and in the case of common funds, the members of the Board of Directors or the managers of the management company.

³⁹ For internally managed AIF, see Section 2.4.4.

⁴⁰ The net asset value per share or unit may be adjusted to incorporate a "swing factor" if swing pricing procedures are in place (see Section 8.6.3.).

⁴¹ Idem.

1.3.2. Basic structures

The decision to create a UCI in contractual form (common fund – FCP) or in corporate form (an investment company, generally with variable capital – SICAV)⁴² is primarily driven by tax, operational and marketing considerations. The following table details the main differences between common funds and investment companies:

	Basic structures	
	Common fund (FCP)	Investment company (SICAV or SICAF)
Management entity	Luxembourg management company which, in the case of an AIF, may appoint an AIFM	Self-managed investment company: Board of Directors, general partner or manager(s) ⁴³ . Managed investment company: <ul style="list-style-type: none"> ▸ UCITS: a management company ▸ AIF: a management company and/or an AIFM
Control	Board of Directors of management company in conjunction with depositary	Board of Directors, general partner or manager(s) ⁴⁴ and ultimately by investors ⁴⁵
Shareholders' or unitholders' meetings	Unitholders' meetings are not mandatory for a common fund	At least one meeting of shareholders must be held annually
Taxable status	Tax transparent (with limited exceptions)	Not tax transparent (with limited exceptions)
Tax implications	Individual underlying investors may benefit from certain double taxation treaties (DTTs)	SICAV may directly benefit from certain DTTs ⁴⁶
VAT status (Value added tax)	VATable person (via its management company)	VATable person

Luxembourg's investment fund regimes and basic structures, and the requirements for each, are described in more detail in Chapter 2.

1.3.3. Traditional investment funds

Traditional investment funds include:

- Equity funds
- Bond funds
- Money market funds (MMF)
- Mixed funds
- Multiple-asset class investment funds: investment funds with multiple compartments investing in different asset classes
- Funds of traditional investment funds

Appendix I describes in more detail what UCIs are and explains the various types of funds and asset classes.

Traditional investment funds may be set up under any of Luxembourg's investment fund regimes (i.e., as UCITS, 2010 Law Part II UCIs, SIFs or RAIFs) using any of the basic structures mentioned previously.

⁴² See also Section 2.3.

⁴³ In the case of public limited companies and in the case of cooperatives in the form of a public limited company, the members of the Board of Directors, in the case of partnerships, the managers or general partner, and in the case of private limited liability companies, the manager(s).

⁴⁴ Idem.

⁴⁵ Except in the case of a partnership.

⁴⁶ See Circular L.G. -1 n°61 on Certificates of Residence for Luxembourg UCIs.

1.3.4. Alternative investment funds (AIFs)

Alternative investment funds (AIFs) include:

- ▶ Hedge funds
- ▶ Real estate funds
- ▶ Private equity funds
- ▶ Debt funds
- ▶ Infrastructure funds
- ▶ Thematic funds such as AIF:
 - ▶ Investing in specific segments, such as environment
 - ▶ Investing in collectibles, such as luxury goods
 - ▶ Investing in intangible assets, such as patents
 - ▶ Meeting specific criteria, such as responsible investment criteria
- ▶ Multiple-asset class AIF: AIF with multiple compartments investing in different asset classes, sometimes with interlinked compartments
- ▶ Funds of AIF
- ▶ European long-term investment funds

Appendix I describes in more detail what UCIs are and explains the various types of funds and asset classes.

AIFs are generally set up either as 2010 Law Part II UCIs, SIFs or RAIFs. Any of the basic structures may be used for 2010 Law Part II UCIs, SIFs or RAIFs. Certain types of AIFs are subject to specific rules (See Section 2.6.). AIFs may also be set up as European long-term investment funds (ELTIF) (See Section 2.4.4.).

UCITS may also, to a limited extent, pursue alternative investment strategies (so-called “alternative UCITS”).

A number of vehicles may be used in conjunction with AIF, for example to hold the underlying investments. Luxembourg vehicles which may be used in conjunction with AIF include commercial companies, referred to as SOPARFIs, and securitization vehicles (see Section 2.7.).

1.3.5. Funds of funds and master-feeder structures

There are two main types of UCIs which invest into other UCIs: funds of funds and master-feeder structures.

1.3.5.1. Funds of funds

A fund of funds invests into several other UCIs. A key role of the manager of a fund of funds is the selection and monitoring of the underlying UCIs.

It is possible to create funds of funds under any of Luxembourg's fund regimes, subject to the applicable eligibility criteria and diversification requirements (see Chapter 4).

Funds of funds may, for example, offer investors diversification and therefore lower risk than direct investment into the underlying UCIs.

1.3.5.2. Master-feeder structures

In master-feeder structures, the feeder UCI invests most of its assets in a master UCI. Therefore, the management of a significant portion of the portfolio of the feeder UCI is effectively performed by the manager of the master UCI.

A feeder UCITS is a non-diversified investment structure investing into a diversified product (master UCITS), permitting the pooling of assets. In a UCITS master-feeder structure, a feeder UCITS invests at least 85% of its assets in a master UCITS. It may invest up to 15% of its assets in liquid assets, financial derivative instruments for hedging purposes or, in the case of investment companies, property essential for the direct pursuit of business. An existing UCITS may be converted into a feeder UCITS. Alternatively an existing UCITS may become a master UCITS. A feeder UCITS may also change its master UCITS. The master UCITS, or one or more of the feeder UCITS, can be located in different EEA Member States. Master and feeder UCITS can be created under Luxembourg's UCITS regime (Part I of the 2010 Law) or the UCITS regime of another EEA Member State. See also Section 2.3.4.1.

In an AIF master-feeder structure, a feeder AIF invests at least 85% of its assets in another AIF, invests in more than one master AIF where those master AIFs have identical investment strategies, or has otherwise an exposure of at least 85% of its assets to such a master AIF. Master and feeder AIFs can be created under any of Luxembourg's AIF regimes, the AIF regime of another EEA Member State or a third country. However, for the AIFM of the feeder AIF to benefit from the AIFM marketing passport, the feeder AIF must invest into a master AIF that is managed by an authorized AIFM (see Section 12.5.).

Master-feeder structures may be used by asset managers as a distribution mechanism to facilitate access to certain markets. For example, some French investors may prefer to invest in a local UCITS. An asset manager which currently only offers a Luxembourg domiciled UCITS may take advantage of the UCITS master-feeder provisions and create a feeder UCITS domiciled in France which invests in the master UCITS domiciled in Luxembourg. This structure will enable the manager to distribute to such French investors while managing only one portfolio of investments.

1.3.6. Specific types of UCIs

Specific types of UCIs can be created under Luxembourg's UCI regimes. These include:

- Money market funds (MMFs)
- Exchange traded funds (ETFs)
- Index tracking UCIs
- UCIs using efficient portfolio management (EPM) techniques, such as securities lending and repurchase transactions
- UCITS using financial derivative instruments (FDIs)
- Structured UCIs
- Hedge funds
- Real estate funds
- Private equity funds
- Debt/Credit funds
- Infrastructure funds
- European long-term investment funds (ELTIFs)

Requirements applicable to specific types of UCIs are covered in Section 2.6.

1.4. Organization of a UCI and its service providers

This section outlines the typical organization of a UCI, summarizes the roles of the main service providers and outlines the factors impacting the choice of organizational model.

1.4.1. Typical organization of a UCI

As part of the formation procedures of a UCI, several service providers must be appointed.

The following diagrams show illustrative examples of the organization of UCIs; other models may be possible.

Typical organization of a UCI



A RAIF must be managed by an authorized AIFM; it cannot be an internally managed AIF.

1.4.2. UCI service providers

This section outlines the principal duties of the main service providers. The appointment of service providers is covered in Section 6.3.1.B.

A. Sponsor, initiator or promoter

For UCITS management companies, the CSSF may ask a “sponsor” to issue a letter of assurance (or “sponsorship”), in which the sponsor commits to the CSSF, that the management company respects, and will continue to respect, the applicable prudential requirements (see also Section 6.4.3.). In practice, the “sponsor” will generally be the main shareholder of the management company, or a group entity to which the main shareholder belongs.

The creator of a UCI is generally referred to in Luxembourg as the promoter in the case of 2010 Law UCIs and the initiator in the case of SIFs. These terms are not defined in Law. A promoter is required for a 2010 Law Part II UCI which is not managed by a UCITS (Chapter 15) management company.

The initiator or promoter generally plays one or more important roles in the activity of the UCI. For example, the initiator or promoter may:

- ▶ Be the portfolio manager or adviser
- ▶ Play a role in the oversight of the activity of the UCI, generally by being represented on the Board of Directors of the UCI or its management company and/or Alternative Investment Fund Manager (AIFM)
- ▶ Be a shareholder of the management company
- ▶ Play a role in the distribution of the UCI

The role of “sponsor” of a Chapter 15 management company replaces the role of “promoter” of a UCI managed by a UCITS management company (see Chapter 6).

See also Sections 1.4.3. and 3.3.2.

B. Management company or AIFM

Management companies and AIFM are companies that manage UCIs. “Management” includes, in general, portfolio management, administration and distribution. A common fund (FCP) must be managed by a management company. An investment company can appoint a management company or an AIFM, or manage itself (see also Section 1.4.3.1. and Chapter 6). A RAIF must be managed by an authorized AIFM; it cannot manage itself.

C. Portfolio manager

The portfolio manager manages the UCI (there may be a range of portfolio managers for different compartments) with respect to the investment, divestment and reinvestment of the assets of the UCI. It is a delegate of the UCI or of its management company.

D. Investment adviser

The investment adviser advises the portfolio manager, the management company or the UCI itself with respect to the investment, divestment and reinvestment of the assets of the UCI. It does not make decisions.

E. Administrator

The administrator is, *inter alia*, responsible for keeping the accounting records of the UCI, calculating the NAV, assisting in preparing the financial statements, and acting as a contact with the CSSF and the independent auditor⁴⁷. Administration is further discussed in Chapter 8.

F. Registrar and transfer agent

The registrar and transfer agent is responsible for keeping the principal register of shareholders or unitholders of the UCI, and for arranging the issue, transfer, allotment, conversion, subscription, redemption and/or purchase and sale of shares or units of the UCI (see also Chapter 8).

⁴⁷ | In this Technical Guide, we use the term “Independent auditor” for Approved statutory auditor.

G. Domiciliation agent

The domiciliation agent provides the registered office of the UCI. It is responsible for providing office accommodation and other facilities to the UCI, keeping all correspondence of the UCI, and arranging payment of bills on behalf of the UCI (see also Chapter 8).

H. Distributor

Distributors are intermediaries who perform one or both of the following activities:

- Actively market the shares or units
- Receive subscription and redemption orders as appointed agents of the UCI

See also Section 12.9.1.

I. Nominee

Nominees act as intermediaries between investors and the UCI of their choice.

See also Section 12.9.2.

J. Market maker

Market makers are intermediaries participating on their own account and at their own risk in subscription and redemption transactions of UCI shares or units.

See also Section 12.9.3.

K. Depositary

The depositary is, *inter alia*, responsible for the safekeeping of the assets of the UCI, and for the day-to-day administration of the assets (e.g., receipts, sales, dividends), based on instructions received from the asset managers or management company (unless they conflict with the constitutional document). It also plays an oversight role. See also Chapter 9.

L. Prime broker

A prime broker is an entity subject to prudential regulation and ongoing supervision, which:

- Offers one or more services to professional investors primarily to finance or execute transactions in financial instruments as counterparty
- May also provide other services such as clearing and settlement of trades, custodial services, securities lending, customized technology and operational support facilities⁴⁸ (see Section 9.8.)

M. Paying agent

The paying agent arranges for payment of distributions made by the UCI. A paying agent may be required in each country where the UCI is distributed. Generally, the depositary and its network will provide paying agent services (see Section 9.4.1.). Paying agent is a term used differently in the context of the EU Savings Directive (see Section 11.3.4.1.).

N. Independent auditor

The financial statements of a UCI must be audited by a Luxembourg independent auditor (*réviseur d'entreprises agréé* – see Section 10.5.10.).

1.4.3. Organizational model considerations

The choice of organizational model for the UCI, its management and service providers will depend on a number of factors, including:

- The basic structure of the UCI
- Preference for a group entity or a third party
- The other fund ranges of the group. Where the group has fund ranges in multiple jurisdictions, it may consider cross-border management
- Service provider considerations

⁴⁸ | Based on the AIFM Directive and AIFM Law definition of a “prime broker”.

1.4.3.1. Basic structure of the UCI

A common fund (FCP) has no legal personality and must be managed by an authorized management company, regardless of whether it is created under the 2010 Law, the SIF Law or the RAIF Law. The Board of Directors/Managers of the management company, in conjunction with the depositary, has ultimate control of the common fund. The management company is responsible for the common fund, including the appointment and oversight of service providers.

On 16 July 2019, the existing RAIF Law has been amended to clarify that a RAIF set up as an FCP may have as management company an entity set up under Chapter 15, 16 or 18 of the 2010 Law. The management company must also be authorized as an AIFM (see Section 6.2.1.B) or appoint an external AIFM (see Section 6.1.4).

An investment company must appoint an approved management company or designate itself as “self-managed”⁴⁹. The Board of Directors of the investment company, and ultimately the shareholders, control the investment company. The Board of Directors is responsible for the investment company, including the appointment and oversight of service providers. It may appoint a management company to manage the investment company, in which case the oversight of some of the service providers is delegated to the appointed management company. The sponsor, initiator or promoter is usually represented on the Board of Directors of the investment company.

Both common funds and investment companies can be single or multiple compartment (sub-fund), and each compartment can have one or more share classes.

It is also possible to create master-feeder structures. In master-feeder structures, the feeder UCI invests most of its assets in a master UCI.

The key differences between the basic structures of UCIs are summarized in Section 1.3. The basic structures, multiple compartment UCIs, and share or unit classes are described in more detail in Section 2.3. and the requirements for UCIs by specific regime (UCITS, Part II 2010 Law, SIF and RAIF) in Section 2.4. Master-feeder structures are covered in Section 2.3.4.1.

1.4.3.2. Group or third party

Sponsors, initiators and promoters can choose between “group” or “third party” models. In the “group” model, the UCI or management entity (management company or AIFM) is created within the group of the sponsor, initiator or promoter, or an existing group structure is used. In the “third party” model, the sponsor, initiator or promoter uses a third party. Third parties may also make available independent Board Members and key function holders.

A. UCI

Sponsors, initiators and promoters generally create their own UCIs.

However, some portfolio managers and investment advisers choose a UCI created by a third party. In this case, a new UCI will be created by the third party, or a new compartment will be created in an existing multiple compartment UCI (see Section 2.3.2.) of the third party; they will then be appointed as the portfolio manager of, or investment adviser to, the compartment.

An option open to sponsors, initiators and promoters who wish to offer UCI products to their clientele, but do not wish to create or manage the products, is to “white label” third party products. In this case, the third party creates and manages the UCI, but the product is generally marketed under the brand of the sponsor, initiator or promoter. The association with the third party will depend on the model implemented.

⁴⁹ | A RAIF must be managed by an authorized AIFM; it cannot manage itself.

“White labeling” enables the same product to be offered to different clients by different sponsors and promoters, such as private banks.

Under one model, specific share or unit classes are created for each sponsor, initiator or promoter within an existing UCI. In this case, the product is generally primarily marketed under the brand of the third party.

Under another model, some of the fund documentation is branded by the sponsor, initiator or promoter. The third party is, for example, referred to in the fund documentation (e.g., as management company and/or Board of the UCI).

The requirements on key investor information (KII) of a UCITS restrict, to a certain extent, white labeling of UCITS. The KII must, in general, be provided to investors before they invest. The KII must be used without alterations or supplements in all Member States where the UCITS is notified (see Sections 10.3.2. and 12.2.1.).

B. Management entity

Sponsors, initiators and promoters who require or wish to use the services of a management company or AIFM (referred to as a “management entity” in this *Technical Guide*) have the following options:

- ▶ Create a new group management entity, or use their existing group management entity

In practice, the group to which the initiator belongs usually holds a majority shareholding in the management company and is represented on the Board. The group to which the initiator belongs thereby controls the management company and the group entity will be considered the “sponsor” of the management company (see also Section 6.2.2.B.).

- ▶ Appoint a third party management entity

A number of groups and independent management entities offer “third party” management services.

In the “third party management entity” model, the initiator or promoter generally does not control the management entity. It may or may not be represented on one of the key committees, such as an investment committee.

C. Key function holders

When appointing key function holders, sponsors, initiators and promoters have the choice between persons belonging to the group and external (“independent”) persons. Independent persons may make themselves available on a one-to-one basis, or be made available by a “third party” entity to which they belong.

Key function holders may include:

- ▶ Members of the Board of Directors of the UCI (see Chapter 5) and management company or AIFM (see also Section 5.1.6.1.)
- ▶ Senior management (also known as “conducting officers” – see Section 5.1.6.2.)
- ▶ Control functions (see Section 6.3.2.1.)

A number of specialist firms offer “third party” key function holders.

1.4.3.3. Cross-border management

The UCITS and AIFM Directives⁵⁰ have introduced “management” passports. The passports allow a management entity (management company or AIFM) to manage UCIs (UCITS and AIF, respectively) cross-border – i.e., in EU/EEA Member States other than their home Member State (“host” Member States).

UCIs may be managed cross-border either directly (free provision of services) or via a branch. Branches do not themselves benefit from a management passport.

UCIs which have not appointed a management entity do not have a management passport.

⁵⁰ | Under the “UCITS IV” recast of the UCITS Directive.

The following table illustrates the cross-border management possibilities under selected group models:

Cross-border management possibilities under selected group models		
UCIs which can be managed		
Management configurations	Local UCIs	UCIs in host Member State(s)
Management company managing:		
▸ Directly	✓	✓
▸ Via a branch in host Member State	X	✓
Self-managed UCIs	✓	X

See also Section 6.3.4.

1.4.3.4. Group management models

Asset management groups, particularly those operating in multiple jurisdictions, have a number of options for the management of their UCIs.

UCITS management companies and AIFM may combine authorizations within a single entity and obtain a “dual” authorization as UCITS management company and AIFM. A “dual” authorized management entity is authorized to manage both UCITS and AIF, and can use the “management” passport to perform the activities for which it has been authorized in other EU/EEA Member States. It also benefits from “product” passports to market the UCITS products it manages to any type of investor, and the AIF products it manages to professional investors, in all EU/EEA Member States.

The optimal model will probably be based on one or a combination of the following:

- The “super” model: creating a single management entity (a management company and/or AIFM) for an ensemble of UCIs, or converting an existing management company to a “super” entity

Typically “super” management entities will manage UCIs cross-border (see also Section 1.4.3.3.).

- The “multiple” model: local management entities in each UCI domicile, or for specific fund ranges
- The “third party” model: appointing one or more third party management entities. Under this model, one third party “super” management entity or multiple third party management entities are appointed rather than setting up group management entities (see also Section 1.4.3.2.)
- The “self-managed” model: self-managed UCITS and internally managed AIF (which are subject to the AIFM Law) are required to comply with most of the requirements applicable to management entities (see Section 6.2.1.D.). However, neither self-managed UCITS nor internally managed AIF benefit from a passport enabling them to provide cross-border services

An increasing number of self-managed UCIs are appointing management entities.

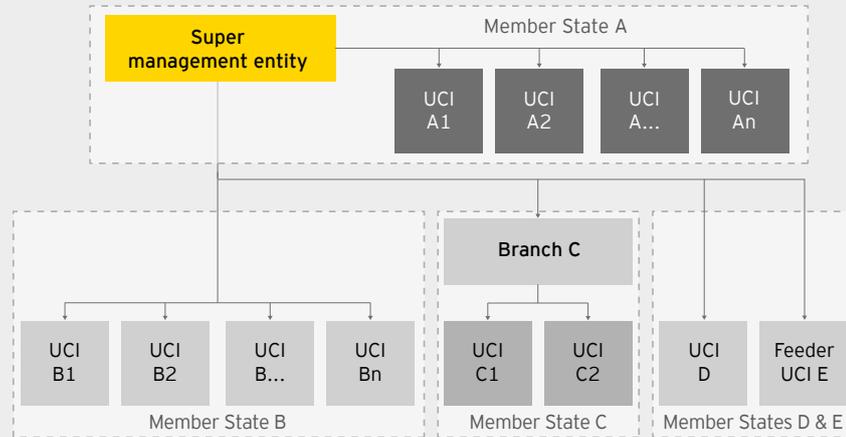
The following table briefly summarizes possible management models for UCITS and AIF:

Possible management models for UCITS and AIF			
	UCITS	AIF	UCITS and AIF
“Super” model	“Super management company”	“Super AIFM”	“Super ManCo and AIFM”
“Multiple” model	Multiple management companies	Multiple management companies and/or AIFM	Multiple management companies and multiple AIFM
“Third party” model	“Third party management company”	“Third party AIFM”	“Third party management company and AIFM”
“Self-managed” model	Self-managed UCITS investment company	Internally-managed AIF investment company	n.a.

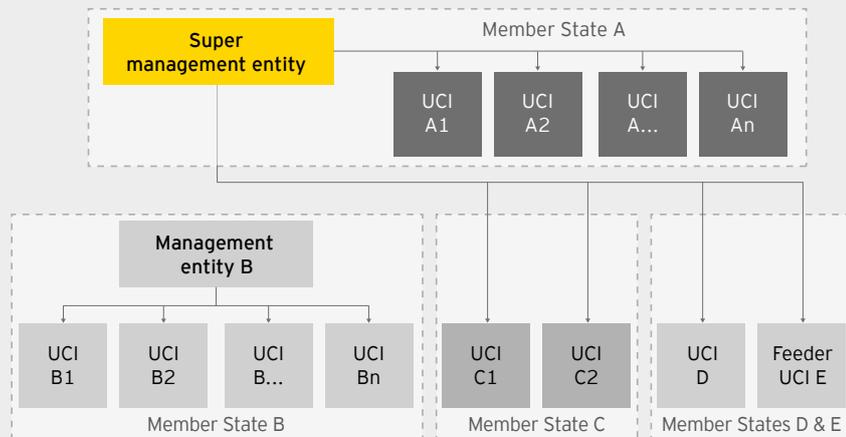
Emerging mixed models

Two “mixed” models are emerging in practice:

- ▶ **“Super” entity model, potentially combining both branches and free provision of services:** These asset management groups will convert existing management entities in some Member States into branches of a single “Super” entity, and make use of free provision of services to manage UCIs in new Member States where the group does not operate (such as feeder UCITS in new domiciles). The following is an illustrative example of this model:



- ▶ **Home Member State “Super” entity plus international domicile entity model:** These asset management groups will opt to keep a management entity in their home domicile, and another in an international fund domicile. One of the management entities will be selected to provide cross-border services to UCIs in other Member States. The following is an illustrative example of this model:



1.4.3.5. Service provider models

Two important considerations when selecting service providers are whether the service provider is a group company or third party, and the domicile of the proposed service provider.

A. Group or third party

Where the UCI or management company is part of a financial group, the Board of a UCI and/or its management entity may choose between group service providers and third parties. In certain cases, a service provider may be created by two or more groups as a joint venture.

In certain cases, delegation within a group is relevant from a regulatory perspective. For example:

- ▶ Management entities may consider delegation to a group internal audit function (see Section 6.3.2.1.C.)
- ▶ IT infrastructure of a management company may be provided by a group company (see Section 6.3.2.2.A.)
- ▶ Conflicts of interest must be considered in a group context (see Section 6.4.1.)

- ▶ In the context of the AIFM letter box provisions, when assessing whether an AIFM delegates the performance of investment management functions (portfolio management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself, one of the factors to be taken into account is whether the delegate is part of the same corporate group as the AIFM (see Section 6.3.3.1.H.)

B. Domicile

Management entities are subject to the delegation requirements of their home Member State. They must also comply with the requirements of the home Member State of the UCIs they manage (the “host Member State” where the UCIs are managed on a cross-border basis) on the constitution and functioning of the UCIs.

In certain cases, asset management groups may therefore have the choice between service providers in:

- ▶ The domicile of the management company
- ▶ The domicile of the UCI
- ▶ Another country

An asset management group may therefore implement one or a combination of the following service provider models:

- ▶ Single service provider:
 - ▶ Centralized: a single service provider is selected to serve the UCIs in all host Member States from a central location
 - ▶ Decentralized: service providers from the same financial services group are selected – generally one in each host Member State
- ▶ Multiple service providers: service providers from different financial services groups are selected to serve different UCIs

From a Luxembourg perspective, there are a number of minimum rules which apply in relation to the domicile of service providers to UCIs, including the following:

- ▶ Administration (see also Chapter 8):
 - ▶ UCITS:
 - ▶ A Luxembourg UCITS management company which manages a Luxembourg UCITS is authorized to delegate the administration of the UCITS to an entity established in Luxembourg which is authorized to provide administration services and has adequate organization in order to perform the administration
 - ▶ A Luxembourg UCITS management company which manages a UCITS domiciled in another Member State is authorized to delegate the administration of the UCITS to an entity established in either:
 - ▶ Luxembourg
 - ▶ The Member State where the UCITS is domiciled
 The entity must be authorized to provide administration services and have an adequate organization in order to perform the administration
 - ▶ Luxembourg AIFs (including Part II 2010 Law UCIs, SIFs and RAIFs): the central administration of the UCI must be in Luxembourg
 - ▶ Depositary: the depositary of a Luxembourg UCI must be established in Luxembourg (see also Chapter 9)

1.4.4. Restructuring a UCI

Asset management groups may decide to restructure UCIs for a variety of reasons including, *inter alia*, optimization of operating models, cost reduction, economies of scale and focusing on certain target investor markets.

Typical types of restructuring of UCIs include:

- ▶ Restructuring UCIs:
 - ▶ Conversion of Luxembourg UCIs: 2010 Law UCIs into SIFs or RAIFs and vice versa (where possible) (see Section 3.6.1.) or from one basic structure to another (see Section 3.6.2.)
 - ▶ Conversion of an existing UCITS to a feeder UCITS (see Section 3.6.3.)
 - ▶ A feeder UCITS changing master UCITS (see Section 3.6.3.)
- ▶ Mergers of UCIs (see Section 3.7.)
- ▶ Creation of a side pocket, typically to hold illiquid assets (see Section 2.3.6. and 3.8.)
- ▶ Transferring foreign UCIs to Luxembourg (see Section 3.9.)
- ▶ Liquidation of UCIs and compartments (see Section 3.10.)

2

UCI structures and specificities

EY supports asset managers, traditional and alternative investment fund houses with the choice of fund vehicle and the creation of a fund structure that meets the relevant regulatory and tax requirements.



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2.1. Introduction

This chapter covers:

- ▶ The principal regulations applicable to Luxembourg investment funds (Undertakings for Collective Investment – UCIs)
- ▶ The types of structures of UCIs:
 - ▶ The basic structures of UCIs (common funds and investment companies)
 - ▶ Single and multiple compartment UCIs
 - ▶ Share or unit classes
 - ▶ Master-feeder structures
 - ▶ Co-management and pooling of assets
 - ▶ Cross investment between compartments of multiple compartment UCIs
 - ▶ Side pockets
- ▶ The requirements applicable to:
 - ▶ Undertakings for Collective Investment in Transferable Securities (UCITS)
 - ▶ 2010 Law Part II UCIs
 - ▶ Specialized Investment Funds (SIF)
 - ▶ Reserved Alternative Investment Funds (RAIF)
 - ▶ Alternative Investment Funds (AIF): full Alternative Investment Fund Managers (AIFM) regime AIF and simplified AIFM registration regime AIF
 - ▶ European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF)
 - ▶ European Long-Term Investment Funds (ELTIF)
- ▶ Minimum capital requirements
- ▶ The requirements applicable to specific types of UCIs:
 - ▶ Money market funds (MMFs)
 - ▶ UCITS exchange traded funds (ETFs)
 - ▶ Index tracking UCITS
 - ▶ UCIs using efficient portfolio management (EPM) techniques, such as securities lending, repurchase transactions and certain risk hedging transactions using FDIs
 - ▶ UCITS using financial derivative instruments (FDIs)
 - ▶ Structured UCITS
 - ▶ Hedge funds
 - ▶ Real estate funds
 - ▶ Private equity funds
- ▶ Vehicles used in conjunction with AIF, with a focus on Luxembourg vehicles:
 - ▶ *Sociétés de Participations Financières* (SOPARFI)
 - ▶ Securitization vehicles

2.2. Principal regulations

The principal regulations applicable to Luxembourg UCIs comprise Luxembourg laws, regulations and circulars issued by the Commission for the Supervision of the Financial Sector (*Commission de Surveillance du Secteur Financier* – CSSF), and also certain Grand-Ducal regulations. The laws and regulations are set out below.

The principal law on UCIs is the Law of 17 December 2010, as amended (the 2010 Law), which covers:

- Part I: UCITS
- Part II: other UCIs (2010 Law Part II UCIs)
- Part III: foreign UCIs
- Part IV: management companies (see Chapter 6)
- Part V: general provisions applicable to UCITS and Part II UCIs

The 2010 Law, *inter alia*, transposed the UCITS Directive (Directive 2009/65/EC – often referred to as UCITS IV) into Luxembourg Law.

The Law of 10 May 2016 (2016 Law) transposed into law *Directive 2014/91/EU of 23 July 2014 on UCITS as regards depositary functions, remuneration policies and sanctions* (UCITS V) thereby amending the 2010 Law and the AIFM Law. The 2016 Law came into force on 1 June 2016.

UCITS V focuses on 3 main areas:

- Revision of the depositary regime that applies to UCITS and their depositaries
- Introduction of rules on remuneration policies and practices that need to be applied by UCITS Management Companies and self-managed UCITS investment companies
- Harmonization of administrative sanctions and other administrative measures applicable to the CSSF

Level 2 measures relating to the implementation of UCITS V have been adopted by the European Commission on 17 December 2015.

The Law of 13 February 2007, as amended, (the SIF Law) covers Specialized Investment Funds.

Two EU Regulations, each creating a fund regime, are directly applicable in Luxembourg: Regulation (EU) No 345/2013 of 17 April 2013 on European Venture Capital Funds (EuVECA) and Regulation (EU) No 346/2013 of 17 April 2013 on European Social Entrepreneurship Funds (EuSEF).

The Law of 12 July 2013 on Alternative Investment Fund Managers, as amended, (the AIFM Law), transposing the AIFM Directive (Directive 2011/61/EU), lays down requirements applicable to AIF.

Regulation (EU) No 760/2015 of 29 April 2015 on European Long-Term Investment Funds (ELTIF) became applicable in Luxembourg on 9 December 2015. The purpose of this regulation is to boost European long-term investments in the real economy.

The regulation applies to EU AIFs that are marketed in the European Union under the ELTIF label. Only authorized EU AIFMs may manage and market ELTIFs. ELTIFs are subject to additional rules requiring them, *inter alia*, to invest at least 70% of their capital in clearly-defined categories of eligible assets (generally illiquid assets). Trading in assets other than long-term investments will only be permitted up to a maximum of 30% of their capital (generally liquid assets). An ELTIF is not required to offer redemption rights before the end of its life. This must be clearly indicated as a specific date in the ELTIF rules or instruments of incorporation and disclosed to investors. ELTIFs target both professional and retail investors in the EU. See Section 2.4.5.

The Law of 23 July 2016 introduced Reserved Alternative Investment Funds (the RAIF Law). The RAIF Law lays down requirements applicable to the creation and operation of RAIFs.

On 30 June 2017, the final text of Regulation (EU) No 2017/1131 of the European Parliament and of the Council of 14 June 2017 on *money market funds* (MMF) was published in the Official Journal of the European Union. The regulation is applicable to all funds and compartments that qualify as money market funds as per the definition set out in article 1 of the Regulation.

On 10 April 2018, the European Commission published a Delegated Regulation, amending and supplementing the MMF Regulation *with regard to simple, transparent and standardised securitisations and asset-backed commercial papers, requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies*.

On 17 April 2018, the European Commission published Commission Implementing Regulation (EU) 2018/708 *laying down implementing standards with regard to the template to be used by managers of money market funds when reporting to competent authorities as stipulated by Article 37 of Regulation (EU) 2017/1131 of the European Parliament and of the Council (the MMF Regulation)*.

On 21 March 2018, ESMA published its *Guidelines on stress test scenarios under Article 28 of the MMF Regulation*, in which they established common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of the MMF Regulation.

2.3. Types of structures of UCIs

UCITS, 2010 Law Part II UCIs, SIFs and RAIFs⁵¹ can be structured:

- In contractual form as a common fund (FCP). A common fund must be managed by a management company
- In corporate form as an investment company:
 - With variable capital (SICAV)
 - With fixed capital (SICAF)

While a UCITS must be open-ended⁵², non-UCITS can be open-ended or closed-ended. The different basic structures are outlined in Section 2.3.1.

A UCI may take the form of a single compartment UCI (a “stand alone” UCI) or a multiple compartment UCI (a multiple “sub-fund” UCI, also known as an “umbrella” UCI). Multiple compartment UCIs are covered in Section 2.3.2. Share or unit classes can be created within a single UCI, or within one or several compartments of a multiple compartment UCI; this is covered in Section 2.3.3.

In order to manage portfolios in an efficient manner, it is also possible to create master-feeder structures as outlined in Section 2.3.4.1. and to co-manage or to pool funds, as outlined in Section 2.3.4.2.

Cross investment between compartments of a multiple-compartment UCI is permitted under certain conditions, as described in Section 2.3.5. Side pockets, typically to hold illiquid assets as described in Section 2.3.6., may be created in exceptional circumstances.

2.3.1. Basic structures

2.3.1.1. Common fund

Common fund (*fonds commun de placement* – FCP)

A common fund is a co-proprietorship whose joint owners are only liable up to the amount they have contributed and whose ownership rights are represented by units.

A common fund has no legal personality and must be managed by an authorized management company:

- A UCITS common fund must be managed by a Luxembourg UCITS (Chapter 15) management company or a management company established in another EU/EEA Member State⁵³
- An AIF common fund must be managed by a Luxembourg management company. The management company may either:
 - Manage the AIF itself; where the assets of all the AIF managed by the management company exceed certain thresholds, the management company will be required to obtain authorization as an AIFM
 - Appoint an authorized AIFM in Luxembourg or another EU/EEA Member State

Management companies and AIFM are covered in Chapter 6.

A common fund is deemed in most cases to be tax transparent.

⁵¹ It is also possible to structure RAIFs in other forms. Common funds and investment companies are expected to be the most frequently adopted structures.

⁵² The shares or units of open-ended UCIs are, at the request of holders, redeemed directly or indirectly, out of the UCI's assets.

⁵³ The European Economic Area (EEA) Member States are the European Union (EU) Member States plus Iceland, Liechtenstein, and Norway. The reference to the EEA is clarified in Section 1.3.1.B.

The constitutional document of a common fund is the management regulations (also known as fund rules). The management regulations of a Luxembourg common fund are subject to Luxembourg Law (see Section 10.2.1.).

2.3.1.2. Investment company

- Investment company with variable capital, (*société d'investissement à capital variable* – SICAV)
- Investment company with fixed capital, (*société d'investissement à capital fixe* – SICAF)

An investment company with variable capital (SICAV) is a company whose capital is always equal to its net assets. No formalities are required for increases and decreases in capital.

The share capital of an investment company with fixed capital (SICAF) may only be increased or decreased by way of a decision of the general meeting of shareholders to be held before a notary, and subject to applicable publication requirements. However, the capital may be increased by the SICAF's managing body directly, without requiring an extraordinary general meeting of shareholders to decide upon the increase, via the authorized share capital mechanism. In such a case, notarization and publication requirements will still apply.

An investment company may:

- Be managed by an authorized management company or AIFM:
 - A UCITS investment company may appoint either:
 - A Luxembourg UCITS (Chapter 15) management company
 - A UCITS management company established in another EU/EEA Member State⁵⁴
 - An AIF investment company (or in the case of a limited partnership or a partnership limited by shares, the managing general partner or the manager) may appoint either:
 - An authorized AIFM, which may either be:
 - A Luxembourg AIFM
 - Another EU/EEA Member State AIFM
 - A Luxembourg management company, which may either be:
 - A Luxembourg UCITS (Chapter 15) management company
 - A Luxembourg non-UCITS (Chapter 16) management company

The management company may either:

- Manage the AIF itself. However, where the assets of all the AIF managed by the management company exceed certain thresholds, the management company will be required to:
 - Obtain authorization as an AIFM
 - Appoint an authorized AIFM
 - Appoint an authorized AIFM which may either be:
 - A Luxembourg AIFM
 - Another EU/EEA Member State AIFM
- Manage itself:
 - A UCITS investment company that manages itself is called a self-managed UCITS. The specific requirements applicable to self-managed UCITS are covered in Sections 2.4.1.5. and 6.2.1.C.
 - An AIF investment company that manages itself is called an internally managed AIF⁵⁵. Where the AIF is in the form of a limited partnership or a partnership limited by shares, and the purpose of the manager of the partnership is limited to the AIF, such AIF may also be considered an internally managed AIF. However, where the assets of the AIF exceed certain thresholds, the internally managed AIF is required to either:
 - Obtain authorization as an AIFM
 - Appoint an authorized AIFM

The specific requirements applicable to internally managed AIF are covered in Section 6.2.1.C.

Management companies and AIFM are covered in Chapter 6.

An investment company is not tax transparent (with very limited exceptions).

The constitutional document of an investment company is the articles of incorporation (also known as instruments of incorporation, articles of association or statutes) or partnership agreement (see Section 10.2.2.).

⁵⁴ The European Economic Area (EEA) Member States are the European Union (EU) Member States plus Iceland, Liechtenstein, and Norway. The reference to the EEA is clarified in Section 1.3.1.B.

⁵⁵ Special limited partnerships are not legal entities; they cannot manage themselves.

UCIs established as investment companies are also subject to the Luxembourg laws covering commercial companies (in particular the Law of 10 August 1915 on commercial companies, as amended – the 1915 Law) insofar as the law governing the UCI (the 2010 Law, the SIF Law or the RAIF Law) does not derogate from it.⁵⁶

Investment companies may, in some cases, be subject to the requirements on remuneration policies in the financial sector (see Section 6.4.3.).

While a 2010 Law SICAV must be set up as a public limited company (*société anonyme* – S.A.) or a European company (S.E.), a SIF SICAV and a RAIF SICAV can be set up as a public limited company, a private limited liability company (*société à responsabilité limitée* – S.à r.l.), a partnership limited by shares (*société en commandite par actions* – S.C.A.), a limited partnership (*société en commandite simple* – S.C.S.), a special limited partnership (*société en commandite spéciale* – S.C.Sp.), or a cooperative company organized as a public limited company (*société coopérative organisée sous forme de société anonyme*). A SICAV set up as a public limited company or a private limited liability company may be created for a single shareholder, enabling SICAVs to be incorporated by a single entity/person and permitting their creation for a single investor.

A 2010 Law Part II SICAF, a SIF SICAF or a RAIF SICAF may take any commercial company form, such as the aforementioned legal forms or, in addition, the form of an unlimited company (*société en nom collectif*).

The following table details the main differences between the corporate forms which may be used to create investment companies:

Main corporate forms of investment companies

	Public limited company	European company	Private limited liability company	Partnership limited by shares	Special limited partnership ⁵⁷	Limited partnership	Cooperative company organized as a public limited company
French name	<i>Société Anonyme</i>	<i>Société Européenne</i> ⁵⁸	<i>Société à responsabilité limitée</i>	<i>Société en Commandite par Actions</i>	<i>Société en Commandite Spéciale</i>	<i>Société en Commandite Simple</i>	<i>Société Coopérative organisée sous forme de Société Anonyme</i>
Common abbreviation	S.A.	S.E.	S.à r.l.	S.C.A.	S.C.Sp.	S.C.S.	S.Co S.A.
Possible use by investment companies	<ul style="list-style-type: none"> ▸ 2010 Law SICAV or SICAF ▸ SIF Law SICAV or SICAF ▸ RAIF Law SICAV or SICAF 	<ul style="list-style-type: none"> ▸ 2010 Law SICAV or SICAF ▸ SIF Law SICAV or SICAF ▸ RAIF Law SICAV or SICAF 	<ul style="list-style-type: none"> ▸ 2010 Law Part II SICAF ▸ SIF Law SICAV or SICAF ▸ RAIF Law SICAV or SICAF 	<ul style="list-style-type: none"> ▸ 2010 Law Part II SICAF ▸ SIF Law SICAV or SICAF ▸ RAIF Law SICAV or SICAF 	<ul style="list-style-type: none"> ▸ 2010 Law Part II SICAF ▸ SIF Law SICAV or SICAF ▸ RAIF Law SICAV or SICAF 	<ul style="list-style-type: none"> ▸ 2010 Law Part II SICAF ▸ SIF Law SICAV or SICAF ▸ RAIF Law SICAV or SICAF 	<ul style="list-style-type: none"> ▸ 2010 Law Part II SICAF ▸ SIF Law SICAV or SICAF ▸ RAIF Law SICAV or SICAF
Legal entity	Yes	Yes	Yes	Yes	No	Yes	Yes
Listing possible	Yes	Yes	No	Yes	No	No	No
Minimum subscribed share capital ⁵⁹	EUR 30,000	EUR 120,000	EUR 12,000	EUR 30,000	None	None	None

⁵⁶ UCIs established as European investment companies must meet the requirements imposed on Luxembourg public limited companies by the 1915 Law, insofar as the Law the UCI is under does not derogate from it, as well as certain other provisions set out in the Law of 25 August 2006 on the European company.

⁵⁷ The AIFM Law implemented significant amendments to the 1915 Law, including the clarification of the partnership regimes and the introduction of a Special limited partnership (*Société en Commandite Spéciale* – S.C.Sp.).

⁵⁸ More generally known by the Latin name *societas europaea*.

⁵⁹ Minimum capital requirements are covered in Section 2.5.

Main corporate forms of investment companies

	Public limited company	European company	Private limited liability company	Partnership limited by shares	Special limited partnership ⁵⁷	Limited partnership	Cooperative company organized as a public limited company
Transferability of shares/units	Free, subject to restriction in articles of association	Free, subject to restriction in articles of association	Restricted	Free, subject to any restrictions in articles of association	Free, subject to any restrictions in articles of association	Requires unanimous consent of all the partners	Not transferable to third parties
Notarial deed	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Minimum number of shareholders, partners or members	1	1	1	2 (1 general partner and 1 limited partner)	2 (1 general partner and 1 limited partner)	2 (1 general partner and 1 limited partner)	7
Maximum number of shareholders, partners or members	Unlimited	Unlimited	100	Unlimited	Unlimited	Unlimited	Unlimited
Minimum number of Directors or managers	One-tier: 3 Directors; Two-tier ⁶⁰ : 2 members of management Board, 3 members of supervisory Board ⁶¹		3 managers ⁶²	3 managers or a general partner (whose Board is composed of at least 3 members)	3 managers or a general partner ⁶³ (whose Board is composed of at least 3 members)	3 managers or a general partner ⁶⁴ (whose Board is composed of at least 3 members)	3 Directors ⁶⁵
Audit requirements	A UCITS must have its financial statements audited within 4 months of its financial year end. A UCI set up under Part II of the 2010 Law, SIF Law or RAIF Law is required to have its financial statements audited within 6 months of the UCI's year end (4 months if the UCI is admitted to trading on a regulated market). See Chapter 10	A UCITS must have its financial statements audited within 4 months of its financial year end. A UCI set up under Part II of the 2010 Law, SIF Law or RAIF Law is required to have its financial statements audited within 6 months of the UCI's year end (4 months if the UCI is admitted to trading on a regulated market). See Chapter 10	A UCI set up under Part II of the 2010 Law, SIF Law or RAIF Law is required to have its financial statements audited within 6 months of the UCI's year end (4 months if the UCI is admitted to trading on a regulated market). See Chapter 10	A UCI set up under Part II of the 2010 Law, SIF Law or RAIF Law is required to have its financial statements audited within 6 months of the UCI's year end (4 months if the UCI is admitted to trading on a regulated market). See Chapter 10	A UCI set up under Part II of the 2010 Law, SIF Law or RAIF Law is required to have its financial statements audited within 6 months of the UCI's year end (4 months if the UCI is admitted to trading on a regulated market). See Chapter 10	A UCI set up under Part II of the 2010 Law, SIF Law or RAIF Law is required to have its financial statements audited within 6 months of the UCI's year end (4 months if the UCI is admitted to trading on a regulated market). See Chapter 10	A UCI set up under Part II of the 2010 Law, SIF Law or RAIF Law is required to have its financial statements audited within 6 months of the UCI's year end (4 months if the UCI is admitted to trading on a regulated market). See Chapter 10

In practice, an investment company is generally set up as an S.A. or an S.à r.l. or, in the case of a partnership, an S.C.S. or an S.C.A.

⁶⁰ Whereas a one-tier structure has a single governing body, a two-tier structure has a Management Board and a Supervisory Board. The Management Board has the power to execute all activities necessary to achieve the company's objectives and must have at least two members (one member is permitted if the share capital of the company is less than EUR 500,000, or if the company has a single shareholder). The Supervisory Board is in charge of the supervision of the company and cannot play a role in the day-to-day management of the company.

⁶¹ Where there is more than one shareholder.

⁶² In practice.

⁶³ Expected minimum requirement.

⁶⁴ Idem.

⁶⁵ In practice.

2.3.2. Multiple compartment UCIs

Multiple compartment UCIs (otherwise known as umbrella funds) are UCIs which comprise, or may comprise, two or more compartments (sub-funds), each with different features – generally a different investment policy/strategy.

Different compartments may, for example, invest in different asset classes.

Multiple compartment structures are favored by the larger promoters and initiators of UCIs.

The assets of each compartment of a multiple compartment UCI are generally segregated and the accounting records of each compartment are kept separate.

Multiple compartment UCIs are recognized under Article 181 of the 2010 Law, Article 71 of the SIF Law and Article 49 of the RAIF Law. Multiple compartment UCIs may be created provided their constitutional document expressly permits it and specifies the applicable operational rules, and their prospectus or offering document specifies the investment policy and specific features of each compartment. By way of derogation from Civil Code, the rights of investors and of creditors concerning a compartment, or which have arisen in connection with the creation, operation or liquidation of a compartment, are limited to the assets of that compartment (i.e., segregation of assets and liabilities on a compartment by compartment basis – protected cell concept), unless a clause included in the constitutional document provides otherwise.

Investors may, if permitted by the constitutional document, prospectus or offering document, “switch” all or part of their investment from one compartment to another, in principle without incurring significant charges.

By permitting investors to switch between compartments, promoters and initiators may retain in the same UCI those investors who wish to change their investment strategy.

A. All multiple compartment UCIs

All multiple compartment UCIs must meet the following requirements:

- ▶ The constitution of a multiple compartment UCI must ensure that each compartment is treated as a separate entity having its own funding, capital gains and losses, expenses, etc.
- ▶ The opening of a new compartment requires CSSF approval (except UCIs set up under the RAIF Law) and a prospectus or offering document update
- ▶ The UCI must have a single name and each compartment should have a distinct name
- ▶ The UCI must have a single depository (i.e., the same depository for all compartments); the depository may use a sub-custodian network
- ▶ The UCI must have a single auditor (i.e., the same auditor for all compartments)
- ▶ Shareholders or unitholders may, in principle, be able to move from one compartment to another without incurring significant charges; the fund documentation of the UCI may restrict this possibility
- ▶ The constitutional document must state the presentation currency of the combined financial statements of the UCI, obtained by aggregating the various compartments
- ▶ The net asset value (NAV) of a share or unit is calculated by reference to the net assets of the compartment for which that share or unit has been issued, by reference to the net assets of the share or unit class in which this share or unit has been issued. The value of shares or units in respect of the same UCI consequently differs between compartments, and within one compartment, between share or unit classes
- ▶ Subscription and redemption of shares or units of each compartment must, for 2010 Law UCIs, be executed at a price obtained by dividing the NAV of each compartment (or, where relevant, of each share or unit class) by the number of shares or units in circulation; SIFs and RAIFs are required to follow the rules laid down in their constitutional document (see Sections 8.6. and 8.7.)
- ▶ Certificates or other documents evidencing the rights of shareholders or unitholders may only differ in respect of the designation of the particular compartment for which they are issued
- ▶ Diversification rules specified by the applicable law or the CSSF must be complied with by each compartment (see however Section 4.2.2.8.2.)

One compartment of a multiple compartment UCI may invest in other compartments of the same UCI (see Section 2.3.5.).

B. Multiple compartment common funds

In addition to the requirements described in Section 2.3.2.A., multiple compartment common funds must meet the following conditions:

- ▶ The UCI must have a single management company (i.e., the same management company for all compartments)
- ▶ The UCI must have a set of management regulations, either global or per compartment, which define the general rules of valuation, supervision, subscription and redemption and investment restrictions

C. Multiple compartment investment companies

In addition to the requirements described in Section 2.3.2.A., multiple compartment investment companies must meet the following conditions:

- ▶ The investment company must have a capital represented by shares, which consequently implies that:
 - ▶ There is a single share capital expressed in a single currency
 - ▶ The nominal or par value is expressed in that same currency
 - ▶ The annual accounts are also expressed in that same currency

However, the NAV of each compartment or, where relevant, of each share class, is denominated in the currency of the relevant compartment or share class (see Section 2.3.3.).

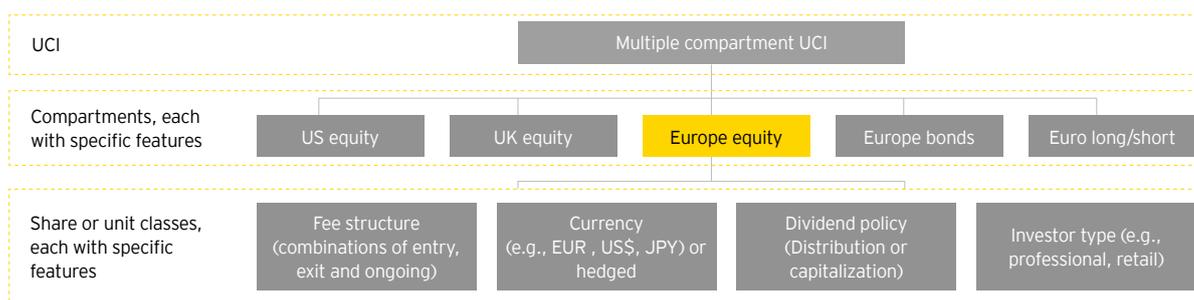
- ▶ Each share of the same type gives the right to one vote. The CSSF recommends that the equality of voting rights is emphasized in the articles of incorporation. In addition, the articles of incorporation should distinguish between those decisions in which all shareholders have an interest and are taken at the company's general meeting of shareholders and those concerning the particular shareholders of one compartment and are taken at the general meeting of shareholders of that compartment (see also Sections 10.2.2. and 10.6.)⁶⁶
- ▶ The articles of incorporation must list the conditions for suspension of the NAV calculation and the subscription and redemption of shares of the UCI and of an individual compartment

2.3.3. Share or unit classes

Multiple share or unit classes may be created within a UCI or, in the case of a multiple compartment UCI, within a compartment.

While the investment policy is defined at the level of the UCI or the compartment, share or unit classes permit the implementation of features, generally customized to one or more specific needs or preferences, such as a specific fee structure, currency of denomination, hedging policy, dividend policy, investor type or country of distribution.

Schematic of a possible multiple compartment, multiple share or unit class structure⁶⁷



Identification numbers (such as ISIN (International Security Identification Number) are attributed at the level of the share or unit class.

The UCITS Directive recognizes the possibility for UCITS to offer different share classes to investors but it does not prescribe whether, and to what extent, share classes of a given UCITS can differ from each other.

⁶⁶ Subject to restrictions for cross investments (see also Section 2.3.5.).

⁶⁷ This graphic is designed to illustrate a multiple-compartment, multiple share or unit class structure; it is not designed to represent a typical structure.

Following observation of the diverging national practices as to the types of share class that were permitted, ranging from very simple share classes e.g., with different levels of fees, to much more sophisticated share classes e.g., with potentially different investment strategies, on 30 January 2017, ESMA issued an opinion on *share classes of UCITS* which covers the extent to which different types of units or shares (share classes) of the same UCITS can differ from one another.

In its Opinion, ESMA sets out four high-level principles which UCITS must follow when setting up different share classes in order to ensure a harmonized approach across the EU:

- ▶ Common investment objective: Share classes of the same UCITS should have a common investment objective reflected by a common pool of assets. ESMA considers that hedging arrangements at share class level - with the exception of currency risk hedging - are not compatible with the requirement for a UCITS to have a common investment objective
- ▶ Non-contagion: UCITS management companies should implement appropriate procedures to minimize the risk that features specific to one share class could have a potentially adverse impact on other share classes of the same UCITS. In this respect ESMA is of the view that amongst other rules the over-hedged positions should not exceed 105% of the Net Asset Value of the share class and under-hedged positions should not fall short of 95% of the portion of Net Asset Value of the share class which is to be hedged against currency risk
- ▶ Pre-determination: All features of the share class should be pre-determined before the UCITS is set up
- ▶ Transparency: Differences between share classes of the same UCITS should be disclosed to investors when they have a choice between two or more classes

In order to mitigate the impact on investors in share classes that were established prior to this Opinion and are not compliant with these principles, ESMA is of the view that the share classes should continue to exist. Consequently, such share classes had to be closed for investment by 30 July 2018.

ESMA's Opinion was adopted by the CSSF following its press release on 13 February 2017. New share classes must immediately comply with the common principles contained within the ESMA Opinion for setting up share classes in UCITS.

In its *Frequently Asked Questions concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment*, the CSSF provided the following clarifications:

A. Common investment objective

- ▶ Currency hedging arrangements which systematically hedge out part or all of the foreign currency exposure in the common pool of assets into the share class currency are compatible with the principle of a common investment objective provided all the requirements set forth in the ESMA Opinion are met

B. Non-contagion

- ▶ Share classes providing a partial hedge of currency risk (for example, 50%) are permitted
- ▶ With respect to share classes which are hedged against currency risk, should the hedging ratio fall out with the 95%-105% range, CSSF Circular 02/77 does not apply. The CSSF expects the UCITS management companies or UCITS itself to define and implement monitoring and control processes/procedures for ensuring compliance with the hedging ratios on an ongoing basis

On 9 January 2018, ALFI issued its *First conclusions on technical issues further to discussions with the CSSF in relation to ESMA's Opinion on UCITS share classes*. ALFI clarified that there is no requirement to set up hedging contracts at share class level but that both derivatives and collateral attributable to every share class must be identifiable at any time and that it is up to each promoter/ sponsor to adopt the most adequate model to ensure compliance with the allocation of collateral at share class level taking into account the specificities of each fund concerned.

C. Pre-determination

- ▶ All the features of a share class should be pre-determined before the share class is set up, including the systematic hedging out of the currency risk. The ESMA Opinion does not provide for any discretionary elements in the currency risk hedging strategy. However the discretion as to the type of derivative instrument used to hedge the currency risk and the operational implementation are not limited by the pre-determination requirement

D. Transparency

- ▶ The UCITS should provide a list in the form of readily available information which should be kept current with respect to share classes with contagion risk. The list can be addressed by means of a website publication provided the prospectus includes a link to the relevant website
- ▶ The prospectus should provide the details of the types and main characteristics of the share classes such as, *inter alia*, fee structure, dividend policy, investor type, currency or currency risk hedging. An exhaustive list of all individual shares with all their individual characteristics is not necessary. Additional information on share classes issued (e.g., list of share classes offered or effectively launched) should be available to investors either on request and free of charge, or through a reference in the prospectus to an internet website, where such information can be found
- ▶ If an update of the prospectus includes changes to the rights/interests of the investors, a notice to the investors is required

2.3.4. Management of assets

In addition to the traditional management of assets, assets may be managed using master-feeder structures or co-management or pooling to manage portfolios in an efficient manner.

2.3.4.1. Master-feeder structures

In master-feeder structures, the feeder UCI invests most of its assets in a master UCI. Therefore, the management of a significant portion of the portfolio of the feeder UCI is effectively performed by the manager of the master UCI.

Master-feeder structures can be created under any of Luxembourg's fund regimes. They can also be created in combination with foreign UCIs – the Luxembourg UCI being the master and the foreign UCI the feeder and *vice versa*.

Taxation issues in relation to master-feeder structures are covered in Section 11.3.

A. UCITS

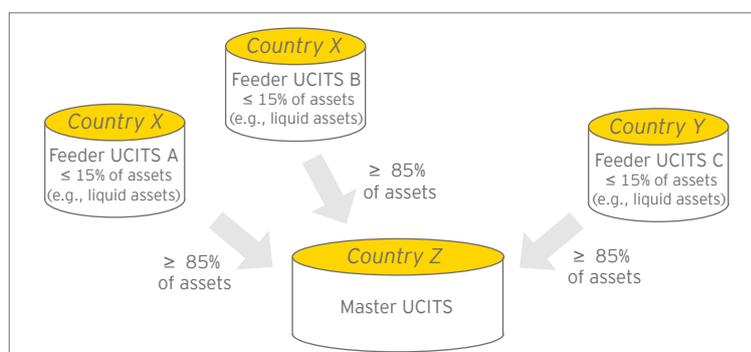
Specific requirements are applicable to master-feeder UCITS structures – i.e., where both the master and feeder are UCITS.

UCITS are, *inter alia*, required to meet detailed diversification requirements (see Section 4.2.2.). The possibility to create a feeder UCITS represents a specific derogation from UCITS investment rules, and is therefore subject to specific requirements. These are outlined in the remainder of this section.

Master-feeder UCITS structures are covered by Chapter 9 of the 2010 Law.

To be deemed a master-feeder UCITS structure under the 2010 Law, the feeder UCITS must invest at least 85% of its assets into a single master UCITS. The feeder UCITS may invest up to 15% of its assets in ancillary liquid assets, financial derivative instruments which may only be used for hedging or, in the case of investment companies, moveable and immoveable property essential for the direct pursuit of business (see also Section 4.2.2.8.1.VII.).

Possible master-feeder scenario



A master UCITS cannot itself be a feeder and cannot invest in a feeder UCITS.

The master UCITS and the feeder UCITS can be located in different EU/EEA Member States.

Before investing into a master UCITS, the feeder UCITS need to obtain approval from the CSSF. The master UCITS and feeder UCITS are required to enter into an agreement, *inter alia*, to provide the feeder UCITS with all documents and information necessary for the feeder UCITS to be able to comply with the requirements of the 2010 Law. The minimum content is detailed in CSSF Regulation 10-5 and includes, *inter alia*:

- ▶ Access to information, including:
 - ▶ How and when the master UCITS provides the feeder UCITS with its constitutional document, prospectus and Key Investor Information (KII), information on delegation of portfolio management and risk management functions, and, where applicable, internal operating documents
 - ▶ The details of constitutional document or bilateral agreement breaches that the master UCITS will notify to the feeder UCITS, the manner and the timing thereof (see Section 8.7.1.1.)
 - ▶ Where the feeder UCITS uses financial derivative instruments for hedging purposes, how and when the master UCITS will provide the feeder UCITS with information about its actual exposure to financial derivative instruments to enable the feeder UCITS to calculate its own global exposure
 - ▶ A statement that the master UCITS will inform the feeder UCITS of any other information-sharing arrangements entered into with third parties, and, where applicable, how they will be made available to the feeder UCITS
 - ▶ Basis of investment and divestment by the feeder UCITS, standard dealing arrangements and events affecting dealing arrangements (see Section 8.7.1.1.)
- ▶ Standard arrangements for the audit report
- ▶ Changes to standing arrangements
- ▶ The applicable law (i.e., the law of the master's and/or feeder's home Member State) and that both UCITS agree to the exclusive jurisdiction of the courts of that Member State

Where both the master UCITS and feeder UCITS are managed by the same management company, the agreement may be replaced by internal conduct of business rules, which should cover, *inter alia*:

- ▶ Measures to mitigate conflicts of interest that may arise between the feeder UCITS and the master UCITS, or between the feeder UCITS and other shareholders and unitholders of the master UCITS, to the extent that these are not sufficiently addressed by the measures applied by the management company (see Section 6.4.1.)
- ▶ Basis of investment and divestment by the feeder UCITS, standard dealing arrangements, and events affecting dealing arrangements (see Section 8.7.1.1.)
- ▶ Standard arrangements for the audit report

The prospectus of the feeder UCITS must declare explicitly its status as a feeder UCITS. The prospectus must include, *inter alia*, information on the investment objectives and policies of both master UCITS and feeder UCITS, a summary of the agreement (or internal conduct of business rules) between master UCITS and feeder UCITS, costs and tax implications as well as an indication of where to obtain the prospectus of the master UCITS (see also Section 10.3.1.J.).

Master UCITS and feeders UCITS may have different depositaries and auditors. Such depositaries and auditors must enter into information-sharing agreements (see also Section 9.4.6.2.).

An existing UCITS may convert to a feeder UCITS. A feeder UCITS may also change its master UCITS. Prior to making such changes, the UCITS must inform its shareholders or unitholders and provide certain information to them including, *inter alia*, its KII and the KII of the master UCITS. The shareholders or unitholders will then have 30 days to request the redemption of their shares or units free of charge (except for divestment costs) (see also Section 3.6.3.).

If any distribution fee or commission is received due to the investment of the feeder UCITS in the master UCITS (by the feeder UCITS itself, its management company or by any other person acting on behalf of the feeder UCITS or its management company), this distribution fee or commission should be paid to the feeder UCITS.

An existing UCITS may become a master UCITS.

A master UCITS should immediately inform the supervisory authority of its home Member State of the identity of each feeder UCITS that invests in its shares or units. The master UCITS must not charge subscription or redemption fees to the feeder UCITS.

B. SIF

SIF feeder structures are permitted under the SIF diversification rules that specify that SIFs are not subject to the SIF diversification rules if they invest into target UCIs subject to risk diversification principles that are at least comparable to those relevant to SIFs (see Section 4.3.).

C. AIF

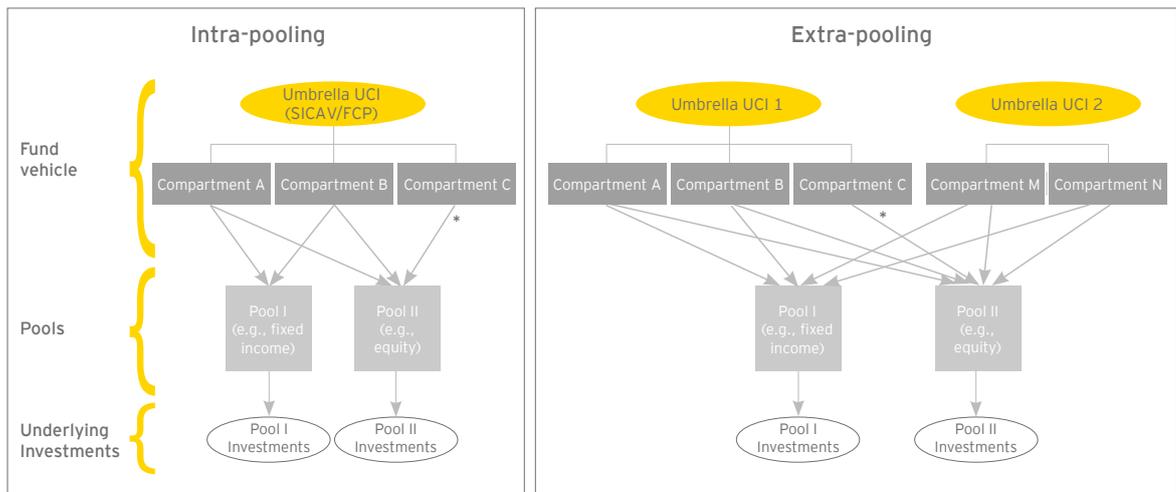
Under the AIFM Law and the AIFM Directive, an authorized AIFM is permitted to market feeder AIF to professional investors in the EU/EEA with a passport only if the master AIF is managed by an authorized EEA AIFM (see Section 12.5.2.1.1.).

2.3.4.2. Co-management and pooling of assets

To ensure efficient portfolio management, and provided the investment policies so permit, the management of a UCI may decide to co-manage, or pool, certain assets within a single fund vehicle (intra-pooling) or between two or more Luxembourg fund vehicles (extra-pooling). Cross-border pooling between fund vehicles domiciled in different national jurisdictions may also be permitted. The assets being co-managed are commonly referred to as a “pool”. Pooling enables different compartments of a fund or funds to invest in a pool or several pools of assets. This arrangement is an administrative process that can reduce portfolio management, administration, and custody costs without changing the legal rights and obligations of shareholders or unitholders.

The pools are not legal entities and are not directly accessible to investors. Each of the co-managed funds remains entitled to its specific assets, and responsible for its liabilities. Where the assets of one or more funds are pooled, the assets of the pool attributable to each fund will initially be based on the value of the assets allocated to the pool. Subsequently, each fund’s portion of the pool will vary according to withdrawals from and additional allocations to the pool.

Each line item held within the pool, as well as all gains and losses generated by the pool, must be allocated to each fund investing in the pool in accordance with the ratio of the pool each fund is entitled to.



* In the scenario, Compartment C invests 100% in Pool II

There is an on-going industry discussion on the application of pooling techniques following the publication of CDRs 2018/1618 and 2018/1619 amending the AIFM and UCITS Directives respectively.

The impact of the European Market Infrastructure Regulation (EMIR) should be carefully considered in the framework of existing and future pooling structures. Whether pools are considered as legal entities under EMIR depends on each specific situation.

2.3.5. Cross investment

Multiple compartment UCIs are permitted to invest in other compartments of the same UCI (cross investment) as long as certain conditions are met.

Conditions to be met in the case of cross investment

	2010 Law UCIs	SIFs/RAIFs
Such investment is provided for in the:		
▸ Constitutional document	X	⁶⁸
▸ Prospectus or offering document	X	X
The target compartment does not invest in the investing compartment	X	X
Not more than 10% of the assets of the target compartment must be invested in other compartments of the same UCI	X	⁶⁹
The voting rights of the investing compartment in relation to its investment into the target compartment are suspended during the period of investment	X	X
The value of cross investments must not be taken into account in calculating the net assets in the context of meeting the minimum net asset requirements	X	X

2.3.6. Creation of a side pocket

Where a UCI or a compartment thereof is invested in illiquid assets, some or all of these assets may, under certain conditions, be transferred to a side pocket. Side pockets may be created within 2010 Law UCIs, SIFs and RAIFs. However, a side pocket may only be created within a UCITS in very limited circumstances. Side pockets may not be used to solve temporary valuation problems.

The two main types of side pocket are:

- A spin-off from an existing share class or unit class to a new share class or unit class
- A spin-off from an existing compartment to a new compartment

On the date of creation of the side pocket, the illiquid assets are allocated to the new share class, unit class or compartment – the side pocket. The investors of the existing share class, unit class or compartment receive shares or units in the side pocket on a pro rata basis according to their holding in the existing share class, unit class, or compartment.

The side pocket is closed to any new subscriptions and suspended for redemptions (and conversions).

The manager is required to manage the assets in the side pocket with the objective of realizing them in the best interests of, and distributing the proceeds to, investors. Upon the sale of the assets in the side pocket, its shares or units are redeemed or cancelled.

The fast-track procedure for the creation of a side pocket is outlined in Section 3.8.

⁶⁸ In practice, for SIFs and RAIFs, such information may also be disclosed in the constitutional document.

⁶⁹ There is no provision in either the SIF Law or RAIF Law relating to the 10% limit.

2.4. Specific requirements by regime

This section outlines specific requirements applicable to 2010 Law UCIs, SIFs, RAIFs and ELTIFs.

In addition to the requirements outlined in this section, UCIs may be subject to specific requirements on:

- Investment rules, covered in Chapter 4
- Portfolio management
- Risk management and valuation, covered in Chapter 7
- Prospectus and issuing document and financial reporting, covered in Chapter 10
- Marketing, covered in Chapter 12

Requirements common to all Luxembourg AIF, including 2010 Law Part II UCIs, SIFs, RAIFs and ELTIFs, are covered in Section 2.4.4.

Requirements applicable to investment companies that have not appointed a management company (self-managed UCITS and internally managed AIF) are covered in Section 6.2.1.C.

2.4.1. UCIs established under the 2010 Law

2.4.1.1. Definition of a UCI under the 2010 Law

This section outlines the provisions of the 2010 Law that must be complied with by UCITS and 2010 Law Part II UCIs.

A. Collective investment of funds

There must be collective investment of funds, which is understood to be the mutual investment of capital raised from individual investors. Such investments may be made in transferable securities or other assets; they must be made in compliance with the applicable investment restrictions (UCITS and 2010 Law Part II UCIs are subject to different investment restrictions – see Chapter 4), as well as the fund documentation (see Chapter 10). The objective of this investment is to generate income or obtain capital appreciation. Consequently, a UCI may normally not acquire holdings where, beyond seeking return, the objective is to achieve a position of significant influence or control over the long-term. As an exception, Part II UCIs that invest in venture capital (see Section 4.2.3.3.) may acquire significant holdings or control as this is indicative of the nature of such investment policy rather than a desire for control.

B. Raised from the public

The funds invested collectively must be raised from the public. The public is approached when the raising of funds is not confined to a restricted circle of investors.

C. Diversification of risk

The investments arising from the collective investment of funds must be made according to the principle of diversification of risk, to prevent the risk attached to an excessive concentration of investments (see also Section 4.2.).

2.4.1.2. Promoters and initiators of 2010 Law UCIs

A promoter is required for a 2010 Law Part II UCI that is not managed by a UCITS (Chapter 15) management company (see Section 1.4.2.A.).

In general, the promoter or initiator is represented in the governing bodies of the UCI, or is a shareholder of the management company of a common fund.

2.4.1.3. Distinction between Part I (UCITS) and Part II UCIs

The 2010 Law distinguishes between UCITS (set up under Part I of the 2010 Law) and Part II UCIs (set up under Part II of the 2010 Law). The distinction between UCITS and 2010 Law Part II UCIs is covered in Section 1.3.

2.4.1.4. Requirements applicable to UCITS (Part I UCI)

In addition to complying with the definition of a UCI in Section 2.4.1.1., a UCITS must:

- ▶ Comply with the specific investment and borrowing rules (see Section 4.2.2.)
- ▶ Be open-ended – i.e., the shares or units of the UCITS are, at the request of holders, redeemed directly or indirectly out of the UCITS' assets
- ▶ Have an approved UCITS management company (authorized either under Chapter 15 of the 2010 Law, or under the UCITS Directive in another Member State), or alternatively in the case of an investment company, designate itself as “self-managed” and comply with most of the requirements applicable to a UCITS management company (see Section 2.4.1.5.)

In accordance with Article 3 of the 2010 Law, specifically excluded from Part I are UCIs:

- ▶ That are closed-ended (see Section 2.3.)
- ▶ That raise capital without promoting the sale of their shares or units to the public within the EU
- ▶ The shares or units of which, under their constitutional document, may only be sold outside the EU (even though they may be listed on the Luxembourg Stock Exchange (LuxSE))
- ▶ For which the specific investment and borrowing rules (see Section 4.2.2.) are inappropriate in view of their investment and borrowing policies

2.4.1.5. Requirements applicable to a self-managed UCITS

As stated in Section 2.4.1.4., a UCITS investment company must either appoint a management company (that complies with Chapter 15 of the 2010 Law – see Chapter 6) or designate itself as “self-managed” (all common funds are managed by a management company). The requirements applicable to a self-managed investment company as stated in Articles 27 and 39 of the 2010 Law and in CSSF Circular 18/698 may be summarized as follows:

- ▶ Minimum capital at date of authorization is EUR 300,000 (see also Section 2.5.)
- ▶ The application for authorization must be accompanied by a business plan (program of activity), setting out, *inter alia*, the organizational structure of the UCITS (see also Section 3.3.2.)
- ▶ It may only manage assets of its own portfolio and may not, under any circumstances, manage assets on behalf of a third party

A self-managed UCITS must also comply with most of the requirements applicable to a UCITS management company (see Section 6.2.1.C.).

2.4.1.6. Delegation by investment companies

A self-managed UCITS investment company must comply with the rules on delegation applicable to a UCITS management company (see Section 6.3.3.).

2010 Law Part II investment companies are required to comply with the requirements on delegation similar to those applicable to Chapter 16 management companies (see Section 6.3.3.). Those qualifying as full AIFM regime AIF are required to comply with the provisions of the AIFM Law in relation to delegation (see Section 2.4.4.1.).

2.4.1.7. 2010 Law investment companies exercising voting rights

A 2010 Law investment company that has designated a management company but has not specifically mandated the management company to exercise the voting rights attached to the instruments held in its portfolio is required to develop and disclose its own strategy for the exercise of voting rights and how it implemented it in practice (see Section 5.1.3.B).

2.4.2. SIFs

2.4.2.1. Objective of a SIF

The primary objective of a SIF must be the collective investment of the funds raised from its investors while applying the principle of risk diversification.

A. *Collective investment of funds*

There must be collective investment of funds, which is understood to be the mutual investment of capital raised from individual investors.

B. *Raised from “well-informed investors”⁷⁰*

SIFs can only raise capital from well-informed investors who are able to understand and assess the risks associated with investment in such a fund. “Well-informed investors” are:

- Institutional investors
- Professional investors
- Other types of investors who have declared in writing that they are well-informed investors, and meet either of the following criteria:
 - They invest a minimum of EUR 125,000

The CSSF has clarified that in the case of co-investment into the SIF by more than one investor, each investor must invest the minimum amount.

- They have an appraisal from a bank, an investment firm or a management company (all of these with a European passport) certifying that they have the appropriate expertise, experience and knowledge to adequately understand the investment made in the SIF

Directors⁷¹ and other persons involved in the management of the SIF are exempt from these requirements.

C. *Diversification of risk*

The investments of the SIF must be made according to the principle of diversification of risk. See also Section 4.3.

2.4.2.2. Risk management

Risk management requirements applicable to SIFs are covered in Section 7.4.

2.4.2.3. Conflicts of interest

SIFs must be structured and organized in such a way as to mitigate the risk of any conflict of interest, which may potentially adversely affect the interests of the investors, such conflict of interest being between the SIF and, where applicable, any person involved in the activities of the SIF or directly or indirectly related to the SIF. In case of potential conflicts of interest, the SIF is required to protect the interests of its investors.

CSSF Regulation 15-07 (which repealed CSSF Regulation 12-01) details the conflicts of interest requirements to be applied by SIFs (those qualifying as internally managed registered AIFM, those managed by an external registered AIFM, those managed by a non-EU AIFM and those that are non-AIFs). This Regulation entered into force on 1 February 2016.

⁷⁰ The CSSF translates the original French term “investisseurs avertis” as “well-informed investors”.

⁷¹ “Directors” means, in the case of public limited companies and cooperatives in the form of a public limited company, the members of the Board of Directors, in the case of partnerships, the managers or general partner, in the case of private limited liability companies, the manager(s), and in the case of common funds, the members of the Board of Directors or the managers of the management company.

For the purpose of identifying potential conflicts of interest whose existence may damage the interests of the SIF, SIFs must take into account, as a minimum, whether any person involved in the activities of the SIF, or directly or indirectly linked to the SIF, is in any of the following situations:

- The person is likely to make a financial gain, or avoid a financial loss, at the expense of the SIF
- The person has an interest in the outcome of a service provided to the SIF or to another client, of an activity carried out for their benefit, or of a transaction carried out on behalf of the SIF or another client, which is distinct from the interest of the SIF in that outcome
- The person has a financial or other incentive to favor the interests of another client or group of clients over the interests of the SIF
- The person carries on the same activities for the SIF as for one or several clients that are not SIFs
- The person receives or will receive from a person other than the SIF an inducement in relation to the collective portfolio management activities performed for the benefit of the SIF in the form of monies, goods or services other than the standard commission or fee for that service

The Regulation requires SIFs to establish, implement and maintain an effective written conflicts of interest policy that:

- Identifies, in relation to collective portfolio management activities performed by or on behalf of the SIF, the circumstances that constitute or may potentially give rise to a conflict of interest entailing a material risk of damage to the interests of the SIF
- Defines the procedures to be followed and the measures to be taken to manage conflicts of interest

The conflicts of interest policy must be proportionate to the organizational structure of the SIF, and to the nature, scale and complexity of its activities.

Where the SIF belongs to a group, the conflicts of interest policy must take into account the potential conflicts of interest resulting from the structure and activities of other members of the group. The conflicts of interest procedures and measures must ensure that persons engaged in activities entailing a conflict of interest act with a level of independence that is appropriate to the size and activities of the SIF and of the group to which it belongs and to the extent of the risk of damage to the interests of the SIF.

SIFs are also required to establish, implement and maintain a policy to prevent any relevant person from entering into personal transactions that may give rise to conflicts of interest.

SIFs are also required to set up an adequate policy to prevent or manage any conflicts of interest resulting from the exercise of voting rights attached to instruments held.

The Regulation requires SIFs to keep, and regularly update, a record of the types of collective portfolio management activities performed by or on behalf of the SIF for which a conflict of interest entailing a material risk of damage to the interests of the SIF has arisen, or may arise.

Where the organizational and administrative arrangements made by the SIF to manage conflicts of interest are not sufficient to guarantee, with reasonable confidence, that risks of damage to the interests of the SIF or its investors will be prevented, the Directors must be informed promptly so that they can take any measure necessary to ensure that the SIF will act in its best interests and those of its investors. The SIF is required to inform the investors of any such conflicts of interest and explain the measures adopted by the SIF (see also Section 10.4.4.1.).

SIFs are required to confirm to the CSSF that they have established a conflicts of interest policy in their application for authorization (see Section 3.3.).

Conflicts of interest requirements applicable to management companies and AIFM are covered in Section 6.4.1.

2.4.2.4. Delegation

When a SIF or its management company delegates one or more of their own functions to third parties, such delegation must be made with a view to conducting operations in a more efficient manner and the following conditions must be complied with:

- The CSSF must be adequately informed of any delegation
- The mandate cannot prevent the effectiveness of supervision of the SIF, and in particular must not prevent the SIF from acting, or the SIF from being managed, in the best interests of the investors
- When the delegation concerns portfolio management, the following requirements must be met:
 - The mandate may only be given to persons or entities that are authorized or registered for the purpose of asset management and subject to prudential supervision
 - In case of delegation to a third country undertaking, there must be cooperation arrangements between the CSSF and the supervisory authority of the third country

- Where the conditions of the previous bullet point cannot be met, the delegate must be of sufficiently good repute and sufficiently experienced, and the delegation is subject to the prior approval of the CSSF
- Portfolio management functions cannot be delegated to the depositary
- When the delegation concerns risk management, the requirements outlined in Section 7.4.4. must be met
- The Directors of the SIF, or of its management company in case of a common fund, must be able to demonstrate that:
 - The delegate is qualified and capable of undertaking the functions in question
 - The delegate was selected with all due care
 - The SIF is in a position to monitor effectively the delegated activity, to give further instructions at any time to the delegate or to withdraw the mandate with immediate effect to protect the interests of the investors
- The prospectus or offering document of the SIF must list the delegated functions

2.4.3. RAIFs

2.4.3.1. Objective of a RAIF

The sole objective of a RAIF must be the collective investment of the funds raised in assets with the aim of spreading the investment risks and giving investors the benefit of the results of the management of the assets.

“Management”, in the context of the RAIF Law, means an activity comprising at least the service of portfolio management.

2.4.3.2. Investors

Similar to SIFs, the securities, or partnership interests, of RAIFs are reserved to one or several well-informed investors. A well-informed investor is:

- An institutional investor
- A professional investor
- Any other investor who:
 - Has stated in writing that he/she adheres to the status of a well-informed investor, and either:
 - (i) Invests a minimum of EUR 125,000 in the RAIF, or
 - (ii) Has an assessment from a credit institution, an investment firm, a UCITS management company or an authorized AIFM certifying his/her expertise, experience and knowledge to adequately appraise an investment in a RAIF

2.4.3.3. Management

A RAIF must be managed by an authorized AIFM. Unlike a SIF, a RAIF cannot be a non-AIF, nor can it be managed by a simplified registration regime AIFM. The AIFM may be established in Luxembourg, in another Member State of the EU, or located in a third country, once the AIFMD passport is available to that third country.

2.4.3.4. Regulation and supervision

The RAIF itself is not subject to approval or supervision by the CSSF. Given that a RAIF is required to be managed by an authorized AIFM, it is regulated under the AIFM Law but is only indirectly supervised by the CSSF through the supervision of its AIFM.

2.4.3.5. Eligible assets and diversification of risk

The RAIF Law provides flexibility with respect to types of investments and does not stipulate specific investment rules or restrictions.

RAIFs may pursue traditional and alternative investment strategies. However, RAIFs that hold investments in risk capital (direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange) may be able to adopt a similar tax regime to that applicable to *Sociétés d'investissement en capital à risque* (SICARs)⁷².

The investments of a RAIF must be made, however, in accordance with the principle of risk spreading unless the RAIF invests solely in risk capital.

⁷² | SICARs are not covered by this publication.

2.4.3.6. Risk management

As all RAIFs are AIFs, the risk management requirements of AIF apply - see Section 7.3.

2.4.3.7. Cross border marketing and management

As a RAIF is managed by an authorized AIFM, it benefits from an EU passport for marketing to professional investors in the EU. The AIFM Law allows the management of RAIFs in the EU on a cross border basis. Marketing of RAIFs is discussed further in Chapter 12.

Depositary requirements for RAIFs are discussed in Chapter 9.

The document and reporting as well as audit requirements for RAIFs are discussed in Chapter 10.

The taxation of RAIFs is discussed in Chapter 11.

2.4.4. Requirements applicable to AIF

AIF, including 2010 Law Part II UCIs and SIFs, will either fall into one of the following categories:

- Full AIFM regime:
 - AIF managed by an authorized AIFM
 - Authorized internally managed AIF
- Simplified AIFM registration regime AIF (i.e., where the AIF assets under management fall below the *de minimis* thresholds outlined in Section 6.1.3.D):
 - AIF managed by simplified registration regime AIFM
 - Simplified AIFM registration regime internally managed AIF
- European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF)
- European Long-Term Investment Funds (ELTIF)

All RAIFs are full AIFM regime AIF managed by an authorized AIFM.

2.4.4.1. Full AIFM regime AIF

AIF managed by authorized AIFM must be managed in accordance with AIFM Directive requirements. These requirements are implemented in Luxembourg by the AIFM Law.

Internally managed AIF that are in scope of the AIFM Law must also be managed in accordance with AIFM Law requirements.

AIFM compliance is required when the assets under management of all AIFs managed by an AIFM, or of an internally managed AIF, exceed certain thresholds (see Section 6.1.3.D.).

AIFM requirements are covered in Chapter 6. The specific requirements applicable to authorized internally managed AIF are covered in Section 6.2.1.C.

The relevant provisions of the AIFM Law must be applied by full AIFM regime AIF, or the AIFM acting on their behalf. The provisions include those on:

- Investments in securitization vehicles (see Section 4.5.)
- Major holdings and control over portfolio companies (see Section 4.6.)
- Risk management, including leverage (see Section 7.3.)
- Delegation of functions (see Section 6.3.3.)
- The depositary of the AIF (see Chapter 9)
- Valuation (see Section 7.6.)
- Information provided to investors (see Chapter 10)
- Marketing (see Chapter 12)

Requirements that must be met by feeder AIF to benefit from the marketing passport are covered in Section 2.3.4.1.C.

2.4.4.2. Simplified AIFM registration regime AIF

AIF managed by simplified registration regime AIFM are impacted by AIFM requirements. Simplified registration regime AIFM are subject to registration and reporting requirements, which includes, *inter alia*, the requirement to provide detailed information to the CSSF on each AIF they manage (see Section 6.1.3.E. and Section 6.2.1.E.).

Simplified AIFM registration regime internally managed AIF are subject to the same registration and reporting requirements as simplified registration regime AIFM.

Simplified registration regime AIFM and simplified AIFM registration regime internally managed AIF may choose to “opt-in” under the AIFM Law to benefit from the rights granted to AIFM (in particular passports). In this case, they must comply with all the provisions of the AIFM Law (see Section 2.4.4.1.).

Simplified registration regime AIFM are required to monitor their assets under management and, when the assets under management exceed the relevant *de minimis* threshold on more than a temporary basis, apply for authorization as an AIFM (see Section 6.2.1.E.).

2.4.4.3. EuVECA and EuSEF

The managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) that are subject to a simplified EU/EEA regulatory regime can benefit from a “passport” permitting them to market the shares or units of the qualifying European funds they manage to suitably qualified investors throughout the EU/EEA.

The applicable regimes are:

- Regulation on European Venture Capital Funds (EuVECA)⁷³
- Regulation on European Social Entrepreneurship Funds (EuSEF)⁷⁴

The regimes create labels (“designations”) for investment funds investing primarily in small and medium sized enterprises (SMEs) and offer their managers “passports” enabling them to market their EuVECA and EuSEF to suitably qualified investors throughout the EU/EEA.

The EuVECA and EuSEF regimes are initially available to managers of UCIs established in the EU/EEA whose assets fall below the AIFM Directive threshold of EUR 500 million applicable to managers managing unleveraged, closed-ended AIF that comply with the organizational requirements and investment rules. The regimes are also available to internally managed AIF.

In their response of 6 January 2016 to the EU consultation on the review of the EuVECA and EuSEF Regulations, the Association of the Luxembourg Fund Industry (ALFI) and the Luxembourg Private Equity and Venture Capital Association (LPEA) stated that they believe that all managers authorized under the AIFMD should be able to manage, name and market their EuVECA and EuSEF compliant vehicles as EuVECA and EuSEF respectively, irrespective of whether they are above the thresholds and/or also manage non-EuVECA/EuSEF vehicles.

They further clarified that a EuSEF can be structured as an open-ended fund.

The two new regimes are voluntary. If a manager chooses not to meet the requirements of one of the regimes and not to benefit from one of the passports, the Regulations do not apply; existing national rules and general EU rules continue to apply.

The managers of EuVECA and EuSEF are covered in Section 6.2.1.F.

The applicable investment restrictions are covered in Section 4.6.

The information to be disclosed to investors before they invest is covered in Section 10.3.6.

The annual reporting requirements are covered in Section 10.5.4.

The marketing of EuVECA and EuSEF is covered in Section 12.6.3.

The audit requirements are covered in Section 10.5.4.

⁷³ Regulation (EU) No 345/2013 of 17 April 2013 on European venture capital funds.

⁷⁴ Regulation (EU) No 346/2013 of 17 April 2013 on European social entrepreneurship funds.

2.4.5. ELTIF

On 29 April 2015, the European Parliament and the Council of the European Union adopted Regulation (EU) 2015/760 that created the European long-term investment fund (ELTIF). The purpose of this regulation is to boost European long-term investments in the real economy. The Regulation entered into force on 8 June 2015 and became applicable in Member States from 9 December 2015.

Following ESMA's final report on draft technical standards under the ELTIF regulation of June 2016, Commission Delegated Regulation (EU) 2018/480 of 4 December 2017, entering into force on 12 April 2018, supplemented Regulation (EU) 2015/760 with regard to regulatory technical standards on financial derivative instruments solely serving hedging purposes, sufficient length of the life of the European long-term investment funds, assessment criteria for the market for potential buyers and valuation of assets to be divested, and the types and characteristics of the facilities available to retail investors, by setting out:

- ▶ The criteria for establishing circumstances in which the use of financial derivative instruments solely serves for hedging purposes
- ▶ The circumstances in which the life of an ELTIF is considered sufficient in length
- ▶ The criteria for the assessment of the market for potential buyers
- ▶ The criteria for the valuation of the assets to be divested
- ▶ Specifications on the facilities available to retail investors

Following discussion with the European Commission, ESMA is postponing the delivery of its ELTIF RTS on the cost disclosure information which must be included in the ELTIF's prospectus, in order to take into account the work being undertaken on cost disclosures for PRIIPs (Package Retail and Insurance-based Investment Products).

On 28 March 2019, ESMA published a consultation on ELTIF cost disclosure information. The consultation covered common definitions, calculation methodologies and presentation formats of costs. On 10 December 2019, ESMA postponed publication of the final draft technical standards until after the conclusion of the current review into PRIIPs KID cost disclosures which is expected at the end of Q3 2020.

A. Authorization and investors

Only EU AIFs are eligible to apply for and to be granted authorization as an ELTIF. ELTIF may be marketed to retail and professional investors.

B. Eligible investments

Eligible investments of an ELTIF include:

- ▶ Eligible investment assets, being:
 - ▶ Equity or quasi-equity instruments
 - ▶ Debt instruments issued by a qualified portfolio undertaking⁷⁶
 - ▶ Loans granted by the ELTIF to a qualifying portfolio undertaking⁷⁷ with a maturity no longer than the life of the ELTIF
 - ▶ Units or shares of one or several other ELTIFs, EuVECAs and EuSEFs provided that those ELTIFs, EuVECAs and EuSEFs have not themselves invested more than 10% of their capital in ELTIFs
 - ▶ Direct holdings or indirect holdings via qualified portfolio undertakings⁷⁸ of individual real assets with a value of at least EUR 10,000,000 or its equivalent in the currency which, and at the time when, the expenditure is incurred
- ▶ Assets eligible for UCITS (see Section 4.2.2.3.)

⁷⁵ A qualified portfolio undertaking is defined by Regulation (EU) 2015/760 as a portfolio undertaking other than a collective investment undertaking that fulfils the following requirements: (i) it is not a financial undertaking, (ii) it is an undertaking that is not admitted to trading on a regulated market or on a multilateral trading facility; or is admitted to trading on a regulated market or on a multilateral trading facility and at the same time has a market capitalization of no more than EUR 500,000,000, and (iii) it is established in a Member State, or in a third country provided that the third country is not a high-risk and non-cooperative jurisdiction identified by the Financial Action Task Force and that the third country has signed an agreement with the home Member State of the manager of the ELTIF and with every other Member State in which the units or shares of the ELTIF are intended to be marketed to ensure that the third country fully complies with Article 26 of the OECD Model Tax Convention on Income and Capital and ensures effective exchange of information in tax matters, including any multilateral tax agreements.

⁷⁶ Idem.

⁷⁷ Idem.

An ELTIF is not permitted to:

- ▶ Short sell assets
- ▶ Take direct or indirect exposure to commodities
- ▶ Enter into securities lending, securities borrowing, repurchase transactions, or any other agreement that has an equivalent economic effect and poses similar risks, if thereby more than 10% of the assets of the ELTIF are affected
- ▶ Use financial derivative instruments, except for hedging purposes of the ELTIF's other investments

Commission Delegated Regulation 2018/480 defines hedging and the circumstances under which it can be used in the ELTIF context.

C. Conflicts of interest

An ELTIF is not permitted to invest in an eligible investment asset in which the manager of the ELTIF has or takes a direct or indirect interest, other than by holding units or shares of the ELTIFs, EuVECAs, or EuSEFs that it manages.

D. Composition and diversification requirements

An ELTIF must comply with the following diversification requirements:

- ▶ An ELTIF must invest at least 70% of its capital in eligible investment assets
- ▶ An ELTIF should invest no more than:
 - ▶ 10% of its capital in instruments issued by, or loans granted to, any single qualifying portfolio undertaking
 - ▶ 10% of its capital directly or indirectly in a single real asset

An ELTIF may raise both of the above 10% limits to 20% provided that the aggregate value of the assets held by the ELTIF in qualifying portfolio undertakings and in individual real assets in which it invests more than 10% of its capital does not exceed 40% of the value of the capital of the ELTIF.

- ▶ 10% of its capital in units or shares of any single ELTIF, EuVECA or EuSEF
- ▶ 5% of its capital in assets eligible to UCITS (see Section 4.2.2.3.)

An ELTIF may raise the 5% limit to 25% where bonds are issued by a credit institution that has its registered office in a Member State and is subject by law to special public supervision designed to protect bond holders.

- ▶ The aggregate value of units or shares of ELTIFs, EuVECAs and EuSEFs in an ELTIF portfolio should not exceed 20% of the value of the capital of the ELTIF
- ▶ The aggregate risk exposure to a counterparty of the ELTIF from OTC derivative transactions, repurchase agreements, or reverse repurchase agreements should not exceed 5% of the value of the capital of the ELTIF
- ▶ Companies that are included in the same group for the purpose of consolidated accounts should be considered as a single qualifying portfolio undertaking or a single body for the purpose of calculating the diversification limits

E. Concentration requirements

An ELTIF cannot acquire more than 25% of the units or shares of a single ELTIF, EuVECA or EuSEF.

An ELTIF should comply with the concentration limits set out in the last bullet point of Section 4.2.2.4. with respect to its holdings in assets eligible for UCITS.

F. Borrowing requirements

An ELTIF may borrow cash provided that such borrowing fulfils the following conditions:

- ▶ It represents no more than 30% of the value of the capital of the ELTIF
- ▶ It serves the purpose of investing in eligible investment assets, except for loans referred to in Section 2.4.5.B.
- ▶ It is contracted in the same currency as the assets to be acquired with the borrowed cash
- ▶ It has a maturity no longer than the life of the ELTIF
- ▶ It encumbers assets that represent no more than 30% of the value of the capital of the ELTIF

G. Redemption policy

Investors will not be able to request redemption of their shares or units in an ELTIF before the end of its life unless certain conditions are met.

The marketing of ELTIFs is discussed in Chapter 12.

2.5. Minimum capital

UCITS with a management company, 2010 Law Part II UCIs, SIFs and RAIFs must have a minimum capital/net assets of EUR 1,250,000, which must be achieved within six months of the date of authorization in the case of 2010 Law UCIs and 12 months in the case of SIFs and RAIFs.

For a self-managed SICAV under Part I of the 2010 Law, the minimum capital at the date of authorization is EUR 300,000. Internally managed AIF that are full AIFM regime AIF must have an initial capital of EUR 300,000.

Measures are to be taken when the capital of the UCI falls below one-fourth and two-thirds of the minimum capital (see also Section 3.10.1.).

Any share premium paid in addition to the subscribed capital is taken into account to compute the minimum capital requirements.

The shares or units of an investment company must be fully subscribed. Those of a 2010 Law SICAV must be fully paid up. However, in the case of a SIF or RAIF investment company, only 5% of the amount of the subscription per share or unit has to be paid up. This will enable structures such as private equity funds to make capital calls over a period of time.

2.6. Requirements applicable to specific types of UCIs

Types of UCIs subject to specific requirements include:

- ▶ Money market funds (MMFs), which are currently subject to the Regulation defining the requirements to be met for investment funds to be labeled as MMF (see Section 2.6.1.)
- ▶ UCITS exchange traded funds (ETFs), which are subject to specific rules and disclosure requirements and must meet additional requirements in relation to the protection of investors dealing on a secondary market (see Section 2.6.2.)
- ▶ Index tracking UCITS, which are subject to disclosure and reporting requirements (see Section 2.6.3.)
- ▶ UCIs using efficient portfolio management (EPM) techniques such as securities lending and currency hedging transactions, which are subject to specific rules (see Section 4.2.2.6.) and disclosure requirements (see Chapter 10) on the use of such techniques
- ▶ UCITS using financial derivative instruments (FDIs), including, *inter alia*, financial indices, which are subject to specific rules (see Section 4.2.2.3.F.) and disclosure requirements (see Chapter 10)
- ▶ Structured UCITS, which are subject to specific disclosure requirements (see Section 2.6.6.)
- ▶ Hedge funds, which are subject to specific requirements (see Section 2.6.7.)
- ▶ Real estate funds, which are subject to specific requirements (see Section 2.6.8.)
- ▶ Private equity funds, which are subject to specific requirements (see Section 2.6.9.)

See also Appendix I.3. on the types of UCIs.

2.6.1. Money market funds (MMFs)

On 30 June 2017, the final text of Regulation (EU) No 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds was published in the Official Journal of the European Union (the “MMF Regulation”). The regulation applies to all funds and compartments that qualify as money market funds as per the definition set out in article 1 of the Regulation.

The Regulation stipulates that money market funds must be set up as one of the following types:

- A variable net asset value (“VNAV”) money market fund
- A public debt constant net asset value (“CNAV”) money market fund
- A low volatility net asset value (“LVNAV”) money market fund

It also foresees two categories of MMFs:

- Standard MMFs
- Short-term MMFs

As described in the Regulation, a UCITS or an AIF is permitted to use the designation “money market fund” in relation to itself or the units or shares it issues only where the UCITS or the AIF has been authorized in accordance with the Regulation. In addition, no collective investment undertaking can be established, marketed or managed in the European Union as a money market fund unless it has been authorized in accordance with the Regulation. Such authorization is valid for all Member States.

The Regulation applies to UCITS and AIF. It lays down detailed requirements on MMF eligible assets, investment policies and risk management, valuation rules, specific requirements for public debt CNAV MMFs and LVNAV MMFs, rules in relation to external support, and transparency requirements.

In summary, the Regulation provides that, *inter alia*:

- CNAV MMF will invest 99.5% of their assets in public debt instruments
- Standard MMF can only be VNAV money market funds
- The three types of MMF can be short-term MMF
- MMF will be required to diversify their portfolios, invest in high quality assets, follow strict liquidity and concentration requirements, and have sound stress testing processes in place. As such MMF will be subject to strict eligible asset rules and diversification rules (see Section 4.7.2.) and risk management procedures (see Section 7.6.5.)
- Assets of MMF should be valued at least once a day using mark-to-market whenever possible
- Managers of CNAV MMFs and LVNAV MMFs must establish and apply rigorous liquidity management procedures for ensuring weekly liquidity thresholds applicable to such funds including application of liquidity fees and redemption gates in certain circumstances to stem sudden outflows
- Weekly reporting should be made to investors on the maturity breakdown of the portfolio, net yield, weighted average life and maturity of the portfolio, credit profile, and details of the top ten investments of the MMF

On 10 April 2018, the European Commission published a Delegated Regulation, amending and supplementing the MMF Regulation with regard to simple, *transparent and standardised securitisations and asset-backed commercial papers, requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies*. This Regulation followed ESMA’s *Final Report on technical advice, draft implementing technical standards and guidelines under the MMF Regulation*, issued on 13 November 2017.

The Delegated Regulation provides updates with respect to:

- Quantitative and qualitative liquidity requirements of assets received as part of a reverse repurchase agreement
- Criteria for:
 - The validation of internal credit quality assessment methodologies
 - Quantifying credit risk, and the relative risk of default of the issuer and of the instrument in which the MMF invests
 - Establishing qualitative indicators in relation to the issuer of the instrument in which the MMF invests
 - Establishing qualitative credit risk indicators in relation to the issuer of instruments in which the MMF invests
- Overrides of outputs of an internal credit quality assessment methodology
- Material changes
- Quantitative and qualitative credit quality requirements for liquid transferable securities or money market instruments, other than those that fulfil the requirements set out in Article 10 of the MMF regulation, received as part of a reverse repurchase agreement

On 19 July 2019, ESMA published the updated version of its *Guidelines on stress test scenarios under Article 28 of the MMF Regulation*, in which they established common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of the MMF Regulation. These Guidelines apply to National Competent Authorities and to MMFs and their managers. ESMA’s Guidelines were implemented in Luxembourg via CSSF Circular 20/735.

On 17 April 2018, the European Commission published Commission Implementing Regulation (EU) 2018/708 *laying down implementing standards with regard to the template to be used by managers of money market funds when reporting to competent authorities as stipulated by Article 37 of Regulation (EU) 2017/1131 of the European Parliament and of the Council* (the MMF Regulation). This implementing Regulation was based on ESMA's Final Report on technical advice, draft implementing technical standards and guidelines under the MMF Regulation, issued on 13 November 2017.

On 28 January 2020, CSSF Circular 20/736 implemented *ESMA Guidelines on the reporting to competent authorities under Article 37 of the MMF Regulation* in Luxembourg.

CSSF Circular 20/734 clarifies specific technical aspects of the reporting MMFs are required to perform.

For 2010 Law UCIs, a reduced tax rate is applicable in the cases described in Section 11.3.2.2.2.

2.6.2. UCITS exchange traded funds (ETFs)

UCITS exchange traded funds (ETF) are subject to ESMA's *Guidelines on ETFs and other UCITS issues*, as amended. The amended version of the guidelines modifies the original provision on diversification of the collateral received by UCITS in the context of the efficient portfolio management techniques and OTC financing derivative transactions.

With respect to UCITS ETFs⁷⁸ these guidelines require:

- ▶ Use of the "UCITS ETF" identifier in the sub-fund/fund name, constitutional document, prospectus, KII, and marketing communications. This English identifier should be used independently of the language of the document. The identifiers "UCITS ETF", "ETF", or "exchange-traded fund" cannot be used by other UCITS
- ▶ Prospectus, KII, and marketing communication disclosure on the policy on portfolio transparency and where information on the portfolio and the indicative net asset value (iNAV) can be obtained
- ▶ Prospectus disclosure on how the iNAV is calculated and the frequency of calculation
- ▶ Prospectus, KII, and marketing communication disclosures for an actively-managed UCITS ETF:
 - ▶ Specific statement of fact that it is actively managed
 - ▶ Strategy to meet the stated investment policy, including any intention to outperform an index
- ▶ Treatment of secondary market investors:
 - ▶ Inclusion of a warning in the prospectus and marketing communications, to the effect that shares or units purchased on the secondary market are generally not redeemable from the ETF
 - ▶ Providing secondary market investors with the possibility to sell their shares or units back to the ETF in case the stock exchange value of the shares or units of the ETF varies significantly from the NAV (e.g., in case of market disruption)

Disclosure requirements are covered further in Chapter 10.

CSSF Circular 14/592 implemented the amended version of the guidelines dated August 2014.

2.6.3. Index-tracking UCITS

For index-tracking UCITS, ESMA's *Guidelines on ETFs and Other UCITS issues*, as amended, require:

- ▶ Prospectus disclosure on the description of the index, including a link to information on its underlying components, how the index will be tracked and implications in terms of exposure to the underlying index and counterparty risk, anticipated tracking error (in normal market conditions), and factors impacting the ability of the UCITS to track the performance of the index. The prospectus can direct investors to a website where the exact compositions of indices are published
- ▶ Summary KII disclosure on how the index will be tracked and implications in terms of exposure to the underlying index and counterparty risk
- ▶ Annual and semi-annual report disclosure on actual tracking error, explanation of any divergence with anticipated tracking error, and annual tracking difference

For index-tracking leveraged UCITS, the guidelines require:

- ▶ Compliance with the limits and rules on global exposure, either through the commitment or VaR approach
- ▶ Prospectus disclosure and KII disclosure, in summary form, on the leverage policy, associated costs and risks, impact on returns, impact of any reverse leverage (short exposure), and description of how the performance may differ significantly from the multiple of the index over the medium to long term

Disclosure requirements are covered further in Chapter 10 and global exposure is covered in Section 7.2.

⁷⁸ A UCITS ETF is a UCITS at least one share or unit class of which is traded throughout the day on at least one regulated market or Multilateral Trading Facility with at least one market maker, which takes action to ensure that the stock exchange value of the shares or units does not significantly vary from the shares or units' net asset value and where applicable the indicative Net Asset Value (iNAV).

2.6.4. UCIs using efficient portfolio management (EPM) techniques

UCIs using efficient portfolio management (EPM) techniques, such as securities lending and currency hedging transactions, are subject to specific rules (see Section 4.2.2.6.) and disclosure requirements (see Chapter 10).

2.6.5. UCITS using financial derivative instruments (FDIs)

UCITS using financial derivative instruments (FDIs), including, *inter alia*, financial indices, are subject to specific rules (see Section 4.2.2.3.F.) and disclosure requirements (see Chapter 10).

2.6.6. Structured UCITS

Structured UCITS are defined as UCITS that provide investors, at certain predetermined dates, with algorithm-based payoffs that are linked to the performance or to the realization of price changes or other conditions, of financial assets, indices or reference portfolios or UCITS with similar features. They include capital-protected and guaranteed UCITS.

Structured UCITS are subject to specific requirements in relation to risk management (see Section 7.2.), the prospectus (see Section 10.3.1.), and the KII (see Section 10.3.2.).

2.6.7. Hedge funds

Hedge funds under Part II of the 2010 Law are subject to specific requirements in relation to:

- ▶ Investments rules for hedge funds (see Section 4.2.3.2.) and future contracts and/or options UCIs (see Section 4.2.3.4.)
- ▶ Prospectus for hedge funds (see Section 10.3.1.1.) and future contracts and/or options UCIs (see Section 10.3.1.3.)
- ▶ Financial reporting for future contracts and options UCIs (see Section 10.5.1.2.)

Full AIFM regime AIF using a prime broker are subject to specific requirements (see Section 9.8.) and to disclosure requirements (see Section 10.3.3.).

2.6.8. Real estate funds

Real estate UCIs under Part II of the 2010 Law are subject to specific requirements in relation to:

- ▶ Investments rules (see Section 4.2.3.5.)
- ▶ Prospectus (see Section 10.3.1.4.)
- ▶ Financial reporting (see Section 10.5.1.3.)

2.6.9. Private equity funds

Venture capital UCIs under Part II of the 2010 Law are subject to specific requirements in relation to:

- ▶ Investments rules (see Section 4.2.3.3.)
- ▶ Prospectus (see Section 10.3.1.2.)
- ▶ Financial reporting (see Section 10.5.1.1.)

Full AIFM regime AIF are subject to specific requirements on major holdings and control over portfolio companies (see Section 4.6.).

2.7. Vehicles used in conjunction with AIF

Alternative assets are often held through holding vehicles, typically holding companies (often referred to as special purpose vehicles – “SPVs” or special purpose entities). Such holding vehicles may be owned either exclusively by the AIF or its AIFM on its behalf, or as joint ventures, for example with other AIF.

Typically, holding vehicles are used in AIF structures to hold assets such as:

- Real estate properties for real estate AIF
- Unlisted companies for private equity AIF

Other non-AIF vehicles may also be used in conjunction with AIF may for other purposes – for example, to structure investments into AIF.

Luxembourg vehicles used in conjunction with AIF include commercial companies, referred to as SOPARFIs, and securitization vehicles. This section provides a brief description of these vehicles. SOPARFIs and securitization vehicles are not covered in detail in this *Technical Guide*.

2.7.1. SOPARFIs

SOPARFI (*Société de Participations Financières*) is the name usually given to Luxembourg companies whose main corporate purpose is the holding of participations in other companies. The SOPARFI is not a specific vehicle or regime; like other Luxembourg companies it is subject to the 1915 Law, as amended.

SOPARFIs play a central role in the structuring of cross-border transactions.

SOPARFIs are fast and inexpensive to incorporate. SOPARFIs are unregulated vehicles that can be set up in any Luxembourg corporate form; the most common corporate forms are the public limited company and the private limited liability company.

SOPARFIs are not subject to risk spreading requirements or restricted to any specific types of investments.

The taxation of SOPARFIs is covered in Section 11.3.3.3.A.

2.7.2. Securitization vehicles

Securitization vehicles (special purpose vehicles) acquire receivables or bear risks associated with commitments taken or activities carried out by third parties and, in exchange, issue securities whose return is directly linked to the risks borne.

Luxembourg securitization vehicles are also occasionally used in combination with AIFs.

The Law of 22 March 2004 on securitization, as amended (the Securitization Law), provides a legal framework for securitization. It offers initiators flexibility to develop workable and efficient structures for securitization transactions.

Luxembourg securitization vehicles may be regulated by the CSSF or unregulated where the securitization vehicle does not make more than three issuances of securities to the public during the year.

The Securitization Law offers investors a very flexible regime for securitization vehicles, a high level of protection and legal certainty as well as a tax-neutral treatment in Luxembourg. Under the Securitization Law, any tangible or intangible asset or activity with a reasonably ascertainable value or predictable future stream of revenues can be securitized. Securitization structures can range from traditional to the most innovative (e.g., such as simple repackaging, term transactions, and commercial paper conduits).

Luxembourg securitization vehicles can either be set up as corporate entities (*sociétés de titrisation*), or funds with no legal personality managed by a management company (*fonds de titrisation*). These can be set up as single or multi-compartment vehicles; each compartment can issue several tranches of securities. The assets of each compartment can be segregated (the protected cell concept). A single securitization vehicle can be established to carry out an entire securitization transaction, or separate securitization vehicles can be established – one to acquire the assets or bear the risks, and another to issue securities to the investors. Multiple layer securitization structures with two or more acquisition or issuing vehicles can be created to optimize the risk spreading.

A reference to the Securitization Law in the constitutional documents should be sufficient to enable the entity to benefit from the provisions of Luxembourg’s securitization regime.

The taxation of Luxembourg securitization vehicles is covered in Section 11.3.3.3.B.

3

EY supports asset managers, traditional and alternative investment fund houses with fund set up and application for authorization, as well as restructuring and liquidation.

Authorization, supervision, restructuring and liquidation



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3.1. Introduction

This Chapter describes the procedures to be followed when setting up or amending a UCI in Luxembourg, as well as ongoing supervisory requirements. This Chapter also sets out requirements and considerations for conversions and mergers of UCIs, the fast-track authorization procedure for the creation of a side pocket, transfer of foreign UCIs to Luxembourg and liquidation of UCIs and compartments, as well as dormant compartments.

In addition, conversions and mergers of UCIs should be considered not only from a regulatory perspective (covered in this Chapter) but also from an expenses and taxation perspective (see Chapter 11).

3.2. Pre-launch considerations

UCITS, 2010 Law Part II UCIs and SIFs must obtain authorization from the Commission de Surveillance du Secteur Financier (CSSF) prior to launch.

RAIFs are supervised indirectly under the AIFMD but are not subject to direct approval or supervision by the CSSF. A RAIF must be managed by an authorized AIFM. As such, a RAIF is indirectly supervised through the prudential supervision carried out by the competent authority of its AIFM.

In practice, a large amount of preparatory work is performed by the sponsor, initiator, promoter, management company (if applicable and already existing), professional advisors and main service providers before submission of the application for authorization of a UCI.

Typically, such work carried out prior to authorization will deliberate and decide upon, *inter alia*:

Investment policy	Distribution strategy	Fund structuring	Governance
Fee structures	Key fund pre-launch considerations		Service providers
Fund information	Valuation & accounting	Operations	Controls

The fund management options, including appointing an existing management company, setting up a new management company, or setting up a self-managed UCITS or an internally managed AIF, are covered in Section 1.4.3. and Chapters 2 and 6.

The costs associated with the set-up of a UCI are outlined in Section 11.2.

3.3. Authorization

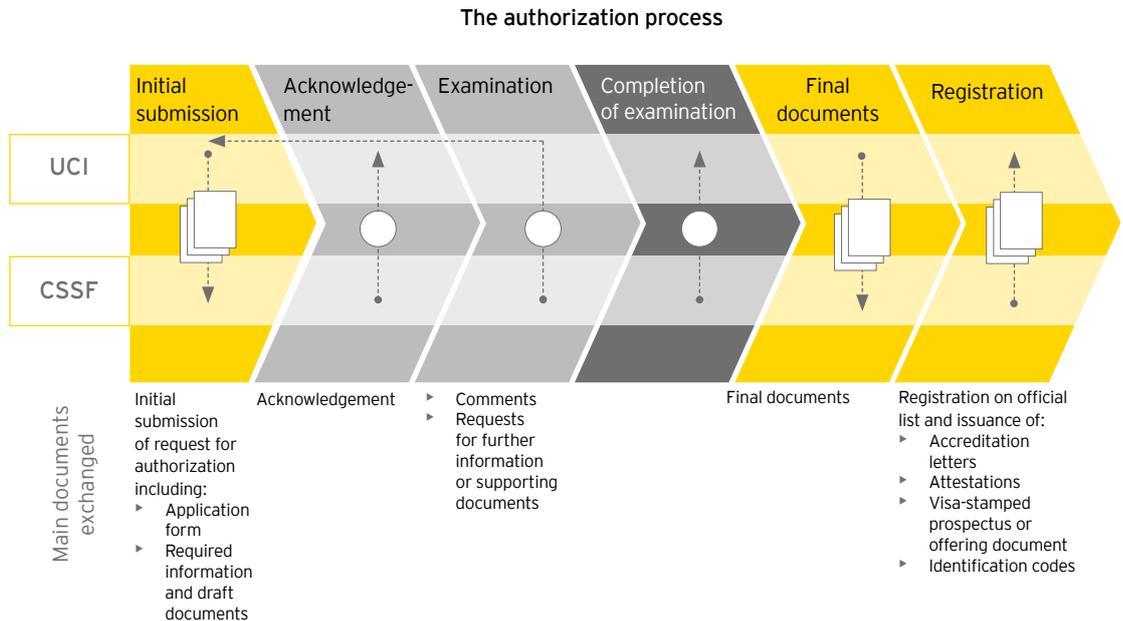
A Luxembourg UCI or its management entity acting on its behalf is required to submit an application for authorization to the CSSF and obtain authorization before commencing activities. This section describes the authorization process and the required information and documents to be provided in the application for authorization.

In addition, an AIF, including 2010 Law Part II UCIs and SIFs, will either be a full AIFM regime AIF or a simplified AIFM registration regime AIF. Where the AIF has not appointed a management entity (i.e., an internally managed AIF), it will also be required to obtain authorization as an AIFM, or will be subject to registration as a simplified AIFM registration regime AIF. For further information, see Section 2.4.4.

A RAIF is not required to obtain authorization from the CSSF. The authorized AIFM of a RAIF may be established in Luxembourg or in another Member State of the EU. The AIFM will need to obtain authorization to manage AIFs from its competent authority.

3.3.1. Authorization process

The authorization process for setting up a new UCI or a new compartment of an existing UCI can be summarized as follows:



- ▶ Initial submission to the CSSF of request for authorization

The request for authorization is submitted in the form of an application file which should include:

- ▶ Application form for the set up of a UCI

The CSSF requires a request to be created in the "UCI Approval" application available under the eDesk portal of the CSSF.

Once the request is duly completed with supporting documents attached, the request is to be submitted to the CSSF directly via eDesk.

The CSSF AML/CFT investment fund market entry form has to be provided in complement of the application questionnaire. This form must be sent when a licencing application is submitted for all funds supervised by the CSSF. These forms must be renewed when requesting approval of an additional sub-fund or when updating outdated information previously submitted.

- ▶ Required information and draft documents (see Section 3.3.2.)

Since 1 November 2019, the application file should be submitted exclusively via the CSSF eDESK portal:

- ▶ eDESK

Access to the eDESK portal requires the creation of a user account. Any person connecting to the eDESK portal is free to create a user account. In order to make a request on behalf of an entity, the account of the employee or representative must first be linked to the entity.

The CSSF recommends applicants to file an application only once all components of the project are available in final draft form.

- ▶ Acknowledgement of receipt of the application file

The CSSF will acknowledge receipt of the application file within two working days and indicate the officer in charge of examining the application.

- ▶ Transmission of comments and, where relevant, further requests of information or documents after initial examination

Within 10 working days of its acknowledgment of the receipt of the authorization application, the CSSF will provide feedback to the applicant (or contact person designated in the application form). The CSSF may:

- ▶ Make comments on the information and documents transmitted
- ▶ Require further information and/or supporting documents to complete the file or explain specific considerations of the application

This phase may be repeated until the CSSF is fully satisfied with the information and documentation submitted.

In case the applicant does not respond to requests for additional information from the CSSF within a reasonable period of time not exceeding three months, the CSSF will contact the applicant to clarify whether the application is to be continued or withdrawn.

- ▶ Completion of examination phase

Once the CSSF informs the applicant about the completion of the examination phase of the application, changes of scope or alterations of the last draft versions of constitutional documents on the basis of which the examination has been completed are no longer permitted.

Any such alterations at this stage will result in the application returning to the examination phase.

- ▶ Submission of final version of compulsory documents

The applicant transmits to the CSSF the final clean version of the required documents as agreed upon and retained during examination. Prospectuses or offering documents have to be submitted in accordance with the requirements of CSSF Circular 19/708 of 28 January 2019 on the electronic transmission of documents to the CSSF (see Section 10.9.1.). The constitutional document and agreements have to be submitted in signed form.

- ▶ Registration on the official list

Upon satisfactory receipt of all required documents as requested, the CSSF will proceed with the registration of the UCI on the relevant official list. 2010 Law UCIs and SIFs are entered by the CSSF on official lists which are published on the website of the CSSF and in the official gazette (the *Mémorial*).

In parallel, the CSSF will, within five working days:

- ▶ Issue, where applicable, the official authorization letter, the related attestations (for UCITS), and identification codes
- ▶ Register the documentation
- ▶ Return a visa-stamped version of the prospectus or offering document previously submitted via the *e-file* system

Authorization procedures specifically relating to European money market funds (MMFs) are outlined in Section 3.3.3.

3.3.2. Required information and draft documents

The application file submitted to the CSSF must include the application form and the following information and documents in English, French or German (all documents in one language only):

- ▶ Draft constitutional document: management regulations (common funds) or articles of incorporation (investment companies) (see Section 10.2.)
- ▶ Draft prospectus for 2010 Law UCIs (see Section 10.3.1.) or offering document for SIFs (see Section 10.3.4.)
- ▶ Draft key investor information (KII) document for UCITS (see Section 10.3.2.)
- ▶ Information on the members of the governing body (see Chapter 5) and senior management (where applicable – see also Chapter 6) including:
 - ▶ Name and position
 - ▶ Curriculum vitae (up-to-date, including place and date of birth, dated and signed, CSSF template optional)
 - ▶ Declaration of honor (CSSF template required)
 - ▶ Extract of criminal record (or affidavit only if criminal record extract cannot be obtained)
- ▶ Information on:
 - ▶ Management company (if applicable)
 - ▶ Draft articles of incorporation of the general partner, if the UCI is structured as a limited partnership
 - ▶ Structure of the investment company, including a program of activity and human and technical infrastructure for self-managed investment companies (see also Section 6.2.1.C.)
- ▶ Information on the promoter of 2010 Law Part II UCIs which are not managed by a Chapter 15 (UCITS) management company including:
 - ▶ Contact details
 - ▶ Description
 - ▶ Organization chart of the group
 - ▶ Track record and relevant experience
 - ▶ List of authorized activities
 - ▶ Certificate from supervisory authority and audited financial reports of the last three years (where available)
- ▶ Information on:
 - ▶ Portfolio manager and investment adviser, including certificate from supervisory authority and audited financial reports of the last three years (where available)
 - ▶ Administration (see Chapter 8)
 - ▶ Depositary (see Chapter 9)
 - ▶ Auditor (see Section 10.5.10.)
 - ▶ Other delegates (see also Sections 2.4.1.6., 2.4.2.4., and 6.3.3.)
- ▶ Draft contracts:
 - ▶ Depositary
 - ▶ Central administration
 - ▶ Domiciliation agent
 - ▶ Portfolio management
 - ▶ Investment advisory
 - ▶ Global distribution
 - ▶ Auditor (mandate acceptance letter)
 - ▶ Any other relevant contracts
- ▶ Description of investment policy (for each compartment):
 - ▶ NAV calculation frequency
 - ▶ Portfolio manager and/or investment adviser
 - ▶ Investment policy
 - ▶ Use of financial derivative instruments (FDIs) (see Chapter 4)
 - ▶ Use of efficient portfolio management (EPM) techniques (see Chapter 4)
 - ▶ Strategy
 - ▶ Countries of distribution
 - ▶ Target investors
 - ▶ For UCITS:
 - ▶ Global exposure calculation method (see Section 7.2.)
 - ▶ Names of share or unit classes
 - ▶ Range of synthetic risk and reward indicator (SRRI) (see Section 10.3.2.1.)
 - ▶ Information on value-at-risk (VaR) approach (if applicable) (see Section 7.2.)

- ▶ Description of valuation principles (see Sections 7.6. and 8.6.)
- ▶ Information on marketing or offering of the shares or units including:
 - ▶ The terms and conditions pertaining to subscriptions and redemptions (see Section 8.3.)
 - ▶ Marketing strategy, target investors, and distribution channels (see Chapter 12)
 - ▶ Distributors, supervision and compliance with anti-money laundering and counter terrorist financing (AML/CFT) requirements (see Section 8.7.4.)
- ▶ For UCITS: Information on the risk management process (see Section 7.2.)
- ▶ For SIFs:
 - ▶ Description of the risk management system (see Section 7.4.5.)
 - ▶ Confirmation that a conflicts of interest policy has been set up (see Section 2.4.2.3.)
- ▶ Investment companies which have not appointed a management company (self-managed UCITS – see Section 2.4.1.5.; and internally managed AIF - see Section 2.4.4.1.) should submit information to demonstrate how they will comply with the applicable requirements:
 - ▶ For self-managed UCITS, see Section 6.2.1.C. on the applicable requirements. The application for authorization must be accompanied by a business plan (see Section 2.4.1.5.)
 - ▶ For internally managed AIF subject to the AIFM Law, see Section 6.2.1.C on the applicable requirements and Section 6.2.1. on the authorization process
 - ▶ For simplified AIFM registration regime internally managed AIF, see Section 6.2.1.E. on the applicable requirements

The CSSF does not require a promoter (see also Section 1.4.2.A.) for:

- ▶ UCITS
- ▶ 2010 Law Part II UCIs which are managed by a Chapter 15 (UCITS) management company
- ▶ SIFs

In practice, the application for authorization of a SIF should also include information on the initiator:

- ▶ Identity of the initiator
- ▶ Evidence of authorization/regulation of the initiator (such as a certificate from the supervisory authority), if any
- ▶ Audited financial reports of the initiator (where available); where audited financial statements are not available, the CSSF will expect information on the track record of the initiator

The CSSF will not perform detailed checks on the status or financial position of the portfolio manager, this being left to the due diligence of the investors.

3.3.3. Authorization for European money market funds

On 30 June 2017, the final text of Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds was published in the Official Journal of the European Union.

The Regulation applies to all funds and compartments that qualify as money market funds (“MMF”) as per the definition set out in article 1 of the Regulation. Funds and compartments wishing to qualify as MMFs, must apply for authorization as MMFs meeting the relevant requirements set out below.

The MMFs must be set up as one of the following types:

- ▶ A variable net asset value (“VNAV”)
- ▶ A public debt constant net asset value (“CNAV”)
- ▶ A low volatility net asset value (“LVNAV”)

As described in the Regulation, a UCITS or an AIF may use the designation “money market fund” or “MMF” in relation to itself or the units or shares it issues only where the UCITS or the AIF has been authorized in accordance with the Regulation. In addition, no UCI may be established, marketed or managed in the European Union as a MMF unless it has been authorized in accordance with the Regulation. Such authorization will be valid for all Member States.

No UCI will be authorized as a MMF unless the competent authority of the MMF is satisfied that the MMF will be able to meet all the requirements of the Regulation.

The authorization requirements for UCITS and AIFs are described below:

a) UCITS authorization

A UCITS-MMF will need to be authorized under both the UCITS and MMF regimes. Where a UCI has already been authorized as a UCITS, it may apply for authorization as a MMF in accordance with the procedure foreseen in the Regulation, as follows:

- For the purposes of authorization as a UCITS MMF, a UCI must submit to its competent authority all of the following documents:
 - The fund rules or instruments of incorporation of the MMF, including an indication of which type of MMF it is
 - Identification of the manager of the MMF
 - Identification of the depositary
 - A description of, or any information on, the MMF available to investors
 - A description of, or any information on, the arrangements and procedures needed to comply with the requirements of the Regulation
 - Any other information or document requested by the competent authority of the MMF to verify compliance with the requirements of the Regulation

b) AIF authorization

An AIF will be authorized as an MMF only if the competent authority of the MMF approves the application submitted by an AIFM, that has already been authorized under the AIFM Directive to manage a MMF that is an AIF, and also approves the fund rules and the choice of the depositary.

When submitting the application for managing a MMF that is an AIF, the authorized AIFM must submit to its competent authority all of the following documents:

- The written agreement with the depositary
- Information on delegation arrangements regarding portfolio and risk management and administration of the AIF
- Information about the investment strategies, the risk profile and other characteristics of the MMFs that are AIFs that the AIFM manages or intends to manage

The competent authority of the MMF may ask the competent authority of the AIFM for clarification and information concerning the documentation referred to in the first paragraph above or an attestation as to whether MMFs fall within the scope of the AIFM's management authorization. The competent authority of the AIFM should respond within 10 working days of such request.

The AIFM must immediately inform the competent authority of the MMF of any subsequent modifications to the authorization documentation.

The competent authority of the MMF can refuse the application of the AIFM only in the event that any of the following applies:

- The AIFM does not comply with the MMF Regulation
- The AIFM does not comply with the AIFM Directive
- The AIFM is not authorized by its competent authority to manage MMFs
- The AIFM has not provided the required authorization documentation

Before refusing an application, the competent authority of the MMF must consult the competent authority of the AIFM.

Authorization of an AIF as a MMF must not be subject to a requirement either that the AIF be managed by an AIFM authorized in the AIF home Member State or that the AIFM pursues or delegates any activities in the AIF home Member State.

Within 2 months of submission of a complete application, the AIFM will be informed whether or not authorization of the AIF as an MMF has been granted. The competent authority of the MMF will not grant authorization of an AIF as a MMF if the AIF is legally prevented from marketing its units or shares in its home Member State.

3.3.4. Constitution of a RAIF

A RAIF does not need to obtain authorization from the CSSF. A RAIF may be set up under 3 different legal forms: common fund (FCP), investment company with variable capital (SICAV) and a RAIF which does not have the legal form of an FCP or a SICAV. The constitutional formalities are as follows:

- ▶ The constitution of the RAIF must be recorded in a notarial deed within 5 working days of its constitution
- ▶ Within 15 working days of the ascertainment of the constitution by notarial deed, a notice with an indication of the AIFM that manages the RAIF must be deposited with the Luxembourg Trade and Companies Register
- ▶ Within 20 working days of the constitution, the RAIF must be registered on a list held by the Luxembourg Trade and Companies Register. The constitutive documents of a RAIF vary depending on its legal form:
 - ▶ FCPs are established by the adoption of management regulations by the management entity. The management regulations must be filed with the Luxembourg Trade and Companies Register
 - ▶ A notice of deposit is published in the “*Recueil électronique des sociétés et associations*” (RESA)
 - ▶ The management regulations should contain the information listed in Section 10.2.1.
 - ▶ The provisions of the management regulations are deemed to be accepted by unitholders upon acquisition of units
- ▶ The constitutive documents of RAIFs established as SICAVs are the articles of incorporation. Contents of the articles of incorporation are set out in Section 10.2.2.

In addition, RAIFs are required to establish an offering document which has to include all information necessary for investors to make an informed judgment on the opportunity to invest in the RAIF, and the risks related thereto.

3.4. Updates to the application for authorization

The granting of authorization by the CSSF implies an obligation for the members of the governing body of the relevant UCI to notify the CSSF on their own initiative of any change regarding the substantial information on which the CSSF based its examination of the initial application before implementing the change. Such changes may include, *inter alia*:

- ▶ Change in the constitutional document
- ▶ Change of the registered address
- ▶ Corporate events (e.g., merger, liquidation, spin off, etc.)
- ▶ Change in governance of an investment company (board members, conducting persons, others)
- ▶ Closure of a compartment(s)
- ▶ Change of denomination of a UCI and/or compartment(s)
- ▶ Change of investment policy/investment restrictions of a UCI and/or compartment(s)
- ▶ Change of set up characteristics of a UCI and/or compartment(s) (consolidation currency, compartment currency, type of share classes, etc.)
- ▶ Change of rules in respect of subscriptions or redemptions
- ▶ Change of management company
- ▶ Change of a service provider (depository bank, administrator, asset managers, domiciliation agent, independent valuer, paying agent, distributors, independent auditor, etc.)

For RAIFs, key elements of the issuing document must be updated before any new issuance of securities or of partnership interests.

3.4.1. Process for amending an existing UCI

The process to amend an existing UCI, or one or several of its compartments, can be summarized as follows:

- ▶ Initial submission of the request for approval of the amendments, together with the necessary documents (see Section 3.4.2.)
- ▶ Acknowledgement of receipt of the amendment file by the CSSF
- ▶ Transmission of comments and possibly further requests of information after initial examination by the CSSF
- ▶ Completion of examination phase
- ▶ Submission of final version of required documents
- ▶ Record of the amendments after entry into force and issuance by the CSSF of an official letter

3.4.2. Required information and documents

The amendment file should contain at least a detailed explanatory letter of the contemplated amendment(s), the relevant CSSF identifier of existing undertaking or compartment(s) subject to amendment, any supporting document, any notices to the investors, where applicable, a new marked-up version of the prospectus, constitutional document, KII (for UCITS) and contracts where applicable. See also Section 10.9.

For open-ended 2010 Law UCIs, the CSSF may assess, on a case-by-case basis and based on the information provided, whether the proposed change should be deemed material and, where appropriate, require notification to investors. Such a material change may, in principle, not be implemented until after the expiration of a notification period of one month. Non-EU jurisdictions may impose a notification period exceeding one month.

During the one month period before the entry into force of the material change, investors have the right to request, without any repurchase or redemption charge, the repurchase or redemption of their shares or units. In addition to the possibility to redeem shares or units free of charge, the UCI may also offer to investors the option to convert their shares or units into shares or units of another UCI (or, in case the change affects only one compartment, into shares or units of another compartment of the same UCI) without any conversion charges.

The CSSF may nevertheless agree, through a duly supported request for derogation made in advance, to not require such a notification period with the ability for investors to redeem or convert their holdings free of charge (for example, in cases where all the investors in the relevant UCI agree with the contemplated change). Similarly, the CSSF may agree to only require a notification period to duly inform the investors of the relevant change before it becomes effective, but without the ability for investors to redeem or convert their holdings free of charge.

3.5. Ongoing supervision

The CSSF supervises UCIs (excluding RAIFs) on a continuous basis.

2010 Law UCIs are required to electronically transmit the final version of their prospectuses, and KII (for UCITS), and, on an ongoing basis, their financial reports, as well as monthly, quarterly, and annual financial information, to the CSSF (see Chapter 10). A long form report also has to be provided to the CSSF for 2010 Law UCIs (see Section 10.5.10.2.).

SIFs are required to electronically transmit the final version of their offering document and, on an ongoing basis, their financial reports, as well as monthly and annual financial information, to the CSSF (see Chapter 10).

The CSSF also has the right, either directly or through an intermediary, to examine the books and records of a UCI.

The depositary is required to provide the CSSF on request with all the information that it has obtained in the exercise of its duties and which is necessary to enable the CSSF to monitor compliance by the UCITS with the 2010 Law (see Section 9.4.1.).

3.6. Restructuring UCIs

It is possible to convert UCIs from one legal regime to another and/or from one basic structure to another. For example, it may be possible to convert a 2010 Law Part II UCI to a UCITS or an FCP to a SICAV. However, it is not possible to convert a UCITS into another type of UCI.

It may be possible to liquidate a UCI and, with shareholder or unitholder consent, contribute its assets to a new UCI.

Restructuring of a Luxembourg UCI is subject to authorization; a new or updated application for authorization should be submitted to the CSSF (see Sections 3.3. and 3.4.). The reasons for the restructuring of the UCI should be explained in the application.

3.6.1. Conversion between regimes

A UCI created under Part II of the 2010 Law may be converted into a UCITS, a SIF, or a RAIF; a SIF can be converted into a UCITS, a 2010 Law Part II UCI or a RAIF; a RAIF may be converted into a UCITS, a 2010 Law Part II UCI or a SIF. However, a UCITS cannot be converted into a 2010 Law Part II UCI, a SIF or a RAIF.

Requirements or considerations to take into account include, for example:

Requirement/consideration	Conversion from a RAIF to a SIF, 2010 Law Part II UCI or UCITS	Conversion from a 2010 Law Part II UCI to a SIF	Conversion from a SIF to a 2010 Law Part II UCI or UCITS	Conversion from a 2010 Law Part II UCI to a UCITS
Investment restrictions (see Chapter 4)	Investment rules applicable to UCITS, 2010 Law Part II UCIs and SIFs are more restrictive than those applicable to RAIFs.	Investment rules applicable to a 2010 Law UCI are more restrictive than those applicable to a SIF.	Investment rules under the 2010 Law are more restrictive than those applicable to a SIF. Investment rules applicable to UCITS are more restrictive than those applicable to 2010 Law Part II UCIs.	Investment rules applicable to UCITS are more restrictive than those applicable to 2010 Law Part II UCIs.
Qualification of shareholders or unitholders	SIF investors are also required to meet the “well-informed investor” criteria. No requirement to meet “well-informed investor” criteria under the 2010 Law.	2010 Law UCI investors may not meet the “well-informed investor” criteria required for SIFs, described in Section 2.4.2.1.B. Action may need to be taken to ensure that all investors qualify as “well-informed investors”.	No requirement to meet “well-informed investor” criteria under the 2010 Law.	In principle, no impact.

Requirement/consideration	Conversion from a RAIF to a SIF, 2010 Law Part II UCI or UCITS	Conversion from a 2010 Law Part II UCI to a SIF	Conversion from a SIF to a 2010 Law Part II UCI or UCITS	Conversion from a 2010 Law Part II UCI to a UCITS
Investors' approval of conversion	Constitutional document needs to be adapted to the SIF Law or 2010 Law requirements, as applicable. Shareholders, or unitholders, need to approve the conversion and must be notified of changes to the prospectus.	Constitutional document needs to be adapted to the SIF Law requirements. Shareholders, or unitholders, need to approve the conversion and must be notified of changes to the prospectus.	Constitutional document needs to be adapted to the 2010 Law requirements. Shareholders, or unitholders, need to approve the conversion and must be notified of changes to the offering document.	Constitutional document needs to be adapted to the UCITS requirements. Shareholders, or unitholders, need to approve the conversion and must be notified of changes to the offering document.
Service provider agreements	Amendments will need to be made to existing agreements.	Amendments will need to be made to existing agreements.	Amendments will need to be made to existing agreements.	Amendments will need to be made to existing agreements.
Promoter or initiator (see Section 1.4.2.A.)	A UCITS management company or a self-managed UCITS is required to have a sponsor. No promoter is required. The CSSF requires detailed information on the promoter of a 2010 Law Part II UCI that is not managed by a UCITS (Chapter 15) management company. For a SIF, information on the initiator is required.	The CSSF should be contacted to ensure that they have sufficient information on the initiator.	The CSSF requires detailed information on the promoter of a 2010 Law Part II UCI that is not managed by a UCITS (Chapter 15) management company.	A UCITS management company or a self-managed UCITS is required to have a sponsor. No promoter is required.
Cross-border distribution (see Chapter 12)	The authorities of the countries where the UCI is distributed should be contacted on conversion.	The authorities of the countries where the UCI is distributed should be contacted on conversion.	The authorities of the countries where the UCI is distributed should be contacted on conversion.	The authorities of the countries where the UCI is distributed should be contacted on conversion.
Tax implications (see Chapter 11)	Subscription tax may be 0.01% or 0.05% per annum of the net asset value.	Subscription tax will generally be levied at 0.01% per annum of the net asset value.	Subscription tax may be 0.01% or 0.05% per annum of the net asset value.	Subscription tax may be 0.01% or 0.05% per annum of the net asset value.
NAV production (see Chapter 8.6)	2010 Law UCIs must publish their NAVs at least twice a month (UCITS) or monthly (2010 Law Part II UCI). A SIF must publish its NAV at least annually.	A SIF must publish its NAV at least annually.	2010 Law UCIs must publish their NAVs at least twice a month (UCITS) or monthly (2010 Law Part II UCI).	UCITS must publish their NAVs at least twice a month.
Financial reporting (see Chapter 10)	2010 Law UCIs are required to produce semi-annual reports including unaudited financial statements, annual reports including audited financial statements and a long form report in accordance with financial reporting requirements, which are more detailed for UCITS than 2010 Law Part II UCIs. A SIF is required to produce annual reports including audited financial statements. No requirement to produce a semi-annual report ⁷⁹ or long form report.	A SIF is required to produce an annual report including audited financial statements. No requirement to produce a semi-annual report ⁸⁰ or long form report.	2010 Law UCIs are required to produce semi-annual reports including unaudited financial statements, annual reports including audited financial statements and a long form report in accordance with financial reporting requirements, which are more detailed for UCITS than 2010 Law Part II UCIs.	More detailed financial reporting requirements apply to UCITS than 2010 Law Part II UCIs.
Offering document (see Chapter 10)	2010 Law UCIs must prepare a prospectus. Specific requirements apply to the prospectus of a UCITS. In addition, a UCITS must prepare a KII. A SIF must prepare an offering document and if it is an AIF, a KID (see Chapter 10).	A SIF must prepare an offering document, and if it is an AIF, a KID (see Chapter 10).	2010 Law UCIs must prepare a prospectus and a KID. A UCITS must prepare a prospectus and a KII.	Specific requirements apply to the prospectus of a UCITS. In addition, a UCITS must prepare a KII.

⁷⁹ Unless it is a listed closed-ended UCI (see Section 10.5.1.).

⁸⁰ Idem.

Requirement/ consideration	Conversion from a RAIF to a SIF, 2010 Law Part II UCI or UCITS	Conversion from a 2010 Law Part II UCI to a SIF	Conversion from a SIF to a 2010 Law Part II UCI or UCITS	Conversion from a 2010 Law Part II UCI to a UCITS
Risk management (see Chapter 7)	UCITS are required to comply with detailed risk management requirements. There are no specific risk management requirements for 2010 Law Part II UCIs; however, if the UCI is managed by an authorized AIFM, AIFM risk management requirements apply. A SIF is required to implement risk management systems. If the SIF is managed by an authorized AIFM, AIFM risk management requirements apply.	A SIF is required to implement risk management systems. If the SIF is managed by an authorized AIFM, AIFM risk management requirements apply.	UCITS are required to comply with detailed risk management requirements. There are no specific risk management requirements for 2010 Law Part II UCIs; however, if the UCI is managed by an authorized AIFM, AIFM risk management requirements apply.	UCITS are required to comply with detailed risk management requirements.

Subject to the UCI's documentation and to shareholder approval, a 2010 Law Part II UCI and a SIF may request the CSSF for the withdrawal of their authorization, and to amend their denomination and more generally their constitutive documentation to delete all references to the 2010 Law and the SIF Law respectively. They would thereafter become unregulated AIF which may then request RAIF status under the RAIF Law, subject to appointing an authorized AIFM.

3.6.2. Conversion from one basic structure to another

It is possible to convert UCIs from one basic structure to another, either directly or indirectly.

The conversion of common funds (FCPs) and investment companies with fixed capital (SICAFs) into investment companies with variable capital (SICAVs) is foreseen under the 2010 Law and the SIF Law.

The conversion of SICAVs and SICAFs into FCPs is not foreseen under the investment fund laws.

In general, the process of conversion requires, *inter alia*:

- A new application for authorization (see Section 3.3.) or an update to the application (see Section 3.4.)
- Shareholder or unitholder approval or consent to the proposed change

It may also be possible to contribute the assets and liabilities of a compartment of one UCI to a compartment of another UCI (see also Section 3.9.3.). Some of the considerations outlined herein are relevant in this case.

The key considerations when converting between basic structures includes:

- Governance: while an investment company has a Board of Directors, general partner or manager, and is ultimately controlled by the shareholders, a common fund has no legal personality and is controlled by its management company. The Board of Directors, general partner or managers of an investment company are responsible for the appointment of service providers, whereas for a common fund, the management company appoints the service providers
- Taxation: investment companies have a legal personality and are therefore subject to taxation. Common funds do not have a legal personality and are therefore generally considered tax transparent

The differences between common funds and investment companies are summarized in Section 1.3.2.

Basic structures are covered in Section 2.3.1.

A. Conversion into an investment company (SICAV or SICAF)

The conversion of an FCP to a SICAV or SICAF involves, *inter alia*:

- Application for authorization from the CSSF for the conversion and the creation of the new investment company (see Section 3.3.)
- Incorporation of the new investment company
- Approval by unitholders of the FCP
- Change of contractual arrangements

On 16 July 2019 the RAIF Law was amended to allow RAIF FCPs to be converted, in a similar manner to SIF FCPs, into SICAVs. The FCP's documentation should be amended by resolution of a general meeting, passed with a two-thirds majority present or represented, regardless of the portion of capital represented.

A SICAF can be converted into a SICAV and *vice versa*. There are two possible scenarios:

- If the contemplated new SICAV or SICAF structure has been incorporated in the same legal form as the existing SICAF or SICAV, only the amendment of the articles of incorporation is required
- If this is not the case (e.g., if a private limited liability company – S.à r.l. – is converted into a public limited company– S.A.), the investment company must follow the procedure for conversion into another company. The procedure depends on the type of company created

The conversion involves, *inter alia*:

- Application for authorization from the CSSF for the conversion (see Section 3.4.)
- If relevant, creation and incorporation of the new investment company
- Approval by shareholders
- If relevant, in particular in case of incorporation of the new investment company:
 - Change of contractual arrangements
 - The contribution of the investment company's assets and liabilities to the new investment company
 - The liquidation of the dissolving investment company, if relevant (see Section 3.10.)

B. Conversion into a common fund (FCP)

The conversion of SICAVs and SICAFs into FCPs is not foreseen under the investment fund laws. It is not possible to exchange the shares of an investment company for units of an FCP, and the voting rights of shareholders in investment companies may not be withdrawn without shareholders' approval.

There may be practical alternatives to conversion, such as: the liquidation of the investment company and the creation of a new FCP with contribution by the shareholders of the SICAV or SICAF of the assets and liabilities to the new FCP, or, for UCITS, through mergers by absorption.

3.6.3. Conversion of UCITS into feeder UCITS and change of master UCITS

An existing UCITS may become a feeder UCITS (see also Section 2.3.4.1.). A feeder UCITS may change its master UCITS.

In both cases, the feeder UCITS must inform, and provide certain information to, its shareholders or unitholders including:

- A statement that the competent authority of the feeder UCITS home Member State approved the investment of the feeder UCITS in shares or units of the master UCITS
- The KII of the master UCITS and the feeder UCITS
- The date when the feeder UCITS starts to invest in the master UCITS or, if it has already invested therein, the date when its investment will exceed the applicable limit (see Section 4.2.2.8.1.III.)
- A statement that the shareholders or unitholders have the right to request, within 30 days, the repurchase or redemption of their shares or units free of charge (except for divestment costs). That right becomes effective from the date the feeder UCITS has provided the information to its shareholders or unitholders

The taxation implications of conversion of a UCITS into a feeder UCITS and changes of master UCITS are covered in Section 11.3.6.

Specific provisions cover the cases of liquidation (see Section 3.10.3.) and merger or division of the master UCITS (see Section 3.7.2.1.).

3.7. Mergers of UCIs

The 2010 Law permits cross-border as well as domestic mergers of UCITS and lays down detailed requirements to be met. The provisions of the 1915 Law relating to mergers are not applicable to mergers of UCITS.

The provisions of the 2010 Law on mergers of UCITS are not applicable to mergers of 2010 Law Part II UCIs or SIFs.

The taxation implications of mergers of UCIs are covered in Section 11.3.6.

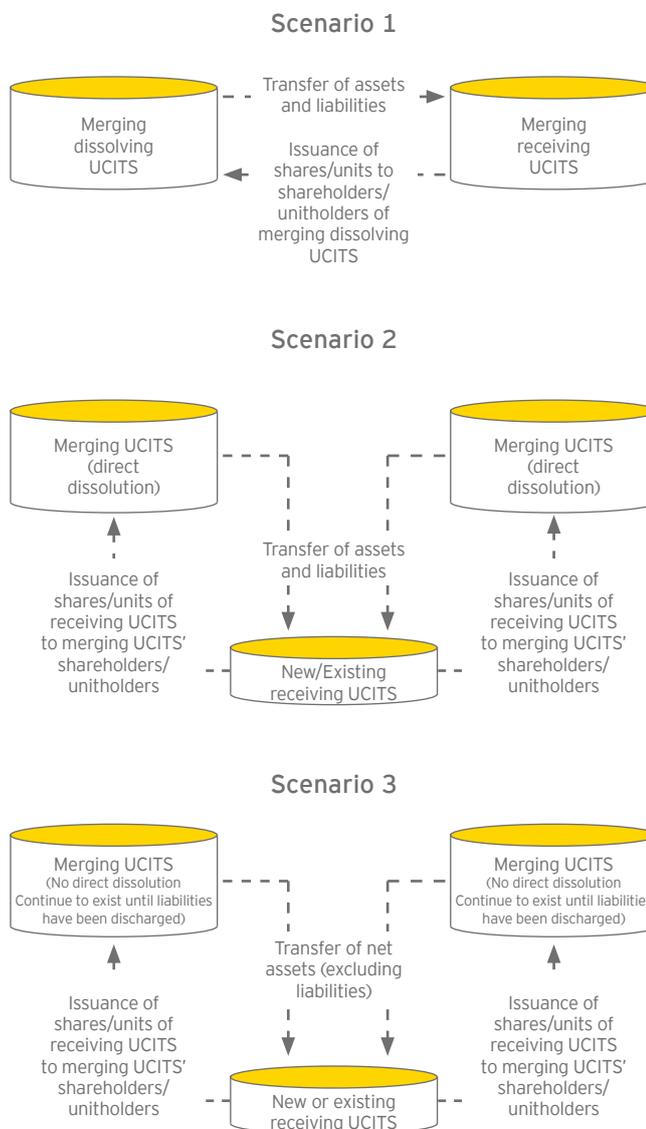
The remainder of this section focuses on the mergers of UCITS.

3.7.1. Principle and the common draft terms of mergers

3.7.1.1. Principle

A merger takes place between one or more UCITS or compartment thereof (“merging UCITS”) and a receiving UCITS or compartment thereof (“receiving UCITS”). There are three possible merger scenarios:

1. The merging UCITS transfer all of their assets and liabilities to an existing receiving UCITS. In exchange, the receiving UCITS issues shares or units to the shareholders or unitholders of the merging UCITS; the receiving UCITS may also make a cash payment. The merging UCITS are dissolved.
2. The merging UCITS transfer all of their assets and liabilities to a receiving UCITS that they form. In exchange, the receiving UCITS issues shares or units to the shareholders or unitholders of the merging UCITS; the receiving UCITS may also make a cash payment. The merging UCITS are dissolved.
3. The merging UCITS transfer their net assets to a receiving UCITS, which may be another compartment of one of the merging UCITS, a new UCITS that they form or another existing UCITS. The merging UCITS continue to exist until their liabilities have been fully discharged.



The merger or the division of a master UCITS will result in the liquidation of the feeder UCITS unless the CSSF grants approval to the feeder UCITS for one of the following:

- Continuing to be a feeder UCITS of the master UCITS or another UCITS resulting from the merger or division of the master UCITS
- Investing at least 85% of its assets in shares or units of another master UCITS not resulting from the merger or the division
- Amending its constitutional document in order to convert into a UCITS that is not a feeder UCITS

For any merging UCITS investment company that ceases to exist, the effective date of the merger must be recorded by notarial deed.

3.7.1.2. Common draft terms of merger

The merging UCITS and the receiving UCITS must draw up common draft terms of merger comprising, *inter alia*, (i) the type of merger and the name of the UCITS involved, (ii) the rationale for the proposed merger, (iii) the expected impact of the proposed merger on the shareholders or unitholders of both the merging UCITS and the receiving UCITS, (iv) the criteria adopted for valuation of the assets and, where applicable, the liabilities on the planned effective date of the merger, (v) the calculation method of the exchange ratio, (vi) the planned effective date of the merger, (vii) the respective fund rules applicable to the transfer of assets and the exchange of shares or units, and (viii) the instruments of incorporation of the receiving UCITS or in case of a merger described in Scenarios 2 and 3 (if there is the creation of a new receiving UCITS), the constitutional document of the newly constituted receiving UCITS.

3.7.2. Authorization

3.7.2.1. The merging UCITS established in Luxembourg

Where a merging UCITS is established in Luxembourg, the merger is subject to prior authorization by the CSSF.

The merging UCITS must provide to the CSSF an authorization file including the following information:

- ▶ The common draft terms of the proposed merger duly approved by the merging UCITS and the receiving UCITS
- ▶ An up-to-date version of the prospectus and KII of the receiving UCITS (if established in another Member State)
- ▶ Statements issued by the depositaries of the merging UCITS and the receiving UCITS, respectively, confirming compliance of certain elements of the common draft terms of the proposed merger with the constitutional document of the relevant UCITS
- ▶ Information that will be provided by the merging UCITS and the receiving UCITS to their respective shareholders or unitholders

This authorization file can be provided to the CSSF in Luxembourgish, French, German or English.

If the authorization file is not complete, the CSSF will request additional information within a maximum of 10 working days.

Where the receiving UCITS is not established in Luxembourg and once the authorization file is complete, the CSSF must immediately transmit copies of the authorization file to the competent authority of the receiving UCITS home Member State.

The CSSF will authorize the merger, providing all relevant conditions have been met, within 20 working days of submission of the complete information. The National Competent Authority of the receiving UCITS does not have to approve the merger. However, the CSSF and the competent authority of the receiving UCITS will assess whether they are satisfied with the proposed information to be provided to the shareholders or unitholders of the merging and receiving UCITS, respectively.

Where approval by the shareholders or unitholders of mergers between UCITS is required, the constitutional document must lay down the quorum and majority requirements applicable. Common draft terms of the merger have to be approved by a simple majority of shareholders or unitholders, without however requiring more than 75% of the votes cast by the shareholders or unitholders present or represented at the meeting.

For any merging UCITS investment company that ceases to exist, the effective date of the merger must be recorded by notarial deed.

3.7.2.2. The merging UCITS established in another Member State and the receiving UCITS established in Luxembourg

The CSSF must receive copies of the authorization file (except the up-to-date version of the prospectus and KII of the receiving UCITS) from the competent authority of the merging UCITS home Member State.

The CSSF and the competent authority of the merging UCITS home Member State will consider the potential impact of the proposed merger on shareholders or unitholders of the receiving UCITS and the merging UCITS, respectively, to assess whether appropriate information is being provided to shareholders or unitholders.

If the CSSF considers it necessary, it may require, in writing, within 15 working days of receipt of the copies of the complete information, that the receiving UCITS modifies the information to be provided to its shareholders or unitholders.

The CSSF will inform the competent authority of the merging UCITS home Member State within 20 working days of being notified thereof whether it is satisfied with the modified information to be provided to the shareholders or unitholders of the receiving UCITS.

3.7.3. Third-party involvement, information and other rights of shareholders or unitholders

The depositaries of the merging UCITS and the receiving UCITS verify the compliance of certain elements of the common draft terms of the proposed merger (including the identification of the type of merger and of the UCITS involved, the planned effective date of the merger, and the rules applicable to the transfer of assets and the exchange of units) with the 2010 Law and the constitutional documents of their respective UCITS (see also Section 9.4.6.3.).

A merging UCITS established in Luxembourg must request an independent auditor to validate (i) the criteria adopted for the valuation of the assets and, if necessary, liabilities, (ii) the calculation method of the exchange ratio, and, where applicable, (iii) the cash payment per share or unit. The independent auditor must also validate the actual exchange ratio.

Investors in the merging and receiving UCITS have the right to redeem their shares or units, or convert them into shares or units of another UCITS with similar investment policies and managed by the same management company or by a related company, free of charge (except for any disinvestment costs).

Information on the proposed merger must be provided to shareholders or unitholders of both the merging and the receiving UCITS, only after the CSSF has authorized the proposed merger, and at least 30 days before the deadline for redemption or conversion. This information shall include the following:

- The background to and the rationale for the proposed merger
- The possible impact of the proposed merger on the shareholders or unitholders of both the merging UCITS and the receiving UCITS (including, *inter alia*, any material differences in respect of investment policy and strategy, costs, expected outcome, periodic reporting, possible dilution in performance, and, where relevant, their tax treatment)
- Any specific rights shareholders or unitholders have in relation to the proposed merger (including, *inter alia*, the right to obtain additional information, the right to obtain a copy of the report of the independent auditor or, if applicable, of the depositary, and the right to request the redemption or, as the case may be, the conversion of their shares or units without charge)
- The relevant procedural aspects and the planned effective date of the merger
- A copy of the KII of the receiving UCITS

3.7.4. Costs and investment limits

The legal, advisory, and administrative costs associated with the preparation and the completion of the merger are to be borne by the management company unless the relevant UCITS are self-managed.

In practice, administrative merger costs are generally borne by the investment manager, sponsor or an affiliated entity.

While ensuring observance of the principle of risk-spreading, the receiving UCITS may derogate from certain diversification rules (see Sections 4.2.2.8.1.I.(1) to (8), II., III. and IV.) for a period of six months starting from the effective date of the merger.

3.8. Authorization of a side pocket

The CSSF has implemented a fast-track authorization procedure for the creation of side pockets for non-UCITS. Side pockets are described in Section 2.3.6.

The fast-track procedure can be used when the assets to be side pocketed represent less than 20% of the total net assets of the UCI or compartment, and where the fees are charged to the side pocket at a reduced level. Where the assets represent more than 20%, the CSSF will treat each application on a case-by-case basis; this will imply an assessment of whether suspension or liquidation are not more appropriate than the creation of the side pocket.

To create a side pocket, the following requirements must be met:

- ▶ The management company of the common fund or the governing body of the investment company must confirm that the proposed side pocketing is not contrary to the constitutional document of the UCI
- ▶ The illiquidity of the assets to be side pocketed must be fully established
- ▶ The administration must be technically capable of servicing the side pocket
- ▶ The assets must be realized as soon as they become liquid

The following information must be submitted to the CSSF with the application for authorization to create a side pocket:

- ▶ Description of the illiquid assets: the percentage of the assets to be side pocketed and the reasons for side pocketing the assets
- ▶ Side pocketing option: the choice of creation of a new share class or unit class or compartment, and the reasons leading to this choice
- ▶ Description of the fees to be charged to the side pocket:
 - ▶ The fees charged to the side pocket are normally expected to be at a reduced level (i.e., less than the total expense ratio (TER) of the compartment initiating the side pocket) as the management and administrative services rendered to the side pocket are deemed to be provided less actively and/or at a reduced level
 - ▶ Except for legal expenses for legal actions to preserve the rights and value in relation to the illiquid assets, only charges that are described in the prospectus can be applied

The fast-track procedure cannot be used where there is any charging of specific or additional charges in relation to the side pockets not in line with the aforementioned principles.

- ▶ Communication to investors: this includes communication on the implementation of the side pocketing option, information on any charges related to the side pocket or the assets therein, and a holdings report at a frequency similar to that of the compartment initiating the side pocket
- ▶ Communication to other authorities, if applicable
- ▶ Confirmation that periodic reports will describe the side pockets existing at the time of their issue

The CSSF will generally provide its authorization or submit comments and observations to the applicant within one week of receipt of the application. Once the side pocket application is approved, the CSSF requires at least quarterly information on the state and the evolution of the side pocket. The CSSF must be informed immediately when a side pocket is paid out or terminated.

For UCIs whose manager is subject to the AIFM Law, side pockets may be one element of the special liquidity management arrangements implemented by AIFM; this is covered in Section 7.3.6.C.

3.9. Transfer of foreign UCIs to Luxembourg

3.9.1. Transfer options

The main options to transfer a foreign UCI to Luxembourg can be summarized as follows:

- Redomiciliation by transfer of the registered office of the foreign UCI to Luxembourg otherwise known as transfer of registered office
- Contribution of the assets and liabilities of the foreign UCI to an existing or newly created Luxembourg UCI, or one or more compartments thereof
- Cross-border merger between the foreign UCI and a Luxembourg UCI, or one or more compartments thereof

When transferring a foreign UCI, there are a number of factors to consider, such as eligibility of the assets and compliance with investment limits, qualification of investors, investor approval, compliance with anti-money laundering and counter terrorist financing requirements, and taxation.

3.9.2. Redomiciliation by transfer of the registered office to Luxembourg

The transfer of the registered office consists of the relocation of the registered office of the foreign UCI to Luxembourg.

The 1915 Law provides the concept of the continuity of legal entities, thereby permitting a foreign UCI to transfer its registered office to Luxembourg. The transfer of registered office is, therefore, permitted for investment companies. However, it is not permitted for common funds.

To transfer the registered office, the following process would normally be followed:

- A corporate decision is made by the shareholders and/or governing body of the foreign UCI to relocate the registered office
- If applicable, a notification is sent to the foreign regulator
- The fund documentation of the foreign UCI is amended to comply with Luxembourg law
- Prior approval of the CSSF is obtained before the transfer (see Sections 3.3. and 3.4.)
- Local service providers are appointed
- An extraordinary general meeting (EGM) of shareholders, in front of a Luxembourg notary, is required to ratify the transfer

In practice, it is advisable to obtain a formal legal opinion confirming that the laws of the country of origin allow such continuation of the legal personality of the foreign UCI after the transfer of its registered office in a foreign country.

3.9.3. Contribution of the assets and liabilities to a Luxembourg UCI

The principle of a contribution in kind is that the foreign UCI contributes all of its assets and liabilities to an existing or newly incorporated Luxembourg UCI, or a compartment thereof. In exchange, the receiving UCI issues shares or units to the shareholders or unitholders of the foreign UCI.

To contribute the assets and liabilities of a foreign UCI to a Luxembourg UCI, the following process would normally be followed:

- ▶ The constitutional document and offering documents of the Luxembourg UCI would need to permit contributions in kind
- ▶ Prior approval of the CSSF would be obtained before the contribution in kind (see Section 3.3.)
- ▶ Contributed assets would need to be eligible assets for the receiving Luxembourg UCI (see Chapter 4)
- ▶ Investors of the foreign UCI would need to be eligible in accordance with the applicable requirements (see Section 2.4.)
- ▶ The shareholders and/or governing body of the Luxembourg UCI would need to approve the contribution in kind before it takes effect
- ▶ A report would be issued by an independent auditor to confirm, *inter alia*, that the value of the contribution in kind corresponds at least to the number and to the value of the shares or units to be issued

3.9.4. Cross-border merger with a Luxembourg UCI

The principle of the cross-border merger is that the foreign UCI transfers all of its assets and liabilities to an existing or newly incorporated Luxembourg UCI, or a compartment thereof. In exchange, the receiving Luxembourg UCI issues shares or units to the shareholders or unitholders of the foreign UCI.

To merge a foreign UCI with a Luxembourg UCI, the requirements on mergers of Luxembourg UCIs have to be met (see in Section 3.7.).

3.10. Liquidation of UCIs and compartments

3.10.1. Liquidation of a UCI

The liquidation procedure for a UCI depends on the reason (voluntary or legally required) and on the legal structure. It is mainly governed by the 1915 Law, the 2010 Law, the SIF Law and the RAIF Law. Taxation on dissolution is covered in Section 11.3.2.3.

3.10.1.1. Voluntary liquidation

3.10.1.1.1. Investment companies

A. Liquidation scenarios

There are three possible voluntary liquidation scenarios for investment companies:

- ▶ According to the 1915 Law, the shareholders of a UCI set up as an investment company can voluntarily decide to dissolve the company and put it into liquidation at an extraordinary general meeting (EGM)
- ▶ If the capital falls below two-thirds of the minimum capital of EUR 1,250,000, the governing body of the UCI must submit the question of the dissolution to the shareholders at an EGM. No quorum is prescribed; the decision is made by a simple majority of the shares represented at the EGM
- ▶ If the capital falls below one-fourth of the minimum capital of EUR 1,250,000, the dissolution may be resolved by shareholders holding one-fourth of the shares at an EGM

In the second and third types of voluntary liquidation, the EGM must be held within 40 days of the date of ascertainment that the net assets have fallen below two-thirds or one-fourth of the minimum capital, as the case may be.

In the case of RAIFs, if the constitutive documents of the investment company do not provide for general meetings or if the capital of the investment company is below one-fourth of the minimum capital for a period exceeding 2 months, the directors or managers must put the RAIF into liquidation and, as the case may be, within a further 3 months, request the District Court to pronounce the dissolution and liquidation of the RAIF.

B. Liquidation process

UCIs that have only one (remaining) ultimate shareholder may be dissolved if the shareholder decides to dissolve the UCI. In such cases the appointment of a liquidator is not required however, the UCI's auditor is required to issue an independent report on the financial statements of the UCI covering the period from the beginning of the accounting period to the beginning of the liquidation period (i.e., until the date that the UCI is removed from the official list of the CSSF). The dissolution of the UCI is formalized by a notary deed.

In all other cases (including cases where the one (remaining) shareholder decides not to apply the simplified process referred to in the preceding paragraph), the liquidation process involves a liquidator. The liquidator's main responsibility is to realize the assets and to settle the liabilities.

The key phases of voluntary liquidation are summarized as follows:

- ▶ An EGM is convened before a public notary in order to, *inter alia*:
 - ▶ Resolve the dissolution and the liquidation of the investment company
 - ▶ Appoint a liquidator and determine his responsibilities. The liquidator has to obtain prior approval from the CSSF before being appointed by the shareholders
- ▶ In practice, the UCI's auditor issues an independent report on the financial statements of the UCI covering the period from the beginning of the accounting period to the beginning of the liquidation period (i.e., until the date that the UCI is removed from the official list of the CSSF)

Additional EGMs may be held to authorize certain actions, such as contribution of the UCIs assets to other companies, or to inform shareholders of the progress of the liquidation.

- ▶ The liquidator issues its liquidation report
- ▶ The independent auditor of the UCI issues a report on the liquidator's report and the liquidation accounts for the period from the beginning of the liquidation to the end of the liquidation
- ▶ A final EGM is convened (generally by private deed) in order to, *inter alia*:
 - ▶ Present the liquidator's report
 - ▶ Present and approve the independent auditor's report on the liquidator's report and the liquidation accounts
 - ▶ Approve the liquidator's report
 - ▶ Grant discharge to the liquidator and the independent auditor
 - ▶ Indicate the place where the corporate books and records are to be kept for a period of at least five years after the publication of the closing of the liquidation in the Official Gazette (*Mémorial*)

3.10.1.1.2. Common funds

A. Liquidation scenarios

The management company of a common fund can define the possible liquidation scenarios in the management regulations. The management company is entitled, or obliged, to liquidate the common fund if one of these defined scenarios occurs.

B. Liquidation process

The liquidation process for a common fund is generally described in the management regulations.

In general, the appointment of a liquidator is mandatory. However, in situations where there is only one remaining unitholder or where the total number of units outstanding is redeemed, the appointment of a liquidator is not required.

The liquidation of the common fund generally takes place as follows:

- ▶ The liquidator – generally the management company itself, or any other liquidator approved by the CSSF – realizes the assets, settles the liabilities and divides the remaining net asset value between the unitholders in proportion to the number of units held by them
- ▶ In practice, the auditor issues an independent report on the financial statements of the UCI covering the period from the beginning of the accounting period to the beginning of the liquidation period (i.e., until the date that the UCI is removed from the official list of the CSSF)
- ▶ The liquidator issues its liquidation report
- ▶ The independent auditor of the UCI then issues a report on the liquidator's report and the liquidation accounts for the period from the beginning of the liquidation to the end of the liquidation

3.10.1.2. Required liquidation

3.10.1.2.1. Investment companies

A UCI whose authorization has been withdrawn may be judicially liquidated upon request of the CSSF or of the Public Prosecutor.

3.10.1.2.2. Common funds

A common fund may also be legally required to be liquidated in the following cases:

- ▶ Upon the expiry of a period which may be fixed by or foreseen in the management regulations
- ▶ In case of bankruptcy of its management company
- ▶ In case of cessation of duties by the management company or by the depositary, if they have not been replaced within two months (until replaced, the depositary must continue to act in the interests of the unitholders)
- ▶ Where the net assets of the common fund have fallen, for more than six months, below one fourth of the legal minimum
- ▶ If authorization of the common fund is withdrawn (in the case of UCITS, 2010 Law Part II UCIs and SIFs)
- ▶ In all other cases provided for in the management regulations

With respect to UCITS, 2010 Law Part II UCIs and SIFs, if the net assets fall below two thirds of the legal minimum of EUR 1,250,000, the management company must immediately inform the CSSF which may require the common fund to be put into liquidation.

3.10.2. Liquidation of a compartment

Compartments of UCIs can be liquidated (i.e., permanently closed) separately as if they were separate entities.

For a UCI incorporated as an investment company, the articles of incorporation state whether the decision to liquidate a compartment should be taken by the governing body or by the shareholders. In the latter case, the articles of incorporation should clarify whether all the shareholders of the UCI should take part in the vote, or only the shareholders of the compartment.

For a common fund, the governing body of the management company is entitled to decide to liquidate a compartment. The management regulations can require the management company to submit the decision to liquidate the compartment to the unitholders; in this case, the management regulations should clarify whether all the unitholders of the UCI should take part in the vote, or only the unitholders of the compartment.

The liquidation of the last compartment of a UCI implies, as a consequence, the liquidation of the UCI.

CSSF Circular 12/540 of July 2012 covers, *inter alia*, compartments in liquidation: a compartment needs to be removed from the prospectus or offering document at its next update and at the latest within six months of the date of the decision by the Board of Directors to either:

- Liquidate the compartment
- Close the compartment by realizing and distributing all assets to the investors

No specific auditor's report is required on the liquidation (i.e., closure) of a compartment at the liquidation date. The liquidation is covered by the audit of the annual financial statements. However, the auditor may, at the request of the UCI, perform agreed-upon procedures on the liquidation NAV and report the results of such procedures.

3.10.3. Liquidation of feeder or master UCITS

The liquidation of a master UCITS entails the liquidation of the feeder UCITS unless the CSSF approves either of the following:

- The investment of at least 85% of the assets of the feeder UCITS in shares or units of another master UCITS – i.e., change of master UCITS (see Section 3.6.3.)
- The amendments of the constitutional document of the feeder UCITS in order to allow it to convert into an ordinary, non-feeder UCITS

In case of voluntary liquidation, the liquidation of the master UCITS cannot take place in the three-month period following the date on which the master UCITS informed all of its shareholders or unitholders and the CSSF of the binding decision to liquidate.

The merger or the division of a master UCITS implies as a consequence the liquidation of the feeder UCITS unless the CSSF approves specific provisions (see Section 3.7.1.1.).

3.11. Dormant compartments

CSSF Circular 12/540 on *non-launched compartments, compartments awaiting reactivation and compartments in liquidation* covers both compartments under the 2010 Law and the SIF Law. Share or unit classes within compartments are not covered by this Circular.

The Circular lays down that:

- Non-launched compartments: new compartments approved by the CSSF, but which have not issued shares or units, have to be launched within a period of 18 months following the date of the CSSF authorization letter
- Compartments awaiting reactivation: compartments that become inactive after the redemption of all of the shares or units can remain inactive for up to 18 months following the date on which they became inactive

Non-launched compartments and compartments that have not been reactivated within the 18-month period must be removed from the prospectus or offering document at its next update and at the latest within an additional six-month period from the end of the 18 month period. Marketing materials must also be adapted. If the compartment does not appear in the prospectus or offering document, the CSSF considers that the proposed launch of the compartment has been abandoned.

4

Investment rules

EY supports asset managers in defining fund investment objectives and policies, analyzing asset eligibility and reviewing compliance with investment restrictions.



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4.1. Introduction

This Chapter summarizes investment and borrowing rules applicable to UCITS, 2010 Law Part II UCIs, SIFs, AIFs, RAIFs, EuVECAs, EuSEFs, money market funds (MMFs) and ELTIFs. UCITS are subject to detailed investment and borrowing rules.

2010 Law Part II UCIs are subject to less detailed investment and borrowing rules that are specific to the type of UCI: UCIs investing in transferable securities, hedge funds, venture capital funds, futures contracts and options funds, and real estate funds.

SIFs and RAIFs are subject to general diversification requirements.

Self-managed UCITS, UCITS management companies and AIFMs managing and/or marketing AIFs in the EU are subject to specific requirements in relation to their investments in securitization positions.

AIFs managed by authorized AIFM and internally managed AIFs that are subject to the AIFM Law (“Full AIFM regime AIFs”) are subject to specific requirements in relation to their investments in major holdings and control of non-listed companies and issuers.

The managers of qualifying EuVECA and EuSEF are required to comply with specific investment restrictions in order to benefit from the passport for the marketing of their EuVECA and EuSEF.

Funds using the label “Short-term money market fund” or “Money market fund” are subject to specific eligible asset requirements and diversification rules.

ELTIFs are subject to specific eligible asset requirements and diversification rules.

In the context of investment rules, CSSF Circular 02/77, entitled *Protection of investors in case of NAV calculation error and correction of the consequences resulting from non-compliance with the investment rules applicable to undertakings for collective investment* (the Circular), establishes guidelines for the Luxembourg fund industry when dealing with NAV calculation errors and breaches of investment restrictions.

On 7 July 2020, the CSSF issued a Frequently Asked Questions document (“FAQ”) providing certain clarifications relating to the application of the Circular 02/77. The FAQ clarifies, *inter alia*, the scope of application of the Circular, the governance and organizational requirements and the process to select the method of correction for non-compliance with the investment rules. Details on the provisions of the Circular and content of the FAQ are set out in Section 8.8.

4.2. UCIs under the 2010 Law

4.2.1. Introduction

4.2.1.1. UCITS and Part II UCIs

The investment and borrowing rules for UCITS (Part I UCIs) are set out in Section 4.2.2.

The investment and borrowing rules for 2010 Law Part II UCIs are set out in Section 4.2.3.

Disclosure requirements for 2010 Law UCIs (e.g., prospectus and financial statement disclosures) are covered in Chapter 10.

4.2.1.2. Multiple compartment UCIs

In the case of multiple compartment UCIs, the investment and borrowing restrictions must be complied with by all compartments, except those relating to significant influence over an issuer (see Sections 4.2.2.8.2. and 4.2.3.1.C.), which apply to all compartments collectively (Article 48 (1) of the 2010 Law and Chapter J of Circular 91/75).

4.2.2. UCITS

This section introduces the concepts of “core” and “non-core” eligible assets and the regulations setting out the investment and borrowing rules applicable to UCITS. It then outlines the investment and borrowing rules, which can be classified as follows:

- Eligible assets (see Section 4.2.2.3. for a summary and Section 4.2.2.7. for further details)
- Diversification requirements (see Section 4.2.2.4. for a summary and Section 4.2.2.8. for further details)
- Borrowing requirements, rules relating to the granting of loans, and short selling (see Section 4.2.2.5. for a summary and Section 4.2.2.9. for further details)
- Techniques and instruments relating to transferable securities and MMIs (see Section 4.2.2.6. for a summary and Section 4.2.2.10. for further details)

4.2.2.1. Core and non-core eligible assets

A UCITS must invest in “eligible assets”. There are two types of eligible assets, which are, for the purposes of this Chapter of the Technical Guide, defined as “core” and “non-core”. “Core” and “non-core” eligible assets are not terms used in the regulations.

Core eligible assets are assets that are eligible for investment by UCITS under Article 41 (1) of the 2010 Law. They include:

A. Transferable securities admitted to or dealt in on a regulated market, including:

- Structured financial instruments (SFIs)
- Transferable securities or money market instruments embedding derivatives
- Recently issued transferable securities or money market instruments

B. Money market instruments (MMIs)

C. Deposits

D. Closed-ended UCIs

E. Open-ended UCIs

F. Financial derivative instruments (FDIs), including FDIs on financial indices

G. Ancillary assets

Non-core eligible assets are assets that are eligible for investment by UCITS under Article 41 (2) a) of the 2010 Law, sometimes referred to as the “trash ratio”. The trash ratio may only include transferable securities and money market instruments.

No more than 10% of net assets may be invested in non-core investments. Where assets are only eligible as non-core investments, this is indicated in this section.

Precious metals and certificates representing them are assets specifically prohibited by the 2010 Law.

4.2.2.2. Applicable regulations

The basic investment and borrowing rules for UCITS are set out in the 2010 Law. These rules have been clarified by a Grand-Ducal Regulation, CSSF Circulars and the European Securities and Markets Authority (ESMA⁸¹) guidelines. Such clarifications remain applicable under the 2010 Law.

The investment and borrowing rules of the 2010 Law transpose the requirements of the UCITS Directive. To further clarify the definition of eligible investments (“eligible assets”) for a UCITS and to ensure consistent interpretation and implementation of the UCITS Directives across all EU Member States, the European Commission issued a Directive clarifying certain definitions (Directive 2007/16/EC of 19 March 2007 - the Eligible Assets Directive).

ESMA has issued two sets of additional guidelines clarifying certain parts of this Directive:

- *Eligible assets for investment by UCITS* of March 2007, as amended. ESMA guidelines concerning eligible assets for investment by UCITS were amended in September 2008
- *Eligible assets for investment by UCITS - The classification of hedge fund indices as financial indices* of July 2007

⁸¹ | The Committee of European Securities Regulators (CESR) became the ESMA on 1 January 2011.

The Grand-Ducal Regulation of 8 February 2008 (the “Grand-Ducal Regulation”) concerning certain definitions of the 2010 Law transposes the Eligible Assets Directive into national regulation.

CSSF Circular 08/339 of 19 February 2008, as amended by CSSF Circular 08/380 of 26 November 2008, reproduces ESMA’s two sets of *Guidelines of the Committee of European Securities Regulators (CESR) concerning eligible assets for investment by UCITS*.

CSSF Circulars 11/512, 08/356, and 91/75 also provide some clarifications relevant to the investment and borrowing rules of UCITS.

ESMA’s *Guidelines on ETFs and other UCITS issues* of 18 December 2012, as amended, impact UCITS using efficient portfolio management (EPM) techniques, such as securities lending, sale and repurchase agreements (repos) and purchase and resale agreements (reverse repos), as well as specific categories of UCITS: ETFs, index-tracking UCITS (including leveraged index-tracking UCITS), UCITS entering into total return swaps (TRS), and UCITS investing in financial indices. ESMA’s guidelines also cover the management of collateral for OTC financial derivative instrument (FDI) transactions and EPM techniques.

ESMA has issued a *Questions and Answers on the Application of the UCITS Directive*. It covers, *inter alia*, regulated markets, investment limits, issuer concentration, master feeder structures, UCITS investing in other UCITS with different investment policies, and ESMA’s guidelines on ETFs and other UCITS issues.

CSSF Circular 14/592 dated 30 September 2014 implements the latest version of ESMA’s guidelines published on 1 August 2014.

The CSSF also issued on 8 December 2015 an FAQ concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment in transferable securities (as amended) and covering, *inter alia*, eligible assets and diversification rules.

On 30 June 2017, the final text of Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on *money market funds* was published in the Official Journal of the European Union. The Regulation applies to funds and compartments that qualify as money market funds (“MMF”) as per the definition set out in article 1 of the Regulation.

4.2.2.3. Eligible assets - summary

This section provides a high level overview of the eligible assets for investment by UCITS.

A. Transferable securities - for example, ordinary shares and bonds

Transferable securities which are listed on or dealt in on a regulated market are eligible as core investments. Transferable securities which are not listed on or dealt in on a regulated market are eligible as non-core investments only.

To be transferable, the following criteria must be met:

- The potential loss on the investment is limited to the amount paid to acquire it
- The liquidity of the instrument must not compromise the ability of the UCITS to meet its repurchase obligations
- A reliable valuation must be available for the investment
- Appropriate information on the investment must be available
- The instrument must be negotiable - i.e., there are no limitations on its transferability
- The acquisition of the investment must be consistent with the investment policy of the UCITS
- The risks associated with the investment must be adequately captured by the risk management process of the UCITS

Detailed requirements are outlined in Section 4.2.2.7.1.

Structured financial instruments (SFIs) - for example, certificates on stock indices, commodities or real estate

Provided they meet the aforementioned transferable securities criteria, financial instruments backed by or linked to the performance of other assets (which may not be eligible assets) are included within the definition of transferable securities.

Detailed requirements are outlined in Section 4.2.2.7.2.

Transferable securities or money market instruments (MMIs) embedding derivatives - for example, convertible bonds

A transferable security or MMI may embed a derivative, i.e., it is an instrument that contains a component fulfilling the following criteria:

- ▶ Some or all of the cash flows of the transferable security or the MMI (host contract) can be modified according to a variable, and therefore vary in a way similar to a stand-alone derivative
- ▶ Its economic characteristics and risks are not closely related to the economic characteristics and risks of the host contract
- ▶ It has a significant impact on the risk profile and pricing of the transferable security or MMI

For those transferable securities or MMIs embedding a derivative, the underlying of the embedded derivative instrument must consist of eligible assets for a UCITS.

Detailed requirements are outlined in Section 4.2.2.7.3.

Recently issued transferable securities or money market instruments (MMIs).

Recently issued transferable securities and MMIs not yet listed on or dealt in on a regulated market are permitted provided that the terms of issue include an undertaking that an application will be made for admission to a regulated market and that such admission is secured within one year of issue.

Detailed requirements are outlined in Section 4.2.2.7.4.

B. Money market instruments (MMIs) – for example, commercial papers

MMIs are eligible as core investments if they meet the following criteria:

- ▶ They are normally dealt in on the money market
- ▶ They are liquid
- ▶ They have a value that can be accurately determined at any time
- ▶ Either:
 - ▶ They are listed on an official stock exchange or traded on a regulated market
 - ▶ Their issue or issuer is regulated for the purpose of protecting investors and savings and one of the following criteria is met:
 - ▶ They are issued or guaranteed by a state or local authority or a supranational issuer
 - ▶ They are issued by an undertaking that has securities which are dealt in on a regulated market
 - ▶ They are issued or guaranteed by an establishment subject to sufficient prudential supervision
 - ▶ They are issued by a securitization vehicle that benefits from a secured banking liquidity line

Detailed requirements are outlined in Section 4.2.2.7.5.

The specific requirements applicable to money market funds are covered in Section 4.8.

C. Deposits with credit institutions

Deposits are eligible as core investments if they meet the following criteria:

- ▶ They are with a credit institution that has its registered office in an EU Member State or, if located in a non-Member State, it is subject to equivalent prudential rules
- ▶ They are repayable on demand or have the right to be withdrawn
- ▶ They have a maturity of up to 12 months

D. Closed-ended UCIs

Closed-ended undertakings for collective investment (UCIs) are eligible as core investments if they are listed on or dealt in on a regulated market, meet the transferable securities criteria (see Section 4.2.2.3.A.), and if:

- ▶ They are subject to corporate governance mechanisms equivalent to those applied to companies

ESMA guidance on investments in closed-ended UCIs in contractual form:

In assessing whether the corporate governance mechanisms for UCIs in contractual form are equivalent, the following factors are indicators, which can be used as guidance:

- a) Unitholders' rights. The management regulations (or other contract on which the UCI is based) should provide for:
 - ▶ Right to vote of the unitholders in the essential decision making processes of the UCI (including appointment and removal of the asset management company, amendment to the contract that set up the fund, modification of investment policy, merger, and liquidation)
 - ▶ Right to control the investment policy of the UCI through appropriate mechanisms
- b) It is understood that the assets of the UCI should be separate and distinct from those of the asset manager and the UCI will be subject to liquidation rules adequately protecting the unitholders.

- ▶ They are managed by an entity subject to national regulation for the purpose of investor protection
- Listed closed-ended hedge funds may, therefore, be eligible as core investments provided these criteria are met.
- Unlisted closed-ended UCIs may be eligible as non-core investments if the aforementioned criteria are met (including the transferable securities criteria).
- UCITS may not invest in closed-ended funds for the purpose of circumventing the investment limits.

The CSSF clarified that it is not necessary to analyze the eligibility of the underlying assets of the closed-ended fund provided that the fund itself meets the transferable securities criteria.

E. Open-ended UCIs

Shares or units of open-ended UCITS and other UCIs, including Exchange Traded Funds (ETFs), are eligible as core investments if:

- ▶ Their sole object consists of collective investment in transferable securities or in other liquid financial assets that are eligible assets for UCITS, they raise capital from the public, and they operate on the principle of risk-spreading
- ▶ Their shares or units are, at the request of holders, repurchased or redeemed, directly or indirectly, out of their assets
- ▶ They are subject to supervision considered by the CSSF to be equivalent to that laid down in EU Law and the cooperation between authorities is sufficiently ensured

ESMA guidance:

In assessing whether a UCI is subject to equivalent supervision, the following factors can be used to guide a decision on equivalence:

- ▶ Memoranda of Understanding (bilateral or multilateral), membership of an international organization of regulators, or other cooperative arrangements (such as an exchange of letters) to ensure satisfactory cooperation between the authorities
 - ▶ The management company of the target UCI, its rules, and choice of depositary have been approved by its regulator
 - ▶ Authorization of the UCI in an Organization for Economic Co-operation and Development (OECD) Member State
- ▶ The level of protection for shareholders or unitholders in the other UCIs is equivalent to that provided for shareholders or unitholders of a UCITS (asset segregation, borrowings, lending, etc.)

ESMA guidance:

In assessing whether the level of protection is equivalent, the following factors can be used to guide a decision on equivalence:

- ▶ Rules guaranteeing the autonomy of the management of the UCI, and management in the exclusive interest of the unitholders
 - ▶ The existence of an independent trustee/custodian with similar duties and responsibilities in relation to both safekeeping and supervision. Where an independent trustee/custodian is not a requirement of local law as regards collective investment schemes (CIS), robust governance structures may provide a suitable alternative
 - ▶ Availability of pricing information and reporting requirements
 - ▶ Redemption facilities and frequency
 - ▶ Restrictions in relation to dealings by related parties
 - ▶ The extent of asset segregation
 - ▶ The local requirements for borrowing, lending and uncovered sales of transferable securities, and money market instruments in relation to the portfolio of the UCI
- ▶ They produce semi-annual and annual reports
 - ▶ They do not invest, according to their constitutional document, more than 10% of their net assets in other UCITS or UCIs

The CSSF clarified that:

- ▶ It is not possible for a UCITS to invest in feeder funds
- ▶ Open-ended SIFs can be eligible investments for a UCITS provided they meet the eligibility criteria for open-ended UCIs and are managed by an authorized AIFM
- ▶ UCITS master funds can be eligible investments for a UCITS which is not a feeder fund provided they meet the eligibility criteria for open-ended UCIs
- ▶ A UCITS master fund can invest in funds or be a fund of funds provided its target funds meet the eligibility criteria for open-ended UCIs

ESMA clarified with respect to UCITS investing in other UCITS or UCIs with different investment strategies or investment restrictions that the prospectus of a UCITS should clearly disclose whether, in the case of fund of fund investments, the target fund(s) may have different investment strategies or restrictions.

Where the fund rules or instruments of incorporation and prospectus of a UCITS expressly rule out certain types of assets or derivative use without any reservations, UCITS management companies/self-managed investment companies should carry out proportionate due diligence to ensure that fund of fund investments do not result in a circumvention of the investment strategies or restrictions set out in the fund rules or instruments of incorporation and prospectus of the investing UCITS.

F. Financial derivative instruments (FDIs)

For FDIs to be eligible, the underlying asset of the FDI must be a core eligible asset - a transferable security, deposit, MMI, closed and open-ended fund or a financial index, interest rates, foreign exchange rates or currency.

If the acquisition or use of an FDI could result in the delivery or the transfer of non-eligible assets, the FDI, regardless of its nature, is not eligible.

“Over-the-counter” (OTC) FDIs must meet the following criteria:

- ▶ The counterparties must be subject to prudential supervision, approved by the CSSF
- ▶ They must be subject to daily, reliable, and verifiable valuation
- ▶ They must be able to be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the UCITS’ initiative

Eligible FDIs include, but are not limited to, futures, options, swaps (interest rate swaps, currency swaps, total return swaps, credit default swaps (CDS), etc.), forwards, and contracts for differences.

Detailed requirements are outlined in Section 4.2.2.7.6.

FDIs on financial indices

To be eligible as the underlying of an FDI, financial indices must meet the following criteria:

- ▶ Be sufficiently diversified
- ▶ Represent an adequate benchmark for the market it refers to
- ▶ Be published in an appropriate manner

Based on these eligibility criteria, eligible indices may, *inter alia*, consist of commodity and metal indices, real estate indices, private equity indices, or hedge funds indices.

Detailed requirements are outlined in Section 4.2.2.7.7.

G. Ancillary assets

Movable and immovable property may be acquired by an investment company if it is essential for its business.

Ancillary liquid assets may be held.

The CSSF clarified that loans do not constitute eligible investments for UCITS (neither as core nor non-core investments) as they do not qualify as:

- Money market instruments, or
- Transferable securities

within the meaning of the definitions included in the Law of 17 December 2010 and Grand-Ducal Regulation of 8 February 2008, further clarified by the CESR *guidelines concerning eligible assets for investment by UCITS, March 2007*.

UCITS that are currently invested in loans must dispose of the positions by 31 December 2020, taking into account the best interests of investors.

In addition, the prospectuses of those UCITS which offer the possibility to invest in loans, have to be updated, by 31 March 2021 at the latest, to no longer provide for the possibility for such investments.

4.2.2.4. Diversification requirements - summary

This section provides a high level overview of the diversification requirements for UCITS.

As well as meeting the eligible assets criteria, the investments of UCITS must meet the following diversification requirements:

- No more than 10% of net assets may be invested in transferable securities or MMIs issued by the same body. In certain cases, a higher limit may be applied (where the issuer or issuance meet specific criteria, and in the case of index replicating UCITS)
- No more than 20% of net assets may be invested in deposits with the same body
- The risk exposure to a counterparty in an OTC FDI transaction may not exceed 10% of net assets in the case of a credit institution and 5% in other cases
- The total value of transferable securities and MMIs held in issuing bodies in each of which is invested more than 5% of net assets must not exceed 40% of net assets
- No more than 20% of net assets may be invested in any combination of the following with a single body:
 - Transferable securities or MMIs
 - Deposits
 - OTC FDIs
 - Techniques and instruments relating to transferable securities and MMIs
- No more than 20% of net assets may be invested in a single UCITS or other UCI (for the purposes of applying this limit, each compartment of a target multiple compartment UCI is considered as a separate issuer)
- No more than 30% of net assets may be invested in aggregate in shares or units of other UCIs (excluding UCITS)
- A UCITS (or its management company in the case of a common fund) may not acquire any shares carrying voting rights which would enable it to exercise significant influence over the management of an issuing body
- Furthermore, a UCITS may acquire no more than:
 - 10% of the non-voting shares of the same issuer
 - 10% of the debt securities of the same issuer
 - 25% of the shares or units of the same UCI
 - 10% of the MMIs issued by the same issuer

Detailed requirements are outlined in Section 4.2.2.8.

4.2.2.5. Borrowing requirements and rules relating to the granting of loans and short selling - summary

This section provides a high level overview of the borrowing requirements and the rules relating to the granting of loans and short selling for UCITS.

Neither an investment company, a management company, nor a depositary acting on behalf of a common fund may borrow. However, there are certain exceptions to this rule, including:

- Up to 10% of net assets may be borrowed on a temporary basis only
- Up to 10% of net assets in the case of an investment company may be borrowed to acquire property essential for the business
- The combined amount of such borrowings may not in total exceed 15% of net assets
- Back-to-back loans may be acquired and are not considered as borrowings for the purposes of these limits

Granting of loans or acting as guarantor on behalf of third parties is not permitted.

Short selling of securities is not permitted.

Detailed requirements are outlined in Section 4.2.2.9.

4.2.2.6. Techniques and instruments relating to transferable securities and MMIs – summary

This section provides a high level overview of the techniques and instruments relating to transferable securities and MMIs that can be used by UCITS.

Techniques and instruments relating to transferable securities and MMIs may be employed provided they are used for the purpose of efficient portfolio management (EPM) and do not result in the UCITS diverging from its investment objectives or in a risk profile higher than that described in its sales documents.

Such techniques and instruments may include, *inter alia*:

- Securities lending transactions
- Sale with the right of repurchase transactions
- Reverse repurchase and repurchase agreement transactions
- Certain hedging transactions using FDIs

Physical short selling of borrowed securities is not a permitted activity. It may be possible to use FDIs to create synthetic short positions.

Permitted techniques and instruments should meet the following criteria:

- Be economically appropriate and realized in a cost-effective manner
- Be entered into for at least one of the following reasons:
 - Risk reduction
 - Cost reduction
 - Generation of additional capital or income for the UCITS, provided that risk levels and diversification remain consistent
- Be captured by the risk management process

Detailed requirements are outlined in Section 4.2.2.10.

4.2.2.7. Detailed rules regarding eligible assets

4.2.2.7.1. Transferable securities – definitions and requirements

Transferable securities that are admitted to an official listing on a regulated market or dealt in on another regulated market that operates regularly and is recognized and open to the public are eligible as core investments. Stock exchanges or other regulated markets that are outside the EU and used by UCITS should be specified in the constitutional document.

Transferable securities are defined in Article 1 of the 2010 Law as:

- Shares and other securities equivalent to shares (“shares”)
- Bonds and other forms of securitized debt (“debt securities”)
- Any other negotiable securities that carry the right to acquire such transferable securities by subscription or exchange, excluding techniques and instruments (see Section 4.2.2.10.(1))

I. The Grand-Ducal Regulation clarifies that transferable securities should meet the following criteria:

- (1) The potential loss, which the UCITS may incur as a result of holding the securities, should be limited to the amount paid for them.

ESMA clarification: a partly paid security must not expose the UCITS to a loss beyond the amount to be paid for it.

- (2) The liquidity of the securities must not compromise the ability of the UCITS to repurchase or redeem its shares or units at the request of the shareholders or unitholders.

ESMA clarification: in determining liquidity, the following may need to be taken into account:

- ▶ Volume and turnover in the security
- ▶ If the price is determined by supply and demand in the market, the issue size and the portion of the issue that the asset manager plans to buy, and evaluation of the opportunity and timeframe to buy or sell
- ▶ Where necessary, an independent analysis of bid and offer prices over a period of time may indicate the relative liquidity and marketability of the instrument, as may the comparability of the available prices
- ▶ In assessing the quality of secondary market activity in a transferable security, analysis of the quality and number of intermediaries and market makers dealing in the transferable security concerned should be considered

The CSSF clarified that, in determining liquidity, the entire portfolio must be taken into consideration and not only transferable securities considered individually.

Financial instruments which are admitted to or dealt in on a regulated market (see Section 4.2.2.7.1.II.(1)) are presumed not to compromise the ability of the UCITS to repurchase or redeem its shares or units at the request of the shareholders or unitholders.

- (3) A reliable valuation is available for them:
 - (i) In the case of securities admitted to or dealt in on a regulated market, in the form of accurate, reliable and regular prices, which are either market prices or prices made available by valuation systems independent from issuers
 - (ii) In the case of other securities, in the form of a periodic valuation that is derived from information from the issuer of the security or from competent investment research
- (4) Appropriate information is available for them:
 - (i) In the case of securities admitted to or dealt in on a regulated market, in the form of regular, accurate, and comprehensive information on the security or, where relevant, on the portfolio of the security
 - (ii) In the case of other securities, in the form of regular and accurate information on the security or, where relevant, on the portfolio of the security
- (5) They are negotiable - i.e., there are no limitations on their transferability

ESMA clarification: there is a presumption, but not a guarantee, that transferable securities admitted to trading on a regulated market are negotiable. The presumption does not apply if the UCITS knows or ought reasonably to know that a particular security is not negotiable.

- (6) Their acquisition is consistent with the investment objectives or the investment policy, or both
- (7) Their risks are adequately captured by the risk management process of the UCITS (see Section 7.2.)

ESMA clarification: the security's risk and its contribution to the overall risk profile of the portfolio must be assessed on an ongoing basis.

II. Regulated Market

- (1) *"Regulated market"*

A "regulated market" within the context of the 2010 Law is a regulated market in the sense of the Markets in Financial Instruments Directive (MiFID)⁸². European Economic Area (EEA)⁸³ regulated markets appear on the relevant European Commission list.

⁸² Markets in Financial Instruments Directive (MiFID), Directive 2004/39/EC, as amended.

⁸³ The European Economic Area (EEA) Member States are the European Union (EU) Member States plus Iceland, Liechtenstein, and Norway.

(2) *“Regulated market which operates regularly and is recognized and open to the public”*

Circular 91/75 defines a regulated market which operates regularly and is recognized and open to the public as follows:

- ▶ *“Regulated”*: the essential characteristic of a regulated market is the clearing, which presupposes the existence of a central market organization for the processing of orders. Such a market may also be distinguished by multilateral order matching (general matching of bid and offers enabling the setting of a single price), transparency (maximum information distribution among buyers and sellers giving them the possibility to follow the evolution of the market so that they may ensure that their orders have been carried out at current conditions), and the neutrality of its organizer (the organizer’s role must be limited to recording and supervision)
- ▶ *“Recognized”*: the market must be recognized by a state or by a public authority delegated by that state or by another entity recognized by the state or by that public authority, such as a professional association
- ▶ *“Operating regularly”*: securities admitted to this market must be dealt in at a certain fixed frequency (no sporadic dealings)
- ▶ *“Open to the public”*: the securities dealt in thereon must be accessible to the public

4.2.2.7.2. Structured financial instruments - for example, certificates

Provided they meet the transferable securities criteria, financial instruments backed by or linked to the performance of other assets (which may not be eligible assets) are included within the definition of transferable securities.

CSSF clarification:

The eligibility analysis of structured financial instruments, i.e., transferable securities linked to the performance of other underlying assets through an FDI, comprises different steps.

In order to qualify as eligible assets in accordance with Sections 4.2.2.7.1. or 4.2.2.7.4. (Article 41 (1) a) – d) of the 2010 Law) and as transferable securities, the structured financial instruments must first meet the transferable securities criteria (see Section 4.2.2.7.1.1.).

Secondly, the security should be analyzed to determine if there is an embedded FDI (see Section 4.2.2.7.3. for criteria). There are two possible situations:

(a) Transferable securities embedding an FDI

In this case, the investment manager must apply the “look through” principle and verify the eligibility of the underlying assets in accordance with the eligibility criteria for FDIs (see Section 4.2.2.7.6. for criteria):

- ▶ If the underlying assets of the FDIs qualify as eligible assets (in accordance with Sections 4.2.2.7.1. and 4.2.2.7.4. and Sections 4.2.2.7.5.II. and III., 4.2.2.3.C., D and E – Article 41 (1) of the 2010 Law), the transferable securities are eligible as core investments for the UCITS
- ▶ If the underlying assets of the FDIs do not qualify as eligible assets, the transferable securities are not eligible investments for the UCITS in accordance with Sections 4.2.2.7.1. or 4.2.2.7.4.

Nevertheless, if the underlying assets of the FDIs qualify as non-core investments, the transferable securities are eligible as non-core investments.

When a transferable security embeds an FDI, the risk management process requirements apply to this FDI (see Section 7.2.).

(b) Transferable securities not embedding an FDI

In principle, in this case, the investment manager is not required to apply the “look through” principle and does not have to verify the eligibility of the underlying assets in accordance with the eligibility criteria for FDIs.

Nevertheless, a UCITS must always be managed in accordance with the principle of risk diversification – i.e., it is not acceptable for a UCITS to exclusively invest in different transferable securities that are all linked to the performance of the same underlying asset.

As a consequence, the principle of risk diversification applies to each transferable security as well as to its underlying assets independently of the fact that the transferable security embeds or does not embed an FDI.

The investment manager and the officers responsible for the UCITS must provide for means to satisfy the principle of risk diversification.

Other CSSF clarification

With respect to transferable securities that do not embed a derivative, the application of a 20% limit of the net assets to each underlying asset of such transferable securities that do not embed a derivative, has to be respected. This limit may be raised up to 35% for a single underlying asset.

4.2.2.7.3. Transferable securities and MMIs embedding FDIs

- (1) Such financial instruments must meet the criteria for transferable securities (see Section 4.2.2.7.1.) or MMIs (see Section 4.2.2.7.5.) and must contain a component that fulfills the following criteria:
 - Some or all of the cash flows that otherwise would be required by the transferable security, which functions as a host contract, can be modified according to a specific interest rate, financial instrument price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, and therefore vary in a way similar to a stand-alone FDI
 - Its economic characteristics and risks are not closely related to the economic characteristics and risks of the host contract
 - It has a significant impact on the risk profile and pricing of the transferable security
- (2) A transferable security or MMI should not be regarded as embedding an FDI where it contains a component that is contractually transferable independently of the transferable security or the MMI.

ESMA states that collateralized debt obligations (CDOs) or asset backed securities using FDIs will generally not qualify as structured financial instruments (SFIs) embedding FDIs, except if they are:

- Leveraged
- Not sufficiently diversified

Where a product is structured as an alternative to an OTC FDI, its treatment should be similar to that of an OTC FDI.

ESMA has indicated that the following instruments may embed FDIs:

- Credit linked notes
- Convertible bonds
- Exchangeable bonds
- SFIs whose performance is linked to the performance of a bond index
- SFIs whose performance is linked to a basket of shares
- SFIs with a fully guaranteed nominal value whose performance is linked to the performance of a basket of shares

UCITS using SFIs embedding FDIs must respect the principles of the 2010 Law regarding FDIs.

For those transferable securities or MMIs embedding an FDI, the underlying of the embedded FDI must consist of assets eligible for a UCITS.

For example, catastrophe bonds and delta one certificates may be eligible provided the transferable securities criteria are met (see Section 4.2.2.7.1.I.). However, leverage loans will not be eligible because they do not qualify as transferable securities or money market instruments.

4.2.2.7.4. Recently issued transferable securities or MMIs

Recently issued transferable securities and MMIs not yet listed on or dealt in on a regulated market are permitted as core investments provided that:

- They first meet respectively the transferable securities criteria (see Section 4.2.2.7.1.I.) or money market instruments criteria (see Section 4.2.2.7.5.I.)
- Secondly, the terms of issue include an undertaking that application will be made for admission to a regulated market (see Section 4.2.2.7.1.II.(1)) or another regulated market that operates regularly and is recognized and open to the public (see Section 4.2.2.7.1.II.(2)) and that such admission is secured within one year of issue

As stated in Section 4.2.2.7.5.I. (2), the liquidity of the securities must not compromise the ability of the UCITS to repurchase or redeem its shares or units at the request of the shareholders or unitholders. This requirement should also be carefully considered in respect of recently issued transferable securities and MMIs not yet listed on or dealt in on a regulated market.

4.2.2.7.5. Money market instruments (MMIs) – for example, commercial papers

I. MMIs

- (1) Article 1 of the 2010 Law defines MMIs as instruments meeting all the following criteria:
- ▶ Normally negotiated on a money market (see Section 4.2.2.7.5.1.(2))
 - ▶ That are liquid (see Section 4.2.2.7.5.1.(3))
 - ▶ Whose value can be determined with precision at any time (see Section 4.2.2.7.5.1.(4))

The Grand-Ducal Regulation clarifies that MMIs should be understood to mean those that are either admitted to trading or dealt in on a regulated market or are not admitted to trading.

ESMA clarifications

Gaining exposure to precious metals through investment in MMIs is forbidden.

Short selling of MMIs is prohibited.

- (2) MMIs normally dealt in on the money market should be understood to mean those that meet one of the following conditions:
- (a) Have a maturity at issuance not exceeding 397 days
 - (b) Have a residual maturity not exceeding 397 days
 - (c) Undergo regular yield adjustments at least every 397 days
 - (d) Have a risk profile, including credit and interest rate risks, that corresponds to that of financial instruments that have a maturity of not exceeding 397 days or are subject to a yield adjustment at least every 397 days

ESMA clarification:

Treasury and local authority bills, certificates of deposit, commercial papers, and banker's acceptances will usually meet the criterion "normally dealt in on the money market".

- (3) Liquid MMIs are those that can be sold at limited cost in an adequately short timeframe, taking into account the UCITS' obligations to repurchase or redeem its shares or units at the request of the shareholders or unitholders.

ESMA advises that when assessing the liquidity of MMIs, the following should be considered:

- ▶ Frequency of trades and quotes for the MMI
- ▶ Number of dealers willing to buy and sell the MMI, time needed to sell the MMI, method of soliciting offers, and method of transfer
- ▶ Size of the issuance/program
- ▶ Possibility to repurchase, redeem, or sell the MMI in a short period, at limited cost, and with short settlement delay

When assessing the liquidity of the UCITS, ESMA advises that the following factors should be taken into consideration to ensure that any single MMI does not affect the liquidity of the UCITS:

- ▶ Shareholder or unitholder structure and concentration of shareholders or unitholders
- ▶ Purpose of funding of shareholders or unitholders
- ▶ Quality of information on the UCITS' cashflow
- ▶ Prospectus guidelines on limiting withdrawals

- (4) MMIs that have a value that can be accurately determined at any time means:
- ▶ They allow the UCITS to calculate its NAV in accordance with the value at which the financial instrument held in the portfolio could be exchanged between knowledgeable willing parties in an arm's length transaction
 - ▶ They are based either on market data or on valuation models including systems based on amortized cost

ESMA is of the view that if an amortization method is used to assess the value of an MMI, the UCITS must ensure that this will not result in a material discrepancy between the value of the MMI and the value calculated according to the amortization method. ESMA is of the view that this would generally be the case in either of the following cases:

- MMI with a residual maturity of less than 3 months and with no specific sensitivity to market parameters, including credit risk
- UCITS investing solely in high-quality instruments with, as a general rule, a maturity, or residual maturity, of at most 397 days, or regular yield adjustments in line with such maturities and with a weighted average maturity of 60 days. The high quality of the instruments should be adequately monitored, taking into account both the credit risk and the final maturity of the instrument

The aforementioned principle, along with adequate procedures defined by the UCITS, should avoid situations where discrepancies between the value of the MMI as defined in Section 4.2.2.7.5.I.(4) and the value calculated according to the amortization method would become material, either at the individual MMI level or at the UCITS' level. The UCITS' procedures might include updating the credit spread of the issuer or selling the MMI.

ALFI's recommendations on the use of amortized cost as the valuation basis for sub-three month paper are outlined in Section 7.6.1.

II. MMIs dealt in on a regulated market

- (1) MMIs normally dealt in on the money market or admitted to, or dealt in on, a regulated market are presumed to be liquid and to have a value that can be accurately determined at any time. As such they are eligible as core investments.

III. MMIs not dealt in on a regulated market

- (1) MMIs not dealt in on a regulated market are also permitted as core investments if the issue or issuer is regulated for the purpose of protecting investors and savings (see Section 4.2.2.7.5.III.(2)) and one of the following criteria is met:
 - They are issued or guaranteed by a central, regional or local authority or central bank of an EU Member State, the European Central Bank, the EU, a non-EU Member State, in the case of a Federal State, by one of the members making up the federation, or by a public international body to which at least one EU Member State belongs
 - They are issued by an undertaking any securities of which are dealt in on regulated markets
 - They are issued or guaranteed by an establishment subject to prudential supervision in accordance with criteria defined by EU law or by an establishment that is subject to and complies with prudential rules considered by the CSSF to be at least as stringent as those of EU law (see Section 4.2.2.7.5.III.(3))
 - They are issued by other bodies belonging to categories approved by the CSSF under various specific conditions
- (2) *Instruments of which the issue or issuer is regulated for the purpose of protecting investors and savings*
 - (a) For MMIs that are not dealt in on a regulated market but the issuer is regulated, the following criteria must be met:
 - Fulfill one of the criteria for MMIs normally dealt in on the money market and all the criteria for MMIs that are liquid and MMIs that have a value that can be accurately determined at any time
 - Appropriate information must be available for them, including information that allows an appropriate assessment of the credit risks related to the investment in such instruments
 - Freely transferable
 - (b) For MMIs described in (a), and issued by an undertaking the securities of which are dealt in on a regulated market (second bullet of Section 4.2.2.7.5.III.(1)), or issued by other bodies belonging to the categories approved by the UCITS' competent authority (fourth bullet of Section 4.2.2.7.5.III.(1)), or issued by a local or regional authority of a Member State or by a public international body but are not guaranteed by a Member State, or, in the case of a Federal State that is a Member State, by one of the members of the federation, appropriate information as mentioned in (a) second bullet should consist of:
 - Information on both the issue or the issuance program and the legal and financial situation of the issuer prior to the issuance of the MMI

- ▶ Updates of this information on a regular basis and whenever a significant event occurs
- ▶ Verification of this information by qualified third parties not subject to instructions from the issuer
- ▶ Available and reliable statistics on the issue or the issuance program

ESMA's view is that regular updates should normally occur on an annual basis and that third parties should specialize in the verification of legal or financial documentation and be composed of persons meeting professional standards of integrity.

- (c) For MMIs described in (a) and issued or guaranteed by an establishment subject to prudential supervision (third bullet of Section 4.2.2.7.5.III.(1)), appropriate information as mentioned in (a) second bullet should consist of:
- ▶ Information on the issue or the issuance program or on the legal and financial situation of the issuer prior to the issue of the MMI
 - ▶ Updates of this information on a regular basis and whenever a significant event occurs
 - ▶ Available and reliable statistics on the issue or the issuance program or other data enabling an appropriate assessment of the credit risks related to the investment in such instruments
- (d) For MMIs referred to in the third bullet of Section 4.2.2.7.5.III.(1), except those referred to in (b) and those issued by the European Central Bank or by a central bank of a Member State, appropriate information as mentioned in (a) should consist of information on the issue or the issuance program or on the legal and financial situation of the issuer prior to the issue of the MMI.

- (3) *Establishment which is subject to and complies with prudential rules considered by the CSSF to be at least as stringent as those of EU law*

The reference to an establishment that is subject to and complies with prudential rules considered by the CSSF to be at least as stringent as those laid down by EU law should be understood as a reference to an issuer that is subject to and complies with prudential rules and fulfils one of the following criteria:

- ▶ It is located in the European Economic Area (EEA)
- ▶ It is located in an OECD Member State belonging to the Group of Ten
- ▶ It has at least investment grade rating
- ▶ It can be demonstrated on the basis of an in-depth analysis of the issuer that the prudential rules applicable to that issuer are at least as stringent as those laid down by EU law

4.2.2.7.6. Financial derivative instruments (FDIs)

Eligible financial derivative instruments include, but are not limited to, futures, options, swaps (interest rate swaps, currency swaps, total return swaps, credit default swaps, etc.), forwards, and contracts for differences.

- (1) FDIs (including equivalent cash-settled instruments) that are dealt in on a regulated market or over-the-counter (OTC) are permitted as core investments provided that:
- ▶ The underlying consists of transferable securities (see Section 4.2.2.7.1.), recently issued transferable securities (see Section 4.2.2.7.4.), money market instruments (see Sections 4.2.2.7.5.II. and III.), deposits with credit institutions (see Section 4.2.2.3.C.), closed-ended UCIs (see Section 4.2.2.3.D.), open-ended UCIs (see Section 4.2.2.3.E.), financial indices (see Section 4.2.2.7.7.), interest rates, foreign exchange rates, or currencies, in which the UCITS may invest in accordance with the Law and its constitutional document
 - ▶ The counterparties to OTC FDIs are institutions subject to prudential supervision, approved by the CSSF

CSSF clarification: counterparties to OTC FDIs must be establishments:

- ▶ Authorized by a financial authority
- ▶ Subject to prudential supervision
- ▶ Either located in the EEA or in a country belonging to the Group of Ten or have at least an investment grade rating
- ▶ Specialized in such transactions

If the counterparty does not fulfil any of the three first criteria, a UCITS has to demonstrate that the prudential rules applicable to such counterparty are equivalent to those laid down in EU Law.

- ▶ In the case of OTC FDIs, the counterparties are institutions subject to prudential supervision and belonging to the categories approved by the UCITS' competent authority and the OTC FDIs are subject to a reliable and verifiable valuation (see Section 4.2.2.7.6.(3)) on a daily basis and can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the UCITS' initiative

FDIs should meet the following criteria:

- ▶ They allow the transfer of the credit risk of an asset independently from the other risks associated with that asset
- ▶ They do not result in the delivery or in the transfer of assets other than eligible assets of UCITS
- ▶ They comply with the criteria for OTC FDIs
- ▶ Their risks are adequately captured by the risk management process of the UCITS

FDIs on commodities (including non-financial indices) are not considered to be eligible assets.

- (2) The global exposure relating to FDIs must not exceed the total net asset value (NAV) of the UCITS (see also Chapter 7).

- (3) *"Reliable and verifiable valuation"*

The requirements for a "reliable and verifiable valuation" are outlined in Section 7.6.1.B.

- (4) Total return swaps or similar instruments

Where a UCITS enters into a total return swap or invests in other financial derivative instruments with similar characteristics:

- ▶ The assets held by the UCITS should comply with the investment limits set out in Sections 4.2.2.8.1. I.- IV. and 4.2.2.8.2. For example, when a UCITS enters into an unfunded swap, the UCITS' investment portfolio that is swapped out should comply with the aforementioned investment limits
- ▶ The underlying exposures of the financial derivative instruments must be taken into account to calculate the investment limits laid down in Sections 4.2.2.8.1. I. and II

Where the counterparty has discretion over the composition or management of the UCITS' investment portfolio or of the underlying of the financial derivative instrument, the agreement between the UCITS and the counterparty should be considered as an investment management delegation arrangement and should comply with the UCITS requirements on delegation.

4.2.2.7.7. FDI on financial indices

Financial indices are defined as those meeting the following criteria:

- (a) They are "sufficiently diversified"

To be sufficiently diversified, the following criteria must be fulfilled:

- ▶ The index must be composed in such a way that price movements or trading activities regarding one component do not unduly influence the performance of the whole index
- ▶ Independent of whether the index is composed of core or non-core eligible assets, the index must be composed in such a way that the diversification limit of 20% (or, if justified, 35%) must be respected in relation to:
 - ▶ Investment in either shares or debt securities, or both, issued by the same body
 - ▶ Other components of the index (e.g., a commodity)

- (b) They "represent an adequate benchmark for the market to which they refer"

To represent an adequate benchmark for the market to which they refer, the following criteria must be fulfilled:

- ▶ The index measures the performance of a representative group of underlying components in a relevant and appropriate way
- ▶ The index is revised or rebalanced periodically to ensure that it continues to reflect the markets to which it refers following criteria that are publicly available
- ▶ The underlying components are sufficiently liquid, which allows users to replicate the index, if necessary

- (c) They “are published in an appropriate manner”

To be published in an appropriate manner, the following criteria must be fulfilled:

- ▶ Their publication process relies on sound procedures to collect prices and to calculate and to subsequently publish the index value, including pricing procedures for components where a market price is not available
- ▶ Material information on matters such as index calculation, rebalancing methodologies, index changes or any operational difficulties in providing timely or accurate information is provided on a wide and timely basis

ESMA’s guidelines state that indices based on FDIs on commodities or indices on property may be eligible provided they comply with the criteria set down for financial indices.

If the composition of the index is not sufficiently diversified, its underlying assets have to be combined with the other assets of the UCITS (see Sections 4.2.2.8.1.I. (1) to (7), 4.2.2.8.1.II. (1) and 4.2.2.8.1.IV. (1)).

CSSF clarification: the governing body of a UCITS should have a methodology for the use of financial derivative instruments with financial indices as underlying assets. This detailed methodology should describe how the investment policy is impacted by its exposure to financial indices.

The ESMA *Guidelines on ETFs and other UCITS issues* clarified that: UCITS should not invest in a financial index that has a single component that has an impact on the overall index return that exceeds the relevant diversification requirements i.e., 20%/35%. In the case of a leveraged index, the impact of one component on the overall return of the index, after having taken into account the leverage, should respect the same limits.

A UCITS should not invest in commodity indices that do not consist of different commodities. Sub-categories of the same commodity (for instance, from different regions or markets or derived from the same primary products by an industrialized process) should be considered as being the same commodity for the calculation of the diversification limits. For example, WTI Crude Oil, Brent Crude Oil, Gasoline, or Heating Oil contracts should be considered as being all sub-categories of the same commodity (i.e., oil). Sub-categories of a commodity should not be considered as being the same commodity if they are not highly correlated. With respect to the correlation factor, two components of a commodity index that are sub-categories of the same commodity should not be considered as highly correlated if 75% of the correlation observations are below 0.8. For that purpose, the correlation observations should be calculated (i) on the basis of equally-weighted daily returns of the corresponding commodity prices and (ii) from a 250-day rolling time window over a five-year period.

A UCITS should be able to demonstrate that an index satisfies the index criteria in Sections 4.2.2.8.1.IV. and 4.2.2.7.7.(a)-(c), including that of being a benchmark for the market to which it refers. For that purpose:

- ▶ An index should have a clear, single objective in order to represent an adequate benchmark for the market
- ▶ The universe of the index components and the basis on which these components are selected for the strategy should be clear to investors and competent authorities
- ▶ If cash management is included as part of the index strategy, the UCITS should be able to demonstrate that this does not affect the objective nature of the index calculation methodology

An index should not be considered as being an adequate benchmark of a market if it has been created and calculated on the request of a market participant or a very limited number of market participants and according to the specifications of those market participants.

UCITS should not invest in financial indices:

- ▶ Whose rebalancing frequency prevents investors from being able to replicate the financial index. Indices that rebalance on an intra-day or daily basis do not satisfy this criterion. For the purpose of these guidelines, technical adjustments made to financial indices (such as leveraged indices or volatility target indices) according to publicly available criteria should not be considered as rebalancing in the context of this paragraph
- ▶ Whose full calculation methodology (*inter alia*, enabling investors to replicate the financial index) is not disclosed by the index provider. This includes providing detailed information on index constituents, index calculation (including effect of leverage within the index), rebalancing methodologies, index changes, and information on any operational difficulties in providing timely or accurate information. Calculation methodologies should not omit important parameters or elements to be taken into account by investors to replicate the financial index. This information should be easily accessible, free of charge, to investors and prospective investors, for example, via the internet. Information on the performance of the index should be freely available to investors

- That do not publish their constituents together with their respective weightings. This information should be easily accessible, free of charge, to investors and prospective investors, for example, via the internet. Weightings may be published after each rebalancing on a retrospective basis. This information should cover the previous period since the last rebalancing and include all levels of the index
- Whose methodology for the selection and the rebalancing of the components is not based on a set of pre-determined rules and objective criteria
- Whose index provider accepts payments from potential index components for inclusion in the index
- Whose methodology permits retrospective changes to previously published index values (“backfilling”)

The UCITS should carry out and appropriately document due diligence on the quality of the index. This due diligence should take into account whether the index methodology contains an adequate explanation of the weightings and classification of the components on the basis of the investment strategy and whether the index represents an adequate benchmark. The due diligence should also cover matters relating to the index components. The UCITS should also assess the availability of information on the index including:

- Whether there is a clear narrative description of the benchmark
- Whether there is an independent audit and the scope of such an audit
- The frequency of index publication and whether this will affect the ability of the UCITS to calculate its NAV

The UCITS should ensure that the financial index is subject to independent valuation.

4.2.2.7.8. Securitizations

With respect to UCITS investing in securitizations, in addition to ensuring that securitizations meet the eligible assets rules, self-managed UCITS and UCITS management companies are subject to requirements outlined in Section 4.5.

4.2.2.8. Detailed rules regarding diversification

4.2.2.8.1. Concentration rules

1. General rules

- (1) No more than 10% of net assets may be invested in transferable securities or MMIs issued by the same body.
- (2) The total value of transferable securities and MMIs held in issuing bodies in each of which the UCITS has invested more than 5% of net assets must not exceed 40% of net assets. This limit does not apply to:
 - Deposits and OTC FDIs made with financial institutions subject to prudential supervision
 - Transferable securities and MMIs referred to in Sections 4.2.2.8.1.I.(3) and 4.2.2.8.1.II.(1)
 - Investments in other UCITS or UCIs
- (3) The limit of 10% in Section 4.2.2.8.1.I.(1) is increased to 25% for certain debt securities if they are issued by a credit institution with registered office in an EU Member State and subject to public supervision designed to protect the holders of debt securities (in the case of bankruptcy). In addition, the total value of such debt securities held in such issuing bodies in each of which the UCITS has invested more than 5% of net assets must not exceed 80% of net assets.
- (4) No more than 20% of net assets may be invested in deposits with the same body.
- (5) The risk exposure to a counterparty in an OTC FDI transaction may not exceed 10% of net assets in the case of a credit institution and 5% in other cases.

The risk exposures to a counterparty arising from OTC FDI transactions and EPM techniques should be combined when calculating the counterparty risk limits.

ESMA's Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS and CSSF Circular 11/512 clarifications:

The types of collateral that are eligible for the purpose of limiting the counterparty risk linked to efficient portfolio management transactions (EPM) also apply in the framework of OTC FDI transactions (see Section 4.2.2.10.(6) (b)).

The UCITS needs to define and apply appropriate and prudent discounts.

Collateral received by the UCITS, other than cash, cannot be sold, reinvested or pledged. Cash collateral can only be reinvested in risk-free assets that are eligible under the 2010 Law, i.e., eligible assets that do not provide a yield greater than the risk-free rate.

Reinvestment of cash collateral should be taken into account within the diversification limits applicable.

ESMA clarified further that only netting arrangements in accordance with the definition and conditions set out in the guidelines referred to above may be taken into account when calculating issuer concentration limits.

- (6) No more than 20% of net assets may be invested in any combination of the following with a single body:
- Transferable securities or MMIs
 - Deposits
 - OTC FDIs
 - Techniques and instruments relating to transferable securities and MMIs
- (7) The limits set out in Sections 4.2.2.8.1.I.(1) – (6) and 4.2.2.8.1.II.(1) may not be combined; thus investments in transferable securities or MMIs issued by the same body, in deposits or FDIs made with this body must under no circumstances exceed in total 35% of the net assets.
- (8) Companies which are included in the same group for the purposes of consolidated accounts, as defined in *Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings*⁸⁴, or in accordance with recognized international accounting rules, are regarded as a single body for the purpose of calculating the limits.

CSSF clarification on single body:

The CSSF considers that the notion of “group”, as defined in Section 4.2.2.8.1.I.(8), does not apply with respect to the application of the limits referred to in Sections 4.2.2.8.1.I.(1), (2), (4), (5) and (6). Consequently, the CSSF considers that the notion of body referred to in Section 4.2.2.8.1.I.(1) should be interpreted as issuer.

The restrictions set out in Section 4.2.2.8.1.I.(2) also apply to the individual issuer.

Furthermore, the CSSF considers that consolidation of accounts allows the presentation of the accounts of a group of companies with common interests and considers that the companies comprised within the scope of consolidation are part of the same group. Consequently, Section 4.2.2.8.1.I.(8) applies to all consolidated companies.

The CSSF also considers, by analogy with the provisions referred to in Section 4.2.2.8.1.I.(6), that the investment restriction relating to the notion of group provided for in Section 4.2.2.8.1.I.(8) applies to all instruments (including deposits and transactions on derivatives) of the group companies.

II. Exception for securities issued by governments

- (1) The limit of 10% in Section 4.2.2.8.I.(1) is increased to 35% if the transferable securities are issued or guaranteed by an EU Member State or its local authorities, by a non-Member State of the EU or by public international bodies of which one or more EU Member States are members.
- (2) The CSSF may authorize investment of up to 100% of net assets in at least six different transferable securities, issued or guaranteed by an EU Member State, its local authorities, a non-Member State of the EU or public international bodies of which one or more EU Member States are members, of which one issue may not account for more than 30% of the total.

The CSSF will only grant such an authorization if it considers that shareholders or unitholders in the UCITS have protection equivalent to that of shareholders or unitholders in UCITS complying with the concentration limits laid down in Section 4.2.2.8.1.I. and Section 4.2.2.8.1.II.(1).

Such UCITS must indicate the States, the local public authorities or public international bodies issuing or guaranteeing securities in which they intend to invest more than 35% of their net assets in:

- Their constitutional document
- Their prospectus or marketing communications, drawing attention to such authorization

⁸⁴ Directive 2013/34/EU repeals Directive 83/349/EEC.

III. Exception for investments in other open-ended UCIs

- (1) No more than 20% of net assets may be invested in a single UCITS or other UCI (for the purposes of applying this limit, each compartment of a target multiple compartment UCI is considered as a separate issuer).
- (2) No more than 30% of net assets may be invested in aggregate in shares or units of other UCIs (excluding UCITS).
- (3) Where investments are made in other UCITS and/or other UCIs that are linked to the investing UCITS (i.e., the same management company or a company linked to the management company), subscription or redemption fees may not be charged to the investing UCITS.

Where a “substantial proportion” of net assets are invested in other UCIs that are linked to the investing UCITS, the prospectus must disclose the maximum level of management fees that may be charged both to the UCITS itself and to the other UCIs in which it intends to invest. In its annual report, it must indicate the “maximum percentage” of management fees charged both to the UCITS itself and to the other UCIs in which it invests.

CSSF clarifications:

- “Substantial portion” is considered to be more than 50% of the net assets of the UCITS
- The “maximum percentage” of management fees that must be disclosed in the annual report should exclude commission that has been retroceded

IV. Exception for index replicating UCITS

- (1) Index replicating UCITS are those that replicate the composition of the underlying assets of the index, including the use of FDIs and other techniques and instruments.

The limit of 10% mentioned in Section 4.2.2.8.1.I.(1) is raised to 20% (or, if justified, 35%) for investment in either shares or debt securities, or both, issued by the same body where the investment policy is to replicate an index that is recognized by the CSSF.

The CSSF bases its recognition on the following criteria:

- Composition of the index is sufficiently diversified (see Section 4.2.2.8.1.IV.(2))
- Index represents an adequate benchmark (see Section 4.2.2.8.1.IV.(3)) for the particular market
- Index is published in an appropriate manner (see Section 4.2.2.8.1.IV.(4))

- (2) *Sufficiently diversified*

An index whose composition is sufficiently diversified is an index that complies with the risk diversification rules of the second sub-paragraph of Section 4.2.2.8.1.IV.(1).

- (3) *Represents an adequate benchmark*

An index that represents an adequate benchmark is an index whose provider uses a recognized methodology that generally does not result in the exclusion of a major issuer to the market to which it refers.

- (4) *Published in an appropriate manner*

An index that is published in an appropriate manner is an index that is accessible to the public and the provider of which is independent from the index-replicating UCITS.

V. Provisional derogations from investment restrictions

- (1) The aforementioned investment restrictions need not be complied with when exercising subscription rights; however the UCITS must remedy the situation as a priority objective. In addition, recently formed UCITS may derogate from Sections 4.2.2.8.1.I.(1) to (7), II., III., and IV. during the first six months.

CSSF clarification:

The derogation period starts in principle from the date of the authorization by the CSSF of the UCITS, or in case of an umbrella fund, of the compartment. However, for a UCITS/compartment not launched since its authorization date, the derogation period starts from the date of its first net asset value. In this case, the first net asset value date must be communicated to the CSSF and must occur within 18 months of the date of the authorization of the UCITS/compartment as foreseen under point 2 of CSSF Circular 12/540.

- (2) Following mergers, the receiving UCITS may derogate from Sections 4.2.2.8.1.1.(1) to (7), II., III. and IV. during the first six months following the effective date of the merger (see Section 3.7.4.).

VI. Investment in other compartments

- (1) A compartment of a UCITS may, subject to the requirements of the constitutional document as well as the prospectus, subscribe, acquire, and/or hold securities to be issued or issued by one or more compartments of the same UCITS without that UCITS, when it is formed as an investment company, being subject to the requirements of the 1915 Law with respect to the subscription, acquisition, and/or the holding by the company of its own shares, provided all the following conditions are met:
- ▶ The target compartment does not, in turn, invest in the compartment invested in this target compartment
 - ▶ Not more than 10% of the assets of the target compartment must be invested in other compartments of the same UCI/UCITS
 - ▶ Voting rights, if any, attaching to the relevant securities are suspended for as long as they are held by the compartment concerned
 - ▶ As long as these securities are held by the UCI/UCITS, their value will not be taken into consideration for the calculation of the net assets of the UCI for the purposes of verifying the minimum threshold of the net assets imposed by the 2010 Law

CSSF clarification:

The following restrictions also apply:

- ▶ The target compartment may not invest, according to its constitutional document, more than 10% of its net assets in other UCITS or UCIs
- ▶ No more than 20% of net assets may be invested in a single target compartment

VII. Rules regarding master-feeder structures

- (1) A feeder UCITS or a compartment of a feeder UCITS must invest at least 85% of its assets in shares or units of another UCITS or compartment thereof (the master UCITS)
- (2) A feeder UCITS may hold up to 15% of its assets in one or more of the following:
- ▶ Ancillary liquid assets
 - ▶ FDIs, which may be used only for hedging purposes
 - ▶ Movable and immovable property that is essential for the direct pursuit of its business, if the feeder UCITS is an investment company
- (3) A master UCITS or a compartment thereof:
- ▶ Must have, among its shareholders or unitholders, at least one feeder UCITS
 - ▶ Must not be itself a feeder UCITS
 - ▶ Must not hold units of a feeder UCITS

4.2.2.8.2. Rules regarding significant influence over an issuer

- (1) An investment company or a management company acting in connection with all the UCITS common funds it manages may not acquire any shares carrying voting rights that would enable it to exercise significant influence over the management of an issuing body.
- (2) Furthermore, a UCITS may acquire no more than:
- ▶ 10% of the non-voting shares of the same issuer
 - ▶ 10% of the debt securities of the same issuer
 - ▶ 25% of the shares or units of the same UCI
 - ▶ 10% of the MMIs issued by the same issuer

CSSF clarification:

For the purpose of the rules mentioned under (2) above the term UCITS means compartments. UCITS remain responsible to apply the 25% limit of the shares or units of the same UCI at the compartment level of the target UCI or at the umbrella level of the entire target UCI.

- (3) The restrictions of Sections 4.2.2.8.2.(1) and (2) are not applicable to:
- Transferable securities and MMIs issued or guaranteed by an EU Member State or its local authorities or by a non-Member State of the EU
 - Transferable securities and MMIs issued by public international bodies of which one or more EU Member States are members
 - Shares held in an intermediary incorporated in a non-Member State of the EU that invests mainly in securities issued by that State and where such holding is the only way in which the UCITS can hold these securities
 - Shares held by an investment company in the capital of subsidiaries carrying on only the business of management, advice, or marketing in the country where the subsidiary is located, regarding the repurchase of shares or units at the request of shareholders or unitholders
- (4) In the case of a multiple compartment UCITS, the restrictions in Section 4.2.2.8.2.(2) limiting the holding of securities of one issuer also apply to all compartments taken together.

4.2.2.9. Detailed borrowing rules and rules relating to granting of loans and short selling

The following section includes a detailed analysis of borrowing, lending, and short selling rules applicable to UCITS.

- (1) In general, neither an investment company nor the management company nor depositary acting on behalf of a common fund may borrow. However, there are three exceptions to this rule:
- Up to 10% of net assets may be borrowed on a temporary basis only
 - Up to 10% of net assets in the case of an investment company may be borrowed to acquire property essential for the business
 - The combined amount of such borrowings may not in total exceed 15% of net assets
 - Back-to-back loans may be acquired and are not considered as borrowings for the purposes of these limits

CSSF clarifications:

- A UCITS cannot use its borrowing entitlement to finance additional investments or for investment purposes, except if the requirements of the next bullet point are met
- A UCITS may borrow up to 10% of its net assets on a temporary basis (i.e., on a non-revolving basis) either to:
 - Meet redemptions
 - For investment purposes under certain conditions: borrowing must be temporary in the sense that it must mature in a reasonable period of time, taking into account the conditions under which it was concluded, and that such borrowing must not be permanently part of the investment policy of the UCITS – i.e., borrowings for investment purposes must not be performed on a recurring basis
 - Anticipate subscriptions provided that the subscriber is obliged to pay within a reasonable delay (two to three days) and that his commitment is formal
- The balances of the current accounts held with the same legal counterparty, whatever the currency, may be netted in the fund currency for the calculation of the 10% limit referred to in the previous bullet provided all the following conditions are met:
 - The UCITS' current accounts are free of pledge
 - The contracts signed by the UCITS and the counterparty governing these current accounts foresee such netting
 - The law that governs aforementioned contracts allows such netting
- Compensation of debit and credit balances with different legal entities is not permitted
- The management of the UCITS remains responsible for ensuring that any borrowing is reimbursed within a reasonable delay taking into account the conditions under which it has been granted

- (2) Granting of loans or acting as guarantor on behalf of third parties is not permitted (acquiring transferable securities that are not fully paid is allowed).
- (3) Short selling of securities is not permitted. However, it may be possible to use FDIs to create synthetic short positions.

4.2.2.10. Detailed rules regarding techniques and instruments relating to transferable securities and MMIs

- (1) Techniques and instruments relating to transferable securities and to MMIs may be employed provided they are used for the purpose of efficient portfolio management (EPM) and do not result in the UCITS diverging from its investment objectives or in a risk profile higher than that described in its sales documents.

Such techniques and instruments may include, *inter alia*:

- Securities lending transactions
- Sale with the right of repurchase transactions
- Reverse repurchase and repurchase agreement transactions
- Certain hedging transactions using FDIs

In September 2008, ESMA removed securities borrowing from the list of techniques and instruments relating to transferable securities and MMIs permitted for use for the purpose of EPM. Therefore, the physical short selling of borrowed securities is not a permitted activity (neither is short selling in general).

In line with this amendment to ESMA's guidelines, CSSF Circular 08/380 updates CSSF Circular 08/339.

The risk exposures to a counterparty arising from OTC FDI transactions and EPM techniques should be combined when calculating the counterparty risk limits.

Permitted techniques and instruments should meet the following criteria:

- Be economically appropriate and realized in a cost-effective manner
- Be entered into for at least one of the following reasons:
 - Risk reduction
 - Cost reduction
 - Generation of additional capital or income for the UCITS, provided that risk levels and diversification remain consistent
- Be captured by the risk management process

According to ESMA's *Guidelines on ETFs and other UCITS issues*, all revenues arising from EPM techniques, net of direct and indirect operational costs, should be returned to the UCITS.

- (2) Certain techniques and instruments relating to transferable securities and MMIs

CSSF Circular 08/356 of 4 June 2008 (as modified by CSSF Circular 11/512 of 30 May 2011) outlines rules applicable to UCIs when they employ certain techniques and instruments relating to transferable securities and MMIs.

CSSF clarification:

CSSF Circular 08/356 does not apply to MMF authorized under the MMF Regulation.

The techniques and instruments covered by the Circular are:

- Securities lending transactions (see Section 4.2.2.10.(3))
- Sale with the right of repurchase transactions (see Section 4.2.2.10.(4))
- Reverse repurchase and repurchase agreement transactions (see Section 4.2.2.10.(5))

The corporate governance principles of the UCI should address the case of securities lending operations taking place when a general assembly of the issuer of the securities is to be held.

- (3) Securities lending transactions

A UCITS may lend its securities:

- Directly
- Via a standardized lending system organized by a recognized securities clearing institution
- Via a lending system organized by a financial institution subject to prudential supervision rules considered by the CSSF as equivalent to those prescribed by EU law and specialized in these types of transactions

A UCITS' involvement in such transactions is subject to the following rules:

- ▶ A UCITS may enter into a securities lending transaction only if the counterparty meets the following criteria:
 - ▶ It is subject to prudential supervision rules considered by the CSSF as equivalent to those laid down in EU law. In case the financial institution acts on its own account, it is to be considered as the counterparty in the securities lending agreement
 - ▶ If the counterparty is a related party to the UCITS, attention must be paid to conflicts of interest, which might result therefrom

CSSF clarification: counterparties to OTC FDIs must be establishments:

- ▶ Authorized by a financial authority
- ▶ Subject to prudential supervision
- ▶ Either located in the EEA or in a country belonging to the Group of Ten or have at least an investment grade rating
- ▶ Specialized in such transactions

If the counterparty does not fulfil any of the three first criteria, a UCITS has to demonstrate that the prudential rules applicable to such counterparty are equivalent to those laid down in EU Law.

- ▶ The UCITS must receive, at the same time or prior to the transfer of securities lent, collateral that meets the requirements set out in Section 4.2.2.10.(6)(b). If, however, the securities lending transaction takes place via a lending system, then securities lent may be transferred before the receipt of the collateral if the intermediary concerned ensures proper completion of the transaction and, in lieu of the borrower, provides the UCITS with eligible collateral assets
- ▶ The UCITS should ensure, at all times, that the level of such transactions entered into at any one time permits the UCITS to meet its redemption obligations
- ▶ The UCITS should ensure that it is able at any time to recall any security lent out or terminate any securities lending agreement it has entered

(4) Sale with the right of repurchase transactions

(a) Purchase of securities with a repurchase option

A UCITS is permitted to enter into a contract to purchase securities with the seller retaining the right to repurchase the securities from the UCITS at a price and date agreed between the two parties.

Such transactions are subject to the following rules:

- ▶ The counterparties to these transactions must be subject to prudential supervision rules considered by the CSSF as equivalent to that prescribed by EU Law

CSSF clarification: counterparties to OTC FDIs must be establishments:

- ▶ Authorized by a financial authority
- ▶ Subject to prudential supervision
- ▶ Either located in the EEA or in a country belonging to the Group of Ten or have at least an investment grade rating
- ▶ Specialized in such transactions

If the counterparty does not fulfil any of the three first criteria, a UCITS has to demonstrate that the prudential rules applicable to such counterparty are equivalent to those laid down in EU Law.

- ▶ Throughout the duration of the transaction, a UCITS is not permitted to sell the securities it acquired as part of the transaction before the counterparty has exercised its option or until the repurchase date has passed, unless the UCITS has other means of coverage
- ▶ The UCITS should ensure, at all times, that the level of such transactions entered into at any one time permits it to meet its redemption obligations
- ▶ Securities that are the subject of a purchase with repurchase option transaction are limited to:
 - ▶ Short-term bank certificates or MMIs (as defined in Section 4.2.2.7.5.1.)
 - ▶ Bonds issued or guaranteed by an OECD Member State, by their local public authorities, or by supranational institutions and undertakings with EU, regional, or worldwide scope
 - ▶ Shares or units issued by MMFs calculating a daily net asset value and being assigned a rating of AAA or its equivalent

CSSF clarification:

Only credit ratings issued or backed by credit rating agencies registered or certified in the EU may be used for regulatory purposes. An updated list is available on the ESMA website.

- ▶ Bonds issued by non-governmental issuers offering adequate liquidity
- ▶ Shares quoted or negotiated on a regulated market of an EU Member State or on a stock exchange of an OECD Member State, on the condition that these shares are included in a main index
- ▶ Securities purchased as part of a purchase with option to repurchase transaction, when combined with the rest of the UCITS' portfolio, comply with the UCITS' investment policies and restrictions

(b) Sale of securities with a repurchase option

Conversely, the UCITS is also permitted to sell securities with a repurchase option. In a similar manner to the transaction described in Section 4.2.2.10.(4)(a), the contract entered into with the buyer would allow the UCITS the right to repurchase the securities from the buyer at a price and date agreed between the two parties on entering into the contract.

UCITS entering into sales of securities with repurchase option transactions must, however, adhere to the following rules:

- ▶ The counterparties to these transactions must be subject to prudential supervision rules considered by the CSSF as equivalent to that prescribed by EU Law

CSSF clarification: counterparties to OTC FDIs must be establishments:

- ▶ Authorized by a financial authority
- ▶ Subject to prudential supervision
- ▶ Either located in the EEA or in a country belonging to the Group of Ten or have at least an investment grade rating
- ▶ Specialized in such transactions

If the counterparty does not fulfil any of the three first criteria, a UCITS has to demonstrate that the prudential rules applicable to such counterparty are equivalent to those laid down in EU Law.

- ▶ On maturity of the repurchase option, the UCITS must have sufficient assets available to be able to pay, if applicable, the amount agreed to buy back the securities, and continue to comply with the investment policy and restrictions

(5) Reverse repurchase and repurchase agreement transactions

(a) Reverse repurchase transactions

Such transactions involve the UCITS entering into a forward transaction at the maturity of which the counterparty (seller) has the obligation to repurchase the assets sold and the UCITS has the obligation to return the assets received under the transaction.

A UCITS can only enter into such transactions if the following rules are complied with:

- ▶ The counterparties to these transactions must be subject to prudential supervision rules considered by the CSSF to be equivalent to those prescribed by EU Law

CSSF clarification: counterparties to OTC FDIs must be establishments:

- ▶ Authorized by a financial authority
- ▶ Subject to prudential supervision
- ▶ Either located in the EEA or in a country belonging to the Group of Ten or have at least an investment grade rating
- ▶ Specialized in such transactions

If the counterparty does not fulfil any of the three first criteria, a UCITS has to demonstrate that the prudential rules applicable to such counterparty are equivalent to those laid down in EU Law.

- ▶ The UCITS may not sell or pledge/give as security the securities purchased as part of the contract throughout the life of the contract, unless it has other means of coverage
- ▶ The value of the reverse repurchase transactions is kept at a level that allows the UCITS to meet its redemption obligations at all times
- ▶ Securities that may be purchased in a reverse repurchase agreement must be:
 - ▶ Short-term bank certificates or MMIs (as defined in Section 4.2.2.7.5.1.)
 - ▶ Bonds issued or guaranteed by an OECD Member State, by their local public authorities or by supranational institutions and undertakings with EU, regional or worldwide scope
 - ▶ Shares or units issued by money market UCIs calculating a daily NAV and being assigned a rating of AAA or its equivalent

CSSF clarification:

Only credit ratings issued or backed by credit rating agencies registered or certified in the EU may be used for regulatory purposes. An updated list is available on the ESMA website.

- ▶ Bonds issued by non-governmental issuers offering adequate liquidity
- ▶ Shares quoted or negotiated on a regulated market of an EU Member State or on a stock exchange of an OECD Member State, on the condition that these shares are included in a main index
- ▶ Securities purchased through a reverse repurchase transaction must, when combined with the rest of the UCITS' portfolio, comply with the UCITS' investment policies and restrictions

(b) Repurchase agreement transactions

A UCITS may enter into repurchase agreement transactions, being forward transactions at the maturity of which the UCITS has the obligation to repurchase the assets sold and the buyer has the obligation to return the assets received under the transaction.

Such transactions are subject to the following rules:

- ▶ The counterparty must be subject to prudential supervision rules considered by the CSSF to be equivalent to those prescribed by EU Law

CSSF clarification: counterparties to OTC FDIs must be establishments:

- ▶ Authorized by a financial authority
- ▶ Subject to prudential supervision
- ▶ Either be located in the EEA or in a country belonging to the Group of Ten or have at least an investment grade rating
- ▶ Specialized in such transactions

If the counterparty does not fulfil any of the three first criteria, a UCITS has to demonstrate that the prudential rules applicable to such counterparty are equivalent to those laid down in EU Law.

- ▶ At the maturity of the agreement, the UCITS must have sufficient assets to enable it to settle the amount agreed with the counterparty, and continue to comply with the investment policy and restrictions
- ▶ The UCITS must ensure that the level of repurchase agreement transactions is kept at a level to enable it to meet all redemption obligations

(6) Limitation of counterparty risk and receipt of appropriate collateral

(a) Limitation of counterparty risk

To ensure that the counterparty risk linked to securities lending transactions is covered at all times, the UCITS must receive eligible collateral assets.

Such assets must, throughout the duration of the agreement, amount to at least 90% of the value of the global valuation of the securities lent (all rights included, i.e., interest, dividends).

UCITS may take into account collateral received in order to reduce the counterparty risk in sale with right of repurchase transactions and/or reverse repurchase and repurchase transactions.

The net exposures (i.e., the exposures of the UCITS less the collateral received by the UCITS) to a counterparty arising from securities lending transactions, reverse repurchase transactions, or repurchase agreement transactions must be taken into account in the calculation of the 20% limit within a single body (see also Section 4.2.2.8.1.1.(6)).

(b) Receipt of eligible assets as collateral

The following assets are considered as eligible collateral:

- ▶ Liquid assets, including:
 - ▶ Cash and short-term bank deposits
 - ▶ MMIs as defined in Section 4.2.2.7.5.I. (issued by an issuer not affiliated to the counterparty)
 - ▶ Letters of credit or guarantees on first demand issued by first class credit institutions not affiliated to the counterparty
- ▶ Bonds issued or guaranteed by:
 - ▶ An OECD Member State, their local authorities, or supranational bodies and organizations with community, regional, or worldwide character
 - ▶ First class issuers offering adequate liquidity
- ▶ Shares or units issued by any of the following:
 - ▶ Daily valued money market UCIs assigned a rating of AAA or equivalent
 - ▶ UCITS investing in bonds issued or guaranteed by first class issuers offering adequate liquidity which is not affiliated to the counterparty
 - ▶ UCITS investing in shares (providing that these shares are included in a main index) admitted to or dealt in on a regulated market of an EU Member State or listed on a stock exchange of an OECD Member State
 - ▶ Shares (providing that these shares are included in a main index) that are either:
 - ▶ Admitted to or dealt in on a regulated market of an EU Member State
 - ▶ Listed on a stock exchange of an OECD Member State

If collateral is given in any form other than cash or shares or units of a UCITS or other UCI, it must be issued by an entity not affiliated to the counterparty.

On receipt of collateral, the UCITS must value the assets received on a daily basis. In addition, the lending agreement must include provisions which require the counterparty to give the UCITS additional collateral, at very short notice, if the value of the collateral initially given is insufficient in comparison with the amount to be covered. In addition, provisions should also provide for margins to take into consideration exchange risks or market risks inherent to the assets accepted as collateral.

The following considerations must be taken into account with respect to collateral:

- ▶ If cash has been received as collateral, the UCITS may be exposed to credit risk vis-à-vis the custodian of the collateral. If this risk exists, the UCITS must take the collateral into consideration for the purpose of the limits on deposits (Article 43 (1) of the 2010 Law - see Section 4.2.2.8.1.I.(4))
- ▶ Cash collateral must not be safekept by the counterparty except if the assets are legally protected from consequences of default of the counterparty
- ▶ Non-cash collateral must not be safekept by the counterparty except if it is adequately segregated from the counterparty's assets
- ▶ The collateral must, at all times, be available either:
 - ▶ Directly
 - ▶ Via a first class financial institution or a wholly-owned subsidiary thereof to enable the UCITS to seize or realize the collateral assets if the counterparty does not comply with its obligation to return the securities lent
- ▶ In case of a reorganization or liquidation, or similar, the UCITS must ensure (via its contractual terms) that it is able to discharge its obligation to return assets received as collateral if the securities cannot be returned under the initially agreed terms

Furthermore, the collateral:

- ▶ Must be received before or at the same time as the transfer of securities lent (see also (3))
- ▶ May not be sold or given as security or pledged by the UCITS, subject to the latter being otherwise covered
- ▶ May be returned at the same time as, or subsequent to, when the lent securities are being returned

According to ESMA's *Guidelines on ETFs and other UCITS issues*, all assets received by UCITS in the context of EPM techniques should be considered as collateral.

Where a UCITS enters into OTC FDI transactions and EPM techniques, all collateral used to reduce counterparty risk exposure should comply with the following criteria at all times:

- ▶ Liquidity - any collateral received other than cash should be highly liquid and traded on a regulated market or multilateral trading facility with transparent pricing so that it can be sold quickly at a price that is close to pre-sale valuation. Collateral received should also comply with the requirements of Section 4.2.2.8.2.
- ▶ Valuation - collateral received should be valued on at least a daily basis and assets that exhibit high price volatility should not be accepted as collateral unless suitably conservative haircuts are in place
- ▶ Issuer credit quality - collateral received should be of high quality
- ▶ Correlation - the collateral received by the UCITS should be issued by an entity that is independent from the counterparty and is expected not to display a high correlation with the performance of the counterparty
- ▶ Collateral diversification (asset concentration) - collateral should be sufficiently diversified in terms of country, markets and issuers. The criterion of sufficient diversification with respect to issuer concentration is considered to be respected if the UCITS receives from a counterparty of EPM and OTC FDI transactions a basket of collateral with a maximum exposure to a given issuer of 20% of its NAV. When UCITS are exposed to different counterparties, the different baskets of collateral should be aggregated to calculate the 20% limit of exposure to a single issuer

According to ESMA's *Guidelines on ETFs and other UCITS issues*, by way of derogation from the aforementioned diversification rules, a UCITS may be fully collateralized in different transferable securities and money market instruments issued or guaranteed by a Member State, one or more of its local authorities, a third country, or a public international body to which one or more Member States belong. Such a UCITS should receive securities from at least six different issues, but securities from any single issue should not account for more than 30% of the UCITS' net asset value.

UCITS that intend to be fully collateralized in securities issued or guaranteed by a Member State, local authorities, third countries, or public international bodies should disclose this fact in the prospectus of the UCITS. UCITS should also identify the Member States, local authorities, third countries, or public international bodies issuing or guaranteeing securities from which they are able to accept as collateral for more than 20% of their net asset value. This derogation does not affect the other criteria for collateral management as set out in the guidelines.

- ▶ Risks linked to the management of collateral, such as operational and legal risks, should be identified, managed, and mitigated by the risk management process
- ▶ Where there is a title transfer, the collateral received should be held by the depository of the UCITS. For other types of collateral arrangement, the collateral can be held by a third party custodian that is subject to prudential supervision and that is unrelated to the provider of the collateral
- ▶ Collateral received should be capable of being fully enforced by the UCITS at any time without reference to or approval from the counterparty

(7) Reinvestment of collateral

If collateral is received in the form of cash, the cash may be reinvested by the UCITS in the following:

- ▶ Shares or units of daily valued MMFs assigned a rating of AAA or equivalent

CSSF clarification:

Only credit ratings issued or backed by credit rating agencies registered or certified in the EU may be used for regulatory purposes. An updated list is available on the ESMA website.

- ▶ Short-term bank deposits
- ▶ MMIs as defined in Section 4.2.2.7.5.I.
- ▶ Short-term bonds issued or guaranteed by an EU Member State, Switzerland, Canada, Japan or the United States or by their local authorities or by supranational institutions and undertakings of a community, regional or worldwide nature
- ▶ Bonds issued or guaranteed by first class issuers offering adequate liquidity
- ▶ Reverse repurchase agreements eligible under CSSF Circular 08/356

If financial assets are purchased through the reinvestment of cash received as collateral, the purchased financial assets:

- If other than bank deposits and shares or units of UCIs, must be issued by an entity not affiliated to the counterparty
- If other than bank deposits, must not be safekept by the counterparty, except if they are segregated in an appropriate manner from the latter's own assets
- If bank deposits, must not be safekept by the counterparty unless they are legally protected from consequences of default of the counterparty
- May not be pledged or given as a guarantee except if the UCITS has sufficient liquidity to return the received collateral in the form of cash
- If short-term bank deposits, MMIs and bonds, must be core eligible investments in accordance with the 2010 Law

Exposures arising from the reinvestment of collateral received by the UCITS from securities lending transactions, sale with right of repurchase transactions, reverse repurchase agreement transactions, and repurchase agreement transactions must be taken into account within the diversification limits applicable under the 2010 Law (see Section 4.2.2.8.). The UCITS must also ensure that:

- If short-term bank assets are likely to expose the UCITS to credit risk vis-à-vis the custodian, the UCITS must take this into account when computing the deposit limits set out in Article 43(1) of the 2010 Law - see Section 4.2.2.8.1.1.(4)
- The reinvestment must be taken into account for the calculation of the global exposure of the UCITS in particular if it creates a leverage effect. Any reinvestment of cash collateral in financial assets providing a return in excess of the risk free rate is subject to this requirement
- Any collateral assets that have been reinvested must be specifically mentioned, with their values given, in an appendix to the financial reports of the UCITS

According to ESMA *Guidelines on ETFs and other UCITS issues*:

- Non-cash collateral received should not be sold, reinvested, or pledged
- Cash collateral received should only be:
 - Placed on deposit with a credit institution that has its registered office in an EU Member State or, if located in a non-Member State, subject to equivalent prudential rules
 - Invested in high-quality government bonds
 - Used for the purpose of reverse repurchase transactions provided the transactions are with credit institutions subject to prudential supervision and the UCITS is able to recall at any time the full amount of cash on an accrued basis
 - Invested in short-term money market funds as defined in Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on *money market funds* (see Section 4.8.)
- Reinvested cash collateral should be diversified in accordance with the diversification requirements applicable to non-cash collateral

ESMA clarified that when a UCITS reinvests cash collateral in short term money market funds, these short term money market funds should not invest, according to their constitutional document, more than 10% of their net assets in other UCITS or UCIs.

4.2.3. Part II UCIs

Part II of the 2010 Law contains no provisions regarding investment or borrowing rules for such UCIs. Such rules are specified in CSSF circulars or determined on a case-by-case basis by the CSSF.

The CSSF has issued rules or guidelines for 2010 Law Part II UCIs investing in the following activities:

- Transferable securities (see Section 4.2.3.1.)
- Alternative investments (i.e., hedge funds) (see Section 4.2.3.2.)
- Venture capital (see Section 4.2.3.3.); see also Section 4.7.1. on the investment restrictions applicable to qualifying EuVECA
- Futures contracts and options (see Section 4.2.3.4.)
- Real estate (see Section 4.2.3.5.)

The rules applicable for UCIs employing certain techniques and instruments relating to transferable securities and money market instruments set out in CSSF Circular 08/356 are also, in principle, applicable to 2010 Law Part II UCIs (see Sections 4.2.2.10.(2) to (7)); however, the requirements of ESMA's *Guidelines on ETFs and other UCITS issues* are, in principle, not applicable to 2010 Law Part II UCIs.

In addition to the general annual reporting requirements, specific requirements apply to these types of 2010 Law Part II UCIs (see Section 10.5.1.).

In addition, full AIFM regime 2010 Law Part II UCIs that:

- Invest in securitization positions are subject to the requirements outlined in Section 4.5.
- Acquire major holdings or control over non-listed companies are subject to the requirements outlined in Section 4.6.

4.2.3.1. Part II UCIs investing in transferable securities

The following summarizes investment and borrowing restrictions as set out in Chapter G of Circular 91/75. Certain of these limits will not apply if they are not compatible with the investment policy of the UCI (e.g., UCI whose investment policy provides for the investment of 20% or more of their net assets in venture capital or the permanent borrowing for investment purposes of at least 25% of their net assets).

A. Unlisted securities

- (1) No more than 10% of net assets may be invested in securities not quoted on a stock exchange or dealt in on another regulated market (see, however, Section 4.2.3.1.D.(1)).

B. Investment in any one security or issuer

- (1) No more than 10% of net assets may be invested in securities issued by any one issuer (see, however, Section 4.2.3.1.D.(1)).

C. Significant influence over an issuer

- (1) No more than 10% of securities issued by any one issuer may be acquired (see, however, Section 4.2.3.1.D.(1)).
- (2) In the case of multiple compartment UCIs, the restriction in Section 4.2.3.1.C.(1) limiting the holding of securities of one issuer also applies to all compartments taken together.

D. Derogation

- (1) Restrictions in Section 4.2.3.1.A.(1) to C.(1) are not applicable to securities issued or guaranteed by OECD Member States or their local authorities or public international bodies with EU, regional or worldwide scope.

E. Investment in other UCIs

- (1) Restrictions in Section 4.2.3.1.A.(1) to C.(1) are applicable to the investment in other UCIs of the open-ended type where those UCIs are not subject to risk diversification requirements comparable to those in Section 4.2.3.1.A.(1) to D.(1). Investment in closed-ended UCIs is permitted and subject to the restrictions applicable to transferable securities. If investment is to be made in other UCIs (fund of funds), this must be expressly stated in the prospectus and, if such investment is to be in other UCIs of the same promoter, the prospectus must specify the nature of fees and expenses arising.

F. Investment in other compartments

- (1) A compartment of a UCI may, subject to the conditions laid down in the constitutional document as well as in the prospectus, subscribe, acquire, and/or hold securities issued or to be issued by one or more compartments of the same UCI without that UCI, when it is formed as an investment company, being subject to the requirements of the 1915 Law with respect to the subscription, acquisition, and/or the holding by the company of its own shares, provided all the following conditions are met:
 - The target compartment does not, in turn, invest in the compartment invested in this target compartment
 - No more than 10% of the net assets of the target compartments, whose acquisition is contemplated, may be invested, pursuant to their constitutional document, in shares or units of other target compartments of the same UCI
 - Voting rights, if any, attaching to the relevant securities are suspended for as long as they are held by the compartment concerned
 - As long as these securities are held by the UCI, their value will not be taken into consideration for the calculation of the net assets of the UCI for the purposes of verifying the minimum threshold of the net assets imposed by the 2010 Law

G. Borrowings

- (1) Borrowings of up to 25% of net assets without any restriction are allowed. Leveraged UCIs are not subject to this restriction.

4.2.3.2. Alternative investments

A. Introduction

UCIs that adopt alternative investment strategies were not specifically covered by the provisions of Circular 91/75. Therefore, the CSSF issued Circular 02/80, which concerns specifically UCIs whose investment objective is to adopt so-called alternative investment strategies, akin to those pursued by hedge funds.

The overall objective of the Circular is to clarify the legal and regulatory framework applicable to such products.

The Circular's purpose is to provide a formal framework for establishing regulated hedge fund products that had previously been approved on a case-by-case basis.

The CSSF may allow departures from the provisions set out in the Circular, where justified, or impose additional investment restrictions, where appropriate. This may include cases where the Circular is more restrictive than subsequent regulations.

B. Short selling

Short selling may be carried out subject to the following rules:

- ▶ Aggregate commitment (i.e., unrealized losses) in terms of short selling may not exceed 50% of assets
- ▶ The short sales of transferable securities for which the UCI holds adequate coverage are not to be considered in the calculation of the total commitments referred to above. The granting by the UCI of a security, of whatever nature, on its assets to third parties in order to secure its obligations towards such third parties, is not to be considered as adequate coverage of the UCI's commitments
- ▶ In connection with short sales on transferable securities, UCIs are authorized to enter, as borrower, into securities lending transactions with first class professionals specialized in this type of transaction. The counterparty risk (i.e., the difference between the value of the securities pledged and the value of the securities borrowed) per lender may not exceed 20% of assets
- ▶ Up to 10% of assets may be invested in short positions of unlisted securities, provided such securities are liquid
- ▶ Not more than 10% of the same type of securities issued by the same issuer may be sold short
- ▶ Short positions on securities issued by the same body may not exceed 10% of assets and/or the commitment on such securities may not exceed 5% of assets
- ▶ If the UCI enters into short sale transactions, it must hold sufficient assets enabling it at any time to close the open positions resulting from such short sales

C. Borrowing

Borrowing for investment purposes on a permanent basis from first class credit institutions who specialize in this type of transaction is permitted subject to the following:

- ▶ Borrowings may not exceed 200% of the net assets. Consequently, the value of the total assets may not exceed 300% of the value of net assets
- ▶ In cases where there is a high degree of correlation between long and short positions, borrowings may increase to 400% of net assets

Counterparty risk (defined under "short selling") cannot represent more than 20% of the UCI's assets per lender.

D. Investments in other UCIs (fund of funds)

Investments in other UCIs are subject to the following provisions:

- ▶ Up to 20% of net assets may be invested in the securities of the same UCI. However, in applying this limit each compartment of a multiple compartment UCI will be considered as a separate UCI, provided that no cross-liability exists between the compartments
- ▶ Up to 100% of the shares issued by a multiple compartment UCI may be held, provided that the total investment in the UCI does not exceed 50% of net assets

These limits are not applicable to investments in open-ended regulated UCIs that apply a diversified investment policy. This derogation may not result in an excessive concentration of the investments of the UCI in one single target UCI provided that for the purpose of this limitation, each compartment of a target UCI with multiple compartments is to be considered as a distinct target UCI and that no cross-liability exists between the compartments.

UCIs that principally invest in other UCIs must make sure that their portfolio of target UCIs presents appropriate liquidity features to enable the UCIs to meet their obligation to redeem their shares. Their investment policies must include a description of how their portfolio of target UCIs presents appropriate liquidity features.

E. Long positions

Long positions must meet the following criteria:

- ▶ No more than 10% of its assets may be invested in unlisted securities
- ▶ No more than 10% of the same type of securities issued by the same entity may be acquired
- ▶ Exposure to a single issuer may not exceed 20% of assets

These restrictions do not apply to investments in other UCIs and to securities issued or guaranteed by an OECD Member State or by its local authorities or by supranational bodies or organizations of an EU, regional or worldwide nature.

F. Securities lending

In general, such UCIs may lend through a standard system organized by a recognized clearing institution or through a first class financial institution, subject to the following provisions:

- ▶ Collateral (in the case of a first class institution only) received must be at least equal to the value of securities lent
- ▶ Securities lent may not exceed 50% of the value of the UCI's portfolio unless the UCI has the right to cancel the contract at any time
- ▶ Lending contracts may not exceed 30 days unless the UCI has the right to cancel the contract at any time

G. Financial derivative instruments (FDIs)

Such UCIs are authorized to use all types of exchange traded/OTC FDIs such as options, forward or futures contracts, as well as swap contracts, provided that the following conditions are met:

- ▶ The UCI's total commitments arising from such instruments (exchange traded and OTC) and short selling cannot exceed the value of the assets
- ▶ Total margin deposits (exchange traded), commitments arising from FDIs (i.e., unrealized losses for OTC instruments), and premiums paid for the acquisition of options outstanding may not exceed 50% of the assets
- ▶ Sufficient liquid assets (for example, term deposits, Treasury bills, Treasury bonds, and MMIs) to finance margin calls must be maintained
- ▶ Borrowings may not be used to finance margin deposits
- ▶ Margin requirements or commitments on a single contract may not exceed 5% of the assets
- ▶ Premiums paid on options with identical characteristics may not exceed 5% of the assets
- ▶ The UCI may not invest directly in commodities, although it may hold commodity futures and hold precious metals dealt in on an organized market
- ▶ The UCI must ensure an adequate spread of investment risks by sufficient diversification
- ▶ The UCI margin requirements/commitments on a single commodity/class of financial futures may not exceed 20% of the assets

UCIs that use such techniques and instruments must include in their prospectus the maximum total leverage and a description of the risks inherent in such transactions.

H. Repurchase and reverse repurchase agreements

The UCI may enter into sale with right of repurchase transactions which entail the purchase and sale of securities where the terms reserve the right to the seller to repurchase the securities from the buyer at a price and at a time agreed between the two parties at the time when the contract is entered into. The UCI can also enter into repurchase transactions which consist of transactions where, at maturity, the seller has the obligation to take back the asset sold whereas the original buyer either has a right or an obligation to return the asset sold.

The UCI can either act as buyer or as seller in the context of the aforementioned transactions.

The UCI may enter into such transactions provided that the following conditions are met:

- ▶ The transactions must be carried out with first class institutions

- ▶ During the duration of a sale with right of repurchase agreement where the UCI acts as purchaser, the UCI may not sell the securities that are the subject of the contract before the counterparty has exercised its right to repurchase the securities or until the deadline for the repurchase has expired, unless the UCI has other means of coverage. If the UCI is open for redemption, it must ensure that the value of such transactions is kept at a level such that it is at all times able to meet its redemption obligations. The same conditions are applicable in the case of a repurchase transaction on the basis of a purchase and firm resale agreement where the UCI acts as purchaser (transferee)
- ▶ Where the UCI acts as seller (transferor) in a repurchase transaction (repo), the UCI may not, during the whole duration of the repo, transfer the title to the security under the repo or pledge them to a third party, or repo them a second time, in whatever form. The UCI must, at the maturity of the repurchase transaction, hold sufficient assets to pay, if appropriate, the agreed repurchase price payable to the transferee

I. *Minimum entry investment*

There is no minimum level of initial investment by investors.

J. *Breach of investment limits*

Where an investment limit is breached due to passive reasons (market movements, ...), the UCI must take corrective action in the best interests of the shareholders or unitholders.

The CSSF has clarified on numerous occasions that breaches of investment restrictions resulting from predictable events (cash inflows or outflows expected due to subscriptions, redemptions, reimbursements of bonds) should be considered as active breaches with the full application of CSSF Circular 02/77. Refer to Section 8.8.

K. *Prime broker*

The use of a prime broker is subject to the counterparty risk limitation mentioned under Section 4.2.3.2.C. and the requirements outlined in Section 9.8.

4.2.3.3. Venture capital UCIs

Investment in venture capital is defined as “investment in securities of unlisted companies because either these companies are recently formed, or they are still in the course of development and therefore have not yet obtained the stage of maturity required to have access to stock markets”. Venture capital UCIs invest in these higher risk companies with the intention of achieving a higher rate of return.

The principal regulations applicable to venture capital UCIs are stated in Chapter I.I. of Circular 91/75. The managers and investment advisers must be able to demonstrate their specific experience in venture capital.

A. *Investment restrictions*

Investments must be diversified in order to spread the risk and, in particular, no more than 20% of net assets may be invested in any one company.

4.2.3.4. Futures contracts and/or options UCIs

The principal regulations applicable to UCIs investing in one or more of commodity futures, financial futures and options are stated in Chapter I.II. of Circular 91/75. The managers and investment advisers must be able to demonstrate their expertise in this field.

A. *Investment restrictions*

- (1) Margin deposits related to commitments on purchase and sale of futures contracts and call and put options may not exceed 70% of net assets, the balance of 30% representing a liquidity reserve.
- (2) Futures contracts, including those underlying options, must be dealt in on an organized market.
- (3) Contracts concerning commodities, other than commodity futures contracts, are not allowed. The acquisition of precious metals, negotiable on an organized market, for cash is permitted.
- (4) Only call and put options dealt in on an organized market are permitted. Premiums paid for such options are included in the 70% limit in Section 4.2.3.4.A.(1).
- (5) Investments must be sufficiently diversified in order to spread risk.
- (6) An open forward position may not be held in any one contract for which the margin requirement represents 5% or more of net assets. This also applies to open positions resulting from the sale of options.

- (7) Premiums paid to acquire options having identical characteristics may not exceed 5% of net assets.
- (8) Open positions in futures contracts concerning a single commodity or a single category of financial futures must be less than 20% of net assets. This also applies to open positions resulting from the sale of options.

B. Borrowings

- (1) Borrowings of up to 10% of net assets are permitted but not for investment purposes.

4.2.3.5. Real estate UCIs

The CSSF defines real estate for the purposes of Circular 91/75 as:

- Property consisting of land and/or buildings registered in the name of the UCI
- Participations in real estate companies (as well as loans to such companies) the exclusive purpose and objects of which are the acquisition, development, and sale together with the letting and tenancing of real estate, assuming that such participations are at least as realizable as those real estate interests held directly by the UCI
- Various long-term real estate related interests such as rights to ground rents, long-term leases and option rights over real estate investments

The principal regulations applicable to real estate UCIs are stated in Chapter I.III. of Circular 91/75. The managers and investment advisers must have experience in real estate investment.

A. Investment restrictions

- (1) Investment in property must be sufficiently diversified in order to spread risk, and in any case no more than 20% of net assets may be invested in any one property. Property which has an economic life dependent on another property is not considered as a separate property. This 20% rule does not apply during a start-up period not exceeding four years.

B. Borrowings

- (1) Total borrowings may not exceed 50% of the value of all properties.

C. Valuations of properties

- (1) One or more experienced independent property valuers must be appointed.
- (2) At the year end, all properties owned by the UCI or its affiliated real estate companies must be valued by the property valuers.
- (3) Properties may not be acquired or sold without a valuation by the property valuers, although a new valuation is not required if the sale of a property occurs within six months of the last valuation.
- (4) The purchase or sale price may not be appreciably higher or lower than the valuation, except under justifiable circumstances, which must be explained in the next financial report.

4.3. SIFs

SIFs are required to comply with general diversification and risk management requirements, but are not subject to detailed investment or borrowing rules. This section covers the diversification requirements; risk management requirements are covered in Section 7.4.

In addition, full AIFM regime SIFs that:

- Invest in securitization positions are subject to the requirements outlined in Section 4.5.
- Acquire major holdings or control over non-listed companies are subject to the requirements outlined in Section 4.6.

SIFs that are EuVECA or EuSEFs are subject to the specific requirements on their investments set out in Section 4.6.

4.3.1. Diversification

The SIF Law states that a SIF should apply the principle of risk diversification. CSSF Circular 07/309 on risk spreading in the context of specialized investment funds complemented the SIF Law and provided clarification on the investment restrictions that must be adhered to in order to ensure adequate risk diversification:

- (1) A SIF cannot, in principle, invest more than 30% of its assets or its commitments to subscribe to securities of the same nature issued by the same issuer. This restriction is not, however, applicable to investments in:
 - Securities issued or guaranteed by an OECD Member State or by its local authorities or by supranational bodies or organizations of an EU, regional, or worldwide nature
 - Target UCIs that are subject to risk diversification principles that are at least comparable to those relevant to SIFs (e.g., a feeder SIF investing in a master UCI). Each compartment of a target multiple compartment UCI may be considered as a distinct issuer provided that the segregation of assets and liabilities on a compartment by compartment basis is implemented
- (2) Short selling cannot, in principle, result in the SIF holding uncovered securities of the same nature issued by the same issuer representing more than 30% of its assets.
- (3) When using financial derivative instruments (FDIs), the SIF must ensure comparable risk diversification through appropriate diversification of the underlying assets. Counterparty risk of OTC operations must be limited according to the quality and qualification of the counterparty.

The risk diversification requirements should, in practice, be complied with by each compartment of a multiple compartment SIF.

The CSSF may provide exemptions from the restrictions laid out in Circular 07/309 on a case-by-case basis - for example, exemptions may be granted, for a limited period, to real estate and private equity SIFs making their first investments. However, the CSSF may also request that additional restrictions are adhered to, in cases of funds with specific investment policies.

A compartment of a SIF may, subject to the conditions set out in the offering document, subscribe, acquire, and/or hold securities issued or to be issued by one or several other compartments of the same SIF, without this SIF, when it is formed as an investment company, being subject to the requirements regarding the subscription, acquisition, and/or holding by a company of its own shares set out in the 1915 Law, subject to the following conditions:

- The target compartment does not, in turn, invest in the compartment invested in this target compartment
- The voting rights, if any, which might be attached to the securities concerned will be suspended for as long as they are held by the relevant compartment and without prejudice to an appropriate treatment in accounting and in the periodical reports
- As long as these securities are held by the SIF, their value must not be taken into account for the calculation of the SIF's net assets for the calculation of the minimum threshold of net assets imposed by the SIF Law

Sufficient information and documentation must be provided to the CSSF to enable it to determine compliance with the investment restrictions.

Details of how the principle of risk diversification will be implemented, including quantifiable investment limits, must be disclosed in the offering document (see Section 10.3.4.).

4.4. RAIFs

The RAIF regime is applicable to Luxembourg AIFs managed by an authorized AIFM:

- That invest in accordance with the principle of risk-spreading
- Whose securities or partnership interests are reserved for well-informed investors
- Whose constitutive documents provide that they are subject to the provisions of the RAIF Law

The RAIF Law allows full flexibility with respect to the assets in which a RAIF may invest .

The RAIF regime is designed to accommodate AIFs that invest in any type of assets and which pursue both traditional and alternative investment strategies.

The RAIF Law does not provide for specific investment rules or restrictions. It only requires that RAIFs are subject to the principle of risk-spreading⁸⁵.

It is the responsibility of the governing body of the RAIF to ensure that the minimum diversification rules implied by the RAIF Law are complied with.

4.5. Investment in securitizations by self-managed UCITS, UCITS management companies or AIFM managing and/or marketing alternative investment funds in the EU

The Securitization Regulation, the Regulation (EU) 2017/2402, came into effect on 1 January 2019. For the purposes of this Regulation, the following definitions apply:

A “securitization” means a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranching, having all of the following characteristics:

- (a) Payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures
- (b) The subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme
- (c) The transaction or scheme does not create exposures which possess all of the characteristics listed in Article 147(8) of Regulation (EU) No 575/2013 (i.e., specialized lending to finance or operate physical assets)

UCITS and AIFs may be able to invest in securitizations providing that eligible assets rules (for UCITS) (see Section 4.2.2.7.) and investment policies are adhered to.

1. Due-diligence requirements:

Self-managed UCITS, UCITS management companies and AIFM managing and/or marketing alternative investment funds in the EU fall within the definition of “institutional investors” as defined in Regulation (EU) 2017/2402.

As such, prior to investing in a targeted securitization, self-managed UCITS, UCITS management companies and AIFM managing and/or marketing alternative investment funds in the EU are required to perform due diligence ensuring that:

- The originator or original lender (except if EU credit institution or investment firm) grants all the credits giving rise to the underlying exposures on the basis of sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing those credits and has effective systems in place to apply those criteria and processes
- The originator, sponsor or original lender complies with risk retention rules set out in the Regulation
- The originator, sponsor or securitization special purpose entity (SSPE) makes available required information with the frequency and modalities provided for in the Regulation

⁸⁵ Unless the RAIF restricts itself to investment in risk capital to benefit from the same tax regime as that applicable to an investment company in risk capital (SICAR).

A self-managed UCITS, UCITS management companies or AIFM managing and/or marketing alternative investment funds in the EU should also carry out a due diligence assessment enabling it to assess the risks involved covering at least the following:

- Risk characteristics of the individual securitization position and of the underlying exposures
- All the structural features of the securitization that can materially impact the performance of the securitization position, including the contractual priorities of payment and priority of payment-related triggers, credit enhancements, liquidity enhancements, market value triggers, and transaction-specific definitions of default

In addition, the self-managed UCITS, UCITS management companies and AIFM managing and/or marketing alternative investment funds in the EU should on an ongoing basis:

- Establish appropriate written procedures that are proportionate to the risk profile of the securitization position and, where relevant, to the UCITS/AIFs trading and non-trading book, in order to monitor, on an ongoing basis, compliance by the originator, sponsor or original lender and the performance of the securitization position and of the underlying exposures
- Perform stress tests
- Ensure internal reporting to its management body so that the management body is aware of the material risks arising from the securitization position
- Be able to demonstrate to its competent authorities, upon request, that it has a comprehensive and thorough understanding of the securitization position and its underlying exposures and that it has implemented written policies and procedures for the risk management of the securitization position and for maintaining records of the verifications and due diligence

II. Corrective action:

Where self-managed UCITS, UCITS management companies and AIFMs managing and/or marketing alternative investment funds in the EU are exposed to securitizations that no longer meet the requirements provided in Regulation (EU) 2017/2402, they should, in the best interest of the investors in the relevant AIFs or UCITS, act and take corrective action, if appropriate.

4.6. Major holdings and control over portfolio companies and issuers

The AIFM Law sets down requirements on the acquisition of major holdings or control of non-listed companies and issuers by AIF.

A “non-listed company” is defined as a company that has its registered office in the EU and the shares of which are not admitted to trading on a regulated market within the meaning of the MiFID Directive⁸⁶.

An “issuer” is defined as an issuer within the meaning of the Transparency Directive⁸⁷ where that issuer has its registered office in the EU and where its shares are admitted to trading on a regulated market within the meaning of the MiFID Directive.

The provisions on acquisition of control apply to AIFM acting individually, or cooperating with one or more other AIFM on the basis of an agreement, managing one or more AIF, which AIF either individually or jointly with other AIF on the basis of an agreement aimed at acquiring control, acquire control of a non-listed company, and, for certain limited provisions, an issuer. Control is defined as more than 50% of the voting rights for non-listed companies and by reference to Article 5(3) of the Takeover Bids Directive⁸⁸ for issuers.

The provisions are neither applicable to EU small and medium-sized enterprises (SMEs⁸⁹) nor to special purpose vehicles (SPVs) with the purpose of purchasing, holding, or administering real estate.

When an AIF acquires, sells, or holds shares of a non-listed company, the AIFM must notify the competent authority of its home Member State of the proportion of voting rights of the non-listed company held by the AIF whenever the proportion reaches, exceeds, or falls below any of the following thresholds: 10%, 20%, 30%, 50%, and 75%.

⁸⁶ Point (14) of Article 4(1) of Directive 2004/39/EC on markets in financial instruments.

⁸⁷ Point (d) of Article 2(1) of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

⁸⁸ Directive 2004/25/EC on takeover bids.

⁸⁹ Micro, small, and medium-sized enterprises (SMEs) are enterprises that employ fewer than 250 persons and have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.

When an AIF acquires, individually or jointly, control over a non-listed company, the AIFM is required to:

- Notify, within ten working days, the non-listed company, its shareholders, and its competent authority of the resulting situation in terms of voting rights and the conditions under which control has been reached, including information about the identity of the different shareholders involved
- Disclose to the non-listed company, its shareholders, and its competent authority:
 - The identity of the AIFM that, either individually or in agreement with other AIFM, manage(s) the AIF that has/have reached control
 - The policy for preventing and managing conflicts of interests
 - The policy for external and internal communication relating to the company, in particular as regards employees

These provisions also apply to issuers.

In addition, the AIFM must disclose:

- To the non-listed company and its shareholders: its intentions regarding the future business of the non-listed company and the likely repercussion on employment
- To its competent authority and the investors of the AIF: information on the financing of the acquisition

In the notification and disclosure to the non-listed company, the AIFM must request the Board of Directors of the company to inform the representatives of employees or the employees themselves of the acquisition of control by the AIF managed by the AIFM and provide the information notified and disclosed. This also applies to issuers.

The AIFM is required to ensure that information on the development of the non-listed company's business is disclosed to the investors in the AIF and make its best efforts to ensure that the information is made available to employees of the company. The AIFM may either:

- Request and use its best efforts to ensure that the annual report of the non-listed company is made available by the Board of Directors of the company to the employees' representatives or, where there are none, to the employees themselves within the period such annual report has to be drawn up in accordance with the applicable national law, and also make the information available to the investors of each such AIF at the latest when the annual report of the non-listed company is made available
- Include in the annual report of each such AIF (see also Section 10.5.2.) information relating to the relevant non-listed company, and also request and use its best efforts to ensure that the Board of Directors of the non-listed company makes available this information to the employees' representatives of the company concerned or, where there are none, to the employees themselves at the latest when the annual report of the AIF is made available

The information to be included in the annual report of the non-listed company or the AIF must include at least a fair review of the development of the company's business representing the situation at the end of the period covered by the annual report and give an indication of:

- The company's likely future development
- The information concerning acquisitions of own shares

In the case of acquisition of control of a non-listed company or issuer by one or more AIF, the AIFM cannot, within 24 months of the acquisition of control of the company by the AIF, facilitate, support, or instruct any distribution, capital reduction, share redemption, and/or acquisition of own shares by the company or vote in favor of a distribution, capital reduction, share redemption, and/or acquisition of own shares by the company where:

- The portfolio company's net assets decreased below the subscribed capital plus legally non-distributable reserves
- Distribution would exceed the amount of available profit

The AIFM is required to make its best efforts to prevent distributions, capital reductions, share redemptions, and/or the acquisition of own shares by the company.

4.7. EuVECA and EuSEF

The managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) are required to comply with regulatory requirements which include investment restrictions.

The EuVECA and EuSEF regimes are introduced in Section 2.4.4.3.; the applicable investment restrictions and leverage provisions are outlined in this section.

4.7.1. Qualifying EuVECA

Qualifying EuVECA are UCIs that invest no more than 30% of their aggregate capital contributions and uncalled committed capital⁹⁰ in assets other than “qualifying investments”.

“Qualifying investments” include:

- ▶ Equity and quasi-equity instruments⁹¹ that are issued by:
 - ▶ A qualifying portfolio undertaking and acquired directly by the EuVECA from the qualifying portfolio undertaking
 - ▶ A qualifying portfolio undertaking in exchange for an equity security issued by a qualifying portfolio undertaking
 - ▶ An undertaking of which the qualifying portfolio undertaking is a majority-owned subsidiary and which is acquired by the EuVECA in exchange for an equity instrument issued by the qualifying portfolio undertaking
- ▶ Secured or unsecured loans granted by the EuVECA to a qualifying portfolio undertaking in which the EuVECA already holds qualifying investments, provided that no more than 30% of the aggregate capital contributions and uncalled committed capital in the qualifying venture capital fund is used for such loans
- ▶ Shares of a qualifying portfolio undertaking acquired from existing shareholders of that undertaking
- ▶ Shares or units of one or several other qualifying EuVECA, provided that those qualifying EuVECA have not themselves invested more than 10% of their aggregate capital contributions and uncalled committed capital in qualifying EuVECA

A “qualifying portfolio undertaking” must:

- ▶ Meet the criteria applicable to a small and medium-sized enterprise (SME) - i.e., have less than 250 employees and must have either a turnover not exceeding EUR 50 million or an annual balance sheet not exceeding EUR 43 million
- ▶ Be established in an EEA Member State or a third country that:
 - ▶ Is not listed as a non-cooperative country and territory (NCCT) by the Financial Action Task Force (FATF)⁹²
 - ▶ Has signed an Organization for Economic Co-operation and Development (OECD) Article 26 Model compliant tax convention⁹³ with the home Member State of the manager of the EuVECA and each other Member State in which the shares or units of the EuVECA are intended to be marketed
- ▶ Not be listed at the time of investment

⁹⁰ After deduction of all relevant costs. Cash and cash equivalents are excluded from the calculation.

⁹¹ Quasi-equity means any type of financing instrument that is a combination of equity and debt, where the return on the instrument is linked to the profit or loss of the qualifying portfolio undertaking and where the repayment of the instrument in the event of default is not fully secured.

⁹² An intergovernmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

⁹³ Article 26 of the OECD Model Tax Convention creates an obligation to exchange information that is foreseeably relevant to the correct application of a tax convention as well as for purposes of the administration and enforcement of domestic tax laws of the contracting states.

4.7.2. Qualifying EuSEF

Qualifying EuSEF are UCIs that invest no more than 30% of their aggregate capital contributions and uncalled committed capital in assets other than “qualifying investments”.

“Qualifying investments” include:

- ▶ Equity and quasi-equity instruments that are issued by:
 - ▶ A qualifying portfolio undertaking and acquired directly by the EuSEF from the qualifying portfolio undertaking
 - ▶ A qualifying portfolio undertaking in exchange for an equity security issued by a qualifying portfolio undertaking
 - ▶ An undertaking of which the qualifying portfolio undertaking is a majority-owned subsidiary and which is acquired by the EuSEF in exchange for an equity instrument issued by the qualifying portfolio undertaking
- ▶ Securitized or unsecured debt instruments issued by a qualifying portfolio undertaking
- ▶ Shares or units of one or several other qualifying EuSEF, provided that those qualifying EuSEF have not themselves invested more than 10% of their aggregate capital contributions and uncalled committed capital in qualifying EuSEF
- ▶ Secured or unsecured loans granted by the EuSEF to a qualifying portfolio undertaking
- ▶ Any other type of participation in a qualifying portfolio undertaking

A “qualifying portfolio undertaking” must:

- ▶ Have the achievement of measurable, positive social impacts as a primary objective in accordance with its constitutional document, where the undertaking meets one of the following criteria:
 - ▶ Provides services or goods to vulnerable, marginalized, disadvantaged or excluded persons
 - ▶ Employs a method of production of goods or services that embodies its social objective
 - ▶ Provides financial support exclusively to such social undertakings
- ▶ Use its profits primarily to achieve its primary social objective
- ▶ Be managed in an accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities
- ▶ Be established in an EEA Member State or a third country that:
 - ▶ Is not listed as a non-cooperative country and territory (NCCT) by the Financial Action Task Force (FATF)
 - ▶ Has signed an Organization for Economic Co-operation and Development (OECD) Article 26 Model compliant tax convention with the home Member State of the manager of the EuSEF and each other Member State in which the shares or units of the EuSEF are intended to be marketed
- ▶ Not be listed at the time of investment

EuSEF managers must employ, for each EuSEF that they manage, clear and transparent procedures to measure the extent to which the qualifying portfolio undertakings in which the EuSEF invests achieve the positive social impact to which they are committed. Indicators may cover one or more of the following subjects:

- ▶ Employment and labor markets
- ▶ Standards and rights related to job quality
- ▶ Social inclusion and protection of particular groups
- ▶ Equal treatment, equal opportunities and non-discrimination
- ▶ Public health and safety
- ▶ Access to and effects on social protection and on health and educational systems

4.7.3. Use of leverage

The manager of the qualifying European fund must not employ any method to increase the exposure at the level of the qualifying fund beyond the level of its committed capital. It may borrow cash or securities, issue debt obligations or provide guarantees where such borrowings, debt obligations or guarantees are covered by uncalled commitments.

4.8. Money market funds (MMF)

On 30 June 2017, the final text of Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on *money market funds* was published in the Official Journal of the European Union. The Regulation applies to funds and compartments that qualify as money market funds (“MMF”) as per the definition set out in article 1 of the Regulation.

A. MMFs Eligible assets - summary

This section provides a high level overview of the eligible assets for investment by an MMF.

- a. An MMF must invest only in one or more of the following categories of financial assets and only under the conditions specified in the Regulation:
 - a) Money market instruments including financial instruments issued or guaranteed separately or jointly by the EU, the national, regional and local administrations of the Member States or their central banks, the European Central Bank, the European Investment Bank, the European Investment Fund, the European Stability Mechanism, the European Financial Stability Facility, a central authority or central bank of a third country, the International Monetary Fund, the International Bank for Reconstruction and Development, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, the Bank for International Settlements or any other relevant international financial institution or organization to which one or more Member States belong
 - b) Eligible securitizations and asset-backed commercial papers (ABCPs)
 - c) Deposits with credit institutions
 - d) Financial derivative instruments
 - e) Repurchase agreements
 - f) Reverse repurchase agreements
 - g) Units or shares of other MMFs
- b. An MMF must not undertake any of the following activities:
 - a) Investing in assets other than those referred to in Section 4.8.A. above
 - b) Short sale of any of the following instruments: money market instruments, securitizations, ABCPs and units or shares of other MMFs
 - c) Taking direct or indirect exposure to equity or commodities, including via derivatives, certificates representing them, indices based on them, or any other means or instrument that would give an exposure to them
 - d) Entering into securities lending agreements or securities borrowing agreements, or any other agreement that would encumber the assets of the MMF
 - e) Borrowing and lending cash
- c. An MMF may hold ancillary liquid assets.

B. Detailed rules regarding eligible assets for MMFs

a. Eligible money market instruments

A money market instrument is eligible for investment by an MMF provided that it fulfils all of the following requirements:

- a) It meets the eligible asset requirement of money market instruments for investment by UCITS (see Section 4.2.2.7.5.)
- b) It displays one of the following alternative characteristics:
 - i. It has a legal maturity at issuance of 397 days or less
 - ii. It has a residual maturity of 397 days or less
- c) The issuer of the money market instrument and the quality of the money market instrument have received a favorable assessment pursuant to the credit quality assessment (see Section 7.5.2.)
- d) Where an MMF invests in a securitization or ABCP, it is subject to the specific eligibility requirements applicable to these investments, set out in Section 4.8.B.

Notwithstanding Section 4.8.B.a.b) above, standard MMFs are also allowed to invest in money market instruments with a residual maturity until the legal redemption date of less than or equal to 2 years, provided that the time remaining until the next interest rate reset date is 397 days or less. For that purpose, floating-rate money-market instruments and fixed-rate money-market instruments hedged by a swap arrangement must be reset to a money market rate or index.

Section 4.8.B.a.c) above does not apply to money market instruments issued or guaranteed by the EU, a central authority or central bank of a Member State, the European Central Bank, the European Investment Bank, the European Stability Mechanism or the European Financial Stability Facility.

b. Eligible securitizations and ABCPs

1. Both a securitization and an ABCP must be considered to be eligible for investment by an MMF provided that the securitization or ABCP is sufficiently liquid, has received a favorable credit quality assessment, and is any of the following:
 - a) A securitization referred to in Article 13 of Commission Delegated Regulation (EU) 2015/61⁹⁴
 - b) An ABCP issued by an ABCP programme which:
 - i. Is fully supported by a regulated credit institution that covers all liquidity, credit and material dilution risks, as well as ongoing transaction costs and ongoing programme-wide costs related to the ABCP, if necessary to guarantee the investor the full payment of any amount under the ABCP
 - ii. Is not a re-securitization and the exposures underlying the securitization at the level of each ABCP transaction do not include any securitization position
 - iii. Does not include a synthetic securitization as defined in point (11) of Article 242 of Regulation (EU) No 575/2013
 - c) A simple, transparent and standardized (STS) securitization, as determined in accordance with the criteria and conditions laid down in Articles 20, 21 and 22 of Regulation (EU) 2017/2402 of the European Parliament and of the Council⁹⁵, or an STS ABCP, as determined in accordance with the criteria and conditions laid down in Articles 24, 25 and 26 of that Regulation
2. A short-term MMF may invest in the securitizations or ABCPs referred to in paragraph 1. provided any of the following conditions is fulfilled, as applicable:
 - a) The legal maturity at issuance of the securitizations referred to in point a) of paragraph 1. is 2 years or less and the time remaining until the next interest rate reset date is 397 days or less
 - b) The legal maturity at issuance or residual maturity of the securitizations or ABCPs referred to in points b) and c) of paragraph 1. is 397 days or less
 - c) The securitizations referred to in points a) and c) of paragraph 1. are amortizing instruments and have a WAL of 2 years or less
3. A standard MMF may invest in the securitizations or ABCPs referred to in paragraph 1. provided any of the following conditions is fulfilled, as applicable:
 - a) The legal maturity at issuance or residual maturity of the securitizations and ABCPs referred to in points a), b) and c) of paragraph 1. is 2 years or less and the time remaining until the next interest rate reset date is 397 days or less
 - b) The securitizations referred to in points a) and c) of paragraph 1. are amortizing instruments and have a WAL of 2 years or less

c. Eligible deposits with credit institutions

A deposit with a credit institution is eligible for investment by an MMF provided that all of the following conditions are fulfilled:

- a) The deposit is repayable on demand or is able to be withdrawn at any time
- b) The deposit matures in no more than 12 months
- c) The credit institution has its registered office in a Member State or, where the credit institution has its registered office in a third country, it is subject to prudential rules considered equivalent to those laid down in EU law in accordance with the procedure laid down in Article 107(4) of Regulation (EU) No 575/2013⁹⁶

d. Eligible financial derivative instruments

A financial derivative instrument is eligible for investment by an MMF provided it is dealt in on a regulated market or OTC and provided that all of the following conditions are fulfilled:

- a) The underlying of the derivative instrument consists of interest rates, foreign exchange rates, currencies or indices representing one of those categories
- b) The derivative instrument serves only the purpose of hedging the interest rate or exchange rate risks inherent in other investments of the MMF
- c) The counterparties to OTC derivative transactions are institutions subject to prudential regulation and supervision and belonging to the categories approved by the competent authority of the MMF
- d) The OTC derivatives are subject to reliable and verifiable valuation on a daily basis and can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the MMF's initiative

⁹⁴ Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to *liquidity coverage requirement for credit institutions*.

⁹⁵ Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

⁹⁶ Idem.

e. Eligible repurchase agreements

A repurchase agreement is eligible to be entered into by an MMF provided that all of the following conditions are fulfilled:

- a) It is used on a temporary basis, for no more than seven working days, only for liquidity management purposes and not for investment purposes other than as referred to in point c)
- b) The counterparty receiving assets transferred by the MMF as collateral under the repurchase agreement is prohibited from selling, investing, pledging or otherwise transferring those assets without the MMF's prior consent
- c) The cash received by the MMF as part of the repurchase agreement is able to be:
 - i. Placed on deposits in accordance with the 2010 Law
 - ii. Invested in assets referred to here below in Section 4.8.B.f.6., but must not otherwise be invested in eligible assets for MMFs, transferred or otherwise reused
- d) The cash received by the MMF as part of the repurchase agreement does not exceed 10% of its assets
- e) The MMF has the right to terminate the agreement at any time upon giving prior notice of no more than two working days

f. Eligible reverse repurchase agreements

1. A reverse repurchase agreement is eligible to be entered into by an MMF provided that all of the following conditions are fulfilled:
 - a) The MMF has the right to terminate the agreement at any time upon giving prior notice of no more than two working days
 - b) The market value of the assets received as part of the reverse repurchase agreement is at all times at least equal to the value of the cash paid out
2. The assets received by an MMF as part of a reverse repurchase agreement must be money market instruments that fulfil the eligibility requirements indicated in Section 4.8.A. above. The assets received by an MMF as part of a reverse repurchase agreement must not be sold, reinvested, pledged or otherwise transferred.
3. Securitizations and ABCPs must not be received by an MMF as part of a reverse repurchase agreement.
4. The assets received by an MMF as part of a reverse repurchase agreement must be sufficiently diversified with a maximum exposure to a given issuer of 15% of the MMF's NAV, except where those assets take the form of money market instruments that fulfil the requirements mentioned in Section 4.8.A.a.a). In addition, the assets received by an MMF as part of a reverse repurchase agreement must be issued by an entity that is independent from the counterparty and is expected not to display a high correlation with the performance of the counterparty.
5. An MMF that enters into a reverse repurchase agreement must ensure that it is able to recall the full amount of cash at any time on either an accrued basis or a mark-to-market basis. When the cash is recallable at any time on a mark-to-market basis, the mark-to-market value of the reverse repurchase agreement must be used for the calculation of the NAV of the MMF.
6. By way of derogation from Section 4.8.B.f.2., an MMF may receive as part of a reverse repurchase agreement liquid transferable securities or money market instruments other than those that fulfil the eligibility requirements of money market instruments provided that those assets comply with one of the following conditions:
 - a) They are issued or guaranteed by the EU, a central authority or central bank of a Member State, the European Central Bank, the European Investment Bank, the European Stability Mechanism or the European Financial Stability Facility provided that a favorable credit quality assessment has been received
 - b) They are issued or guaranteed by a central authority or central bank of a third country, provided that a favorable credit quality assessment has been receivedThe assets received as part of a reverse repurchase agreement must be disclosed to MMF investors, in accordance with the Securities and Financing Transaction Regulation.
The assets received as part of a reverse repurchase agreement must fulfil the requirements mentioned in Section 4.8.A.a.a).
7. *The Commission Delegated Regulation (EU) 2018/990* of 10 April 2018 specifies, *inter alia*, quantitative and qualitative liquidity requirements applicable to assets referred to in Section 4.8.B.f.6 and quantitative and qualitative credit quality requirements applicable to assets referred to in Section 4.8.B.f.6.a) above as follows:
 - i. Reverse repurchase agreements must meet established market standards and their terms and conditions must enable managers of MMFs to fully enforce their rights in case of default of the counterparty to such agreements, or their early termination and give managers of MMFs the unrestricted right to sell any assets received as collateral.
 - ii. The assets referred to above must be subject to a haircut, that is equal to the volatility adjustment figures referred to in tables 1 and 2 of Article 224(1) of Regulation (EU) No 575/2013 for a given residual maturity, in respect of a 5-day liquidation period and the highest assessment in terms of credit quality step.

- iii. Where necessary, managers of MMFs must apply an additional haircut to that referred to in paragraph ii. to assess whether such an additional haircut is necessary, they must take into account all of the following factors:
 - (a) The credit quality assessment of the counterparty to the reverse repurchase agreement
 - (b) The margin period of risk, as defined in Article 272(9) of Regulation (EU) No 575/2013
 - (c) The credit quality assessment of the issuer or of the asset that is used as collateral
 - (d) The remaining maturity of the assets used as collateral
 - (e) The volatility of the price of the assets used as collateral
- iv. For the purpose of paragraph iii., managers of MMFs must put in place a clear haircut policy adapted to each asset received as collateral. That policy must be documented and must substantiate each decision to apply a specific haircut to the value of an asset.
- v. Managers of MMFs must regularly revise the haircut referred to in paragraph 2, taking into account changes in the residual maturity of the assets used as collateral. They must also revise the additional haircut referred to in paragraph iii., whenever the factors referred to in that paragraph change.
- vi. Paragraphs i. to v. shall not apply if the counterparty to the reverse repurchase agreement is any of the following:
 - (a) A credit institution supervised under Directive 2013/36/EU of the European Parliament and of the Council⁹⁷, or a credit institution authorized in a third country, provided that the prudential supervisory and regulatory requirements are equivalent to those applied in the European Union
 - (b) An investment firm supervised under Directive 2014/65/EU of the European Parliament and of the Council⁹⁸, or a third country investment firm, provided that the prudential supervisory and regulatory requirements are equivalent to those applied in the European Union
 - (c) An insurance undertaking supervised under Directive 2009/138/EC of the European Parliament and of the Council⁹⁹, or a third country insurance undertaking, provided that the prudential supervisory and regulatory requirements are equivalent to those applied in the European Union
 - (d) A central counterparty authorized under Regulation (EU) No 648/2012 of the European Parliament and of the Council¹⁰⁰
 - (e) The European Central Bank
 - (f) A national central bank
 - (g) A third country central bank, provided that the prudential supervisory and regulatory requirements applied in that country have been recognized as equivalent to those applied in the European Union in accordance with Article 114(7) of Regulation (EU) No 575/2013¹⁰¹
- g. Eligible units or shares of MMFs
 - 1. An MMF may acquire the units or shares of any other MMF ("target MMF") provided that all of the following conditions are fulfilled:
 - a) No more than 10% of the assets of the target MMF are able, according to its fund rules or instruments of incorporation, to be invested in aggregate in units or shares of other MMFs
 - b) The target MMF does not hold units or shares in the acquiring MMF

An MMF whose units or shares have been acquired must not invest in the acquiring MMF during the period in which the acquiring MMF holds units or shares in it.
 - 2. An MMF may acquire the units or shares of other MMFs, provided that no more than 5% of its assets are invested in units or shares of a single MMF.
 - 3. An MMF may, in aggregate, invest no more than 17.5% of its assets in units or shares of other MMFs.
 - 4. Units or shares of other MMFs are eligible for investment by an MMF provided that all of the following conditions are fulfilled:
 - a) The target MMF is authorized under the MMF regulation

⁹⁷ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

⁹⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

⁹⁹ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

¹⁰⁰ Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

¹⁰¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

- b) Where the target MMF is managed, whether directly or under a delegation, by the same manager as that of the acquiring MMF or by any other company to which the manager of the acquiring MMF is linked by common management or control, or by a substantial direct or indirect holding, the manager of the target MMF, or that other company, is prohibited from charging subscription or redemption fees on account of the investment by the acquiring MMF in the units or shares of the target MMF
 - c) Where an MMF invests 10% or more of its assets in units or shares of other MMFs:
 - i. The prospectus of that MMF must disclose the maximum level of the management fees that may be charged to the MMF itself and to the other MMFs in which it invests and
 - ii. The annual report must indicate the maximum proportion of management fees charged to the MMF itself and to the other MMFs in which it invests
5. Sections 4.8.B.g.2. and 3. above do not apply to an authorized MMF that is an AIF, if all of the following conditions are met:
- a) The MMF is marketed solely through an employee savings scheme governed by national law and which has only natural persons as investors
 - b) The employee savings scheme referred to in point a) only allows investors to redeem their investment subject to restrictive redemption terms which are laid down in national law, whereby redemptions may only take place in certain circumstances that are not linked to market developments
- By way of derogation from Sections 4.8.B.g.2. and 3. above, an authorized MMF that is a UCITS may acquire units or shares in other MMFs in accordance with Article 55 or 58 of Directive 2009/65/EC under the following conditions:
- a) The MMF is marketed solely through an employee savings scheme governed by national law and which has only natural persons as investors
 - b) The employee savings scheme referred to in point a) only allows investors to redeem their investment subject to restrictive redemption terms which are laid down in national law, whereby redemptions may only take place in certain circumstances that are not linked to market developments
6. Short-term MMFs may only invest in units or shares of other short-term MMFs.
7. Standard MMFs may invest in units or shares of short-term MMFs and standard MMFs.

C. Provisions on investment policies

a. Diversification

1. An MMF must invest no more than:
 - a) 5% of its assets in money market instruments, securitizations and ABCPs issued by the same body
 - b) 10% of its assets in deposits made with the same credit institution, unless the structure of the banking sector in the Member State in which the MMF is domiciled is such that there are insufficient viable credit institutions to meet that diversification requirement and it is not economically feasible for the MMF to make deposits in another Member State, in which case up to 15% of its assets may be deposited with the same credit institution

CSSF clarification:

A Luxembourg MMF is not authorized to invest more than 10% of its net assets in deposits with the same credit institution as foreseen in the preceding paragraph as the CSSF considers that the conditions laid down in article 17(1)(b) of the MMF Regulation are not met for Luxembourg domiciled MMFs because:

- There are sufficient viable credit institutions in Luxembourg
- It is economically feasible for the MMF to make deposits in another Member State

2. By way of derogation from Sections 4.8.C.a.1.a), a VNAV MMF may invest up to 10% of its assets in money market instruments, securitizations and ABCPs issued by the same body provided that the total value of such money market instruments, securitizations and ABCPs held by the VNAV MMF in each issuing body in which it invests more than 5% of its assets does not exceed 40% of the value of its assets.
3. The aggregate of all of an MMF's exposures to securitizations and ABCPs must not exceed 20% of the assets of the MMF, whereby up to 15% of the assets of the MMF may be invested in securitizations and ABCPs that do not comply with the criteria for the identification of STS securitizations and ABCPs.
4. The aggregate risk exposure to the same counterparty of an MMF stemming from OTC derivative transactions must not exceed 5% of the assets of the MMF.

5. The aggregate amount of cash provided to the same counterparty of an MMF in reverse repurchase agreements must not exceed 15% of the assets of the MMF.
6. Notwithstanding the individual limits laid down in point 1 and 4, an MMF must not combine, where to do so would result in an investment of more than 15% of its assets in a single body, any of the following:
 - a) Investments in money market instruments, securitizations and ABCPs issued by that body
 - b) Deposits made with that body
 - c) OTC financial derivative instruments giving counterparty risk exposure to that body

By way of derogation from the diversification requirement provided for in the first subparagraph, where the structure of the financial market in the Member State in which the MMF is domiciled is such that there are insufficient viable financial institutions to meet that diversification requirement and it is not economically feasible for the MMF to use financial institutions in another Member State, the MMF may combine the types of investments referred to in points a) to c) up to a maximum investment of 20% of its assets in a single body.

7. By way of derogation from point a) of paragraph 1., the competent authority of an MMF may authorize an MMF to invest, in accordance with the principle of risk-spreading, up to 100% of its assets in different money market instruments issued or guaranteed separately or jointly by the EU, the national, regional and local administrations of the Member States or their central banks, the European Central Bank, the European Investment Bank, the European Investment Fund, the European Stability Mechanism, the European Financial Stability Facility, a central authority or central bank of a third country, the International Monetary Fund, the International Bank for Reconstruction and Development, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, the Bank for International Settlements, or any other relevant international financial institution or organization to which one or more Member States belong.

The first subparagraph only applies where all of the following requirements are met:

- a) The MMF holds money market instruments from at least six different issues by the issuer
 - b) The MMF limits the investment in money market instruments from the same issue to a maximum of 30% of its assets
 - c) The MMF makes express reference, in its fund rules or instruments of incorporation, to all administrations, institutions or organizations referred to in the first subparagraph that issue or guarantee separately or jointly money market instruments in which it intends to invest more than 5% of its assets
 - d) The MMF includes a prominent statement in its prospectus and marketing communications drawing attention to the use of the derogation and indicating all administrations, institutions or organizations referred to in the first subparagraph that issue or guarantee separately or jointly money market instruments in which it intends to invest more than 5% of its assets
8. Notwithstanding the individual limits laid down in paragraph 1., an MMF may invest no more than 10% of its assets in bonds issued by a single credit institution that has its registered office in a Member State and is subject by law to special public supervision designed to protect bond-holders. In particular, sums deriving from the issue of those bonds must be invested in accordance with the law in assets which, during the whole period of validity of the bonds, are capable of covering claims attaching to the bonds and which, in the event of failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.

Where an MMF invests more than 5% of its assets in the bonds referred to in the first subparagraph issued by a single issuer, the total value of those investments must not exceed 40% of the value of the assets of the MMF.

9. Notwithstanding the individual limits laid down in paragraph 1., an MMF may invest no more than 20% of its assets in bonds issued by a single credit institution where the requirements set out in point (f) of Article 10(1) or point (c) of Article 11(1) of Delegated Regulation (EU) 2015/61¹⁰² are met, including any possible investment in assets referred to in paragraph 8. above.

Where an MMF invests more than 5% of its assets in the bonds referred to in the first subparagraph issued by a single issuer, the total value of those investments must not exceed 60% of the value of the assets of the MMF, including any possible investment in assets referred to in paragraph 8., respecting the limits set out therein.

10. Companies which are included in the same group for the purposes of consolidated accounts under Directive 2013/34/EU of the European Parliament and of the Council or in accordance with recognized international accounting rules, must be regarded as a single body for the purpose of calculating the limits referred to in paragraphs 1. to 6. above.

¹⁰² Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions.

b. Concentration

1. An MMF must not hold more than 10% of the money market instruments, securitizations and ABCPs issued by a single body.

CSSF clarification:

The above mentioned limitation applies at single issuer level and not on a consolidation basis

2. This limit will not apply in respect of holdings of money market instruments issued or guaranteed by the EU, national, regional and local administrations of the Member States or their central banks, the European Central Bank, the European Investment Bank, the European Investment Fund, the European Stability Mechanism, the European Financial Stability Facility, a central authority or central bank of a third country, the International Monetary Fund, the International Bank for Reconstruction and Development, the Council of Europe Development Bank, the European Bank for Reconstruction and Development, the Bank for International Settlements, or any other relevant international financial institution or organization to which one or more Member States belong.

c. Portfolio rules

A. Short term MMFs

1. A short-term MMF must comply on an ongoing basis with all of the following portfolio requirements:
 - a) Its portfolio is to have a WAM of no more than 60 days
 - b) Its portfolio is to have a WAL of no more than 120 days, subject to the second and third subparagraphs
 - c) For LVNAV MMFs and public debt CNAV MMFs, at least 10% of their assets are to be comprised of daily maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of one working day or cash which is able to be withdrawn by giving prior notice of one working day. A LVNAV MMF or public debt CNAV MMF is not to acquire any asset other than a daily maturing asset when such acquisition would result in that MMF investing less than 10% of its portfolio in daily maturing assets
 - d) For a short-term VNAV MMF, at least 7.5% of its assets are to be comprised of daily maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of one working day, or cash which is able to be withdrawn by giving prior notice of one working day. A short-term VNAV MMF is not to acquire any asset other than a daily maturing asset when such acquisition would result in that MMF investing less than 7.5% of its portfolio in daily maturing assets

CSSF clarification:

Deposits with a one week or one month term can be considered as daily maturing assets when they can be withdrawn by giving prior notice of one working day. Reverse repos with a fixed term that can be terminated by giving prior notice of one working day can also be considered as daily maturing assets.

- e) For LVNAV MMFs and public debt CNAV MMFs, at least 30% of their assets are to be comprised of weekly maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of five working days or cash which is able to be withdrawn by giving prior notice of five working days. A LVNAV MMF or public debt CNAV MMF is not to acquire any asset other than a weekly maturing asset when such acquisition would result in that MMF investing less than 30% of its portfolio in weekly maturing assets
- f) For a short-term VNAV MMF, at least 15% of its assets are to be comprised of weekly maturing assets, reverse repurchase agreements which are able to be terminated by giving prior notice of five working days, or cash which is able to be withdrawn by giving prior notice of five working days. A short-term VNAV MMF is not to acquire any asset other than a weekly maturing asset when such acquisition would result in that MMF investing less than 15% of its portfolio in weekly maturing assets
- g) For the purpose of the calculation referred to in point e), assets referred to in Section 4.8.C.a.7. which are highly liquid and can be redeemed and settled within one working day and have a residual maturity of up to 190 days may also be included within the weekly maturing assets of a LVNAV MMF and public debt CNAV MMF, up to a limit of 17.5% of its assets
- h) For the purpose of the calculation referred to in point f), money market instruments or units or shares of other MMFs may be included within the weekly maturing assets of a short-term VNAV MMF up to a limit of 7.5% of its assets provided they are able to be redeemed and settled within five working days

For the purposes of point b) of the first subparagraph, when calculating the WAL for securities, including structured financial instruments, a short-term MMF must base the maturity calculation on the residual maturity until the legal redemption of the instruments. However, in the event that a financial instrument embeds a put option, a short-term MMF may base the maturity calculation on the exercise date of the put option instead of the residual maturity, but only if all of the following conditions are fulfilled at all times:

- i. The put option is able to be freely exercised by the short-term MMF at its exercise date
- ii. The strike price of the put option remains close to the expected value of the instrument at the exercise date
- iii. The investment strategy of the short-term MMF implies that there is a high probability that the option will be exercised at the exercise date

By way of derogation from the second subparagraph, when calculating the WAL for securitizations and ABCPs, a short-term MMF may instead, in the case of amortizing instruments, base the maturity calculation on one of the following:

- i. The contractual amortization profile of such instruments
 - ii. The amortization profile of the underlying assets from which the cash-flows for the redemption of such instruments result
2. If the limits referred to in this section are exceeded for reasons beyond the control of an MMF, or as a result of the exercise of subscription or redemption rights, that MMF must correct the situation, taking due account of the interests of its unit holders or shareholders.
 3. All MMFs may take the form of a short-term MMF.

B. Standard MMFs

1. A standard MMF must comply on an ongoing basis with all of the following requirements:
 - a) Its portfolio is to have at all times a WAM of no more than 6 months
 - b) Its portfolio is to have at all times a WAL of no more than 12 months, subject to the second and third subparagraphs
 - c) At least 7.5% of its assets are to be comprised of daily maturing assets, reverse repurchase agreements which can be terminated by giving prior notice of one working day or cash which can be withdrawn by giving prior notice of one working day. A standard MMF is not to acquire any asset other than a daily maturing asset when such acquisition would result in that MMF investing less than 7.5% of its portfolio in daily maturing assets
 - d) At least 15% of its assets are to be comprised of weekly maturing assets, reverse repurchase agreements which can be terminated by giving prior notice of five working days or cash which can be withdrawn by giving prior notice of five working days. A standard MMF is not to acquire any asset other than a weekly maturing asset when such acquisition would result in that MMF investing less than 15% of its portfolio in weekly maturing assets
 - e) For the purpose of the calculation referred to in point d), money market instruments or units or shares of other MMFs may be included within the weekly maturing assets up to 7.5% of its assets provided they are able to be redeemed and settled within five working days

For the purposes of point b) of the first subparagraph, when calculating the WAL for securities, including structured financial instruments, a standard MMF should base the maturity calculation on the residual maturity until the legal redemption of the instruments. However, in the event that a financial instrument embeds a put option, a standard MMF may base the maturity calculation on the exercise date of the put option instead of the residual maturity, but only if all of the following conditions are fulfilled at all times:

- i. The put option is able to be freely exercised by the standard MMF at its exercise date
- ii. The strike price of the put option remains close to the expected value of the instrument at the exercise date
- iii. The investment strategy of the standard MMF implies that there is a high probability that the option will be exercised at the exercise date

By way of derogation from the second subparagraph, when calculating the WAL for securitizations and ABCPs, a standard MMF may instead, in the case of amortizing instruments, base the maturity calculation on one of the following:

- (i) The contractual amortization profile of such instruments
- (ii) The amortization profile of the underlying assets from which the cash-flows for the redemption of such instruments result

2. If the limits referred to in this section are exceeded for reasons beyond the control of a standard MMF or as a result of the exercise of subscription or redemption rights, that MMF must correct the situation, taking due account of the interests of its unit holders or shareholders.
3. A standard MMF may not take the form of a public debt CNAV MMF or a LVNAV MMF.

4.9. European long-term investment funds (ELTIFs)

The ELTIF regime is introduced in Section 2.4.5.; the applicable investment restrictions and diversification rules are outlined in this section.

A. Eligible investments

Eligible investments of an ELTIF include:

- ▶ Eligible investment assets, being:
 - ▶ Equity or quasi-equity instruments
 - ▶ Debt instruments issued by a qualified portfolio undertaking¹⁰³
 - ▶ Loans granted by the ELTIF to a qualifying portfolio undertaking¹⁰⁴ with a maturity no longer than the life of the ELTIF
 - ▶ Units or shares of one or several other ELTIFs, EuVECAs, and EuSEFs provided that those ELTIFs, EuVECAs, and EuSEFs have not themselves invested more than 10% of their capital in ELTIFs
 - ▶ Direct holdings or indirect holdings via qualified portfolio undertakings¹⁰⁵ of individual real assets with a value of at least EUR10,000,000 or its equivalent in the currency which, and at the time when, the expenditure is incurred
- ▶ Assets eligible for UCITS (see Section 4.2.2.3.)

An ELTIF is not permitted to:

- ▶ Short sell assets
- ▶ Take direct or indirect exposure to commodities
- ▶ Enter into securities lending, securities borrowing, repurchase transactions, or any other agreement that has an equivalent economic effect and poses similar risks, if thereby more than 10% of the assets of the ELTIF are affected
- ▶ Use financial derivative instruments, except for hedging purposes of the ELTIF's other investments

Following ESMA's final report on draft technical standards under the ELTIF regulation of June 2016, Commission Delegated Regulation (EU) 2018/480 of 4 December 2017, entered into force on 12 April 2018, supplemented Regulation (EU) 2015/760 with regard to regulatory technical standards on financial derivative instruments solely serving hedging purposes, sufficient length of the life of the European long-term investment funds, assessment criteria for the market for potential buyers and valuation of assets to be divested, and the types and characteristics of the facilities available to retail investors.

With respect to financial derivative instruments solely serving hedging purposes, the Regulation specifies that they qualify as hedging derivatives if they meet all of the following criteria:

- ▶ A financial derivative instrument should only be used for hedging risks arising from exposures to eligible asset investments. The purpose of hedging the risks arising from exposures to the assets should only be considered to be fulfilled where the use of that financial derivative instrument results in a verifiable and objectively measurable reduction of those risks at the ELTIF level. Where financial derivative instruments to hedge the risks arising from the exposure to the assets are not available, financial derivative instruments with an underlying of the same asset class may be used

¹⁰³ A qualified portfolio undertaking is defined by Regulation (EU) 2015/760 as a portfolio undertaking other than a collective investment undertaking that fulfils the following requirements: (i) it is not a financial undertaking, (ii) it is an undertaking which is not admitted to trading on a regulated market or on a multilateral trading facility; or is admitted to trading on a regulated market or on a multilateral trading facility and at the same time has a market capitalization of no more than EUR 500,000 000, and (iii) it is established in a Member State, or in a third country provided that the third country is not a high-risk and non-cooperative jurisdiction identified by the Financial Action Task Force and that the third country has signed an agreement with the home Member State of the manager of the ELTIF and with every other Member State in which the units or shares of the ELTIF are intended to be marketed to ensure that the third country fully complies with Article 26 of the OECD Model Tax Convention on Income and Capital and ensures effective exchange of information in tax matters, including any multilateral tax agreements.

¹⁰⁴ Idem.

¹⁰⁵ Idem.

- ▶ The use of the financial derivative instruments aimed to provide a return for the ELTIF will not be deemed to serve the purpose of hedging the risks
- ▶ The manager of the ELTIF should take all reasonable steps to ensure that the financial derivative instruments used to hedge the risks inherent to other investments of the ELTIF reduce the risks at the ELTIF level in accordance with paragraph 1 above, including in stressed market conditions

B. Composition and diversification requirements

An ELTIF must comply with the following diversification requirements:

- ▶ An ELTIF must invest at least 70% of its capital in eligible investment assets
- ▶ An ELTIF should invest no more than:
 - ▶ 10% of its capital in instruments issued by, or loans granted to, any single qualifying portfolio undertaking
 - ▶ 10% of its capital directly or indirectly in a single real asset

An ELTIF may raise both of the above 10% limits to 20% provided that the aggregate value of the assets held by the ELTIF in qualifying portfolio undertakings and in individual real assets in which it invests more than 10% of its capital does not exceed 40% of the value of the capital of the ELTIF.

- ▶ 10% of its capital in units or shares of any single ELTIF, EuVECA, or EuSEF
- ▶ 5% of its capital in assets eligible to UCITS (see Section 4.2.2.3.)

An ELTIF may raise the 5% limit to 25% where bonds are issued by a credit institution that has its registered office in a Member State and is subject by law to special public supervision designed to protect bondholders.

- ▶ The aggregate value of units or shares of ELTIFs, EuVECAs, and EuSEFs in an ELTIF portfolio should not exceed 20% of the value of the capital of the ELTIF
- ▶ The aggregate risk exposure to a counterparty of the ELTIF from OTC derivative transactions, repurchase agreements, or reverse repurchase agreements should not exceed 5% of the value of the capital of the ELTIF
- ▶ Companies that are included in the same group for the purpose of consolidated accounts should be considered as a single qualifying portfolio undertaking or a single body for the purpose of calculating the diversification limits

C. Concentration requirements

An ELTIF cannot acquire more than 25% of the units or shares of a single ELTIF, EuVECA, or EuSEF. An ELTIF should comply with the concentration limits set out in the last bullet point of Section 4.2.2.4. with respect to its holdings in assets eligible for UCITS.

D. Borrowing requirements

An ELTIF may borrow cash provided that such borrowing fulfils the following conditions:

- ▶ It represents no more than 30% of the value of the capital of the ELTIF
- ▶ It serves the purpose of investing in eligible investment assets, except for loans referred to in Section 4.8.B.
- ▶ It is contracted in the same currency as the assets to be acquired with the borrowed cash
- ▶ It has a maturity no longer than the life of the ELTIF
- ▶ It encumbers assets that represent no more than 30% of the value of the capital of the ELTIF

5

Governance and liability

EY supports asset managers, traditional and alternative investment fund houses in defining and implementing governance models for investment funds and their managers, performing due diligence on delegates and service providers, and also offers technical training to members of governing bodies.



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5.1. Governance

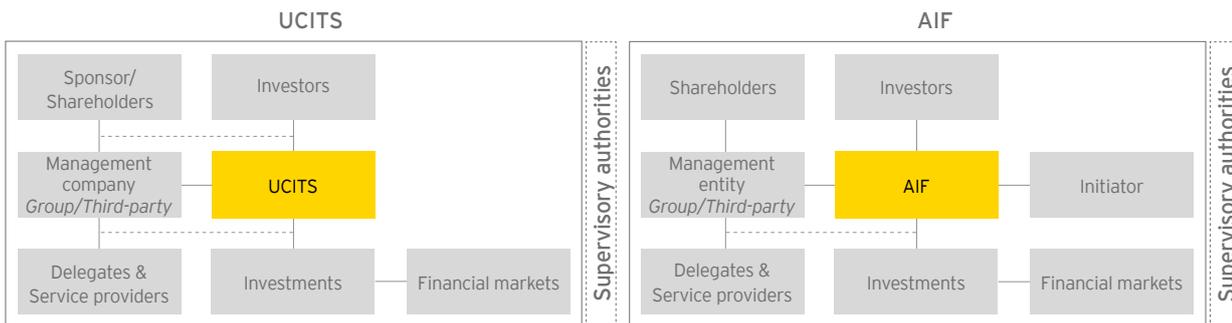
5.1.1. Introduction

“Governance provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”¹⁰⁶ Governance from a strategic perspective is covered in Section 5.1.2.

“Governance involves a set of relationships between a company’s management, its Board, its shareholders and other stakeholders.”¹⁰⁷

In the context of UCIs, there are many types of direct and indirect relationships with stakeholders. They may be illustrated as follows:

Illustration of stakeholders in the context of UCIs¹⁰⁸



The relationships between UCIs, their management entities (management companies and/or AIFM), and other stakeholders are recurring themes throughout this chapter.

Governance in relation to investors, investments, and financial markets is covered in Section 5.1.3.

The impact of the structure and organization of a UCI on its governance is covered in Section 5.1.4. Governance models in Luxembourg are covered in Section 5.1.5.

In the context of UCIs, a number of regulatory requirements cover:

- The role and responsibilities of governing bodies and senior management
- The qualifications of governing bodies and senior management
- Internal organization
- Delegation

Governance roles in the context of UCIs are covered in Section 5.1.6.

UCIs and management entities are required to comply with rules of conduct. Furthermore, UCIs and their management entities may voluntarily apply corporate governance principles including general corporate governance principles, such as the OECD’s *Principles of Corporate Governance*, as well as principles specific to UCIs, such as ALFI’s *Code of Conduct for Luxembourg Investment Funds*. Governance principles and rules of conduct are covered in Section 5.1.7.

The oversight of UCIs is covered in Section 5.1.8.

¹⁰⁶ Preamble to Principles of Corporate Governance, Organisation for Economic Co-operation and Development (OECD), 2004, as amended.

¹⁰⁷ Idem.

¹⁰⁸ In these illustrations, the UCI is managed by a management company or an AIFM. For a UCI that has not appointed a management company or AIFM, the illustration would be slightly different - see also Section 1.4.

5.1.2. Governance from a strategic perspective

The role of the governing body of a management entity or a UCI can also be seen from a strategic perspective. It may be argued that the governing body is:

- Responsible for establishing and maintaining the vision, mission, and values
- Responsible for determining the strategy
- Responsible for overseeing the implementation of the strategy
- Accountable to unit/shareholders and responsible towards stakeholders

A. Establish and maintain vision, mission and values

A key role of the governing body is to establish and maintain the vision, mission, and values:

- Vision indicates a view of the future
- Mission statement outlines what needs to be done to achieve the envisaged state
- Values are a set of principles and standards that drive decision making

B. Determine the strategy

The vision, mission, and values should be implemented by a strategy, which is approved by the governing body. This may include:

- Choice of organizational model for the UCI, its management, and service providers. Some of the organizational model choices are outlined in Section 1.4.
- Drawing up a program of activities: management entities and UCIs that have not appointed a management entity are required, in the application for authorization, to provide the CSSF with a program of activities, setting out, *inter alia*, the organizational structure of the entity, as described in Section 6.3.1.
- Determining the strategy to meet the investment policy of the UCI

C. Oversee the implementation of the strategy

Overseeing the implementation of the strategy includes, *inter alia*:

- Implementing the investment policy of the UCI, in compliance with investor disclosures and fund documentation, and the law
- Maintaining an appropriate governance structure and internal organization (see Section 5.1.6.)
- Complying with applicable values statements, governance principles, and rules of conduct (see Section 5.1.7.)
- Appointing and overseeing external delegates and other service providers (see Section 5.1.6.F.)
- Complying with contractual obligations

D. Accountable to unit/shareholders and responsible towards stakeholders

UCIs are required to demonstrate accountability to investors, making available:

- Initial disclosures: prospectus, key investor information (KII) document, or issuing document
- Annual/semi-annual reports
- Specific disclosures, *inter alia*, on:
 - Conflicts of interest
 - Policy and practice on exercise of voting rights
 - Any preferential treatment of certain investors
 - Remuneration policy and amounts of remuneration
 - Fees and inducements
 - Prime brokerage arrangements

The governing body, or governing bodies, are ultimately responsible for these disclosures, and will in some cases approve them. In many cases, these disclosures will be made public. They are covered in more detail in Chapter 10.

With respect to UCIs in corporate form, such as investment companies, the governing body will be responsible for convening shareholder meetings, including the annual general meeting (see Section 10.6.).

UCIs (except RAIFs) and their management entities are subject to the ongoing supervision of the CSSF. They are required, *inter alia*, to:

- ▶ Provide the CSSF with updates to any information submitted in their application for authorization, as outlined in Section 3.4. for UCIs and Section 6.2.1.D. for management entities
- ▶ Submit to the CSSF information on their activities on a regular basis, as outlined in Section 3.5. for UCIs and Section 6.5.2. for management entities
- ▶ Promptly provide information requested by the CSSF

5.1.3. Governance in the wider context of UCIs

This section focuses on roles and responsibilities of the UCI and management entity in relation to stakeholders not covered in the previous sections.

A. Investors

The UCI or its management entity has a direct responsibility to investors, for example in terms of implementing the investment policy with a view to generating returns, being transparent on costs and risks involved, acting in the best interests of the UCI and its investors and accountability.

However, it may also have an indirect responsibility to many more investors. Institutional investors, such as pension funds, funds of funds, and nominee accounts may, in turn, represent thousands of individuals.

B. Investments

As an investor, the UCI directly or indirectly plays a role in society. The role of the UCI as an investor will depend on the type of investments. For example:

- ▶ An equity UCI, as a shareholder of a listed company, should exercise its voting rights in accordance with the Law and in line with its policy on the exercise of voting rights, and may exercise influence on the company in concert with other shareholders
- ▶ A fixed income UCI may play an important role in financing public bodies and companies
- ▶ Private equity UCIs will generally control non-listed companies, either acting individually or jointly. In relation to the investee company, the private equity UCI may play roles ranging from incubator to a pure investor role. The UCI can exert significant influence over the governing body and the management of a company
- ▶ A real estate UCI may invest in assets of significant importance for a community, such as residential properties, offices or shopping centers
- ▶ An infrastructure UCI may play an important role in developing and managing infrastructure in areas such as the environment, energy, healthcare, urban infrastructure, public and local utility facilities, telecommunications and transport

UCIs and their management entities are required to define and implement a policy on the exercise of voting rights in the portfolio of assets of the UCI.

On 1 August 2019, Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (the Shareholders' Rights Directive II - "SRD II") was transposed into Luxembourg law.

The Law amends the Luxembourg law of 24 May 2011 on the exercise of certain rights of shareholders in general meetings of listed companies.

The Law introduces new obligations on various entities, including UCITS management companies, self-managed UCITS and AIFMs (hereafter also referred to as "IFMs"), as shareholders in companies which have their registered office in a Member State and whose shares are admitted to trading on a regulated market situated or operating within a Member State, to develop an engagement policy outlining how shareholder engagement is embedded in the fund investment strategy.

- ▶ Such policy must describe how IFMs monitor investee companies' strategies, financial and non-financial performance, risks, capital structures, ESG impacts and how they engage with these companies, exercise voting rights, communicate with stakeholders, cooperate with other shareholders and manage potential conflicts of interests related to their engagement.
- ▶ IFMs should, on an annual basis, publicly disclose how their engagement policy has been implemented, including a general description of their voting behavior, an explanation of the most significant votes and the use of the services of proxy advisors. They must publicly disclose how they have cast votes in the general meeting of investee companies, at least when the subject matter of the vote or the size of their holding is significant.

The above-mentioned disclosures must be made available free of charge on the asset manager's website.

Arrangements between IFMs and institutional investors should be publicly disclosed by institutional investors and should outline how the IFM is incentivized:

- ▶ To align its strategy and decisions with the profile and duration of the liabilities of the institutional investor
- ▶ To make investment decisions based on assessments about medium and long term financial and non-financial performance of the investee company
- ▶ To engage with these investee companies in order to improve their performance in the medium to long-term.

Arrangements should indicate their duration, describe how remuneration and performance evaluation of the IFM are aligned with longer term objectives of the institutional investors and how portfolio turnover costs are monitored.

Specific annual reports should be provided, publicly, or directly to those institutional investors, outlining how the investment strategy implementation complied with the arrangement, emphasizing longer term risks, portfolio composition, portfolio turnover and turnover costs, policy on securities lending and how it has been applied to fulfil engagement activities.

On 11 May 2020, ALFI issued a Q&A on SRD II including clarifications on SRD II obligations and timeline, engagement policy and implementation disclosures as well as transparency towards institutional investors.

C. Financial Markets

UCIs and management entities are required to respect the integrity of the market. They are covered by securities laws, such as those on market abuse, and also reporting or clearing obligations in relation to derivatives. UCIs are also subject to specific investment rules (see Chapter 4).

UCIs and management entities are also required to provide regular information to the competent authorities, which use such information, *inter alia*, for the purposes of monitoring systemic risk (see Section 3.5. for UCIs and Section 6.5.2. for management entities).

5.1.4. The impact of the structure and organization of a UCI on its governance

The governance model of a UCI is driven by the basic structure of the UCI, and the organization of its management company and/or AIFM (except in the case of investment companies that have not appointed a management entity). The basic structures of UCIs are described in more detail in Section 2.3.1. The possible fund management models are illustrated in Section 6.1.4.

A. Common funds

A common fund (FCP) has no legal personality and must be managed by an authorized management company.

A common fund is controlled by the management company, and ultimately the governing body of the management company is in charge of the governance of the common fund, under the oversight of the depositary on certain matters, except in very specific circumstances.

On 16 July 2019, the existing RAIF Law has been amended to clarify that a RAIF set up as an FCP may have as management company an entity set up under Chapter 15 or 16 of the 2010 Law. The management company must also be authorized as an AIFM (see Section 6.2.1.B) or appoint an external AIFM (see Section 6.1.4 model C).

Unitholders of a common fund generally have no control over the fund. There is no requirement to hold unitholder's meetings.

B. Investment companies

An investment company (SICAV or SICAF) has a legal personality. An investment company is controlled by its governing body (generally a Board of Directors). The shareholders of an investment company have ultimate control over the investment company. The governing body of the investment company is required to convene annual shareholders' meetings.

An investment company may either:

- Appoint an authorized management entity (a management company or AIFM)
- Manage itself (so called self-managed UCITS or internally managed AIF). In this case, the governing body of the UCI plays the role of the management entity

Where investment companies delegate management to a management entity, at least two governing bodies are involved:

- The governing body of the UCI
- The governing body of the management company or AIFM

Where multiple governing bodies are involved, a clear governance model is required to ensure that there are no overlaps or gaps. Cross-border management creates an additional level of complexity.

C. Management companies managing AIF

Under the AIFM Directive, management companies can manage AIF in the following ways:

- Manage the AIF itself, where the management company also has an AIFM authorization (see Section 6.2.1.), or where the AIF under management falls below the *de minimis* thresholds (see Section 6.1.3.D.)
- Designate an authorized AIFM, in the case of a management company that is not authorized as an AIFM

The models are illustrated in Section 6.1.4.

Where the management company of a common fund in turn appoints an AIFM, two Boards are involved:

- The governing body of the management company
- The governing body of the AIFM

In this case, the governing body of the management company of a common fund plays a role comparable to that of the governing body of an investment company.

Where an investment company delegates management to a management entity, which in turn appoints an AIFM, three Boards are involved:

- The governing body of the UCI
- The governing body of the management company
- The governing body of the AIFM

D. Role of the management entity

The management company or AIFM is generally responsible for the key functions of:

- Portfolio management
- Risk management (see also Chapter 7)
- Administration (see also Chapter 8)
- Marketing/Distribution (see also Chapter 12)
- In the case of AIFM, activities related to the assets of AIF¹⁰⁹

The entity is permitted to delegate some of its functions. Section 5.1.6.F. covers delegation from a governance perspective.

Responsibility for the appointment and oversight of other service providers, such as the depositary, the auditor, and, where applicable, the management entity, also depends on the basic structure. In general responsibility for the appointment and oversight of other service providers lies with:

- In the case of a common fund, the management company
- In the case of an investment company, the governing body of the UCI

The responsibilities of governing bodies on the appointment of delegates and service providers are illustrated in Section 6.3.1.B.

¹⁰⁹ See Section 6.21.

E. The organization of the UCI

Board Members must fully understand the UCI structures and their roles and duties with respect to the specificities of the structure.

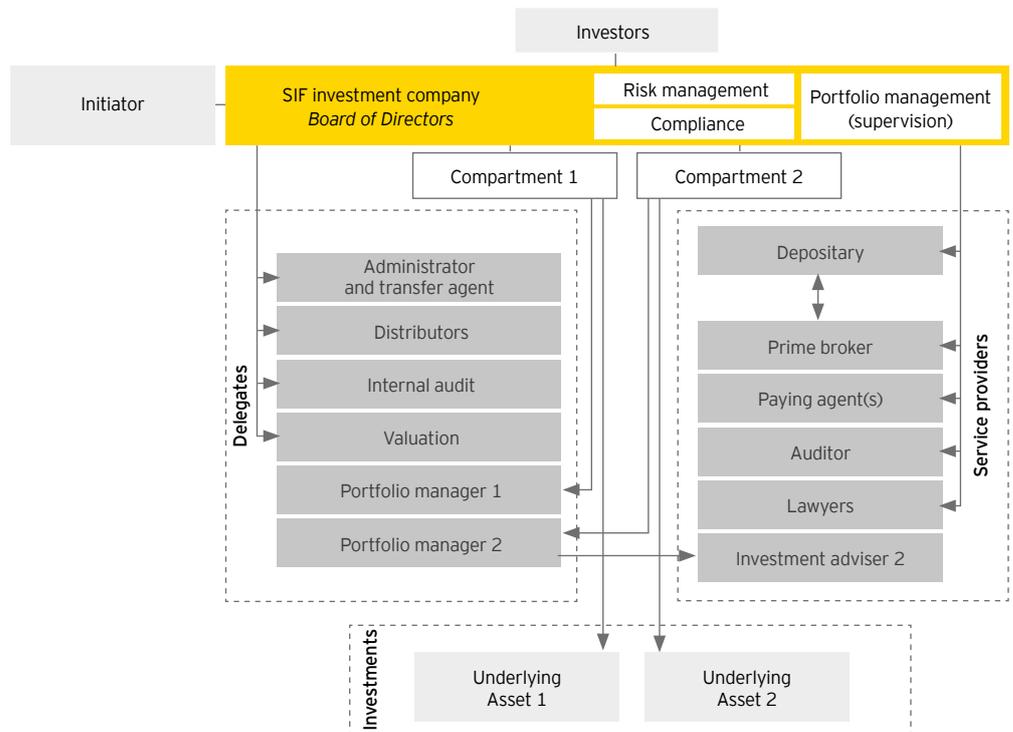
It is good practice for Board Members to ensure that the UCI formalizes and maintains illustrations of its relationship with the management entity or asset management group/sponsor/initiator, covering, *inter alia*:

- The relationship between the UCI, the management entity, and investors
- The internal organization of the management entity
- The relationship with group entities and third parties, covering, *inter alia*, responsibility for the due diligence, appointment, and ongoing monitoring of:
 - Delegates, such as portfolio managers, distributor and administrator (see also Section 5.1.6.F.)
 - Other service providers, such as depositary, auditor, and legal advisers
- The holding and investment structures of the UCI

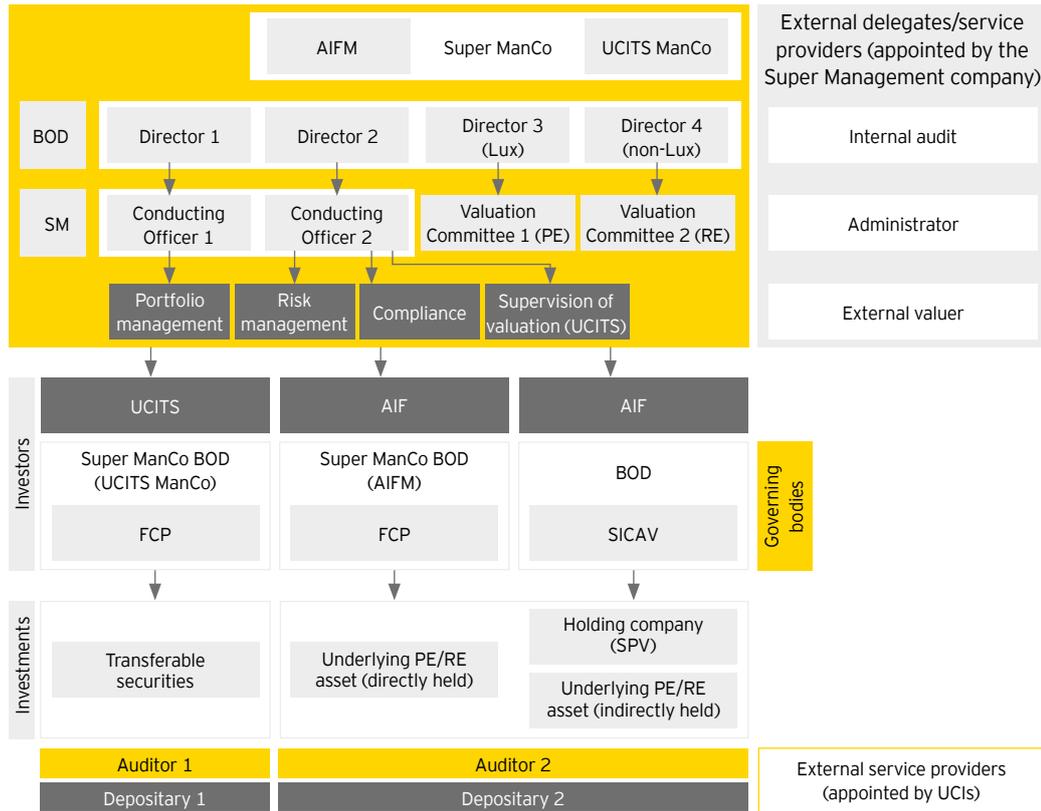
The following diagrams illustrate two typical Luxembourg UCI structures:

- Internally-managed AIF - a Specialized Investment Fund (SIF)
- Super management company with multiple UCIs

Internally-managed AIF - a Specialized Investment Fund (SIF)



Super ManCo with multiple UCIs



5.1.5. Governance models in Luxembourg

Luxembourg companies have the choice between two possible governance models:

- One tier
- Two tier

In a one tier governance model, the governing body (generally, the Board of Directors) plays the dual roles of ultimate decision-making body and the supervisory function.

In practice, day-to-day decisions are generally made by senior management in accordance with policies approved by the board.

In a two tier governance model, these roles are separated. The Management Board has the power to execute all activities necessary to achieve the company’s objectives. The Supervisory Board, on the other hand, is in charge of the supervision of the company and cannot play a role in the day-to-day management of the company.

The following table illustrates how these two roles or governing bodies may typically be implemented in a one tier and two tier governance structure:

	Typical implementation of roles of governing in one tier and two tier governance models	
	One tier	Two tier
Ultimate decision making body	Board of Directors	Management Board
Supervisory function	Members of the Board of Directors responsible for the supervision of senior management	Supervisory Board

The one tier governance model is the most common in Luxembourg.

5.1.6. Governance roles in the context of UCIs

Governance is primarily the responsibility of the management company's governing body (in the case of common funds) or the UCI's governing body (in the case of investment companies), as described in Section 5.1.4.

The governance structure of a UCI or its management entity may be considered to be composed of:

- ▶ Board of Directors
- ▶ Senior management
- ▶ Internal organization

A key role of the governing body is overseeing internal and external delegates.

5.1.6.1. Governing body

The governing body is generally a Board of Directors, but may also be the Board of Managers, depending, as the case may be, on the corporate form of the UCI and of the management company. Directors can be categorized as:

- ▶ Related to the promoter, initiator, or sponsor
- ▶ Related to the UCI's management company, related parties, or service providers
- ▶ Independent

CSSF Circular 18/698 on *Authorisation and organisation of investment fund managers incorporated under Luxembourg law - Specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent* was issued on 23 August 2018 and is applicable to Luxembourg investment fund managers ('IFM') which includes:

- ▶ Chapter 15 management companies
- ▶ AIFMs
- ▶ Self-managed UCITS
- ▶ Internally managed AIFs
- ▶ Luxembourg branches of IFM set up under Chapter 17 of the 2010 Law

The remainder of Section 5.1. sets out principal provisions of the Circular relating to governance.

A. *Governing body - Required skills, experience, reputation and composition of the management/governing body*

The following table provides more precise definitions of governing bodies used in relation to Chapter 15 management companies and AIFM:

Definitions of governing bodies of Chapter 15 management companies and AIFM

	Chapter 15 management company	AIFM
Ultimate decision making body	<p>"Board of Directors" means the Board of Directors of the management company.</p> <p>The term "Board of Directors" does not comprise the Supervisory Board when management companies have a dual structure composed of a Board of Directors and a Supervisory Board.</p>	<p>"Governing body" means the body with ultimate decision making authority in an AIFM, comprising the supervisory and the managerial functions, or only the managerial function if the two functions are separate.</p>
Supervisory function	<p>"Supervisory function" means the relevant persons or body or bodies responsible for the supervision of the senior management and for the assessment and periodical review of the adequacy and effectiveness of the risk management process and of the policies, arrangements, and procedures put in place to comply with the obligations under the 2010 Law.</p>	<p>"Supervisory function" means the relevant persons or body or bodies responsible for the supervision of the AIFM's senior management and for the assessment and periodical review of the adequacy and effectiveness of the risk management process and of the policies, arrangements, and procedures put in place to comply with the obligations under the AIFM Directive/AIFM Law¹¹⁰.</p>

¹¹⁰ Source: ESMA's Guidelines on sound remuneration policies under the AIFMD, February 2013.

CSSF Circular 18/698 requires an IFM governing body, in a one-tier system, to have at least three members. In a two-tier structure, the supervisory board must comprise at least three members and the management board at least two members.

Members of the management/governing body must:

- ▶ Possess sufficient skills and professional experience in relation to the relevant type(s) of UCI(s) as well as to the investment strategies of managed UCIs
- ▶ Have sufficient professional experience, having, for example, already performed similar activities to a high level of responsibility and autonomy
- ▶ Provide evidence of his/her professional reputation
- ▶ Taken as a whole, the management/governing body must be composed in a manner which allows the body to fully fulfill all of its responsibilities. This includes the professional skills as well as the personal qualities of the members, thus allowing the body to have a perfect understanding of all the activities, risks incurred by the IFM and the UCIs managed, as well as the economic and regulatory environment in which the IFM develops. Each individual member must understand the internal governance system and their responsibilities within the IFM
- ▶ Each member must be able to carry out their mandate effectively, i.e., with the commitment, availability, objectivity, critical abilities and independence required. Consequently, the management/governing body cannot be composed of a majority of executive members (conducting officers or other employees of the IFM) unless adequately justified

Luxembourg UCIs increasingly appoint non-executive directors, *inter alia*, in order to enhance the level of independence, experience, and objectivity in the decision-making process.

- ▶ In cases such as a UCI set up in corporate form, i.e., a SICAV or SICAF, with a management entity, it is recommended that the managing/governing body of the management entity and that of the UCI are not predominantly composed of the same people
- ▶ If a member of the management/governing body is also part of senior management, i.e., a conducting officer, he/she may:
 - ▶ Combine the mandate of member of the management/governing body with the role of Compliance Officer, the person responsible for monitoring compliance with the professional obligations with respect to AML/CFT or the person responsible for risk management
 - ▶ Combine the mandate of member of the management/governing body with the role of the person responsible for internal audit

Both the 2010 and SIF Laws require that Directors¹¹¹ be of sufficiently good repute and be sufficiently experienced in relation to the type of business carried out by the UCI.

The governing body is responsible for managing the business of the UCI in good faith, with reasonable care, in a competent, prudent, and active manner for the benefit of the UCI and its shareholders or unitholders.

¹¹¹ “Directors” means, in the case of public limited companies and in the case of cooperatives in the form of a public limited company, the members of the Board of Directors, in the case of partnerships, the managers or general partner, in the case of private limited liability companies, the manager(s), and in the case of common funds, the members of the Board of Directors or the managers of the management company.

The following table outlines the required minimum qualifications of governing bodies of management entities:

Minimum qualifications of governing bodies of management entities

	Chapter 15 management company	AIFM
Knowledge, skills, and experience	<p>Every member of the Board of Directors, or representative if a legal person has been appointed as Director, must be adequately skilled and experienced in relation to the type of UCIs concerned. Adequate professional experience must have been gained through having already performed similar activities to a high level of responsibility and autonomy.</p> <p>The members of the management body/governing body must ensure that their personal qualities enable them to properly perform their mandate as member of the management body/governing body, with the required commitment, availability, objectivity, critical thinking and independence.</p> <p>The members of the management body/governing, as a collective body, must have a perfect understanding of all the activities, risks incurred by the Chapter 15 management company and the UCITS managed, as well as the economic and regulatory environment in which the management company operates.</p>	<p>The governing body of the AIFM must possess adequate collective knowledge, skills, and experience to be able to understand the AIFM's activities, in particular the main risks involved in those activities and the assets in which the AIF is invested.</p> <p>The members of the management body/governing body must ensure that their personal qualities enable them to properly perform their mandate as member of the management body/governing body, with the required commitment, availability, objectivity, critical thinking and independence.</p>
Sufficient time	<p>Every member of the Board of Directors must dedicate sufficient time and attention to his duties. He is required to limit the number of other professional engagements, in particular the mandates held in other companies, to the extent necessary in order to be able to perform his tasks correctly.</p> <p>As a result, every candidate for the position of member of the IFM's management body/governing body must ensure compliance with the following requirements:</p> <ul style="list-style-type: none"> a) The number of hours spent fulfilling professional engagements cannot exceed 1,920 hours per year; and b) The number of mandates in regulated entities and in operating companies cannot exceed 20 mandates. <p>Thresholds reduced when justified by nature, scale or complexity of the activities, or by reduction in the applicant's working time.</p> <p>Governing bodies meet at least once per quarter and must document the work in writing (agenda of meetings and minutes of meetings)</p>	<p>The members of the governing body must commit sufficient time to properly perform their functions in the AIFM, and must therefore limit the number of other professional engagements and mandates accordingly.</p> <p>As a result, every candidate for the position of member of the IFM's management body/governing body must ensure compliance with the following requirements:</p> <ul style="list-style-type: none"> a) The number of hours spent fulfilling professional engagements cannot exceed 1,920 hours per year; and b) The number of mandates in regulated entities and in operating companies cannot exceed 20 mandates. <p>Thresholds reduced when justified by nature, scale or complexity of the activities, or by reduction in the applicant's working time.</p> <p>Governing bodies meet at least once per quarter and must document the work in writing (agenda of meetings and minutes of meetings)</p>

	Chapter 15 management company	AIFM
Reputation ¹¹² , integrity, independence	<p>Every member of the Board of Directors, or representative if a legal person has been appointed as Director, must be of sufficiently good repute.</p> <p>The composition of the Board of Directors of a Chapter 15 management company must not compromise its independence, for example:</p> <ul style="list-style-type: none"> ▶ When a depositary is a shareholder of the management company and also appointed as depositary of the UCITs managed by the management company, the Board of Directors of the management company must not be predominantly composed of representatives of the depositary ▶ When a management company is appointed by an investment company, the Board of Directors of the two entities should not be predominantly composed of the same people 	<p>Each member of the governing body must act with honesty, integrity, and independence of mind.</p> <p>The composition of the governing body of an AIFM must not compromise its independence, for example:</p> <ul style="list-style-type: none"> ▶ AIFM must ensure that no member of its governing body or any other management body is also a member of the management body or an employee of the depositary of UCIs it manages ▶ Where a group link exists between the IFM and the depositary with which assets of UCIs managed by the AIFM are deposited, the AIFM must ensure the independence of the management bodies of the two entities and, where appropriate, of their supervisory function
Training	<p>The compliance function must raise awareness of the staff about the significance of compliance and related aspects and assist them in the daily activities relating to compliance. To this end, it must also develop an ongoing training programme and ensure its implementation.</p>	

B. Number of hours and mandates

CSSF Circular 18/698 requires each member of the management/governing body to ensure that their mandate¹¹³ is compatible with their other professional engagements in terms of required time and conflicts of interest.

The Circular limits the number of hours spent fulfilling professional engagements and number of mandates each member of the management/governing body of the IFM can have:

- ▶ 1,920 hours per year dedicated to professional engagements, and
- ▶ No more than 20 mandates in regulated entities and operational companies

Certain exceptions to the above limits may be accepted by the CSSF on a case-by-case basis, in situations such as:

- ▶ Multiple entities forming part of the same structure
- ▶ Mandates having the same promoter/sponsor

In such situations, applicants should attach to their application for authorization a description of the measures to be taken to ensure that the mandates will receive the time and attention required.

There must be at least three members of the management body/governing body. However, in case of a two-tier system in which the supervisory and management functions are separated, the supervisory board must be composed of at least three members and the management board must be composed of at least two members.

For staff seconded/made available by an intra-group entity or a third party, the contract must be submitted to the CSSF.

¹¹² The concept of good repute of members of the Board of Directors or of senior management does not seem to be clarified in the regulations in relation to management entities. However, the AIFM Directive Level 2 does provides some clarifications with respect to the “good repute” of persons who effectively conduct the business of a delegate.

They shall not be deemed of sufficiently good repute if they have any negative records relevant both for the assessment of good repute and for the proper performance of the delegated tasks or if there is other relevant information that affects their good reputation. Such negative records shall include but shall not be limited to criminal offences, judicial proceedings, or administrative sanctions relevant for the performance of the delegated tasks. Special attention shall be given to any offences related to financial activities, including but not limited to obligations relating to the prevention of money laundering, dishonesty, fraud or financial crime, bankruptcy, or insolvency. Other relevant information shall include information indicating that the person is not trustworthy or honest.

Furthermore, when the delegate is regulated in respect of its professional services within the EU, the persons who conduct the business may be deemed to be of “good repute” when the relevant supervisory authority has reviewed the criterion of “good repute” within the authorization procedure, unless there is evidence to the contrary.

¹¹³ “Mandate” within CSSF Circular 18/698 is any role as a member of a management/governing body, or of a supervisory function or of conducting officer, in regulated or unregulated entities.

C. Tasks of the governing body

The tasks of the governing body include, *inter alia*:

- Ensuring that the UCI is managed in accordance with its strategy and objectives (investment strategy, realization of objectives in compliance with the applicable laws, regulations, CSSF Circulars, and prospectus)
- Convening annual and extraordinary general meetings
- Preparing management reports and financial statements

The Board may create dedicated committees (e.g., audit, investment, valuation, remuneration) for the fulfilment of its duties; this does not diminish in any way the Board's collective responsibility.

UCIs and their management entities can be configured in many different ways to deal with the specificities of different asset classes, geographies, frequently or infrequently traded assets, and the trend towards investor influence in the oversight of a UCI.

In these different configurations, there can be a range of governance and oversight bodies alongside the Boards, which, together, form the fabric of the governance structure.

The key oversight bodies of UCIs and their management entities may include a combination of the following:

- Board of UCI
- Board of management company
- Board of AIFM
- Board committees:
 - Investment committee (dedicated or not to a specific asset class)
 - Corporate governance committee
 - Appointment committee
 - Valuation committee
 - Audit committee
 - Remuneration committee
 - Shareholder/Unitholder/Investor Advisory Committee (with or without decision powers)
- Senior management
- Internal control functions:
 - Risk management
 - Compliance
 - Internal audit
- Boards of delegate portfolio manager, risk manager, other delegates, advisers, and service providers
- Boards of holding and investment structures

The roles of governing bodies of Chapter 15 management companies and AIFM, as laid down in the regulations, include the following:

Roles and responsibilities of governing bodies of Chapter 15 management companies and AIFM

	Chapter 15 management company	AIFM
Oversight of management entity's activities	The Management Board (the body composed of senior management) must regularly provide the Board of Directors of the management company with written complete information on the activities of the management company and the UCITS that it manages.	

Compliance	<p>Senior management and, when it exists, the supervisory function, are responsible for the management company's compliance with its obligations under the 2010 Law.</p> <p>Senior management and, when appropriate, its governing body or supervisory function must:</p> <ul style="list-style-type: none"> ▸ Assess and periodically review the effectiveness of the policies, arrangements, and procedures put in place to comply with the obligations laid down in the 2010 Law ▸ Take appropriate measures to address any deficiencies 	<p>The governing body, the senior management, and, when it exists, the supervisory function are responsible for the AIFM's compliance with its obligations under the AIFM Directive.</p> <p>Senior management and, when appropriate, its governing body or supervisory function must:</p> <ul style="list-style-type: none"> ▸ Assess and periodically review the effectiveness of the policies, arrangements, and procedures put in place to comply with the obligations laid down in the AIFM Directive ▸ Take appropriate measures to address any deficiencies
Internal controls (see also Section 6.3.2.)	<p>The supervisory function, if any, must receive written reports on matters of compliance, internal audit, AML/CFT, and risk management indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies.</p>	<p>The governing body or the supervisory function, if any, must receive on a regular basis written reports on matters of compliance, internal audit, AML/CFT, and risk management indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies.</p>
Risk management (see also Chapter 7)	<p>The management company's Board of Directors receives advice from the permanent risk management function as regards the identification of the risk profile of each managed UCITS.</p> <p>The management company's Board of Directors and, when it exists, its supervisory function, receives regular reports from the permanent risk management function on:</p> <ul style="list-style-type: none"> ▸ The consistency between the current levels of risk incurred by each managed UCITS and the risk profile agreed for that UCITS ▸ The compliance of each managed UCITS with relevant risk limit systems ▸ The adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies <p>The risk management policy must state the terms, contents, and frequency of reporting of the risk management function to the Board of Directors and to senior management and, when appropriate, to the supervisory function</p>	<p>The risk management function must be represented in the governing body or the supervisory function, when it has been established, at least with the same authority as the portfolio management function.</p> <p>The AIFM's governing body and, when it exists, its supervisory function:</p> <ul style="list-style-type: none"> ▸ Must be notified in a timely manner by the permanent risk management function when it considers the AIF's risk profile inconsistent with the risk limits or sees a material risk that the risk profile will become inconsistent with these limits ▸ Receives regular updates from the permanent risk management function on: <ul style="list-style-type: none"> ▸ The consistency between and compliance with the risk limits and the risk profile of the AIF as disclosed to investors ▸ The adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been or will be taken in the event of any actual or anticipated deficiencies ▸ Reviews the functional and hierarchical separation of the risk management function (see Section 7.3.5.)
Specific appointments	<p>The Board of Directors has the obligation to designate Senior Management, including in particular an AML/CFT Compliance Officer and a Cloud Officer. It is also responsible to validate appointments of a functional manager as per applicable regulations.</p>	

	Chapter 15 management company	AIFM
Conflicts of interest (see also Section 6.4.1.)	The governing body should approve the conflicts of interest policy and monitor its implementation.	The governing body of the AIFM and, when it exists, the supervisory function must establish the safeguards against conflicts of interest, regularly review their effectiveness, and take timely remedial action to address any deficiencies.
Remuneration (see also Section 6.4.3.)	The Board of Directors is responsible for: <ul style="list-style-type: none"> ▸ Determining the remuneration of the members of the Board of Directors and management bodies¹¹⁴ of the management company ▸ Approving/reviewing/updating the remuneration policy of the management company and supervising its implementation 	The management body of the AIFM, in its supervisory function, must adopt and periodically review the general principles of the remuneration policy and is responsible for its implementation
Internal Audit	The management body/governing body and senior management of the IFM are assisted by internal audit; the latter enables them to optimize the control over their activities and the risks related thereto and thus to protect the IFM's organization and reputation. The internal audit function must be able to operate independently and must comply with the principle of segregation of duties in order to identify any risk of non-compliance of the IFM.	
AML/CFT	The management/governing body of the IFM must validate the summary report on compliance with AML/CFT professional obligations, as prepared by the AML/CFT compliance officer at least once a year.	

D. Independence requirements

The UCITS V Delegated Regulation sets out the following independence requirements with respect to the governing bodies of the self-managed investment company or management company and the depositary:

- (i) No person may, at the same time, be both a member of the management body of the management company, or self-managed investment company, and a member of the management body of the depositary
- (ii) No person may, at the same time, be both a member of the management body of the management company, or self-managed investment company, and an employee of the depositary
- (iii) No person may, at the same time, be both a member of the management body of the depositary and an employee of the management company or the self-managed investment company
- (iv) Where the management body of the management company, or self-managed investment company, is not in charge of the supervisory functions within the company, no more than one third of the members of its body in charge of the supervisory functions should consist of members who are, at the same time, members of the management body, the body in charge of the supervisory functions or employees of the depositary
- (v) Where the management body of the depositary is not in charge of the supervisory functions within the depositary, no more than one third of the members of its body in charge of the supervisory functions should consist of members who are at the same time members of the management body of the management company, or the body in charge of the supervisory functions of the management company or of the self-managed or employees of the management company or of the investment company

¹¹⁴ | CSSF Circular 10/437.

In its *Frequently Asked Questions covering the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment*, the CSSF clarified that

- ▶ When the depositary of a UCITS is a Luxembourg branch of an entity having its registered office in another EU Member State, the independence requirements should be assessed at the level of the Chapter 15 management company (or self-managed SICAV) established in Luxembourg with regard to the management body of the head office of the depositary and the employees of the depositary (both at the level of its head office and of the Luxembourg branch)
- ▶ When the management company of a UCITS is established as a Luxembourg branch of a management company having its registered office in another EU Member State, independence requirements are assessed at the level of the depositary established in Luxembourg with regard to the management body of the head office of the management company and the employees of the management company (both at the level of its head office and of the Luxembourg branch)

Where there is a group link between the management company or the self-managed investment company and the depositary, independent member of the bodies may be appointed as follows:

- (i) Where the management body of the management company and the management body of the depositary are also in charge of the supervisory functions within the respective companies, at least one third of the members, or two persons, whichever is lower, of each management body, must be independent
- (ii) Where the management body of the management company and the management body of the depositary are not in charge of the supervisory functions within the respective companies, at least one third of the members, or two persons, of the body in charge of the supervisory functions within the management company and within the depositary must be independent.

In the above context, members are deemed to be independent if they are neither members of the management body or the body in charge of the supervisory functions nor employees of any of the other undertakings between which a group link exists and are free of any business, family or other relationship with the management company or the investment company, the depositary and any other undertaking within the group that gives rise to a conflict of interest such as to impair their judgment.

In most cases the supervisory functions are performed by members of the management body of the management company or the self-managed investment company.

In its *Frequently Asked Questions covering the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment*, the CSSF clarified that where there is a group link between the management company or the self-managed SICAV and the depositary, all 7 bullets above apply ((i) - (v) and (i)-(ii)).

The CSSF's *Frequently Asked Questions covering the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment*, also clarified that:

- ▶ The minimum number of independent members of the Chapter 15 management body depends on the total number of members within the relevant body:
 - ▶ There must be a minimum of one independent member in bodies of four members or less
 - ▶ There must be a minimum of two independent members in bodies of five/six members
- ▶ Individuals previously involved with, or linked to, the Chapter 15 management company, the self-managed SICAV, or the depositary must respect a cooling-off period of twelve months.

E. Meetings of the governing body

CSSF Circular 18/698 states that management/governing bodies must meet at least once per quarter to fulfill their responsibilities effectively, subject to nature, scale and complexity of the activities of the IFM.

Written documentation should be kept of these meetings, including agenda, minutes, ensuring documentation of decisions and measures taken by the management/governing body.

F. Delegation

In practice, the governing body generally delegates, wholly or partially, the performance of certain:

- ▶ Activities to service providers - refer to the list below
- ▶ Management activities to conducting officers (also known as senior management) - refer to Section 5.1.6.2 below

In order to carry out its activities in a more efficient manner, each IFM may be authorized to delegate one or more of its functions to third parties. The Circular sets out the organization arrangements to be put in place in case of delegation of management functions.

In principle, an IFM may delegate the following activities:

- ▶ Portfolio management
- ▶ Risk management
- ▶ Valuation function
- ▶ Complaints handling
- ▶ Discretionary portfolio management
- ▶ Certain AML/CFT tasks

An IFM may also be authorized to delegate the following:

- ▶ Compliance function
- ▶ Internal audit function
- ▶ Operation of IT systems
- ▶ Accounting function
- ▶ Marketing function

The following tasks cannot be delegated:

- ▶ Determination of the general investment policy for each UCI that has not been established in the form of a company
- ▶ Determination of the risk profile of each managed UCI
- ▶ Interpretation of the risk management analyses
- ▶ Setting up and managing of the conflict of interest policy
- ▶ Setting up and monitoring of a best execution policy
- ▶ Determination of a probably realizable value of an investment in absence of a representative price
- ▶ The decision as to the choice of relevant delegate
- ▶ Monitoring and control of the delegated functions
- ▶ AIFMs must ensure the correct valuation of an AIF's assets as well as the calculation and publication of the AIF's net asset value
- ▶ The CSSF recommends that Chapter 15 management companies also ensure the correct valuation of a UCITS' assets as well as the calculation and publication of the UCITS' net asset value

CSSF Circular 18/698 sets out requirements which apply on case of delegation. Such requirements are set out in Section 6.3.3.

Delegation must always be reasonable, justified, in the interest of the UCI and its shareholders or unitholders, and under the supervision of the governing body. The governing body retains overall responsibility, including responsibility for performing due diligence on the delegate, making the decision to delegate, and monitoring the delegate.

It is possible for an IFM to delegate activities to third parties but not to the extent that the delegation results in the IFM becoming a "letter box entity". In practice, governing bodies in UCI structures have to meet regulatory and tax substance requirements (Board, senior management, control, professionals) at all levels (manager, fund, holding, and investment structures).

5.1.6.2. Senior management

Senior management (i.e., the conducting officers), and the supervisory function (if any), effectively conduct the business of the IFM.

The persons who effectively conduct the business of a Chapter 15 management company or an AIFM are referred to as "senior management" or, in Luxembourg, "conducting officers". There must be at least two conducting officers who, in principle, should be Luxembourg residents. This does not however prevent the conducting officers from having their domicile in a place enabling them, in principle, to come to Luxembourg every day.

The conducting officers of a Chapter 15 management company collectively form a "Board of Management".

For staff seconded/made available by an intra-group entity or a third party, the contract must be submitted to the CSSF.

“Senior management” is defined slightly differently for Chapter 15 management companies and AIFM:

Definitions of “senior management” of Chapter 15 management companies and AIFM

Chapter 15 management company	AIFM
“Senior management” means the persons who effectively conduct the business of a management company.	“Senior management” means the person or persons who effectively conduct the business of an AIFM and, as the case may be, the executive member or members of the governing body

While there are no explicit requirements on the senior management of a Chapter 16 management company, the management company must provide in its application for authorization to the CSSF information on the members of senior management (see Section 6.2.1.).

A. Number, location of conducting officers, and their relationship with the IFM

CSSF Circular 18/698 requires that a minimum of two conducting officers be appointed to carry out the day-to-day business of the IFM, and they must permanently reside in Luxembourg, or be able to come to Luxembourg every day.

Two conducting officers must be employed in Luxembourg and must be allocated full-time to their tasks within the IFM. The CSSF may accept that one or more conducting officer(s) be available or seconded providing that contracts exist defining their rights and obligations, and reporting lines.

With respect to the number of mandates a conducting officer can perform, the Circular introduces a threshold of portfolios under management of the IFM of EUR 1.5 billion.

If the IFM manages less than EUR 1.5 billion, the conducting officers must not perform more than two mandates as conducting officers of IFM. In such situations, the CSSF may accept that one conducting officer permanently resides in Luxembourg providing that the IFM employs sufficient competent staff to support the conducting officer who does not permanently reside in Luxembourg, and that the conducting officer is able to regularly visit Luxembourg.

If portfolios managed by the IFM exceed EUR 1.5 billion, the two appointed conducting officers must not perform any other conducting officer mandates and must permanently reside in Luxembourg. If the IFM appoints more than two conducting officers, one or more of the conducting officers may not permanently reside in Luxembourg and may not work full-time to the relevant conducting officer task, providing that the IFM employs enough people to support the relevant conducting officer and he/she is able to regularly visit Luxembourg.

People who perform more than one conducting officer mandate must be able to demonstrate to the CSSF that he/she has adequate time to dedicate to each mandate.

The CSSF must be able to contact the conducting officers directly and they must be able to provide the CSSF with all required information for its supervision.

B. Required skills, experience, and reputation of the conducting officers

CSSF Circular 18/698 requires conducting officers to possess the following:

- ▶ Sufficient skills and professional experience in relation to the relevant type(s) of UCI(s) as well as to the investment strategies of managed UCIs
- ▶ Adequate professional experience, having, for example, already performed similar activities to a high level of responsibility and autonomy
- ▶ Evidence of his/her professional reputation
- ▶ Both individually and jointly, they must have the necessary professional skills, reputation and personal qualities to fulfill their tasks, with a view to ensuring sound and prudent management of the IFM

Qualifications of senior management of management entities

	Chapter 15 management company	AIFM	Chapter 16 management company
Appropriate composition	The composition of the members of the management body/governing body as a whole must be appropriate so that the management body/governing body can fully meet its responsibilities. The appropriateness refers in particular to professional skills (knowledge, understanding and experience), as well as personal qualities of the members of the management body/governing body.		

	Chapter 15 management company	AIFM	Chapter 16 management company
Knowledge, skills, and experience	<p>The persons who effectively conduct the business of a management company must be adequately experienced also in relation to the type of UCITS managed by the management company.</p> <p>Members of senior management must have already acquired an adequate level of professional experience through the performance of similar activities at a senior level in terms of responsibility and independence.</p>	<p>The persons who effectively conduct the business of the AIFM must be adequately experienced also in relation to the investment strategies pursued by the AIFM managed by the AIFM.</p>	<p>The persons who effectively conduct the business must have already acquired an adequate level of professional experience through the performance of similar activities at a senior level in terms of responsibility and independence.</p>
Reputation, integrity, and independence of mind	<p>The persons who effectively conduct the business of a management company must be of sufficiently good repute.</p> <p>The principle of independence of the management company from the depositary of the UCITS under management implies that the conducting officers cannot be employees of the depositary.</p>	<p>The persons who effectively conduct the business of the AIFM must be of sufficiently good repute.</p>	<p>The persons who effectively conduct the business must prove their good repute.</p> <p>The principle of independence of the management company from the depositary of the UCIs under management implies that the conducting officers cannot be employees of the depositary.</p>

C. Tasks of the conducting officers

The roles and responsibilities of senior management of Chapter 15 management companies and AIFM, as laid down in the regulations and the Circular 18/698, include the following:

Roles and responsibilities of senior management of Chapter 15 management companies and AIFM

	Chapter 15 management company	AIFM
Providing governing body with overview of management entity's activities	<p>The executive committee regularly informs the management body/governing body, in an exhaustive manner and in writing, on the activities of the IFM and the UCIs it manages.</p>	
Compliance	<p>The governing body, the senior management, and, when it exists, the supervisory function are responsible for the UCI's compliance with its obligations under the Law and CSSF Circular 18/698.</p> <p>Senior management and, when appropriate, its governing body or supervisory function must:</p> <ul style="list-style-type: none"> ▸ Assess and periodically review the effectiveness of the policies, arrangements, and procedures put in place to comply with relevant regulatory framework ▸ Create, maintain and implement compliance charter ▸ Take appropriate measures to address any deficiencies 	
Central administration (see also Section 6.3.2.3.)	<p>Senior management is responsible for the implementation of strategies and guiding principles for central administration and internal governance through specific written internal policies and procedures.</p> <p>The concept of "central administration" covers the management functions and the operational and control functions, which should enable the management company to control all of its activities.</p>	

Internal controls (see also Section 6.3.2.)	<p>Senior management is responsible for the implementation of adequate internal control mechanisms (permanent compliance, permanent risk management, permanent internal audit functions, and permanent IT and Accounting support functions).</p> <p>Senior management is responsible for ensuring that the management company has a permanent and effective compliance function, even if this function is performed by a third party.</p> <p>Senior management must receive on a frequent basis, and at least annually, written reports on matters of compliance, internal audit, and risk management indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies.</p> <p>Senior management is responsible for drafting and maintaining operating procedures and an internal audit charter.</p>
Risk management (see also Chapter 7)	<p>Senior management must:</p> <ul style="list-style-type: none"> ▶ Approve and review on a periodic basis the risk management policy (RMP) and Risk management procedure including arrangements, processes and techniques for implementing that policy, including the risk limit system for each managed UCI, and filing these for review ▶ Ensure and verify on a periodic basis that the risk limits of each managed UCI are properly and effectively implemented and complied with, even if the risk management function is performed by third parties ▶ Receive from the permanent risk management function regular reports outlining the current level of risk incurred by each managed UCI and any actual or foreseeable breaches to their limits, to ensure that prompt and appropriate action can be taken
Portfolio management	<p>Senior management:</p> <ul style="list-style-type: none"> ▶ Is responsible for the implementation of the general investment policy, as defined, when relevant, in the prospectus or the offering document, and, if applicable, the UCITS KII and/or PRIIPS KIID as well as the constitutional document, for each managed UCI and a portfolio management procedure ▶ Must oversee the approval of investment strategies for each managed UCI ▶ Must ensure and verify on a periodic basis that the general investment policy and the investment strategies are properly and effectively implemented and complied with ▶ Must approve and review on a periodic basis the adequacy of the internal procedures for undertaking investment decisions for each managed UCI to ensure that such decisions are consistent with the approved investment strategies ▶ Investment advisor limited to advisory role ▶ Requirement to define and implement a procedure describing the arrangements for the critical and independent analysis of the transactions proposed by the investment advisor ▶ Mere verification by the IFM of the compliance of the transaction with the investment restrictions is not sufficient ▶ Prior analysis and validation of “white lists” and investment models by the IFM ▶ Adequate disclosure of the role of the IFM and the investment advisor in the prospectus

	Chapter 15 management company	AIFM
Valuation (see also Section 7.6.)	<p>Senior management should ensure that valuation policies and procedures are established and implemented.</p> <p>Given that the Chapter 15 management company must also put in place appropriate procedures to ensure the accurate and precise valuation of assets and liabilities of UCITS pursuant to Article 9(3) of CSSF Regulation 10-4, the CSSF recommends that the Chapter 15 management company complies with the provisions as set for AIFMs.</p>	<p>Senior management is responsible for ensuring that the valuation policies and procedures are established and implemented and for approving any changes thereto.</p> <p>Senior management must also approve any model used to value the assets of the AIF.</p> <p>Policy/procedure should include:</p> <ul style="list-style-type: none"> ▸ Descriptions of the type of model and characteristics thereof (mere reference to standard model not sufficient) ▸ Name of person who has developed the model and name of person responsible for validating it ▸ Process applied to modify existing models or to change a model (incl. name of person responsible for approving) ▸ Arrangements for modifying a price which has been determined via models (incl. process for validation) <p>Prior to the launch of a new investment strategy, the valuation policies and procedures must be re-examined by the AIFM then submitted to the CSSF with a view to obtaining authorization for the extension of the authorization to the new strategy in question.</p> <p>For complex and illiquid strategies, the separation of the risk and valuation function is recommended.</p> <p>Valuation Committee ('VC') is recommended to include senior management and staff of the AIFM located in Luxembourg or in proximity on a permanent basis as well as director responsible for valuation.</p> <p>Members composing the VC need to be independent of the process of investment management, including the selection of the investments.</p> <p>Work of the VC needs to be documented in writing, recording notably the analysis of risks linked to investment as well as decisions and measures taken.</p>
Conflicts of interest (see also Section 6.4.1.)	<p>Senior management must receive on a frequent basis, and at least annually, written reports on matters of compliance, internal audit, and risk management indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies.</p>	<p>Senior management must receive on a frequent basis, and at least annually, written reports on monitoring of conflicts of interest.</p> <p>When the organizational or administrative arrangements made by the AIFM for the management of conflicts of interest are not adequate to ensure, with reasonable confidence, that risks of damage to the interests of the AIF or investors in the AIF are prevented, the senior management or other competent internal body of the AIFM must be promptly informed in order to take any necessary decision or action to ensure that the AIFM acts in the best interests of the AIF or the investors in that AIF.</p>

	Chapter 15 management company	AIFM
Distribution (see also Chapter 12)	Senior management is responsible for implementing and monitoring the marketing activity and the oversight of distribution network of the UCIs under management.	
Prime brokers (see Section 6.3.5.2.)		Senior management must approve the list of selected prime brokers.
Remuneration (see also Section 6.4.3.)	Senior management is responsible for establishing and applying a remuneration policy that meets the IFMs Law requirements. Authorized management ¹¹⁵ is responsible for implementing the remuneration policy. It must elaborate procedures to this effect and submit them to the Board of Directors for approval. It must also inform the relevant personnel of the policies and procedures.	
Resources	Senior Management must ensure that the IFM has the technical infrastructure and human resources necessary to exercise its activity.	

D. Meeting obligations

Conducting officers must be in regular contact with each other and hold at least monthly meetings. The frequency should be determined based on the size and organization of the IFM, as well as the nature, scale and complexity of its activities. At its meetings, the Board of Management must, *inter alia*, discuss "Management Information" which must be a permanent item on its agenda.

Written minutes of these meetings should be maintained, documenting decisions and measures taken by the IFM.

E. Approval as members of managing/governing bodies and conducting officers

The CSSF must approve members of managing/governing bodies and conducting officers prior to appointment.

The notification sent to the CSSF must be accompanied by the following:

- ▶ Recent curriculum vitae, signed and dated
- ▶ Copy of passport/identity card
- ▶ Declaration of honor (may be downloaded from the CSSF website)
- ▶ Recent extract of criminal record
- ▶ Table listing professional activities and mandates in regulated entities, or not, specifying the time devoted to each activity and mandate

The IFM must send to the CSSF annually, within 5 months of its financial year end, an updated table listing the professional activities as well as mandates performed.

F. Independence from the depositary

A conducting officer of an IFM cannot be employed by the depositary of the UCI that the IFM manages.

The managing/governing body of a Chapter 15 management company cannot also be a member of the managing body or an employee of the depositary that it manages. It must ensure that none of its employees are also members of the management body of the depositary of the UCITS that it manages. If there is a group link between the management company and the depositary with which the assets of the UCITS are deposited, the management company must ensure independence of the management bodies of the two entities.

The CSSF recommends that AIFM also comply with the provisions in the previous paragraph relating to Chapter 15 management companies.

G. Internal organization

The conducting officers of every IFM must be members of the management committee. The members of this committee work together in close partnership to take all actions falling within the scope of their responsibilities.

¹¹⁵ This term is used in CSSF Circular 10/437.

In the context of the operation of the executive committee and irrespective of the legal form or structure of the IFM, each conducting officer is assigned specific areas of responsibility, notably with regard to the following functions/activities:

- Investment management
- Risk management
- Administration of UCIs
- Marketing
- Compliance
- Internal audit
- Claim and complaint handling
- AML/CFT
- Valuation
- IT function
- Accounting function

The composition of the executive committee must be adapted to the size of the IFM as well as the nature, scale and complexity of its activities. Consequently, the IFM must assess the need to appoint more than two conducting officers. The allocation of tasks amongst the conducting officers must be organized to avoid conflicts of interest. The functions of risk-taking and independent control of these same risks cannot be assigned to the same conducting officer. As an example, the performance and/or control of the risk management function and that of the investment management function cannot be carried out by the same conducting officer.

Functional and hierarchical separation of portfolio management and risk management at senior management levels

Chapter 15 management company	AIFM
<p>The permanent risk management function must be hierarchically and functionally independent from the operating units.</p> <p>A conducting officer cannot be responsible for both investment management and risk management (see also Section 7.2.5.).</p>	<p>The functional and hierarchical separation of the risk management function from the operating units, including the portfolio management function, must be ensured throughout the whole hierarchical structure of the AIFM, up to its governing body (see also Section 7.3.5.).</p>

The conducting officer in charge of the internal audit function cannot exercise the function of the Compliance Officer, of the AML/CFT Compliance Officer or of the person in charge of risk management and cannot be assigned to one of the above-mentioned functions or activities¹¹⁶.

The conducting officers of an IFM may also, on the basis of a service level agreement, make use of the expertise and/or technical means of other units within the group to which the management company belongs or a third party that has the competencies, quality, and authorizations necessary to provide the required support in a professional manner.

An IFM must meet requirements regarding organization and procedures:

- Establish management information and internal reporting systems allowing it to monitor its own activities and those of its delegates
- Establish, implement and maintain an adequate business continuity policy of its activities and services allowing for disaster recovery and periodic testing of back-up facilities
- Establish arrangements which allow it to identify and assess the risks of new business relationships and new products, including with respect to money laundering and terrorist financing, in particular regulatory and operational risks related to the launch of a UCI, a compartment or a new type of assets, the entering into of a new business relationship or in case of entry of the IFM in new markets or geographies
- Establish a clear and precise procedures manual which describes its internal functioning, the allocation of tasks amongst its staff as well as hierarchical lines
- Establish a written complaints handling policy which is made available to all relevant staff members
- Establish written procedures regarding personal transactions
- Manage conflicts of interest
 - Chapter 15 management companies should try to avoid conflicts of interest and, when they cannot be avoided, ensure that the UCITS it manages are fairly treated
 - AIFMs must take all reasonable steps to identify conflicts of interest and, when they cannot be avoided, to identify, handle, monitor and disclose those conflicts of interest in order to prevent them from affecting the interests of AIFs and their investors and to ensure that the AIFs they manage are fairly treated
 - Establish, implement and maintain an effective written conflicts of interest policy
 - Maintain a record of conflicts of interest
 - Inform investors of situations where the organization or administrative arrangements made by the IFM for handling conflicts of interest have not been sufficient to guarantee, with reasonable confidence, that the risk of damage to the interests of the UCI or of its investors will be prevented

¹¹⁶ In practice the CSSF considers internal audit as a joint responsibility of all conducting officers, i.e the management committee.

- ▶ Establish rules of conduct including procedures, arrangements and policies to ensure that:
 - ▶ It executes the investment decisions taken for account of the UCIs managed in accordance with objectives, investment strategy and risk limits
 - ▶ It takes all reasonable steps to execute directly itself the orders to obtain the best possible result
 - ▶ It executes rapidly and equitably the orders on behalf of managed UCIs
- ▶ Implement a remuneration policy
- ▶ Develop an adequate and effective strategy for determining when and how voting rights attached to instruments held in managed portfolios are to be exercised so that these rights benefit exclusively the UCI concerned and its investors
- ▶ Establish procedures and arrangements to ensure that UCIs under management comply with the EMIR obligations, where applicable.
- ▶ Implement procedures and arrangements to ensure compliance with the MMF Regulation, where applicable

The principle of proportionality may apply: IFMs should take into account the nature, scale, and complexity of their activities, and the range of services performed.

The general organizational requirements applicable to management entities are covered in more detail in Section 6.3.1.

UCITS management companies and external AIFMs insofar as they are providing the investment services of individual portfolio management or non-core services and only in connection with the provision of these services will also have to comply with the ESMA's *Guidelines for the assessment of knowledge and competence of investment firms' personnel*.

In particular, staff giving information about investment products, investment services, and ancillary services should:

- ▶ Understand the key characteristics, risk, and features of those investment products available through the firm, including any general tax implications and costs to be incurred by the client in the context of transactions
- ▶ Understand the total amount of costs and charges to be incurred by the client in the context of transactions in an investment product, or investment services or ancillary services
- ▶ Understand the characteristics and scope of investment services or ancillary services
- ▶ Understand how financial markets function and how they affect the value and pricing of investment products on which they provide information to clients
- ▶ Understand the impact of economic figures, national/regional/global events on markets and on the value of investment products on which they provide information
- ▶ Understand issues relating to market abuse and anti-money laundering
- ▶ Assess data relevant to the investment products on which they provide information to clients such as the Key Investor Information Documents, prospectuses, financial statements, or financial data
- ▶ Understand specific market structures for the investment products on which they provide information to clients and, where relevant, their trading venues or the existence of any secondary markets
- ▶ Have a basic knowledge of valuation principles for the type of investment products in relation to which the information is provided
- ▶ Understand the difference between past performance and future performance scenarios as well as the limits of predictive forecasting

In addition to the above, according to the ESMA Guidelines, staff giving investment advice shall comply, *inter alia*, with the following criteria:

- ▶ Fulfil the obligations required by firms in relation to the suitability requirements including the obligations set out in the ESMA Guidelines on certain aspects of the MiFID suitability requirements
- ▶ Understand how the type of investment product provided by the firm may not be suitable for the client, having assessed the relevant information provided by the client against potential changes that may have occurred since the relevant information was gathered
- ▶ Understand the fundamentals of managing a portfolio, including being able to understand the implications of diversification regarding individual investment alternatives.

5.1.7. Governance principles in the context of UCIs

Governance is increasing in importance at International, European and local levels both individually in governance specific texts as well as part of the European Commission's sustainable action plan.

As a result, there are a number of governance principles that may be applied in the context of UCIs.

General governance principles include the OECD's *Principles of Corporate Governance*, the Luxembourg Stock Exchange's *Ten Principles of Corporate Governance*, and INREV's *The Principles of Corporate Governance*.

In March 2018, the European Commission issued its sustainable finance action plan. The key features of the action plan include:

- ▶ Establishing a common language for sustainable finance, i.e., a unified classification system or taxonomy - to define what is sustainable and identify areas where sustainable investment can make the biggest impact
- ▶ Creating EU labels for green financial products on the basis of this EU classification system: this will allow investors to easily identify investments that comply with green or low-carbon criteria
- ▶ Clarifying the duty of asset managers and institutional investors to take sustainability into account in the investment process and enhance disclosure requirements
- ▶ Requiring insurance and investment firms to advise clients on the basis of their preferences on sustainability
- ▶ Incorporating sustainability in prudential requirements
- ▶ Enhancing transparency into corporate reporting

On 27 November 2019, the European Parliament and the Council adopted the Regulation (EU) 2019/2088 on *sustainability-related disclosures in the financial services sector*, which contains a number of governance-related provisions which will be phased-in as from 10 March 2021.

Boards should make sure ESG factors are embedded in IFMs and fund governance processes covering product development, portfolio management, risk management and reporting. Remuneration policies should reflect how meeting sustainability risk mitigation objectives will impact senior management bonuses. For more details, see Section 14.3.

The European Fund and Asset Management Association ('EFAMA') issued its updated *Stewardship Code in 2018, covering Principles for asset managers' monitoring of, voting in, engagement with investee companies*. Adoption of this code by industry participants is voluntary, however, it aims to be a reference document for asset managers seeking to comply with SRD II. EFAMA believes that through stewardship, asset managers can encourage business and management practices on environmental, governance, human rights and social challenges thereby encouraging long-term value creation and economic stability. The Code's principles are:

- ▶ Asset managers should have an engagement policy available to the public on whether, and if so how, they exercise their stewardship responsibilities. Where asset managers decide not to develop an engagement policy, they should give a clear and reasoned explanation as to why this is the case
- ▶ Asset managers should monitor their investee companies, in accordance with their engagement policy
- ▶ Asset managers should establish clear guidelines on when and how they will escalate engagement with investee companies to protect and enhance value of their clients' investments
- ▶ Asset managers should consider acting with other investors, where appropriate, having due regard to applicable rules on acting in concert
- ▶ Asset managers should exercise their voting rights in a considered way
- ▶ Asset managers should disclose the implementation and results of their stewardship and voting activities

UCIs may also apply principles specific to UCIs. A key reference governance code in the context of Luxembourg UCIs is the Association of the Luxembourg Fund Industry's (ALFI) *Code of Conduct for Luxembourg Investment Funds* updated in 2013. The objective of the *Code of Conduct* is to provide Boards of Directors with a framework of high-level principles and best practice recommendations for the governance of Luxembourg investment funds and of management companies, where appropriate.

ALFI recommends that the *Code of Conduct* be applied by all UCIs - listed and unlisted - and to management companies in order to have a uniform and consistent approach in the marketplace.

Under the *Code of Conduct*, the Boards of Luxembourg funds should:

- ▶ Ensure that high standards of corporate governance are applied at all times
- ▶ Have good professional standing and appropriate experience and ensure that it is collectively competent to fulfill its responsibilities
- ▶ Act fairly and independently in the best interests of the investors
- ▶ Act with due care and diligence in the performance of its duties
- ▶ Ensure compliance with all applicable laws, regulations, and with the fund's constitutional documents
- ▶ Ensure that investors are properly informed, are fairly and equitably treated, and receive the benefits and services to which they are entitled
- ▶ Ensure that an effective risk management process and appropriate internal controls are in place
- ▶ Identify and manage fairly and effectively, to the best of its ability, any actual, potential, or apparent conflict of interest and ensure appropriate disclosure
- ▶ Ensure that shareholder rights are exercised in a considered way and in the best interests of the fund
- ▶ Ensure that the remuneration of the Board members is reasonable and fair and adequately disclosed

ALFI and the Institut Luxembourgeois des Administrateurs (ILA) have developed guidance materials on topics included in the *Code of Conduct*, covering matters such as board member independence, board evaluations, board member time capacity, board member letter of appointment, board reports and conflicts of interest.

The Accounting Directive¹¹⁷ published in June 2013, requires that Public Interest Entities (“PIEs”) include a corporate governance statement in their management report. That statement must be included as a specific section of the management report and must contain, *inter alia*, the following information:

- ▶ A reference to the following, where applicable:
 - ▶ The corporate governance code to which the undertaking is subject
 - ▶ The corporate governance code that the undertaking may have voluntarily decided to apply
 - ▶ All relevant information about the corporate governance practices applied over and above the requirements of national law
- ▶ Where an undertaking, in accordance with national law, departs from a corporate governance code referred above, an explanation by the undertaking as to which parts of the corporate governance code it departs from and the reasons for doing so; where the undertaking has decided not to refer to any provisions of a corporate governance code referred above, it shall explain its reasons for not doing so
- ▶ A description of the main features of the undertaking's internal control and risk management systems in relation to the financial reporting process
- ▶ The composition and operation of the administrative, management, and supervisory bodies and their committees

The financial reports of UCIs are covered in Section 10.5. and listed UCIs are covered in Chapter 13.

5.1.8. The oversight of UCIs

The governing body plays a key role in the oversight of UCIs. Other entities playing important roles in the ongoing oversight of UCIs include:

- ▶ The management company, and delegates thereof: the senior management and control functions play key roles, but also all heads of units and each member of staff play a role (see Chapter 6)
- ▶ The depositary in the context of its oversight duties (see Chapter 9)
- ▶ The auditor (see Section 10.5.10.)
- ▶ The supervisory authorities (see Section 3.5.)

¹¹⁷ Directive 2013/34/EU of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

5.2. Criminal and civil liability

This section provides a brief overview of criminal and civil liability of entities and individuals in the context of Luxembourg UCIs.

Directive 2014/91/EU of 23 July 2014 on *UCITS as regards depositary functions, remuneration policies and sanctions* (the “UCITS V Directive”) was published in the Official Journal of the European Union on 28 August 2014. On 12 May 2016, the Luxembourg law of 10 May 2016 (the “UCITS V Law”), transposing the UCITS V Directive and amending the 2010 Law, was published in the Luxembourg Mémorial A (Mémorial A 88 of 12 May 2016). One of the areas of focus of the UCITS V Directive is the harmonization of administrative sanctions.

Article 148 paragraph 4 of the 2010 Law, as amended stipulates that the CSSF may impose the following penalties and other administrative measures:

- a) A public statement that identifies the person responsible and the nature of the violation of the law
- b) An order requiring the person responsible to cease the conduct and to desist from the repetition of that conduct
- c) In the case of a UCI or a management company, suspension or withdrawal of the authorization of the UCI or the management company
- d) A temporary or, for repeated serious violations of the law, a permanent ban against a member of the management body of the management company or the UCI or against any other natural person employed by the management company or the UCI who is held responsible, from exercising management functions in those or in such entities
- e) In the case of a legal person, a maximum fine of EUR 5 million or a maximum amount of 10% of the total annual turnover of the legal person according to the last available accounts approved by the management body
- f) In case of a natural person a maximum fine of EUR 5 million
- g) As an alternative to points e) and f), a maximum administrative fine of at least twice the amount of the benefit derived from the infringement of the law where that benefit can be determined, even if that exceeds the maximum amounts in points e) and f)

Article 149 of the 2010 Law, further provides that the CSSF shall publish on its website any decision against which there is no appeal imposing an administrative sanction or measure for infringements of the provisions of the 2010 Law without undue delay after the person on whom the sanction or measure was imposed has been informed of that decision. The publication shall include at least information on the type and nature of the infringement and the identity of the persons responsible. This obligation does not apply to decisions imposing measures that are of an investigatory nature.

The Law of 23 July 2016 on the audit profession (the “audit profession law”) transposing European Directive 2014/56/EU and implementing European Regulation 537/2014 deals with sanctions regime that is notably applicable to individual PIE audit committee members, directors, management, and the PIEs themselves in the event of non-compliance with the audit profession law and EU regulation.

According to Article 43 of the audit profession law, the CSSF has the power to impose the following administrative measures and sanctions for breaches of the provisions of the audit profession law and, where applicable, of the EU Regulation:

- a) A notice requiring the natural or legal person responsible for the breach to cease the conduct and to abstain from any repetition of that conduct
- b) A public statement which indicates the person responsible and the nature of the breach, published on the CSSF’s website
- c) A temporary prohibition, of up to three years’ duration, banning the *réviseur d’entreprises agréé* (approved statutory auditor), the *cabinet de révision agréé* (approved audit firm) or the key audit partner from carrying out statutory audits and/or signing audit reports
- d) A declaration that the audit report does not meet the requirements of Article 35 of this law or, where applicable, Article 10 of Regulation (EU) No 537/2014
- e) In case of a legal person, an administrative fine of a maximum of EUR 1 million or a maximum of 5% of the total annual net turnover of the company as reflected in the latest accounts approved by the management board or supervisory board
- f) In case of a natural person, an administrative fine of up to EUR 500,000
- g) As an alternative to e) and f), an administrative fine of an amount equal to at least twice the benefit derived from the infringement, if it can be determined, even if that amount exceeds the maximum amounts referred to in points e) and f)
- h) The permanent deregistration from the public register and the permanent prohibition for the *réviseur d’entreprises agréé* (approved statutory auditor), the *cabinet de révision agréé* (approved audit firm) or the key audit partner to carry out statutory audits and/or sign audit reports

- i) A temporary prohibition, of up to three years' duration, banning the *réviseur d'entreprises* (statutory auditor) or the *cabinet de révision* (audit firm) from carrying out the activities listed in letter (b) of the first subparagraph and in the second subparagraph of Article 1(34)
- j) A permanent prohibition banning the *réviseur d'entreprises* (statutory auditor) or the *cabinet de révision* (audit firm) from carrying out the activities listed in letter (b) of the first subparagraph and in the second subparagraph of Article 1(34)

The sanctions and administrative measures taken by the CSSF may be appealed pursuant to Article 46 of the audit profession law. The application of the penalty or administrative measure is suspended during the period for appeal and for the duration of the procedure.

5.2.1. Criminal liability

Both legal entities (including Luxembourg UCIs set up as investment companies and management companies) and individuals (including the directors and managers of such legal entities) can be held criminally liable for misdemeanors (minor offences) and crimes (serious offences).

While the criminal liability of directors and managers of Luxembourg UCIs as individual physical persons has always existed, criminal liability of UCIs as corporate entities was only implemented in Luxembourg law in 2010.

5.2.1.1. Criminal liability of directors and managers

Luxembourg law subjects all individuals holding a "*de jure*" or "*de facto*" management function with respect to a management company or investment company to criminal liability.

The criminal liability of physical persons prevents individuals from hiding behind a "*corporate veil*".

Under Articles 1500-1 and 1500-2 of the 1915 Law, any person who, purporting to be the owner of shares or bonds which do not belong to it, participates in a company constituted under the 1915 Law, in any vote in a general meeting of shareholders or bondholders and any person who has delivered shares or bonds so that they may be used for the purpose described above are punishable by a fine of EUR 500 to EUR 25,000.

The same penalty shall be imposed upon:

- 1) The persons who fail to include information on, *inter alia*, the capital, denomination, registered office, corporate object, share classes, in the documentation published on the RCS or filed in accordance with the 2002 Law, in subscription forms, prospectuses, circulars, announcements and notices published in newspapers
- 2) The managers and directors who have failed to submit to the general meeting within six months after the end of the financial year, the annual accounts, the consolidated accounts, the management report, the certificate of the person entrusted with the audit as well as the managers and directors who have failed to publish such documentation in violation of the 2002 Law
- 3) The managers and directors who have failed to publish the report on payments to governments or the consolidated report on payments to governments in violation of the requirements of Article 1760-4 of the 1915 Law and Article 72septies of the 2002 Law
- 4) The managers and directors who have failed to publish the non-financial statement or the corporate governance statement referred to in Article 1730-1 of the 1915 Law and Articles 68bis and 68er of the 2002 Law
- 5) The directors, commissaires or liquidators who have failed to convene, within three weeks of being requested to do so, the general meeting provided for in Article 450-8, second sub-paragraph
- 6) The persons who contravene the regulations adopted in implementation of Article 813-9, first sub-paragraph, concerning the audit of *sociétés coopératives*
- 7) The managers of *société à responsabilité limitée* and of civil companies and, in the latter, in the absence of managers, the members who have failed to publish changes of membership in accordance with Article 100-13, paragraph 2, point 3
- 8) The managers who, directly or through intermediaries have opened a public subscription for corporate units or profit units of a *société à responsabilité limitée*
- 9) The directors of *sociétés anonymes* who fail to file the report referred to in Article 430-18, paragraph 2, or who present a report not containing the minimum information prescribed thereby
- 10) The Persons referred to in Article 1300-12 who have failed to carry out the publications provided for by Articles 1300-5 to 1300-7, 1300-9, 1300-10

According to articles 1500-4 and 1500-5 of the 1915 Law, directors and/or managers can be sentenced one month to two years in prison and/or fined EUR 5,000 to EUR 125,000 if they:

- 1) By fraudulent means, cause or attempt to cause the price of the UCI's shares, bonds, or other securities to rise or fall

- 2) Fraudulently provide incorrect information in the statement of bonds outstanding referred to in Article 470-12 of the 1915 Law
- 3) Fail, with fraudulent intent, to publish the annual accounts, the consolidated accounts, the management report, or the certificate of the person entrusted with the audit, as provided for by Articles 461-8, 813-4 and 1770-1 of the 1915 Law and Article 79 of the 2002 Law
- 4) Any director contravening article 420-13 of the 1915 Law

The directors and/or managers can be jailed for five to ten years and fined EUR 5,000 to EUR 250,000 if they commit forgery, with fraudulent intent or the intent to cause damage, on the balance sheets or profit and loss statements of the UCI prescribed by law or the articles, by the various means mentioned in Article 1500-8 of the 1915 Law.

Moreover, the *de jure* and *de facto* managers can be sanctioned by a prison term of one to five years and/or a fine of EUR 500 to EUR 25,000 if they in bad faith:

- 1) Used the UCI's assets or credit, knowing such use was contrary to the UCI's interests, for personal gain or for the benefit of another UCI or undertaking in which the manager has a direct or indirect stake
- 2) Used their power or votes, knowing such use was contrary to the UCI's interests, for personal gain, or for the benefit of another UCI or undertaking in which the manager has a direct or indirect stake

A shareholder, creditor, or any third party who is aware of a criminal offence and has suffered a loss may file a criminal complaint with an investigating judge (*juge d'instruction*) and start a civil action for damages. A complaint may also be filed with the police or the public prosecutor's office. If a civil action is not started at the same time, the public prosecutor will assess whether to appoint an investigating judge to conduct an independent criminal investigation.

Finally, delegation by the governing body of a Luxembourg management company or investment company to conducting officers and the chain of sub-delegation increases the number of individuals who can potentially incur the criminal liability of a management company or investment company, and who can be held liable as physical persons.

5.2.1.2. Criminal liability of Luxembourg legal entities

Any Luxembourg legal entity can be held criminally liable for misdemeanors and crimes, and may therefore be subject to the same criminal penalties as physical persons. Therefore, investment companies and management companies may be held criminally liable. Furthermore, criminal proceedings may also be brought against a foreign entity that has breached Luxembourg criminal law.

In order for a legal entity to be held criminally liable in Luxembourg, the misdemeanor or crime must meet all the following conditions:

- 1) Be the result of one or more of the actions/omissions of the "*de jure*" or "*de facto*" directors or managers
- 2) Have been committed both:
 - In the name of the company
 - For the benefit of the company (such benefit not necessarily being of financial nature)

Under Luxembourg law, the disappearance of the legal personality (e.g., through a dissolution or merger) results in the end of any pending criminal proceedings but does not remove the obligation of such legal entity to execute any penalty it was sentenced to prior to dissolution or merger. Public prosecution and investigating judges may also delay or prohibit dissolution or any transaction that could lead to it.

5.2.1.3. Punishable misdemeanors and crimes, and applicable penalties

Legal entities and physical persons may be held criminally responsible for all types of misdemeanors and crimes covered by the Luxembourg criminal code, as well as for those covered by specific laws, such as the 2010 Law, the SIF Law, the RAIF Law, the AIFM Law and the Law against Money Laundering and Terrorist Financing of 12 November 2004, as amended.

The most serious types of "general" crimes for which they may be held criminally liable include money laundering and concealment, acts of terrorism and financing of terrorism, misappropriation of public funds, embezzlement, active and passive corruption, and private corruption.

In addition, the 2010 Law and the SIF Law provide for specific offences including, *inter alia*:

- 1) Where a person makes use of designations or descriptions giving the impression that the activities are subject to the 2010 Law or SIF Law without having obtained the relevant authorization from the CSSF
- 2) Where a person carries out, or directs the carrying out of, operations involving receipt of funds from investors if the relevant UCI is not duly authorized

- 3) Where a person has made loans or advances on units of a common fund using assets of the common fund, or has by any means at the expense of the common fund made payments in order to pay up units, or acknowledged payments to have been made that have not actually been so made
- 4) When the assets of the UCI fall below the minimum thresholds required by the applicable law (see Sections 2.5. and 3.10.1.) and:
 - In the case of a common fund, the CSSF is not informed without delay
 - In the case of an investment company, a general meeting is not convened
- 5) Where the issuance and redemption price of the shares or units of the UCI is not determined at the required specified intervals, where the share or unit issuance and redemption price is not determined, or the net asset value (NAV) is not calculated in accordance with the requirements of the law, or where, in the case of 2010 Law, such price is not made public (see also Sections 10.1.1. and 8.6.)

While the main sanctions applicable to physical persons are fines (up to EUR 50,000¹¹⁸) and imprisonment (up to two years¹¹⁹), the main penalties for legal entities are fines (up to EUR 750,000¹²⁰ for crimes and twice the amount of the fine applicable to individuals under the relevant law for misdemeanors) and dissolution (where the entity was created for the sole purpose of committing the crime). Additional penalties for legal entities also include, for example, the seizure of assets.

The AIFM Law subjects AIFM, and their governing bodies or management, to administrative penalties for sanctionable behaviors as follows:

Sanctionable behavior	Possible penalties	Disclosure
<ul style="list-style-type: none"> ▸ Failing to comply with the obligations of the AIFM Law and the relevant implementing measures ▸ Refusing to provide accounting documents or other requested information ▸ Providing documents or other information that proves to be incomplete, inaccurate, or false ▸ Contravening the rules governing the publication of balance sheets and accounts 	<ul style="list-style-type: none"> ▸ Warning ▸ Reprimand ▸ Fine of between EUR 250 and EUR 250,000 	The CSSF may publicly disclose the penalties imposed, unless such disclosure would seriously jeopardize the financial markets or cause disproportionate damage to the parties involved
<ul style="list-style-type: none"> ▸ Preventing the CSSF from exercising its powers of supervision, inspection, and investigation ▸ Failing to act in response to orders of the CSSF ▸ Behaving in a manner that risks jeopardizing the sound and prudent management of the institution concerned 	<ul style="list-style-type: none"> ▸ Temporary or definitive prohibition on carrying out operations or activities, as well as any other restrictions on the activity of the person or entity ▸ Temporary or definitive prohibition on acting as directors, managers, or conducting persons of entities subject to the supervision of the CSSF 	

When imposing a penalty, the CSSF is required to take into account the nature, duration, and the severity of the infringement, the conduct and past record of the natural or legal person to be sanctioned, the damage caused to third parties, and the potential benefits or gain and/or those effectively deriving from the infringement.

Article 51 of the RAIF Law provides that a penalty of imprisonment of one month to one year and a fine of EUR 500 to EUR 25,000 or either of one of those penalties shall be imposed upon:

- a) Any person who has issued or redeemed or caused to be issued or redeemed units of a common fund in the cases referred to in articles 10, paragraph 2 and 19, paragraph 3 of the RAIF Law
- b) Any person who has issued or redeemed units of a common fund at a price other than that obtained by application of the criteria provided for in article 10, paragraph 1 of the RAIF Law
- c) Any person who, as director, manager, or auditor of the management company or the depositary, has made loans or advances on units of the common fund using assets of the said fund or who has by any means at the expense of the common fund made payments in order to pay up units or acknowledged payments to have been made that have not actually been made

¹¹⁸ This maximum amount of fine may be increased up to EUR125,000 in case of fraudulent intention.

¹¹⁹ This may be increased up to ten years in case of fraudulent bankruptcy.

¹²⁰ This amount may be increased up to five times if the crime is made against the State or in case of money laundering, terrorist financing or any other case listed in Article 37 of the Luxembourg Criminal Code.

5.2.2. Civil liability

The civil liability of the governing or managing body of a UCI and its members is mainly established by Luxembourg corporate and contractual laws. Neither the 2010 Law, the SIF Law, the RAIF Law nor the AIFM Law regulate the civil liability of the governing or managing body of a UCI, or its members. The civil liability of a management company of a common fund is mainly established by the Luxembourg Civil Code.

5.2.2.1. Civil liability of directors and managers of Luxembourg investment companies

UCI are subject to specific laws, however, when these specific laws do not foresee a ruling, then for corporate forms, reference is made to the 1915 Law.

The main duty of the directors and/or managers is to act in the UCI's best interest, which means that they must place the company's interests before their own when taking decisions. All managerial decisions must be to the company's benefit. In defining corporate strategy, the directors and/or managers shall act as a reasonably prudent person (*bon père de famille*). Above all, when taking decisions, the directors/managers must respect the duties imposed by the 1915 Law and by the company's articles of association.

Directors and/or managers can incur civil liability on the basis of article 441-9 of the 1915 Law for a public limited liability company (*société anonyme*), article 710-16 of the 1915 Law for a private limited liability company (*société à responsabilité limitée*), or articles 1382 and 1383 of the Luxembourg Civil Code. Pursuant to articles 441-9 and 710-16 of the 1915 Law, a director and/or a manager can be held civilly liable to the company or its shareholders for negligence or misconduct committed during his or her term of office.

Moreover, directors and/or managers can also incur civil liability if they violate the 1915 Law or the company's articles of association and thereby cause damage to a third party. In this case, the company or any third party can hold the director and/or manager liable on the basis of articles 1382 and 1383 of the Luxembourg Civil Code, provided the director and/or manager's act or omission caused direct, personal harm to the applicant.

The 1915 Law provides that the directors/managers shall be jointly and severally liable to both the company and any third parties for damage resulting from a violation of the 1915 Law or the company's articles of association. They shall be released from liability if they were not a party to the violation in question, provided no misconduct can be attributed to them and they reported the violation at the first general meeting held after they gained knowledge thereof.

Liability to the shareholders under Article 441-9 of the 1915 Law

Managers¹²¹ and/or directors are liable not only for fraud but also for any misconduct in the management of the company's affairs.

Pursuant to applicable case law, misconduct does not imply a wrongful act on the part of the director and/or manager. Liability may also be incurred for omissions and negligence. Under normal circumstances, a manager is expected to behave as a reasonably prudent person who, when making a decision, benefits from the same knowledge and information as any other manager in the same circumstances. If a manager takes a decision on the basis of information that appears to be sufficient and trustworthy and that does not indicate that the decision, although it may entail a risk, is contrary to the UCI's interests, it should not be possible to hold the manager liable.

According to the majority view in the case law and literature, the general meeting of shareholders has the power to take legal action against a manager in connection with wrongful acts committed by that manager in the performance of his or her official duties.

Creditors of a company may, under certain circumstances, bring an action on behalf of the UCI if the latter fails to do so and if such failure harms their interests.¹²² Since in this case the creditors are merely exercising a right on behalf of the debtor (the company), any proceeds from the action must be returned to the company.

A director and/or manager who is found liable must indemnify the company for any damage suffered, including indirect damage. It is however important to note that only reasonably foreseeable damage need be indemnified. Only in the case of fraud can a manager also be held liable for unforeseeable damage.

¹²¹ Article 710-16 of the 1915 Law refers to article 441-9 of the 1915 Law

¹²² Article 1166 of the Luxembourg Civil Code

Directors and/or managers may not be held liable to the company for acts that appear in the company's books of account at the time discharge is granted to the board by the annual general meeting. This discharge is valid for the period covered by the accounts presented to and approved by the meeting, provided the accounts do not contain any errors, omissions, or false statements of a material fact.

Liability to the Company and third parties under Article 441-9 of the 1915 Law

The second paragraph of article 441-9 of the 1915 Law refers only to a violation of the 1915 Law or of the company's articles of association.

Liability can be incurred only as the result of a wrongdoing, which may be either an intentional act or negligence.

Both the company and third parties, i.e., any shareholder or creditor with a legitimate interest, can initiate proceedings. With respect to shareholders, they may only seek damages under this article 441-9 for harm that is distinct from the company's collective harm, i.e., individual, personal damage.

The basis for liability is different, depending on whether proceedings are initiated by the company or by a third party. An action by the company will be based on contract, while third-party actions will be based on tort.

In the context of contract-based actions, only reasonably foreseeable damage must be repaired, except in the case of fraud. For liability in tort, however, damages can be sought for all actual harm caused by the tortious act.

The directors and/or managers are jointly liable with respect to any action brought under Article 441-9 of the 1915 Law. In order to avoid joint liability, the director and/or manager must be able to prove that she/he did not take part in the violation of the 1915 Law or the company's articles of association, that no misconduct can be attributed to her/him, and that she/he reported the breach to the first general meeting of shareholders held after gaining knowledge thereof.

A discharge by the general meeting of shareholders extinguishes liability to the company, as is the case under Article 441-9 of the 1915 Law. It is important to note that proceedings initiated by third parties are not affected by this discharge.

Liability to the Company and third parties under Articles 1382 and 1383 of the Civil Code

The directors and/or managers may also be held liable in accordance with the general rules of civil liability¹²³ for cases not covered by Article 441-9 of the 1915 Law.

Under these provisions, liability can be incurred only as the result of a wrongdoing (an act, omission, or negligence) that caused damage to the company or a third party having dealings with the company. In this case, an action may be initiated by the company or the third party, provided the damage suffered does not result from managerial misconduct or a violation of the 1915 Law or the company's articles of association.

Third parties must prove that the manager's wrongdoing caused them personal, specific damage.

The statute of limitations for civil liability claims against the managers is five years from the date the act was committed, except in the case of fraud.

5.2.2.2. Civil liability of a Luxembourg management company

As an entity acting in the name and on behalf of a UCI, a management company of a common fund is liable to the unitholders for any loss resulting from the non-fulfillment or improper fulfillment of its obligations¹²⁴. The management company is subject to civil law provisions governing its mandate and remains fully liable with respect to any delegated functions.

Directors and managers of the management company of a common fund are subject to the provisions of the 1915 Law and the Luxembourg Civil Code, and may only be held liable if a fault can be attributed to them.

The management company of an investment company, or a management company providing services to an investment company, is contractually liable towards the UCI. In such cases, individual shareholders of the investment company are not permitted to sue the management company. Unlike the Directors or managers of a UCI, the Directors of the management company cannot be discharged of their liability by the general meeting of shareholders of the UCI it manages or services.

¹²³ Articles 1382 and 1383 of the Luxembourg Civil Code

¹²⁴ Article 15 of the 2010 Law

6

Management of UCIs: Management companies, AIFM and other Investment Fund Managers

EY supports “Investment Fund Managers” (IFMs), including asset managers, traditional and alternative investment fund houses in defining an efficient operating model and business plan, and in complying with the applicable regulatory and tax requirements, including:

- ▶ Drafting policies, procedures, and processes
- ▶ Application for authorization
- ▶ Tax planning
- ▶ Review of fee structures
- ▶ Reporting on controls (e.g., ISAE 3402, US Attestation Standard AT-C section 320)



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6.1. Introduction

6.1.1. General Introduction

A management company or alternative investment fund manager (AIFM), referred to as Investment Fund Managers (IFMs) under CSSF Circular 18/698, is a legal entity that manages one or more UCIs. For the purposes of this Chapter, these entities are collectively referred to as “management entities”.

Since it has no legal personality, a common fund (FCP) must always be managed by a management company. An investment company (SICAV or SICAF) must either appoint a management company or manage itself.

This Chapter:

- Outlines the scope of activities and key governance functions of management entities
- Lists the key regulations applicable to Luxembourg management entities
- Summarizes requirements applicable to the setting up and operation of Luxembourg management entities and investment companies that manage themselves (self-managed UCITS and internally managed AIF)
- Outlines the management passports
- Summarizes the expenses and taxation of management entities

In much of this Chapter, we outline the regulatory requirements applicable to IFMs - in particular UCITS management companies and AIFMs. We also indicate the type of entity to which the regulatory requirements apply.

The remainder of the introduction to this Chapter provides a brief summary of:

- The scope of activities of management entities
- The basic fund management models
- The responsibilities of management entities in relation to the appointment and oversight of service providers
- Key limitations on delegation by management entities
- Services that management entities may provide as delegates
- The relationship between management entities and other regulated entities
- Regulatory reporting duties and required communication with the CSSF

Based on input from various sources and stakeholders, the European Commission provided a report to the European Parliament and the Council on 10 June 2020 including the results of the AIFMD framework assessment and possible areas for improvement in relation to identified shortcomings impacting investors, alternative investment funds (AIFs) and their managers (AIFMs) as well as financial system stability.

The report recognizes the role of AIFMD in creating an internal EU market, reinforcing the regulatory and supervisory framework and enhancing transparency for both investors and supervisors on AIFM activities. The issues raised in the report mainly relate to distribution, the depositary regime, reporting, supervision, valuation and remuneration rules, namely:

- Lack of clarity, harmonization of the National Competent Authorities' possibility to impose leverage limits or suspend redemptions in the public interest
- Lack of cooperation between National Competent Authorities in cases where suspensions of redemption have cross-border implications
- Exclusion of combined use of internal and external valuers since there is uncertainty around the liability of external valuers, determined under national law
- Lack of clarity in situations where AIFMs use tri-party collateral management
- Lack of clarity where central securities depositories act as custodians
- Concentration risk due to the lack of a depositary passport in smaller markets
- Reporting overlaps with other sectorial law requirements
- Missing data reporting on leveraged loans, collateralized loan obligations and indirect linkages between banks and non-banks
- Adjustments may be required on leverage calculation methods
- Lack of harmonization of forms, processes and central management of databases

- ▶ Lack of harmonization of remuneration rules with regimes provided in banking legislation (smaller institutions and small variable amounts may be exempted from payment deferral pursuant to Directive 2019/878 of 20 May 2019 amending directive 2013/36/EU (CRD IV))
- ▶ Efficiency of the EU AIFM impaired by national marketing rules, particularly detrimental for smaller AIFMs unable to bear compliance cost
- ▶ Limitation of AIFM passport to marketing to professional investors
- ▶ AIFs offered to retail investors predominantly through banks and insurance companies promoting mainly in-house funds
- ▶ Investors unable to access non-EU AIFs in Member States without national private placement (“NPPR”) regimes
- ▶ Un-level playing field created by NPPR between non-EU AIFMs subject to lighter requirements and EU AIFMs
- ▶ National barriers encountered by private equity fund managers who do not adhere to AIFMD or EuVECA regulation

Some responses to certain issues have already been implemented recently or are being subject to consultation processes, while further legislative, regulatory or supervisory actions may be expected for the others, most probably by the first quarter of 2021.

6.1.2. Scope of activities of management entities

“Management” includes, in general, investment management, administration, and marketing. In practice, many management entities delegate some of these functions. The management entity remains responsible for overseeing and supervising all delegated functions.

Management entities may combine authorizations as summarized in Section 6.2.1.B. The following table outlines the permitted activities of management entities:

	Scope of activities of management entities		
	Chapter 15 management company	AIFM	Chapter 16 management company not authorized as AIFM
Scope of UCIs that may be managed	UCITS and other UCIs for which the management company is subject to prudential supervision	AIF	Non-UCITS AIF below <i>de minimis</i> threshold
Scope of management activity	Management of UCITS includes: <ul style="list-style-type: none"> ▶ Portfolio management ▶ Risk management (see Chapter 7)¹²⁵ ▶ Administration (see Chapter 8) ▶ Marketing (see Chapter 12) 	Managing AIF means performing, for one or more AIFs, at least the investment management functions relating to: <ul style="list-style-type: none"> ▶ Portfolio management ▶ Risk management (see Chapter 7) AIFM may also provide the services of: <ul style="list-style-type: none"> ▶ Administration (see Chapter 8) ▶ Marketing (see Chapter 12) ▶ Activities related to the assets of AIF¹²⁶ 	Either of the following: <ul style="list-style-type: none"> ▶ Management company that designates an AIFM for the AIF it manages ▶ Managing AIF itself, when assets of the AIF under management do not exceed the threshold above which authorization as AIFM is required¹²⁷

¹²⁵ Not explicitly mentioned as a function included in the activity of collective portfolio management in the Annexes to the 2010 Law and the UCITS Directive.

¹²⁶ Such activities include:

- ▶ Services necessary to meet the fiduciary duties of the AIFM
- ▶ Facilities management
- ▶ Real estate administration activities
- ▶ Advice to undertakings on capital structure
- ▶ Advice to undertakings on industrial strategy and related matters
- ▶ Advice and services relating to mergers and the purchase of undertakings
- ▶ Other services connected to the management of the AIF and the companies and other assets it has invested in

¹²⁷ See Section 6.1.3.C

	Chapter 15 management company	AIFM	Chapter 16 management company not authorized as AIFM
Passport for management activity	Yes, for management of UCITS	Yes, for management of AIF	None
Additional activities	<p>Discretionary portfolio management: management of portfolios of investments, including those owned by pension funds, on a discretionary client-by-client basis, when such portfolios include one or more of the financial instruments¹²⁸</p> <p>As non-core services: Investment advice concerning one or more financial instruments Safekeeping and administration in relation to shares or units of UCIs.</p>	<p>Discretionary portfolio management: management of portfolios of investments, including those of pension funds and institutions for occupational retirement provision, on a discretionary, client-by-client basis.</p> <p>As non-core services: Investment advice Safekeeping and administration in relation to shares or units of UCIs.</p> <p>Reception and transmission of orders in relation to one or more financial instruments.</p>	<p>Managing investment vehicles other than AIF, as defined by the AIFM Directive¹²⁹.</p> <p>Such entities may, for example, include holding companies and joint ventures.</p> <p>This activity cannot be the sole activity of the management company.</p>
Passport for additional activities	Yes	Yet to be phased in ¹³⁰	No
Specific requirements applicable to the provision of additional services	<p>Neither Chapter 15 management companies nor AIFMs can be authorized to provide only discretionary portfolio management services and non-core services, or to provide non-core services without being authorized to provide discretionary portfolio management services.</p> <p>The provision of such additional services is subject to conduct of business obligations and organizational requirements (see Section 6.2.1.D).</p>		This activity cannot be the sole activity of the management company.

¹²⁸ Financial instruments are listed in Section B of Annex II to the Law of 5 April 1993 on the financial sector, as amended (the 1993 Law). They include:

- ▶ Transferable securities
- ▶ Money market instruments
- ▶ Units in collective investment undertakings
- ▶ Options, futures, swaps, forward rate agreements, and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices, or financial measures that may be settled physically or in cash
- ▶ Options, futures, swaps, forward rate agreements, and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (other than by reason of a default or other termination event)
- ▶ Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market or a multilateral trading facility (MTF)
- ▶ Options, futures, swaps, forwards, and any other derivative contracts relating to commodities that can be physically settled but not otherwise mentioned in the previous bullet point, and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, *inter alia*, they are cleared and settled through recognized clearing houses or are subject to regular margin calls
- ▶ Derivative instruments for the transfer of credit risk
- ▶ Options, futures, swaps, forward rate agreements, and any other derivative contracts relating to climatic variables, freight rates, emission allowances, or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (other than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices, and measures that have the characteristics of other derivative financial instruments, having regard to whether, *inter alia*, they are traded on a regulated market or an MTF, are cleared and settled through recognized clearing houses, or are subject to regular margin calls

¹²⁹ The law explicitly states that a Chapter 16 management company may perform the administration of its own assets as an ancillary activity.

¹³⁰ The AIFM Directive permits AIFM to manage AIF on a cross-border basis, but does not explicitly permit AIFM to provide additional services for which it has been authorized, including portfolio management and investment advice, on a cross-border basis. However, the recast MiFID Directive (MiFID II), *inter alia*, modifies the AIFM Directive to permit AIFM to provide on a cross-border basis additional services for which it has been authorized.

	Chapter 15 management company	AIFM	Chapter 16 management company not authorized as AIFM
Provision of domiciliary services	Management entities are permitted to provide domiciliation services ¹³¹ to: <ul style="list-style-type: none"> ▶ The UCIs they manage ▶ Subsidiaries of the UCIs they manage 		

- ▶ Self-managed UCITS and internally managed AIFs are subject to almost all of the same requirements applicable to management companies and AIFMs (see Section 6.2.1.C)
- ▶ It is necessary to distinguish between authorized AIFMs, which are required to comply fully with the AIFM Law or AIFM Directive requirements, and “simplified registration regime AIFM”¹³², whose assets under management are below the *de minimis*¹³³ thresholds.
- ▶ In this Chapter, “AIFM” means “authorized AIFM”, unless otherwise specified.

6.1.3. Requirement for an authorized management entity

This section provides an overview of key factors to be taken into account when determining whether an authorized management entity is required. The choice of organizational model is covered in Section 1.4.3.

A. Basic structure of the UCI

A common fund must always be managed by a management company.

An investment company (or in the case of a limited partnership or a partnership limited by shares, the managing general partner or the manager) must either appoint a management company or manage itself.

For further information, see Section 2.3.1.

B. Managing UCITS

A UCITS must either be managed by a UCITS management company or designate itself as self-managed. Only investment companies can be self-managed. Self-managed UCITS are subject to most of the requirements applicable to management companies (see Section 6.2.1.C.).

C. Managing AIF

Each AIF is required to have a single AIFM, which is responsible for ensuring compliance with the requirements of the AIFM Directive, which is implemented in Luxembourg by the AIFM Law.

An AIFM is any legal person whose regular business is managing one or more AIF. The AIFM may be an external manager, or the AIF itself (internally managed AIF¹³⁴) when the AIF’s governing body chooses not to appoint an external AIFM and such is permitted by the corporate structure of the AIF.

Managing AIF means performing, for one or more AIF, at least the following investment management functions of:

- ▶ Portfolio management
- ▶ Risk management

¹³¹ The domiciliation of companies is, in general, subject to the Law of 31 May 1999 governing the domiciliation of companies, as amended. However, the Law provides for exemptions in relation to:

- ▶ The domiciliation of a company with a natural person who is himself a direct or indirect partner exerting a significant influence over the conduct of the company’s affairs
- ▶ The domiciliation of an investment company or of any other undertaking for collective investment having the legal form of a commercial company, with a management company of undertakings for collective investment
- ▶ The domiciliation of a management company of undertakings for collective investment or an advisory company of undertakings for collective investment with another management company of undertakings for collective investment
- ▶ The domiciliation of a company with a company belonging to the same group

Management entities are not authorized to provide domiciliation services to entities other than the aforementioned entities. Credit institutions and certain financial sector professionals (PSFs) are authorized to provide corporate domiciliation services; they are subject to the supervision of the CSSF.

The administrator of the UCI may also provide domiciliation services to UCIs - see Section 8.2.1.

¹³² “Simplified registration regime AIFM” are covered in Section 6.2.1.E.

¹³³ See Section 6.1.3.D.

¹³⁴ A RAIF cannot be internally managed. It must be managed by an authorized AIFM.

In order to be considered the AIFM of an AIF, the AIFM must be appointed to perform the portfolio management and risk management of the AIF (although it may wholly or partially delegate at least one of these functions – see Section 6.3.3.I.); i.e., the AIFM must be responsible for both portfolio management and risk management.

The AIFM may also be appointed to perform activities including administration and marketing, but this is not required.

An AIF is any UCI¹³⁵, including investment compartments thereof, that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors and is not a UCITS.

An undertaking as a whole should be considered as an AIF when a compartment of the undertaking exhibits all the elements in the definition of an AIF.

An undertaking that exhibits all the following characteristics should be considered as a UCI:

- ▶ It does not have a general commercial or industrial purpose
- ▶ It pools together capital raised from its investors for the purpose of investment with a view to generating a pooled return for those investors

The unitholders or shareholders of the undertaking, as a collective group, have no discretion or control, beyond that normally exercised through shareholder meetings, over operational matters relating to the daily management of the undertakings' assets. "Raising capital" means taking direct or indirect steps by the undertaking, the AIFM, or another entity acting on its behalf to procure the transfer or commitment of capital by one or more investor(s) to the undertaking for the purpose of investment in accordance with a defined investment policy. Such activity may:

- ▶ Take place once, on several occasions, or on an ongoing basis
- ▶ Be in the form of subscriptions or redemptions in kind

When capital is raised from a pre-existing group for the investment of whose wealth the undertaking has been exclusively established, this is not likely to be within the scope of raising capital. A pre-existing group is a group of family members whose existence pre-dates the establishment of the undertaking.

A family office vehicle that invests the private wealth of investors without raising external capital should not be considered an AIF.

When a UCI is not prevented by national law, the constitutional document, or a provision or arrangement with binding effect from raising capital from more than one investor, it should be considered as a collective investment undertaking that raises capital from a "number of investors" even if it has:

- ▶ Only one investor
- ▶ A sole investor, which invests funds raised from more than one legal or natural person for the benefit of those persons or consists of an arrangement or structure with in total more than one investor (e.g., feeder structures or fund of fund structures and certain nominee arrangements)

A "defined investment policy" is a policy about how the pooled capital in the undertaking is to be managed to generate a pooled return for the investors. The factors that may indicate the existence of such a policy include:

- ▶ The investment policy is determined and fixed, at the latest by the time that investors' commitments to the undertaking become binding on them
- ▶ The investment policy is set out in a document that becomes part of, or is referenced in, the constitutional document of the undertaking
- ▶ The undertaking, or the entity managing it, has an obligation to investors, which is legally enforceable by them, to follow the investment policy
- ▶ The investment policy specifies investment guidelines in relation to pursuit of certain strategies, investment in certain categories of asset or geographical regions, or conformity to restrictions, for example, on leverage, holding periods, or risk diversification

All AIF are covered by the AIFM Directive, independent of their open-ended or closed-ended nature (see also Section 6.1.3.D.), legal form, and structure.

¹³⁵ | The AIFM Directive refers to "collective investment undertakings" (CIUs).

D. AIFM authorization

An AIFM may be either an:

- External AIFM: External AIFM are separate legal entities that can manage one or more AIF
- The AIF itself - an internally managed AIF¹³⁶: the activities of internally managed AIF are limited to the management of the assets of the AIF itself. Only AIF in corporate form can be internally managed. Internally managed AIF are subject to almost all the same requirements as AIFM (see Section 6.1.3.C.)

An AIFM authorization is required when the AIF assets managed by the management entity are above the AIFM Law *de minimis* thresholds:

- AIFM that manage portfolios of AIF whose assets under management, including any assets acquired through use of leverage, in total, do not exceed a threshold of EUR 100 million
- AIFM that manage portfolios of AIF whose assets under management, in total, do not exceed a threshold of EUR 500 million when the portfolio of AIF consists of AIF that are not leveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF

An AIFM may be either or both of the following:

- An AIFM of open-ended AIF
- An AIFM of closed-ended AIF

An AIFM of an open-ended AIF is an AIFM that manages an AIF whose shares or units are, at the request of any of its shareholders or unitholders, repurchased or redeemed prior to the commencement of its liquidation phase or wind-down, directly or indirectly, out of the assets of the AIF and in accordance with the procedures and frequency set out in its rules or instruments of incorporation, prospectus, or offering documents.

A decrease in the capital of the AIF in connection with distributions according to the rules or instruments of incorporation of the AIF, its prospectus, or offering documents, including one that has been authorized by a resolution of the shareholders passed in accordance with those rules or instruments of incorporation, prospectus, or offering documents, is not taken into account for the purpose of determining whether or not the AIF is an open-ended AIF.

AIF's shares or units that can be negotiated on the secondary market and are not repurchased or redeemed by the AIF are not taken into account for the purpose of determining whether or not the AIF is an open-ended AIF.

An AIFM of a closed-ended AIF is an AIFM that manages an AIF other than open-ended AIF. AIFM of closed-ended AIF may benefit from certain grandfathering provisions (see Section 6.1.3.G.) or certain exemptions in relation to liquidity management (see Section 7.3.6.C.) and valuation (see Section 7.6.).

E. Simplified registration regime AIFM

AIFM that are below the *de minimis* thresholds (e.g., Chapter 16 management companies, internally managed 2010 Law Part II investment companies, and internally managed SIF investment companies, whose assets under management, in each case, falling below the *de minimis* thresholds) are required to monitor their assets under management and are subject to certain limited registration and regulatory reporting requirements.

Such AIFM may choose to "opt-in" under the AIFM Law in order to benefit from the rights granted to AIFM (in particular passports); in this case, they must comply with all the provisions of the AIFM Law.

A specific European regime exists for the managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF). The EuVECA and EuSEF regimes are initially applicable to managers who manage portfolios of AIF whose assets under management, in total, do not exceed a threshold of EUR 500 million when the portfolio of AIF consists of AIF that are not leveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF.

F. Management companies managing AIF

Management companies that manage AIF have the following options:

- To become fully AIFM compliant:
 - Luxembourg UCITS management companies (Chapter 15 management companies) may choose to obtain an additional authorization as an AIFM; thus management companies can benefit from dual UCITS management company and AIFM authorizations

¹³⁶ | A RAIF cannot be internally managed. It must be managed by an authorized AIFM.

- ▶ Luxembourg management companies of non-UCITS (Chapter 16 management companies) may choose to obtain authorization as an AIFM
- ▶ Not to become fully AIFM compliant: both Chapter 15 and Chapter 16 management companies may also continue to perform management company functions for AIF, without obtaining authorization as AIFM. In this case, the following restrictions apply to the activities they can perform:
 - ▶ When AIF assets under management of the management company do not exceed the threshold above which authorization as AIFM is required, they may manage the AIF themselves as simplified registration regime AIFM (see Section 6.1.3.E.)
 - ▶ When AIF assets under management of the management company exceed the threshold above which authorization as AIFM is required, they must designate another authorized entity as AIFM of the AIF they manage. The AIFM may be in Luxembourg or in another EU/EEA Member State. It must perform at least the portfolio management and the risk management of the AIF. The management company has the choice between performing the functions of administration and/or marketing itself, delegating one or both of the functions to the AIFM, and/or delegating one or both of the functions to another third party

G. Grandfathering, Brexit and exemptions

Managers of some closed-ended AIF existing at the final date of transposition may benefit from grandfathering clauses, namely:

- ▶ Managers of closed-ended AIF “which do not make any additional investments” after 22 July 2013 may continue to manage such AIF without authorization under the AIFM Directive

The AIFM Law provides for several exemptions from the Directive’s provisions. Full exemptions apply to holding companies as defined in the Directive¹³⁷, securitization special purpose entities, institutions for occupational retirement provision (IORP), and their managers insofar as they do not manage AIF, and to certain group AIFM entities¹³⁸.

ESMA’s opinion on *General principles to support supervisory convergence in the context of the United Kingdom withdrawing from the European Union* (commonly referred to as “Brexit”) of 31 May 2017, sets out principles which are applicable to the specific case of relocation of entities, activities and functions. Requirements for authorization should be guided by key principles:

1. No automatic recognition of existing authorizations
2. Authorizations granted by EU27 national competent authorities (NCAs) should be rigorous and efficient
3. NCAs should be able to verify the objective reasons for relocation
4. Special attention should be granted to avoid letter-box entities in the EU27
5. Outsourcing and delegation to third countries are only possible under strict conditions
6. NCAs should ensure that substance requirements are met
7. NCAs should ensure sound governance of EU entities
8. NCAs must be in a position to effectively supervise and enforce Union law
9. Coordination to ensure effective monitoring by ESMA

Those principles are further detailed in the ESMA opinion of 13 July 2017 (ESMA34-45-344) to support supervisory convergence in the area of investment management in the context of the United Kingdom withdrawing from the European Union.

The implementation of those principles, while in response to the Brexit situation, will cascade down and impact any new activity set-up or change.

The initial deadline to complete the rulebook equivalence assessment and for agreeing an extension of the transition period, which is due to expire on 31 December 2020, was 30 June 2020. The COVID-19 pandemic caused significant disruption to the negotiation of a partnership agreement between the United Kingdom and the European Union.

¹³⁷ Under the Directive, a “holding company” is a company with shareholdings in one or more other companies, the commercial purpose of which is to carry out a business strategy or strategies through its subsidiaries, associated companies, or participations in order to contribute to their long-term value, and that is either:

- ▶ A company operating on its own account and whose shares are admitted to trading on a regulated market in the European Union
- ▶ A company not established for the main purpose of generating returns for its investors by means of divestment of its subsidiaries or associated companies, as evidenced in its annual report or other official documents

¹³⁸ AIFM insofar as they manage one or more AIF whose only investors are the AIFM or the parent undertakings or the subsidiaries of the AIFM or other subsidiaries of those parent undertakings, provided that none of those investors itself is an AIF.

The new draft Partnership Treaty proposed by the European Union on 18 March 2020 and the draft UK-EU Free Trade agreement published on 19 May 2020 by the UK government both contain a similar provision for the prudential carve-out enabling both parties to adopt or maintain measures for prudential reasons such as, *inter alia* the protection of investors (...) or ensuring the integrity and stability of a Party's financial system.

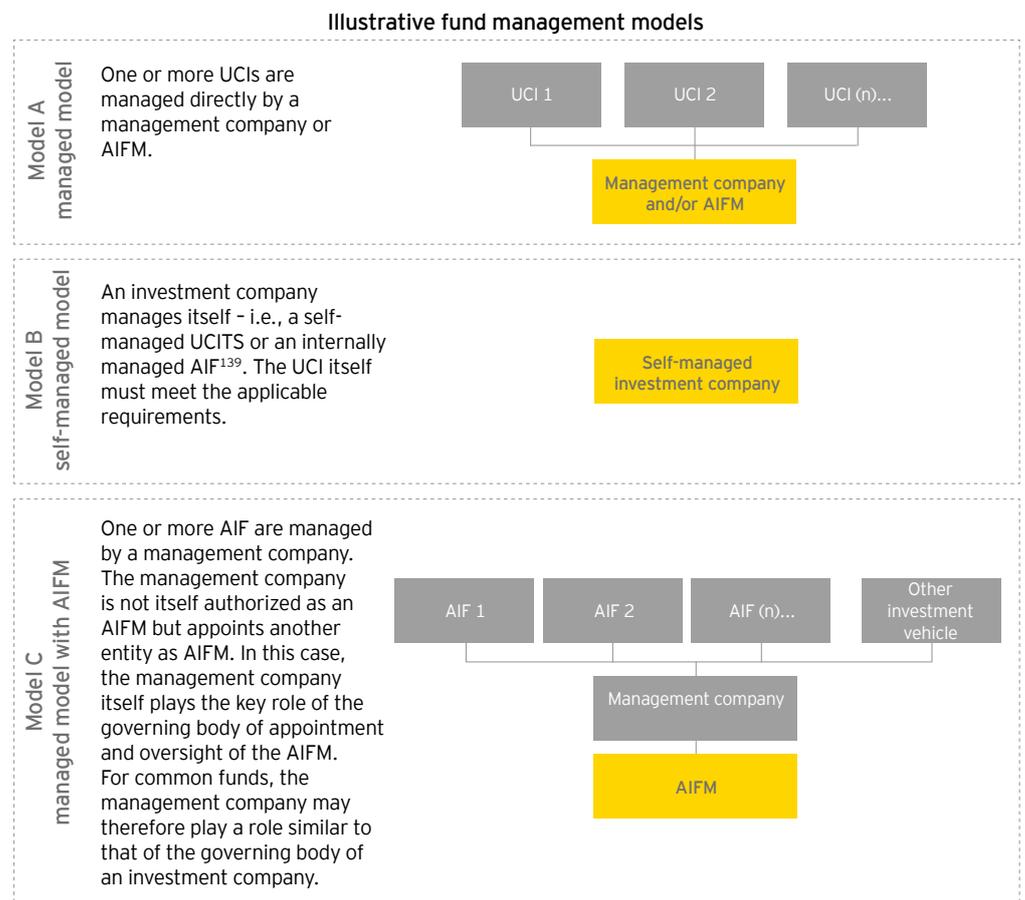
The most sensitive topics for fund managers and promoters are likely to remain the rules applicable to the access to the other party's market, the delegation and the pre-marketing rules, in particular for alternative investment fund managers.

On 17 July 2020, ESMA reminded financial market participants to finalise preparations and implement suitable contingency plans in advance of the end of the transition period on 31 December 2020. This includes appropriate communication to clients on any resulting consequences.

ESMA, EU national securities regulators and the UK's Financial Conduct Authority ("FCA") also confirmed that previously agreed Memoranda of Understandings announced on 1 February 2019 to cover cooperation and exchange of information with the FCA in the event the UK left the EU without a Withdrawal Agreement remain valid and will take effect on 31 December 2020.

6.1.4. Fund management models

The following figure illustrates the typical management models for UCIs:



Group management models are covered in Section 1.4.3.4.

¹³⁹ | A RAIF cannot be internally managed. It must be managed by an authorized AIFM.

6.1.5. Relationship between management entities and other regulated entities

Management entities are not permitted to obtain authorization as another type of financial sector entity, such as a credit institution, an investment firm, or another type of professional of the financial sector (PSF).

Other financial sector entities are not permitted to obtain authorization as a management entity.

Management entities, credit institutions, and investment firms may delegate certain activities to each other, such as portfolio management or investment advice, subject to the applicable requirements, such as those on delegation and on conflicts of interest.

There is some overlap between the permitted activities of management entities, credit institutions, and investment firms. Certain services may be offered by both types of entity:

Areas of overlap between services that may be offered by management entities and MiFID¹⁴⁰ firms

Services offered by credit institutions and investment firms	UCITS management company	AIFM
Investment services and activities	<ul style="list-style-type: none"> ▸ Portfolio management ▸ Investment advice 	<ul style="list-style-type: none"> ▸ Portfolio management ▸ Investment advice ▸ Reception and transmission of orders in relation to one or more financial instruments
Ancillary services	<ul style="list-style-type: none"> ▸ In relation to shares or units of UCIs: Safekeeping and administration 	<ul style="list-style-type: none"> ▸ In relation to shares or units of UCIs: Safekeeping and administration ▸ In relation to the assets of AIF: advice to undertakings on capital structure, industrial strategy, and related matters, and advice and services on mergers and the purchase of undertakings

6.1.6. Main applicable regulations

The main regulations applicable to Luxembourg management entities are listed in Appendix II.

¹⁴⁰ Markets in Financial Instruments Directive (MiFID II), Directive 2014/65/EU

6.2. Establishment of a management entity

This section summarizes the requirements applicable to the set up and operation of a management entity covering:

Scope of applicability of provisions covered in this section

	Chapter 15 management company and self-managed UCITS ¹⁴¹	AIFM and internally managed AIF	Chapter 16 management company
Corporate information			
Authorization	✓	✓	✓
Legal form and office	✓		✓
Shareholders, sponsor, and related parties	✓	✓	✓
Own funds and professional liability cover	✓	✓	✓
Governance			
General organizational requirements	✓	✓	✓
Governing bodies	✓	✓	✓
Senior management	✓	✓	✓
Central administration	✓	✓	
Accounting function	✓	✓	
Human resources	✓	✓	
Technical resources	✓	✓	
Rules of conduct	✓	✓	
Delegation framework	✓	✓	
Depositary appointment	✓	✓	
Prime brokers and counterparties		✓	
Conflicts of interest	✓	✓	✓
Complaints handling	✓	✓	
Remuneration policy	✓	✓	✓
Reporting to the CSSF	✓	✓	✓
Annual accounts	✓	✓	✓
Requirements applicable to management entities providing additional services (when relevant)	✓	✓	
Requirements applicable to Simplified registration regime AIFM (when relevant)		✓	✓
Requirements applicable to managers of EuVECA and EuSEF (when relevant)			✓
Liquidation and insolvency	✓	✓	✓
Internal control			
Internal control framework	✓	✓	
Internal control and risk functions	✓	✓	
Compliance	✓	✓	✓
Accounting function	✓	✓	✓
AML/CTF & KYC	✓	✓	✓
IT function	✓	✓	✓
Business functions			
Portfolio management	✓	✓	✓
Valuation	✓	✓	✓
Distribution	✓	✓	✓

¹⁴¹ | When applicable. The provisions applicable to self-managed UCITS investment companies are listed in Section 6.2.1.D.

The “proportionality” principle may be invoked by management entities in relation to the application of certain provisions¹⁴². In general, this means that the CSSF will take into account the nature, scale, and complexity of the activities of the management entity when considering whether the management entity complies with certain requirements.

For Chapter 15 management companies, the CSSF has clarified that, in its assessment of proportionality, it will take into account, *inter alia*, the following factors: the number of UCITS and other UCIs managed by the management company, the total assets under management, investment into assets that are considered to be riskier, the extent of the delegated functions, and specific intra-group expertise.

6.2.1. Authorization

Management entities must obtain authorization from the CSSF prior to incorporation and commencing business.

A. Application for authorization

The main objective of the application for authorization is to demonstrate to the CSSF how the management entity will comply with the applicable legal requirements.

In summary, the application for authorization must contain, *inter alia*, the information on:

Corporate information

- The applicant
- Shareholding structure
- Own funds, professional liability cover, and budget forecast

Governance

- Governing bodies and senior management
- Program of activities, in particular arrangements regarding the central administration and internal governance
- Organization and infrastructure

Internal control

- Internal control and risk management
- Organization of the fight against money laundering and terrorist financing (AML-CTF)
- IT
- Accounting
- Information exchange between the IFM and the depositary
- Requirements with respect to organization and procedures, including:
 - Management information and internal reporting systems
 - Business continuity
 - Approval of new business relationships and new products
 - Manual of procedures
 - Claim and complaints handling
 - Personal transactions
 - Management of conflicts of interest
 - Rules of conduct
 - Remuneration policy
 - Exercise of voting rights
 - Monitoring of compliance with the obligations under EMIR and MMF Regulation

¹⁴² We have, in general, indicated when the proportionality principle applies in the following sections.

Core and business functions, as per their Delegation status

- Specific organizational arrangements covering Delegation of (if applicable and subject to CSSF notification):
 - Collective portfolio management
 - Risk management
 - Valuation
 - Administration of UCIs
 - Complaints handling
 - Discretionary portfolio management (DPM) and ancillary services
- Specific organizational arrangements covering Delegation (if applicable and subject to CSSF authorization):
 - Compliance
 - Internal audit
 - IT
 - Accounting
- Additional information for management entities providing additional services such as Discretionary Portfolio Management, investment advice and ancillary services
- External audit

The CSSF may request additional information necessary to complete the assessment of the application for authorization.

The detailed list of information to be included in the application for authorization of a management company or AIFM is available on the CSSF website.

The following pages provide more details on the information to be provided in the application for authorization.

Information to be provided in the application for authorization

	Chapter 15 management company	AIFM ¹⁴³	Chapter 16 management company
	Corporate information		
Information on the applicant	<ul style="list-style-type: none"> ▸ Presentation of the management company (denomination, legal form, initial capital) ▸ Contact person in Luxembourg ▸ Draft constitutional document ▸ Reasons for establishing business in Luxembourg 	<ul style="list-style-type: none"> ▸ Name, registered office, head office, and legal form ▸ Contact person in Luxembourg ▸ Draft constitutional document or updated constitutional document ▸ For existing regulated entities: confirmation, when applicable, that there have not been any changes since the last filing with the CSSF in relation to: <ul style="list-style-type: none"> ▸ Governing bodies and senior management ▸ Shareholding structure ▸ Program of activity ▸ Organizational requirements ▸ In addition, for existing unregulated entities: <ul style="list-style-type: none"> ▸ Information on any branches 	<ul style="list-style-type: none"> ▸ Presentation of the management company (denomination, legal form, initial capital) ▸ Contact person in Luxembourg ▸ Draft constitutional document ▸ Reasons for establishing business in Luxembourg
Shareholding structure (direct or indirect qualifying shareholders - see also Section 6.2.3.1.)	<ul style="list-style-type: none"> ▸ Legal entities: <ul style="list-style-type: none"> ▸ Description of the group ▸ Organization chart of the direct and indirect shareholding structure, highlighting entities subject to prudential supervision and their respective supervisory authorities ▸ Identification of the beneficial owners ▸ Denomination of the shareholders, with an indication of the number of shares held ▸ Annual reports including audited financial statements for the last three years ▸ The constitutional document ▸ Information on any consolidated supervision of the group to which the shareholder belongs ▸ Confirmation that the initial capital has not been sourced from a loan or other cash advance and that the shares of the management company are unsecured ▸ Declaration of honor signed by the natural person acting as the legal representative of the legal person ▸ The jurisdiction in which it is established, the existence of prudential supervision and the nature of authorization(s) granted to the entities concerned 	<ul style="list-style-type: none"> ▸ Organization chart of the direct and indirect ownership structure ▸ Identification of all direct and indirect shareholders or members, including nationality, supervisory authority (if applicable), direct or indirect nature of holding, and amount of holding ▸ Qualifying holdings: information listed in the Appendix to the <i>Guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC</i> (see Section 6.2.3.1.A.), in order for the CSSF to be able to evaluate the sound and prudent management of the proposed shareholders ▸ Relationship with other financial institutions (AIFM, UCITS management company, investment firm, or credit institution): name and supervisory authority of: <ul style="list-style-type: none"> ▸ Any financial institution of which the AIFM is a subsidiary ▸ Any parent entity that controls another financial institution ▸ Information on any consolidated supervision of the group to which the shareholder belongs ▸ Information on any “close links” (see Section 6.2.3.1.C.) 	<ul style="list-style-type: none"> ▸ Information on the shareholding structure (direct or indirect), and when applicable, organization chart of the group

¹⁴³ | New AIFM, existing management companies requesting authorization as AIFM, and internally managed AIF.

Corporate information

Shareholding structure (direct or indirect qualifying shareholders - see also Section 6.2.3.1.)

- ▶ Any additional information listed in the Appendix to the *Guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC* (see Section 6.2.3.1.A.), in order for the CSSF to be able to evaluate the quality and financial strength of the proposed shareholders
- ▶ Natural persons:
 - ▶ Proof of fulfillment of the conditions of good repute and required skills, including: Signed and dated curriculum vitae, extract of recent criminal record or affidavit, declaration of honor, and copy of their identity card or passport
 - ▶ Evidence that the shareholder has sufficient financial resources to ensure the sound and prudent management of the management company
 - ▶ Confirmation that the initial capital has not been sourced from a loan or other cash advance and that the shares of the management company are unsecured
 - ▶ Confirmation that the shareholder holds the shares for their own account
 - ▶ Indication of beneficial owners
 - ▶ Indication of whether the shareholder is subject to regulation by a supervisory authority
- ▶ Qualifying holdings: Any additional information listed in the Appendix to the *Guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC* (see Section 6.2.3.1.A.), in order for the CSSF to be able to evaluate the sound and prudent management of the proposed shareholders

Corporate information

Own funds, professional liability cover (see Section 6.2.3.2.), and budget forecast

- | | | |
|---|--|---|
| <ul style="list-style-type: none"> ▶ Own funds: <ul style="list-style-type: none"> ▶ Initial capital ▶ Details of the investment policy in relation to the initial capital, indicating when applicable, the name of the financial institution at which the initial capital is deposited ▶ When relevant, the draft guarantee agreement provided by a credit institution or insurance undertaking in relation to any additional amount of own funds ▶ Provisional three-year budget forecast | <ul style="list-style-type: none"> ▶ Own funds: <ul style="list-style-type: none"> ▶ Initial capital ▶ Value of portfolios of AIF managed ▶ Amount of own funds ▶ When relevant, information on any guarantee agreement provided by a credit institution or insurance undertaking in relation to any additional amount of own funds ▶ Type of assets in which own funds will be invested ▶ Professional liability cover, either: <ul style="list-style-type: none"> ▶ Additional own funds: amount as a percentage of portfolio managed, breakdown of the calculation, date of annual recalculation, and confirmation that additional own funds amount to at least 0.01% of the value of the portfolios managed ▶ Professional indemnity insurance: information on issuer and its supervisory authority, information on insurance issuance date, term, excess, and cancellation, persons and liability risks covered, any excess covered by professional own funds and amount, and confirmation of the coverage of individual claims and aggregate claims per year ▶ Evolution of the business, covering the AIF managed or intended to be managed, total assets under management, and forecast financial statements for a three-year period | <ul style="list-style-type: none"> ▶ Own funds |
|---|--|---|

Governance

<p style="writing-mode: vertical-rl; transform: rotate(180deg);">Governing bodies and senior management (see also Sections 5.1.6.1. and 5.1.6.2)</p>	<ul style="list-style-type: none"> ▶ Governing bodies (including Board of Directors, supervisory bodies (if any)), and senior management: curriculum vitae, extract of criminal record or affidavit, declaration of honor, and copy of identity card or passport ▶ Senior management (often referred to as conducting officers): <ul style="list-style-type: none"> ▶ Areas of responsibility, and relevant experience in these areas ▶ Employment contract, or convention regulating the availability of senior management ▶ In case the members of senior management work for several companies, evidence that they are able to fulfill at all times the tasks for which they are responsible ▶ Any request for derogation from the requirement that at least two conducting officers permanently reside in Luxembourg, or a country permitting them to come to Luxembourg on a daily basis ▶ Description of the method of operation of the Board of Management 	<ul style="list-style-type: none"> ▶ Governing bodies and senior management: <ul style="list-style-type: none"> ▶ Curriculum vitae, extract of criminal record, declaration of honor, and copy of identity card or passport ▶ Any "close links" (see also Section 6.2.3.1.C.) ▶ Governing bodies: <ul style="list-style-type: none"> ▶ Justification of adequate collective knowledge, skills, and experience ▶ Demonstration that each member can dedicate the required time and attention ▶ Types of training foreseen ▶ Senior management: <ul style="list-style-type: none"> ▶ Contact details ▶ Nature and date of contractual agreement ▶ Justification of experience in relation to the AIF investment strategies ▶ List of other mandates with other AIFM, and demonstration of sufficient time and resources to fulfill duties ▶ Any request for derogation from the requirement that at least two conducting officers permanently work in Luxembourg 	<ul style="list-style-type: none"> ▶ Information on senior management: Curriculum vitae, extract of criminal record, declaration of honor, and copy of their identity card or passport
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	Chapter 15 management company	AIFM ¹⁴³	Chapter 16 management company
Program of activities	Governance		
	<ul style="list-style-type: none"> ▶ Scope of activities and services for which authorization is sought (see also Section 6.1.2.) ▶ Information on the UCIs to be managed directly or as a delegate for the next three financial years, including, number and net assets, covering UCIs that are created at the initiative of the group to which the management company belongs and those created at the initiative of other groups ▶ The investment policies of the UCIs and financial instruments and markets in which they are to invest ▶ Additional information in relation to UCIs managed: <ul style="list-style-type: none"> ▶ Information on the initiators of the UCIs managed by the management company ▶ When the management company intends to manage UCIs under foreign law, the country of origin of the UCIs, their investment policies, and services offered 	<ul style="list-style-type: none"> ▶ Scope of activities and services for which authorization is sought (see also Section 6.1.2.) ▶ Information on the AIF it intends to manage, including: <ul style="list-style-type: none"> ▶ Information about the investment strategies, including the types of underlying funds if the AIF is a fund of funds, the AIFM's policy as regards the use of leverage, risk profiles, and other characteristics of the AIF it manages or intends to manage ▶ The EU or third country domiciles and countries where the AIF is marketed ▶ Information on where the master AIF is established if the AIF is a feeder AIF ▶ The constitutional documents of each AIF it intends to manage* ▶ Evidence of how the AIFM will ensure that a depositary will be appointed for each AIF the AIFM intends to manage and details of the depositary for each AIF, including draft depositary contracts or current status of depositary negotiations, confirmation that the contract meets the minimum requirements (see Section 6.3.5.1.), confirmation that portfolio management or risk management are not delegated to the depositary, and confirmation in relation to asset segregation by the depositary and any sub-custodians (see Sections 9.4.2.1.A2 and 9.7.3.) ▶ Appointment of prime broker (where appropriate) 	<ul style="list-style-type: none"> ▶ Program of activity, including information on the UCIs to be managed for the next three financial years

	Chapter 15 management company	AIFM ¹⁴³	Chapter 16 management company
	Governance		
Organization and infrastructure	<ul style="list-style-type: none"> ▶ Functional organization chart, number of persons working for the management company, and, when possible, their names (see also Section 6.3.2.2.C.) ▶ Confirmation of the existence of a procedures manual, which details its internal functioning, the allocation of tasks to staff, reporting lines, and, when relevant, the information exchange procedures with and the controls performed on delegates (see Sections 6.3.2.3. and 6.3.2.2.C.) ▶ Description of the administrative, accounting, and IT infrastructure (including hardware, software and information sources) (see Section 6.3.2.2.A.) ▶ Designation of a person responsible for the provision of information on the financial situation of the management company 	<ul style="list-style-type: none"> ▶ Functional organization chart, number of employees, details of any secondments from other companies (see Section 6.3.2.2.C.) ▶ Evidence that the AIFM complies with the organizational requirements (see Section 6.3.1.) ▶ Evidence that the AIFM has: <ul style="list-style-type: none"> ▶ Sound administrative and accounting procedures (see Section 6.3.2.2.B.) ▶ Control and safeguard arrangements for electronic data processing (see Section 6.3.2.2.A.) ▶ Adequate internal control mechanisms, including: rules for personal transactions by its employees, rules for the holding or management of investments to invest on its own account, rules to ensure that each transaction involving AIFs may be reconstructed, rules to ensure that the assets of AIFs managed by the AIFM are invested in accordance with the AIF's constitutional document and legal provisions in force. (see Section 6.3.2.2.C.) ▶ Details of the AIFM's technical infrastructure, including business continuity plan and back-up solutions (see Section 6.3.2.2.A.) 	<ul style="list-style-type: none"> ▶ Description of the organizational structure (human and technical resources)

	Chapter 15 management company	AIFM ¹⁴³	Chapter 16 management company
Internal control (see Section 6.3.2.) and risk management (see Chapter 7)	<ul style="list-style-type: none"> ▶ Information, including curriculum vitae, on the persons in charge of: <ul style="list-style-type: none"> ▶ Compliance ▶ Internal audit ▶ Risk management ▶ Risk management process (see Section 7.2.) 	<ul style="list-style-type: none"> ▶ Name and brief description of relevant professional experience of: <ul style="list-style-type: none"> ▶ Compliance officer ▶ Internal auditor ▶ Risk manager ▶ Risk management (see Section 7.3.): <ul style="list-style-type: none"> ▶ Risk management process including description of delegates and a description of the investment due diligence procedure ▶ Qualitative and quantitative risk limits for each AIF, for at least market, credit, liquidity, counterparty, and operational risk ▶ Comprehensive description of permanent risk management function and evidence that the function is functionally and hierarchically independent from the operating units, including portfolio management (see Section 6.3.2.1.) ▶ Leverage and re-use of collateral: for each AIF, maximum leverage calculated according to gross and commitment methods and right of re-use of collateral or guarantee granted under a leveraging arrangement (see Section 7.3.) ▶ Description of the liquidity management system (see Section 7.3.) 	
	Organization of the fight against money laundering and terrorist financing		

Internal control

IT	<ul style="list-style-type: none"> ▶ IT function is considered as a support function and integrated into the second line of defence ▶ Appoint a DPO (Data Protection Officer) & Cloud Officer if applicable ▶ Requirement to have internally established IT system and procedures ▶ Establishment of a business continuity plan to work in case of IT disruption 		
	Accounting	<ul style="list-style-type: none"> ▶ Accounting function is considered as a support function and integrated into the second line of defence ▶ Requirement to have an internally established accounting function and a person responsible for it (notify the CSSF) ▶ The IFM must appoint from among its staff a person responsible for the accounting administration of UCIs. This function may be combined with other functions ▶ Description of the accounting organization and procedures in an accounting procedures manual which complies with the relevant accounting rules in order to keep the accounts of the UCI and its compartments and ensure an effective calculation of the NAV and execution of subscriptions and redemptions 	
Information exchange between the IFM and the depositary		<ul style="list-style-type: none"> ▶ The IFM must ensure that the depositary receives, upon commencement of its duties and on an ongoing basis thereafter, all the relevant information it needs to perform its functions for the UCI for which it has been designated as depositary, so that the depositary may comply with its obligations in accordance with the applicable legal and regulatory provisions. ▶ Procedure describing <ul style="list-style-type: none"> ▶ information that must be provided in this context to the depositary of the managed UCITS ▶ nature of the information for which the IFM should play a centralized role in order to facilitate the flow of information 	<ul style="list-style-type: none"> ▶ The IFM must ensure that the depositary receives, upon commencement of its duties and on an ongoing basis thereafter, all the relevant information it needs to perform its functions for the UCI for which it has been designated as depositary, so that the depositary may comply with its obligations in accordance with the applicable legal and regulatory provisions. ▶ Procedure describing <ul style="list-style-type: none"> ▶ information that must be provided in this context to the depositary of the managed UCITS. ▶ Nature of the information for which the IFM should play a centralized role ▶ When a prime broker is appointed, name and details of the interactions between the prime broker, the AIFM, and related parties, and draft agreement (see Section 6.3.5.2.)

Internal control

Requirements with respect to organization and procedures : Focus on Rules of conduct (see Section 6.4.2.), conflicts of interest (see Section 6.4.1.), and remuneration (see Section 6.4.3.)

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| <ul style="list-style-type: none"> ▶ Confirmation regarding compliance with the requirements on rules of conduct and conflicts of interest policy ▶ Description of the remuneration policy ▶ Information on the person responsible for complaints handling and a description of the complaint handling procedures (see Section 6.4.4.) ▶ Draft anti-money laundering and counter-terrorist financing procedures (see Section 8.7.4.) | <ul style="list-style-type: none"> ▶ Evidence that the AIFM has procedures: <ul style="list-style-type: none"> ▶ To ensure that the assets of the AIF are invested in accordance with the applicable requirements and on the basis of appropriate due diligence ▶ On order handling, best execution and recording of transactions (see Section 8.5.1.) ▶ On recording and reporting of subscription and redemption orders (see Section 8.7.3.) ▶ On fair treatment of investors, inducements, personal transactions by its employees (see Section 6.4.2.) ▶ On the selection and appointment of counterparties and prime brokers (see Section 6.3.5.2.) ▶ When the AIF invests in securitization positions, basis of such exposures (e.g., main investment strategy, ancillary basis) and associated risk mitigation (see Section 4.5.) ▶ Confirmation that the AIFM has established an adequate and effective strategy for the exercise of voting rights ▶ Confirmation that the AIFM has established and maintains an effective conflicts of interest policy, covering, <i>inter alia</i>, the investments on its own account ▶ Description of the remuneration policy, demonstrating compliance with remuneration requirements | <ul style="list-style-type: none"> ▶ Description of management of potential conflicts of interest ▶ Description of the remuneration policy |
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Core and business functions, as per their Delegation status

Delegation (see also Section 6.3.3.) and service providers

- | | | |
|---|---|---|
| <ul style="list-style-type: none"> ▶ Detailed description of insourced and delegated activities, including information on delegates ▶ Draft contracts with delegates ▶ Detailed description of due diligence carried out by the management company on delegates with Risk Based Approach (RBA) ▶ Information on the person or company responsible for the accounting of the management company, and, when relevant, the company responsible for maintaining the management company's accounting records (see Section 6.3.2.2.B.) ▶ Information on the person responsible for accounting administration of the UCIs at the management company (see also Chapter 8) ▶ In case the management company intends to act as administrator, required additional information (see also Section 8.2.1.) ▶ Name of auditor (see Section 6.5.2.) ▶ Information on the distribution network, including countries of distribution, intermediaries, and target clients (see also Chapter 12) | <ul style="list-style-type: none"> ▶ Information on arrangements made for full or partial delegation and sub-delegation to third parties covering: <ul style="list-style-type: none"> ▶ Delegated functions: portfolio management, risk management, administration, marketing, and activities related to the assets of AIF ▶ Name of the delegate, country, authorization(s), issuing authorities, full or partial delegation (indicating activities delegated vs those retained) ▶ Delegation to group vs other entities ▶ Copy of each delegation agreement ▶ Objective reasons for delegation ▶ Evidence that AIFM effectively supervises the delegate ▶ Initial and ongoing due diligence on delegate with Risk Based Approach (RBA) ▶ Delegation of compliance and internal audit: information on the entity to which the function is delegated and the name of the person within the AIFM responsible for monitoring the delegated function ▶ Valuation (see Section 7.6.), including information on: <ul style="list-style-type: none"> ▶ Function: external valuer (indicating professional registration and supervisory authority), AIFM itself (including evidence of functional independence and conflicts of interest mitigation), or depositary (including evidence of functional and hierarchical separation, conflicts of interest management, and due diligence) ▶ Valuation models and validation thereof ▶ Policies and procedures ▶ Person in charge of the accounting function of the AIFM (see Section 6.3.2.2.B.) | <ul style="list-style-type: none"> ▶ Detailed description of insourced and delegated activities, including information on delegates ▶ Draft contracts with delegates ▶ Detailed description of due diligence carried out by the management company on delegates with Risk Based Approach (RBA). In case the management company intends to act as an administrator, additional information required (see also Section 8.2.1.) ▶ Name of auditor (see Section 6.5.2.) and accountant, if applicable ▶ Information on the distribution network, including countries of distribution, intermediaries, and target clients (see also Chapter 12) |
|---|---|---|

	Chapter 15 management company	AIFM ¹⁴³	Chapter 16 management company
Core and business functions, as per their Delegation status			
Additional information for management entities providing additional services (see Section 6.2.1.D.)	<ul style="list-style-type: none"> ▶ Additional information to be included in the program of activities: <ul style="list-style-type: none"> ▶ Discretionary portfolio management: number of private, institutional, and pension fund clients, assets under management by client type, financial instruments, and markets ▶ The credit institutions at which the client assets will be deposited ▶ The risk management policy applied in relation to discretionary portfolio management ▶ When relevant, the non-core services offered ▶ Template of the discretionary management contracts and, if relevant, investment advisory services contracts, which the management company intends to request its clients to sign ▶ Confirmation of Deposit Guarantee Association, Luxembourg (FGDL) membership ▶ Confirmation of compliance with the additional requirements of the MiFID Directive¹⁴⁴ 		<ul style="list-style-type: none"> ▶ Additional information to be included in the program of activities: <ul style="list-style-type: none"> ▶ Discretionary portfolio management: number of private, institutional, and pension fund clients, assets under management by client type, financial instruments, and markets ▶ The credit institutions at which the client assets will be deposited ▶ The risk management policy applied in relation to discretionary portfolio management ▶ Staff involved in the provision of additional services ▶ Technical infrastructure to provide additional services ▶ Template of the discretionary management contracts and, if relevant, investment advisory services contracts, which the management company intends to request its clients to sign ▶ For AIFM intending to provide discretionary portfolio management services, confirmation of commitment to adhere to investor compensation scheme ▶ Confirmation of compliance with the additional requirements of the MiFID Directive¹⁴⁵
External Audit	<ul style="list-style-type: none"> ▶ In accordance with Article 104 of the 2010 Law and Article 7a of the 2013 Law, every IFM must entrust the audit of its annual accounting documents to one or more réviseurs d'entreprises agréés (approved statutory auditors) who can prove that they have adequate professional experience (See Section 6.5.2.) 		

* Information marked with an asterisk (*) may be provided up to one month before commencing business

B. Dual authorization

Management entities may combine authorizations as follows:

- ▶ Chapter 15 management company/AIFM. With this “dual” authorization, a management entity is authorized to manage both UCITS and AIFs and benefits from the “management” passport to perform in other EU/EEA Member States the activities for which it has been authorized and “product” passports to market the UCITS products it manages to any type of investor and the AIF products it manages to professional investors in all EU/EEA Member States
- ▶ Chapter 16 management company/AIFM. With this “dual” authorization, a management entity is authorized to manage AIFs - both AIF common funds (for which a Luxembourg management company is required) and investment companies - and benefits from the “management” passport to manage AIFs in other EU/EEA Member States and “product” passports to market the AIF products it manages to professional investors in all EU/EEA Member States

¹⁴⁴ Markets in Financial Instruments Directive (MiFID II), Directive 2014/65/EU.

¹⁴⁵ Idem.

The following management entity authorizations may be combined:

Combined authorizations of management entities

	Chapter 15 management company	AIFM
AIFM	✓	N/A
Chapter 16 management company	X	✓

C. Investment companies which have not appointed a management entity

A self-managed UCITS investment company is required to comply with prudential requirements. It is required to have sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing, and adequate internal control mechanisms.

A self-managed UCITS must have its registered office and decision-making center and administrative center in Luxembourg (see Section 6.3.2.3.). It may delegate administration to a Luxembourg administrator - i.e., a service provider in Luxembourg that is authorized to provide administration to UCIs (see Chapter 8).

It is required to comply, *inter alia*, with requirements on:

- Capital and business plan (see Section 2.4.1.5.)
- Sponsor (see Section 6.2.2.B.)
- Governing bodies and senior management (see Sections 5.1.6.1. and 5.1.6.2.)
- The portfolio management function and, when applicable, delegation thereof
- Permanent risk management function and risk management process (see Chapter 7)
- Delegation of functions (see Section 6.3.3.)
- Conflicts of interest (see Section 6.4.1.)
- Rules of conduct (see Section 6.4.2.)
- Remuneration policy (see Section 6.4.3.)
- Complaints handling (see Section 6.4.4.)
- Reporting to the CSSF (see Section 6.5.1.)
- Securities and instruments regulatory requirements
- External audit (see Section 10.5.10.)

A full AIFM regime internally managed AIF¹⁴⁶ is subject to the same requirements as an AIFM, except the capital requirements. However, an internally managed AIF is subject to initial capital requirements applicable to UCIs of EUR 300,000 (see also Section 2.5.) and to professional liability cover requirements - see Section 6.2.3.2.D. An internally managed AIF can only manage assets of its own portfolio. It cannot under any circumstances provide services to third parties.

D. Management entities providing additional services

The additional services that may be provided by management entities are discretionary portfolio management and non-core services including investment advice (see Section 6.1.2.). The provision of such additional services is subject to prior authorization (see Section 6.2.1.).

The provision of discretionary portfolio management or non-core services by UCITS management companies and AIFM is also subject to:

- The conduct of business obligations of Article 37-3 of the 1993 Law when providing investment services to clients
- The organizational requirements of Article 37-1 of the 1993 Law

The provision of such services is also subject to most of the implementing measures laid down in the Grand-Ducal Regulation of 13 July 2007 on the organizational requirements and operating conditions for investment firms and the relevant MiFID rules of conduct in the financial sector laid down in CSSF Circular 07/307, as amended.

Neither management companies nor AIFM that are authorized to provide discretionary portfolio management services may invest on behalf of their discretionary portfolio management clients in shares or units of UCIs they manage without prior general approval of the client.

¹⁴⁶ | A RAIF cannot be internally managed. It must be managed by an authorized AIFM.

The risk management policy applied to discretionary portfolio management must be submitted to the CSSF in the application for authorization.

Management companies that are authorized to provide discretionary portfolio management services must join the Deposit Guarantee Fund, Luxembourg (*Fonds de Garantie des Dépôts, Luxembourg - FGDL*).

By 31 March each year, FGDL members are required to provide the FGDL with figures at 31 December of the previous year, on

- Deposits
- Claims (instruments and monies)

In practice, this information is collected by the CSSF.

E. Simplified registration regime AIFM

Simplified registration regime AIFM are subject to registration with the CSSF. They are required to provide the following information:

- Identity
- Identity of the AIF that they manage, including the total value of assets under management
- For each AIF, the offering document or a relevant extract from the offering document or a general description of the investment strategy, including at least:
 - The main categories of assets in which the AIF may invest
 - Any industrial, geographic, or other market sectors or specific classes of assets that are the focus of the investment strategy
 - A description of the AIF's borrowing or leverage policy

Simplified registration regime AIFM are required to monitor their assets under management at least annually. This implies, *inter alia*:

- Identifying all AIF for which it is appointed as the external AIFM or the AIF for which it is the AIFM, when the legal form of the AIF permits internal management
- Identifying for each managed AIF the portfolio of assets and determining the corresponding value of assets under management, including all assets acquired through use of leverage
- Aggregating the determined values of assets under management for all AIF managed. Derivative instruments must be converted into their equivalent position in the underlying assets (see Section 7.3.6.A.)
- Comparing the resulting total value of assets under management to the relevant *de minimis* threshold (see Section 6.1.3.D.)

Simplified registration regime AIFM are required to monitor the assets under management on an ongoing basis.

Simplified registration regime AIFM must notify the CSSF in the event that they exceed the AIFM Law *de minimis* threshold. When the assets under management exceed the relevant *de minimis* threshold on more than a temporary basis (i.e., it is likely to continue for more than three months), the AIFM has 30 days to apply for AIFM authorization.

Simplified registration regime AIFM must report to the CSSF annually on the main instruments in which they are trading and on the principal exposures and most important concentrations of the AIF that they manage in order to enable the competent authorities to monitor systemic risk effectively (see Section 6.5.1.B.).

F. Managers of EuVECA and EuSEF

The managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) must be legal persons whose regular business includes managing at least one qualifying European fund and they must be established in the EU/EEA. The manager benefits from the AIFM Directive exemption applicable to managers who manage portfolios of AIF whose assets under management, in total, do not exceed a threshold of EUR500 million when the portfolio of AIF consists of AIF that are not leveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF. Such managers are subject to certain registration and regulatory reporting requirements under the AIFM Directive. They may also manage other types of UCIs.

When the total assets under management subsequently exceed the AIFM Directive threshold of EUR 500 million, the manager (who must obtain authorization under the AIFM Directive) may continue to use the qualifying European fund designations provided it continues to meet requirements of the qualifying European fund regime.

The managers of qualifying European funds are required to meet conduct of business requirements including:

- Act honestly, fairly, and with due skill, care, and diligence in conducting their activities
- Apply appropriate policies and procedures for preventing malpractices
- Conduct their business activities so as to promote:
 - The best interests of the qualifying European funds they manage, the investors in those qualifying European funds, and the integrity of the market
 - In the case of EuSEF, the positive social impact of the qualifying portfolio undertakings
- Apply a high level of diligence in the selection and ongoing monitoring of investments in qualifying portfolio undertakings and, in the case of EuSEF, the positive social impact of those undertakings
- Possess adequate knowledge and understanding of the qualifying portfolio undertakings in which they invest
- Treat investors fairly
- Ensure that no investor obtains preferential treatment, unless such preferential treatment is disclosed in the constitutional document of the qualifying fund

The manager of a qualifying European fund may delegate functions to third parties. The delegation must not prevent that manager from acting, or the qualifying venture capital fund from being managed, in the best interests of the investors therein. The manager's liability towards the qualifying European fund or the investors therein is not affected by the delegation. The manager cannot delegate functions to the extent that it becomes a letter-box entity.

The managers of qualifying European funds are required to identify and avoid conflicts of interest and, when they cannot be avoided, manage, monitor, and disclose those conflicts of interest in order to prevent them from adversely affecting the interests of the qualifying European funds and their investors and to ensure that the qualifying European funds they manage and their investors are fairly treated.

The manager of a qualifying European fund must have sufficient own funds and employ adequate and appropriate human and technical resources.

The EuVECA and EuSEF regimes are introduced in Section 2.4.4.3.

G. Granting authorization

Following submission of a complete application, the CSSF will inform the management entity whether or not authorization has been granted within a period of six months in the case of a management company and three months (extendable) in the case of an AIFM. The management entity may commence business following approval of the application.

CSSF Circular 18/698 provides clarification and guidance on all matters pertaining to the organization of Luxembourg management companies and self-managed investment companies. It outlines in particular the CSSF's expectations in terms of substance, reporting duties and key functions (such as AML-CFT, risk management, marketing), internal corporate governance and sets out requirements for the key policies and procedures. With a dedicated section covering delegation oversight, the Circular also addresses the requirements for external governance.

Time to approval of a management entity

	Chapter 15 management company	AIFM ¹⁴⁷	Chapter 16 management company
Time to approval	6 months	3 months ¹⁴⁸ The CSSF may extend this period for up to three additional months, when they consider it necessary due to the specific circumstances of the case and after having notified the AIFM accordingly.	6 months

¹⁴⁷ New AIFM, existing management companies requesting authorization as AIFM, and internally managed AIF.

¹⁴⁸ In practice, the three month period is very often extended to six months in total

If the CSSF refuses the application, the CSSF will outline the reasons for the refusal. See also Section 6.2.1.J.

Authorized management companies are entered by the CSSF on a list, which it publishes. Entry onto the list is equivalent to authorization and is notified by the CSSF to the concerned management company. This list and any modifications made thereto are also published in the Official Gazette (*the Mémorial*).

H. Restrictions on activities

The CSSF may restrict the scope of the authorization of a management entity, in relation to:

- The types of UCITS that a Chapter 15 management company is authorized to manage
- The investment strategies of AIF that an AIFM is allowed to manage

I. Updates to authorization

The management entity must, on its own initiative and before implementation, inform the CSSF of any material changes to the conditions for initial authorization.

J. Withdrawal of authorization

The CSSF can withdraw authorization of the management entity when such entity:

- Does not make use of the authorization within 12 months, expressly renounces the authorization, or has ceased the activity covered by the authorization for the preceding six months
- No longer meets the conditions under which authorization was granted
- Has seriously or systematically infringed the provisions of the Law
- Has obtained the authorization by making false statements

6.2.2. Incorporating the management company

A. Legal form and office

Management companies may be set up under any of the following forms:

- Public limited company (*société anonyme* - S.A.)
- Private limited company (*société à responsabilité limitée* - S.à r.l.)
- Cooperative company (*société cooperative*)
- Cooperative company organized as a public limited company (*société coopérative organisée sous forme de société anonyme*)
- Corporate limited partnership (*société en commandite par actions*)

Any legal person whose regular business is to manage one or more AIFs can apply for authorization as an AIFM.

Both the head office and registered office of a management entity must be in Luxembourg.

B. Sponsor

The CSSF may request a letter of assurance from a “sponsor”. In the letter of sponsorship, the sponsor makes a commitment to the CSSF that the management company respects/will respect the applicable prudential requirements, in particular the own funds of the management company. Such a letter may be requested:

- At the time of authorization
- When there is a change of shareholders
- When the financial capacity of one or more of the shareholders of the management company or of the management company itself is no longer certain

In practice, the “sponsor” will generally be the main shareholder at incorporation of the management company, or a group entity to which the main shareholder belongs (see also Section 6.2.3.1.).

The role of “sponsor” of a Chapter 15 management company replaces the role of “promoter” of a UCI managed by a Chapter 15 management company (see Section 1.4.2.A.).

6.2.3. Funding the management company

6.2.3.1. Shareholders and related parties

A. Shareholders and their suitability

The CSSF must be informed of the identity of the direct and indirect shareholders (or members) of the management entity that have qualifying holdings, and the amounts of those holdings. The shareholders may be individuals or legal persons.

The CSSF will need to be satisfied as to the reputation and suitability of such shareholders or members.

The ownership structure of the management entity must be transparent and organized in a way that permits prudential supervision to be exercised effectively (see also 6.2.3.1.D.).

The CSSF has outlined in more detail the requirements applicable to the shareholders or members of a Chapter 15 management company and AIFM. The CSSF requires that:

- Each individual acquiring, directly or indirectly, a qualifying holding in a Chapter 15 management company or AIFM must be suitable to ensure sound and prudent management of the company. The criteria for evaluating suitability include:
 - Reputation of the proposed acquirer
 - Reputation and experience of those who will direct the business
 - Financial soundness of the proposed acquirer
 - Compliance with the prudential requirements at group level
 - Anti-money laundering and counter-terrorist financing (see also Section 8.7.4.)

Each company entering into a direct shareholding structure of a management company must, in principle, dispose of own funds at least equivalent to the amount it intends to invest in the capital of the management company, after deduction, when appropriate, of other holdings held. (see also Section 6.2.3.2.B.).

- Shareholder(s) contribution should, in principle, be carried out on the shareholder's own account and not on behalf of third parties. Shares in the IFM cannot be pledged.
- Where the appointed depositary holds a direct or indirect qualifying holding in the IFM, the IFM is required to identify potential conflicts of interest and seek to avoid them in accordance with the procedures set out in the conflict of interest management policy of the IFM

Qualifying holdings are deemed to be holdings of 10% or more of the capital or of the voting rights, whether direct or indirect, or when it is possible to exercise significant influence.

B. Consultation with other Member States

The authorities of other Member States will be consulted prior to authorization when the management company is:

- A subsidiary of an entity authorized in another Member State
- A subsidiary of the parent undertaking of another entity authorized in another Member State
- Controlled by the same persons/entity that control other entities authorized in another Member State

C. Close links

The CSSF will refuse authorization of the management entity when the effective exercise of its supervisory functions is prevented by any of the following:

- "Close links" between the management entity and other natural or legal persons
- The laws, regulations, or administrative provisions of a third country governing natural or legal persons with which the management entity has close links
- Difficulties involved in the enforcement of those laws, regulations, and administrative provisions

"Close links" means a situation in which two or more individuals or legal persons are linked by ownership, directly or by way of "control", of 20% or more of the voting rights or capital of an undertaking. "Control" refers to the relationship between a parent undertaking and a subsidiary or a similar relationship.

6.2.3.2. Minimum capital requirements, own funds and professional liability cover

A. Summary

Chapter 15 management companies and AIFM are covered by the 2010 Law and AIFM Law, respectively, “own funds” requirements for their collective portfolio management activities (covering the portfolios of common funds and investment companies, but excluding portfolios managed under delegation).

They are also covered by capital adequacy requirements in the same way as investment firms under MiFID when they perform discretionary portfolio management services. These requirements only cover the individual discretionary portfolio management activities of management companies, not collective portfolio management.

B. Minimum initial capital and own funds

	Capital requirements of a management entity		
	Chapter 15 management company	AIFM	Chapter 16 management company
Initial capital	EUR 125,000	EUR 125,000	EUR 125,000
Additional own funds	Additional own funds ¹⁴⁹ of 0.02% of the amount of the portfolios ¹⁵⁰ that exceeds EUR 250 million.		n.a.
	Maximum total required capital, however, is EUR 10 million, unless the minimum amount of “own funds”, defined below, is higher.		
	Up to 50% of the additional own funds may be provided by means of a guarantee given by a credit institution or an insurance undertaking established in the EU or in a non-EU country subject to prudential rules considered by the CSSF as equivalent to those laid down in EU law.		
Minimum amount of “own funds” (floor)	One quarter of their preceding year’s fixed overheads ¹⁵¹ (the amount prescribed in Article 97 of Regulation No 575/2013) or, in the case of new management entities, of the fixed overheads projected in the business plan.		n.a.

¹⁴⁹ The definition of own funds for management companies and AIFM, under both the 2010 Law and the AIFM Law, refers to the definition of own funds applicable to investment firms. The Capital Requirements Regulation (CRR - Regulation No 575/2013 on prudential requirements for credit institutions and investment firms) defines own funds, *inter alia* for investment firms. Under the CRR, own funds include, *inter alia*:

- Capital instruments which meet specific requirements
- Share premium accounts related to capital instruments
- Retained earnings
- Accumulated other comprehensive income
- Other reserves

¹⁵⁰ For capital requirements purposes, portfolios are deemed to be UCIs managed by the management entity, including portfolios for which it has delegated the management function, but excluding portfolios that it is managing under delegation.

¹⁵¹ Overheads include the costs for staff and administrative bodies, as well as operating costs. For investment firms, the European Banking Authority (EBA) draft Regulatory Technical Standards on own funds requirements for investment firms based on fixed overheads lays down the methodology for calculating fixed overheads. In summary, investment firms should calculate the fixed overheads of the preceding year by using figures resulting from the applicable accounting framework by subtracting the following items from the total expenses after the distribution of profits in their most recent audited annual financial statements:

- Discretionary staff bonuses payable is contingent upon the actual receipt of the commission and fees receivable
- Employees’, directors’, and partners’ shares in profits, to the extent that they are fully discretionary
- Other appropriations of profits and other variable remuneration, to the extent that they are fully discretionary
- Shared commission and fees payable that are directly related to commission and fees receivable, which are included within total revenue, and when the payment of the commission and fees
- Fees, brokerage, and other charges paid to clearing houses, exchanges, and intermediate brokers for the purposes of executing, registering, or clearing transactions
- Fees to tied agents
- Interest paid to customers on client money
- Non-recurring expenses from non-ordinary activities

A tied agent is a natural or legal person who, under the full and unconditional responsibility of only one investment firm on whose behalf it acts, promotes investment and/or ancillary services to clients or prospective clients, receives and transmits instructions or orders from the client regarding investment services or financial instruments, places financial instruments, and/or provides advice to clients or prospective clients regarding those financial instruments or services. 35% of all the fees related to tied agents should be added to the result to obtain the fixed overheads.

An AIFM is required to maintain financial resources adequate to its assessed risk profile (see also Section 7.3.6.B.).

Self-managed UCITS and internally managed AIF are subject to initial capital requirements of EUR 300,000 (see also Section 2.5.).

C. Requirements in relation to minimum amount of "own funds"¹⁵²

The capital of the management entity must be represented by registered shares.

The own funds must consist of liquid assets or assets easily convertible into liquid short-term assets. The CSSF does not, in principle, accept contributions in kind, such as debt contributions, either at the time of incorporation or in case of a capital increase.

The legally required minimum amount of own funds must be permanently available to the management entity and invested in its own interests. Subject to the principle of prudence, the own funds may be invested to finance the management company's operating costs.

The own funds cannot be invested in or loaned to the shareholder. Funds can be invested in liquid assets or assets readily convertible to cash in the short term, but must not contain speculative positions.

Every holding of the management entity in another company must be notified to the CSSF and financed exclusively by surplus own funds above the legally required minimum amount. The activity of a subsidiary must be aligned with the activities of the management entity.

Surplus own funds may be invested in non-liquid assets according to CSSF Circular 18/698.

D. Professional liability cover

To cover potential professional liability risks, AIFM must either have additional own funds or hold professional indemnity insurance.

The amount of additional own funds or professional indemnity insurance depends on the value of the "portfolios of AIFs managed". The "portfolios of AIFs managed" is defined as the sum of the absolute value of all assets of all AIF managed by the AIFM, including assets acquired through the use of leverage, whereby derivative instruments are valued at their market value.

Methods to cover professional liability

Additional own funds	Professional indemnity insurance
<p>The additional own funds should be at least equal to 0.01% of the value of the portfolios of AIF managed. However, the CSSF may, on the basis of a three-year historical loss assessment, authorize the AIFM to hold a lower amount of additional own funds of not less than 0.008% of the value of the portfolios of AIF managed by the AIFM.</p>	<p>The coverage of the insurance for an individual claim must be equal to at least 0.7% of the value of the portfolios of AIF managed by the AIFM.</p> <p>The coverage of the insurance for claims in aggregate per year must be equal to at least 0.9% of the value of the portfolios of AIF managed by the AIFM.</p>
<p>This additional own funds requirement must be recalculated at the end of each financial year or when the value of the portfolios of AIF managed increases significantly, and the amount of additional own funds adjusted accordingly.</p>	<p>The professional liability insurance must:</p> <ul style="list-style-type: none"> ▶ Have an initial term of no less than one year ▶ Have a notice period for cancellation of at least 90 days ▶ Cover professional liability risks ▶ Be taken out from an EU or non-EU undertaking authorized to provide professional indemnity insurance in accordance with EU law or national law ▶ Be provided by a third party entity

Operational management requirements, including the scope of professional liability risks and the requirement to set up a historical loss database, are covered in Section 7.3.6.B.

¹⁵² This Section consolidates and summarizes the CSSF's expectations in relation to own funds. The reference sources include:

- ▶ The 2010 Law and the AIFM Law
- ▶ CSSF Circular 18/698
- ▶ The CSSF's explanations concerning the authorization procedure of Chapter 15 and Chapter 16 management companies (available on the CSSF website)

E. Additional requirements applicable to management entities that provide discretionary portfolio management services

When a Chapter 15 management company or an AIFM is also engaged in the management of portfolios of investments that include financial instruments on a discretionary and individual basis (see Section 6.1.2.), it must respect specific own funds requirements regarding these discretionary portfolio management activities.

CSSF Circular 07/290, as amended, covers the definition of capital ratios pursuant to the Law of 5 April 1993 on the financial sector, as amended (the 1993 Law).

The Circular defines a capital adequacy ratio designed to ensure that investment undertakings, such as management companies, set aside sufficient own funds to cover their exposures to risks. The capital adequacy ratio compares eligible own funds to the overall capital requirement for the risks concerned.

The Circular covers, *inter alia*:

- ▶ Definition of own funds
- ▶ Coverage of risks: general principles and coverage on a consolidated basis
- ▶ Minimum capital requirements for credit risk, settlement risk, counterparty credit risk, recognition of credit risk mitigation techniques, coverage of credit risks associated with securitization, position risk, foreign exchange risk, commodities risk, operational risk, and large “exposures”. The aforementioned requirements may be subject to review in the context of the Luxembourg implementation of the Capital Requirements Directive IV Package¹³³.

6.2.4. Liquidation and insolvency

In the event of a voluntary liquidation of a management company, the liquidator(s) must be approved by the CSSF. The liquidator(s) must provide all guarantees of honorability and professional skills.

The assets of the UCIs under management do not form part of the estate in case of insolvency of the management company and cannot be claimed by the creditors of the management company.

6.3. Organization and function of a management entity

6.3.1. Organizational requirements

A. Internal organizational requirements

Management companies and AIFM are required to comply with general organizational requirements including the following:

- ▶ Establish, implement, and maintain decision-making procedures and an organizational structure that specifies reporting lines and allocates functions and responsibilities clearly and in a documented manner (see Sections 6.3.2.3. and 6.3.2.2.C.)
- ▶ Ensure that the staff is aware of the procedures to be followed for the proper discharge of their responsibilities (see Section 6.3.2.2.C.)
- ▶ Establish, implement, and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the management entity (see Section 6.3.2.1.)
- ▶ Establish, implement, and maintain effective internal reporting and communication of information at all relevant levels of the management entity (see Section 6.3.2.3.) and effective information flows with any third party involved (see Section 6.3.3.)
- ▶ Maintain adequate and orderly records of their business and internal organization (see Section 6.3.2.3.)

¹⁵³ The CRD IV package consists of:

- ▶ Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (the Capital Requirements Regulation - CRR - this Regulation is directly applicable in Luxembourg without national transposition)
 - ▶ Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (the Capital Requirements Directive - CRD IV - this Directive must be transposed into Luxembourg Law)
- The package is completed by implementing measures and guidelines.

- ▶ Establish, implement, and maintain systems and procedures that are adequate to safeguard the security, integrity, and confidentiality of information, taking into account the nature of the information in question (see Section 6.3.2.2.A.)
- ▶ Establish, implement, and maintain an adequate business continuity policy aimed at ensuring, in the event of an interruption to their systems and procedures, the preservation of essential data and functions and the maintenance of services and activities or, when that is not possible, the timely recovery of such data and functions and the timely resumption of their services and activities (see Section 6.3.2.2.A.)
- ▶ Establish, implement, and maintain accounting policies and procedures and valuation rules that enable them, at the request of the CSSF, to deliver in a timely manner to the CSSF financial reports that reflect a true and fair view of their financial position and comply with all applicable accounting standards and rules (see also Section 6.3.2.2.B., 6.5.1. and 6.5.2.)
- ▶ Monitor and, on a regular basis, evaluate the adequacy and effectiveness of their systems, internal control mechanisms, and arrangements and take appropriate measures to address any deficiencies (see also Section 5.1.6. and 6.3.2.1.)

The roles, responsibilities of the governing bodies and senior management, as well as the applicable requirements are covered in more detail in Section 5.1.6.

B. Appointment and oversight of service providers

The responsibilities of the management entity depend on the basic structure of the investment fund:

- ▶ A common fund has no legal personality; it is created and managed by a management company. The management company may delegate certain of its collective management functions; it must monitor the activities of its delegates. It must also appoint the other required service providers
- ▶ An investment company is a legal entity, with a governing body; it can appoint a management entity or manage itself:
 - ▶ Investment company managed by a management entity: one of the main responsibilities of the governing body is the appointment and monitoring of the management entity. The management entity may, itself, delegate certain of its collective management functions; it must monitor the activities of its delegates. The governing body is also responsible for the appointment and oversight of other service providers
 - ▶ Investment company manages itself (a self-managed UCITS or an internally managed AIF¹⁵⁴): the governing body is responsible for the appointment and oversight of all the service providers

Collective management delegated functions may include, for example, portfolio management, administration, risk management, and marketing. Delegation is summarized in Section 6.3.3.

The other service providers include, *inter alia*, the depositary (see Chapter 9), paying agent (see Section 1.4.2.M.), and auditor (see Section 10.5.10.).

The following illustrates the typical responsibilities in relation to the appointment and monitoring of service providers:

Who usually appoints and monitors the service providers?

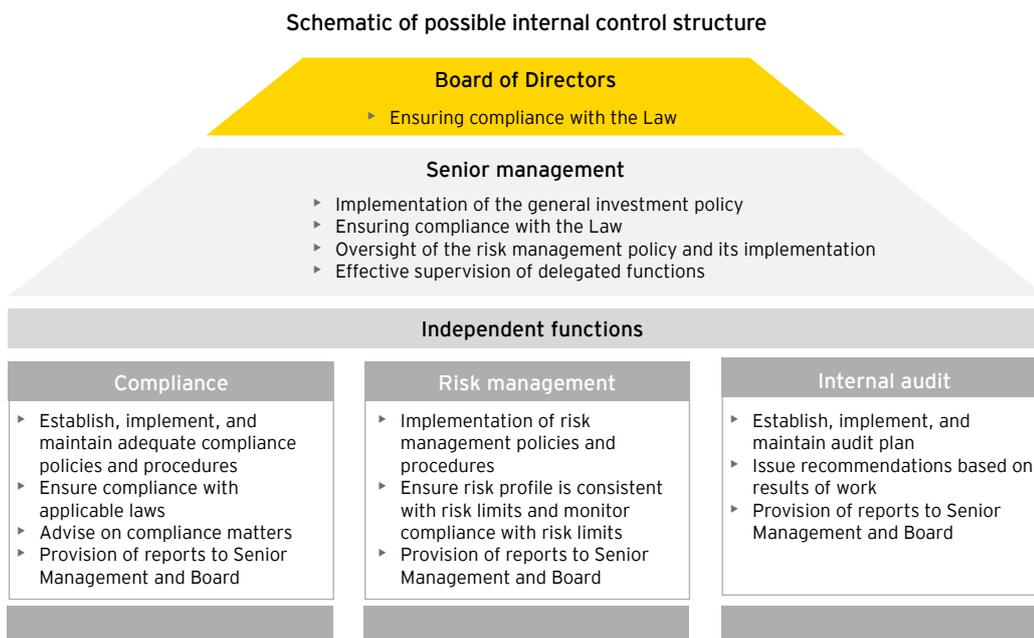
	Management entity	Collective management delegates (e.g., portfolio manager, risk management function service provider, administrator, or distributor)	Other service providers (e.g., depositary, auditor, legal advisor)
Common fund	n.a. Management company creates the common fund - it is not appointed	Management company	Management company
Investment company:			
Externally managed	Governing body of investment company	Management entity	Governing body of investment company
Self-managed or internally managed ¹⁵⁵	n.a.	Governing body of investment company	Governing body of investment company

¹⁵⁴ A RAIF cannot be internally managed. It must be managed by an authorized AIFM.

¹⁵⁵ Idem.

6.3.2. Internal control framework

The following diagram illustrates a possible internal control framework of a management entity:



IFMs must set up an internal governance system that complies with the “three-lines-of-defence model” concept.

The first line of defence consists of the business units that take or acquire risks under a predefined policy and limits and carry out controls.

The second line of defence consists of the permanent risk management and compliance functions that contribute to independent risk control, as well as of the support functions, including the IT function and the accounting function.

The third line of defence consists of the internal audit function which carries out an independent, objective and critical evaluation of the first two lines of defence.

6.3.2.1. Internal control functions

The internal control functions of a management entity are compliance, risk management, which form part of the second line of defence and internal audit, which forms part of the third line of defence. Pursuant to the CSSF Circular 18/698, supporting functions such as IT and accounting are also part of the second line of defence.

Chapter 15 management companies and AIFM are required to establish and maintain operational permanent compliance, risk management, and, subject to proportionality considerations, internal audit functions.

The internal control functions must:

- ▶ Be permanent and independent functions
- ▶ Have sufficient authority and access to the governing body/management body, auditor and CSSF
- ▶ Work objectively: must possess independence from operating units they control
- ▶ Have high professional competences and up to date knowledge;
- ▶ Have the necessary HR/infrastructure/budgets
- ▶ Have a remuneration not linked to performance of the funds
- ▶ Document the work carried out in order to enable the interventions and the conclusions to be traced
- ▶ Verify that a follow-up is effectively carried out of the recommendations
- ▶ Inform senior management and the governing /management body where required.

Each head of internal control function should be appointed and dismissed in line with a written procedure. Appointments and dismissals must be approved by the managing body / governing body and their names communicated to the CSSF. Heads of internal control functions who are entering such a position for the first time must demonstrate extensive professional experience and sufficient theoretical knowledge.

They must provide the senior management and the managing body/governing body with the advice and guidance they deem appropriate to improve the central administration and the internal governance of the IFM. They should communicate as soon as feasible with the senior management and the managing/governing bodies to reply to their requests for advice or to inform them when they consider that the effective, sound or prudent management of the activities is compromised.

Senior management must receive on a frequent basis, and at least annually, written reports on matters covered by internal control functions indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies.

The CSSF has clarified that, in a Chapter 15 management company, the risk management and/or compliance function cannot be combined with the internal audit function, but risk management and compliance may be combined. Neither the compliance officer, the head of risk management, nor the internal auditor can be a member of the Board of Directors of the management company. A conducting officer may be responsible for the permanent risk management function provided the officer has the relevant qualifications, knowledge, and experience. When the compliance and internal audit functions have been delegated, the monitoring of these functions cannot be carried out by the same individual.

A Chapter 15 management company must promote an internal culture of control and monitoring of risk, which aims to ensure that all members of staff actively participate in the detection, declaration, and control of risks incurred by the management company. Continuous and updated training must be organized for each employee of the internal control functions.

The internal control functions must cover the activities of branches, representative offices, agencies and subsidiaries of an IFM.

Anti-money laundering and counter-terrorist financing internal control requirements are covered in Section 8.7.4.

Management entities are required to submit to the CSSF on an annual basis a written report of the management on the state of the internal controls. The report must address the realization of the internal control objectives, describe the means implemented, and summarize the main observations made and deficiencies observed by the internal control functions, the corrective measures taken, and the effective follow-up of these measures. It should include a copy of the summary report on the controls carried out by the internal audit during the previous financial year.

A. Compliance

Chapter 15 management companies and AIFM are required to establish, implement, and maintain adequate policies and procedures, including a compliance charter designed to detect any risk of failure to comply with its obligations under the Law, and the associated risks, and put in place adequate measures and procedures designed to minimize such risk. The management entity should take into account the nature, scale, and complexity of its business and the nature and range of services and activities undertaken in the course of that business.

Chapter 15 management companies and AIFM are required to establish and maintain a permanent and effective compliance function, responsible for:

- Monitoring of adequacy and effectiveness of measures, policies, and procedures put in place to detect any risk of failure by the management entity to comply with its obligations under the Law, as well as the associated risks and the actions taken to address any deficiencies in the management entity's compliance with its obligations
- Advising and assisting relevant persons responsible for carrying out services and activities on matters of compliance with the Law

The management entity must ensure that:

- The compliance function has the necessary authority, resources, expertise, and access to all relevant information
- A compliance officer is appointed. The compliance officer is responsible for:
 - The compliance function
 - Reporting on a frequent basis, and at least annually, to senior management on matters of compliance, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies
- Persons in the compliance function are not involved in the performance of services or activities they monitor
- The method of determining the remuneration of a compliance officer and other persons in the compliance function does not affect their objectivity and is not likely to do so (see also Section 6.4.3.)

A management entity is not required to comply with either of the last two bullet points when it is able to demonstrate that, in view of the nature, scale, and complexity of its business and the nature and range of its services, those requirements are not proportionate and that its compliance function continues to be effective.

The compliance function should not be outsourced to third parties. This principle shall not preclude the possibility to use the expertise or technical means of third parties or the possibility to establish, where applicable, a functional link with the group compliance function. In particular a management company providing additional services (see Section 6.1.2.) is not permitted to delegate the compliance function.

The operational arrangements of the compliance function in terms of objectives, responsibilities and powers must be laid down in a compliance charter drawn up by the compliance function and approved by the senior management and ultimately by the management body/governing body.

The compliance function must raise awareness of the staff about the significance of compliance and related aspects and assist them in the daily activities relating to compliance. To this end, it must also develop an ongoing training programme and ensure its implementation.

ESMA's *Guidelines on certain aspects of the MiFID compliance function requirements* published in July 2012 provide additional insight into the responsibilities and organization of the compliance function in the MiFID context. The guidelines are not applicable to most management entities.

On the responsibilities of the compliance function, the guidelines cover:

- ▶ Compliance risk assessment: risk-based approach
- ▶ Monitoring obligations: compliance monitoring program, the priorities of which should be determined by the compliance risk assessment
- ▶ Reporting obligations: regular reporting to senior management and when there are significant findings
- ▶ Advisory obligations including: support for staff training, day-to-day assistance for staff, and participation in the establishment of new policies and procedures within the investment firm

On the organizational requirements for the compliance function, the guidelines cover:

- ▶ Effectiveness: appropriate human and other resources, authority, information, and knowledge, experience, and expertise of the compliance officer
- ▶ Permanence: performance of the responsibilities of the compliance function on an ongoing basis
- ▶ Independence: ensuring that the compliance staff act independently when performing their tasks and appointment
- ▶ Exemptions: remuneration when the compliance function may be involved in the performance of services or activities it monitors
- ▶ Combining compliance with other functions
- ▶ Outsourcing of the compliance function

The guidelines are applicable to investment firms, including credit institutions that provide investment services and UCITS management companies that provide the investment services of individual portfolio management or investment advice.

The IFM should monitor compliance with EMIR for each UCI it manages and which enter into derivative contracts. In particular, the IFM must have procedures and arrangements in place to:

- ▶ Monitor the month-end notional aggregate amount ("AANA") for each UCI or UCI sub-fund and comply with the obligation to notify the CSSF when the threshold is breached or when the UCI chooses to not calculate ANAA
- ▶ Ensure that new or novated OTC derivatives pertaining to a product class which has been declared subject to the clearing obligation are cleared within four months of the notification to the CSSF
- ▶ Ensure the information on all derivative contracts is adequately reported in a timely manner
- ▶ Measure, monitor and mitigate operational risk and counterparty credit risk for OTC derivatives contracts not cleared by a contract clearing counterparty, including:
 - ▶ Ensure the timely confirmation of the terms of the OTC derivative contract
 - ▶ Implement formalised, robust, resilient and auditable procedures to reconcile portfolios, to manage associated risk, to anticipate potential disputes between parties, resolve them and to monitor the value of the outstanding contracts

- Ensure the mark-to-market valuation on a daily basis or, when market conditions prevent reliable marking-to-market, reliable and prudent marking-to-model
- Ensure the timely, accurate and appropriate segregation of exchange of collateral with respect to outstanding contracts in scope of margin requirements

In the event of delegation, the IFM must also comply with the rules on delegates oversight. See Section 6.3.3.

The head of the compliance function is required to prepare a summary report on its activities and operations once a year. See Section 6.5.1.

B. Risk management

The risk management function is covered in Chapter 7.

C. Internal audit

Chapter 15 management companies and AIFM are required to establish and maintain an internal audit function, when this is appropriate to the nature, scale, and complexity of the business as well as the nature and range of collective portfolio management activities undertaken.

The internal audit function is responsible for:

- Establishing, implementing, and maintaining an internal audit plan to examine and evaluate the adequacy of the management entity's systems, internal control mechanisms, and arrangements
- Issuing recommendations based on the work carried out
- Verifying compliance with the recommendations issued
- Issuing internal audit reports, at least annually

The operational arrangements of the internal audit function in terms of objectives, responsibilities and powers must be laid down in an internal audit charter drawn up by the internal audit function and approved by the senior management, confirmed, where appropriate, by the audit committee and ultimately approved by the management body/governing body of the IFM.

The internal audit function must be independent from the other internal control functions which it audits. Consequently, the risk management function or the compliance function cannot be performed by the person responsible for the internal audit function of the IFM. However, these functions may take into account the internal audit work as regards the verification of the correct application of the standards in force to the exercise of the activities by the IFM.

6.3.2.2. Support functions

A. IT

Pursuant to CSSF Circular 18/698, IFMs are required to have internally established IT system and procedures to safeguard the security, integrity and confidentiality of information but also IT risks. The IT function is integrated in the second line of defence.

Each IFM must comply with the provisions of CSSF Circular 11/504 concerning fraud and incidents due to external computer attacks.

CSSF Circular 19/714 on IT outsourcing relying on a cloud computing infrastructure is as well applicable when IT conditions referred to in this latest circular apply.

In case of use of third party services, IFMs must :

- Obtain service agreement, perform initial due diligence and notify the CSSF
- Ensure the rapid and unrestricted access to data

A business continuity plan should be established to work in case of IT disruption.

The CSSF has clarified that every IFM has the following options relating to its IT infrastructure:

- Implement its own IT infrastructure, including its own computers and duly documented programs at its premises in Luxembourg. This IT infrastructure should be supported by the IFM's own IT department, organized and surrounded by an internal control system determined by the management authority. The IFM may use the services of a third party, including advice, programming, and maintenance, under a formalized agreement
- Be connected via a link to a data processing center at its parent company or a subsidiary thereof. In this case, the IFM must verify that the parent company or subsidiary is qualified and capable of providing the service in question. It must have quick and unlimited access to its data. The system must ensure security of communication and confidentiality of client information

The electronic data systems, accounting, recording of portfolio transactions and of subscription and redemption orders, and record-keeping requirements are covered in Chapter 8.

Chapter 15 management companies and AIFM are required to establish, implement, and maintain systems and procedures that are adequate to safeguard the security, integrity, and confidentiality of information, taking into account the nature of the information in question.

Chapter 15 management companies and AIFM are required to monitor and, on a regular basis, evaluate the adequacy and effectiveness of their systems and take appropriate measures to address any deficiencies.

Chapter 15 management companies and AIFM are required to establish, implement, and maintain an adequate business and service continuity policy aimed at ensuring, in the event of an interruption to their systems and procedures, the preservation of essential data and functions and the maintenance of services and activities, or, when that is not possible, the timely recovery of such data and functions and the timely resumption of their services and activities.

The CSSF has clarified that the IFM must establish, implement, and maintain a business continuity plan permitting it to resume its activity after a disaster and foreseeing regular verification of the backup capacity. When the IFM delegates, in whole or in part, one or more of its collective portfolio management activities, including risk management it must ensure that the service provider has implemented an adequate business continuity plan.

B. Accounting

Pursuant to CSSF Circular 18/698, IFMs are required to have an internally established accounting function and a person responsible for it. The accounting function is integrated in the second line of defence.

A Chapter 15 management company or AIFM can either put in place its own accounting function or use, under its responsibility, and subject to prior CSSF notification, the expertise of a third party specialized in the area of accounting.

In case of use of third party services, IFMs must obtain a service agreement, perform initial due diligence and ongoing monitoring. Independent of the organization of the accounting function (see Section 8.4.), the accounting records on the activity of a Chapter 15 management company must be available at, or electronically accessible from, the headquarters of the management company in Luxembourg.

Every Chapter 15 management company and AIFM must communicate to the CSSF the name of the person responsible within the management company who can provide information on the financial information of the management company.

The entire accounting organization and procedures must be described in a manual of accounting procedures that provide for:

- ▶ Identification and recording of all transactions undertaken by the IFM
- ▶ Explanation of changes in accounting balances from one accounting period to the next by retaining movements affecting accounting items
- ▶ Safekeeping of all accounting documents in accordance with the applicable legal requirements
- ▶ The performance of reconciliations between accounts and accounting entries
- ▶ Ensuring the reliability of financial reporting

While defining and implementing these procedures, the IFM must ensure compliance with the principle of integrity in order to avoid in particular that the accounting system is used for fraudulent purposes.

C. Human resources

An organization chart and job description must be drawn up on the basis of the principle of segregation of duties (to be provided to the CSSF upon request); staff are, in principle, employees of the IFM (employment contract).

Management companies and AIFM are required to establish, implement, and maintain decision-making procedures and an organizational structure that specifies reporting lines and allocates functions and responsibilities clearly and in a documented manner.

Chapter 15 management companies and AIFM are required to employ personnel with the skills, knowledge, and expertise, both individually and collectively, necessary for the discharge of the responsibilities allocated to them, taking into account the nature, scale, and complexity of their business and the nature and range of services and activities undertaken in the course of that business.

The CSSF may, however, grant a derogation from this requirement and allow some or all of the personnel to be seconded or temporarily assigned from an entity belonging to the same group or from a third party entity. In such cases, the agreement covering such arrangement must be submitted to the CSSF. In addition, this agreement must deal with the conflicts of interest between the personnel concerned and the entity, if it belongs to the same group. The staff seconded or assigned must be available in Luxembourg during normal business hours.

Chapter 15 management companies and AIFMs must ensure that the performance of multiple functions by relevant persons does not and is not likely to prevent those relevant persons from discharging any particular function soundly, honestly, and professionally.

Every IFM must employ at least three full-time equivalent (FTE) people at the head office in Luxembourg who perform key functions. Depending on the nature and complexity of its activity, the IFM must adapt the size of the teams performing key functions and employ more people with the necessary skills, knowledge and expertise in order to perform key functions. Long-term absences or resignations must not prevent the well-functioning of the Chapter 15 management company and AIFM.

In its application for authorization, an AIFM must provide:

- A detailed organization chart of the applicant AIFM, showing the names and positions of all managers, and the names of the departments for which they are responsible
- Indicate the number of employees and give details of any employees that are seconded from other companies

Chapter 15 management companies and AIFM are required to ensure that the staff is aware of the procedures to be followed for the proper discharge of their responsibilities.

6.3.2.3. Central administration

Chapter 15 management companies and AIFMs are required to have and employ the human and technical resources and procedures that are necessary for the proper performance of their business activities.

The letter-box entity concept is assessed in terms of size of the teams dedicated to key functions, volumes under management, complexity and number of UCIs managed by the IFM.

The CSSF has clarified the concept of “central administration”, which must be at the head office of the management company. The “central administration” consists of two key elements:

- A decision-making center: senior management and the heads of the administrative and control functions, or the different departments or professionals existing within the management company
- An administrative center: human and technical resources including a sound administrative and accounting organization permitting adequate execution of operations, correct and complete recording of operations, the timely production of reliable management information, the oversight over delegated activities, the management of conflicts of interest, and the respect of the applicable rules of conduct

Central administration of the IFM, which comprises the functions of direction and management, execution and control, must permit the IFM to have control of all of its activities.

Chapter 15 management companies and AIFM must establish a precise and clear procedures manual describing its internal functioning, the allocation of tasks among its staff, hierarchical lines, and, when applicable, the procedures for exchanging information with and controls undertaken on delegates. The manual has to be available at the registered office of the IFM, accessible to its staff, and kept up to date, taking into account the evolution of the management company’s activity.

Chapter 15 management companies and AIFM are required to elaborate a number of procedures, and regularly update them. The management company must confirm the existence of such procedures to the CSSF in its application for authorization. The CSSF may request a copy of the relevant procedure at any time. The procedures should include, *inter alia*:

- Personal transactions (see Section 6.4.2.)
- Conflicts of interest (see Section 6.4.1.)
- Rules of conduct (see Section 6.4.2.)
- Strategy for the exercise of voting rights
- Remuneration (see Section 6.4.3.)

Chapter 15 management companies and AIFM should generate “management information” on their activities, and those of its delegates. The management information should cover, *inter alia*:

- Results of controls performed on the activities of delegates
- Risk management analysis
- Incidents related to collective management (e.g., NAV calculation errors, breaches of investment limits, valuation issues, reconciliation issues, situations giving rise to conflicts of interest)
- Best execution policy
- Complaints
- Minutes of previous meetings

Chapter 15 management companies and AIFM should maintain adequate and orderly records of its business and internal organization.

Chapter 15 management companies and AIFM must at all times have the necessary expertise and resources to effectively monitor the activities carried out by delegates on the basis of an arrangement with the management company, especially with regard to the management of the risk associated with the delegation. Chapter 15 management companies and AIFM should ensure that they receive all the information they require from delegates in order to effectively oversee their activities and, in the case of Chapter 15 management companies, in order to be able to generate management information (see also Section 6.3.3.).

Management information must be available in Luxembourg and preferably saved in a central database available at any time in Luxembourg.

The administration function is covered in Chapter 8.

6.3.3. Rules on delegation

6.3.3.1. Delegation by management entities

A management entity is permitted to delegate some of its tasks, generally in order to achieve a more efficient conduct of its business. However, a management entity should not delegate its tasks to the extent that it becomes a letter box entity. The following table provides a summary of some of the key limitations on delegation:

Overview of key limitations on delegation of activities by management entities		
	Activities that may be delegated ¹⁵⁶	Activities that cannot be delegated
Chapter 15 management companies	<p>The management functions of collective portfolio management:</p> <ul style="list-style-type: none"> ▸ Portfolio management ▸ Valuation ▸ Administration ▸ Marketing ▸ Risk management ▸ Complaints handling ▸ Outsourcing of specific tasks pertaining to the compliance function ▸ Outsourcing of specific tasks pertaining to the AML/CFT function ▸ Internal audit function (in principle if no management company branches are set-up) ▸ Operation of the IT system ▸ Accounting ▸ Other specific non-core services 	<ul style="list-style-type: none"> ▸ Definition of the general investment policy of a common fund ▸ Definition of the risk profile of each UCITS ▸ Interpretation of the risk management analysis, including any corrective measures ▸ Implementing the conflicts of interest policy, and its monitoring ▸ Implementing the best execution policy, and its monitoring ▸ When a representative price is not available, ensuring that senior management has taken a decision on the determination of a probable fair value or have all the necessary supporting information to take such a decision ▸ Choice of service provider ▸ Monitoring and control of delegated functions
AIFM	<p>The AIFM is not permitted to delegate activities to the extent that the AIFM:</p> <ul style="list-style-type: none"> ▸ No longer retains the necessary expertise and resources to supervise the delegated tasks effectively and manage the risks associated with the delegation ▸ No longer has the power to take decisions in key areas that fall under the responsibility of senior management or no longer has the power to perform senior management functions, in particular the implementation of the general investment policy and investment strategies ▸ Loses its contractual rights to inquire, inspect, have access, or give instructions to its delegates or the exercise of such rights becomes impossible in practice 	

¹⁵⁶ Subject to the applicable requirements.

If portfolio management and risk management are delegated, they should be delegated to regulated entities. These include:

- ▶ AIFM
- ▶ UCITS management companies
- ▶ Investment firms authorized to perform portfolio management
- ▶ Credit institutions authorized to perform portfolio management
- ▶ Third country entities authorized or registered for the purpose of asset management and effectively supervised by a competent authority in those countries, and subject to the existence of cooperation agreements between the CSSF and the third country supervisory authority

In the case of AIFM and Chapter 16 management companies, the CSSF may also, on a case-by-case basis, permit delegation to unregulated entities.

AIFM are not permitted to delegate the performance of investment management functions (i.e., portfolio management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself.

A. General requirements

Management entities and investment companies are permitted to delegate, or partially delegate, to third parties the execution of one or more of their functions on their behalf. The management entity remains responsible for the delegated activities.

The requirements to be met vary between management entities. Generally, they include the following:

Summary of delegation requirements applicable to management entities

All types of delegation	Specific to the investment management function
<ul style="list-style-type: none"> ▶ The CSSF must be adequately informed of the delegation ▶ There must be an objective reason for the delegation, such as the efficient conduct of business ▶ The management entity must perform initial and ongoing due diligence on the delegate, following Risk Based Approach (RBA) ▶ The delegation should be formalized in a written agreement ▶ The delegate should be qualified and capable of undertaking the delegated functions ▶ The management entity must effectively supervise the delegated functions ▶ The mandate must not prevent effective supervision of the management company or prevent it from acting, or the UCI from being managed, in the best interests of its investors 	<ul style="list-style-type: none"> ▶ Investment management should be delegated to authorized and supervised undertakings ▶ When the investment management related mandate is given to a third-country undertaking, there should be appropriate cooperation arrangements in place between the CSSF and the supervisory authority of such country ▶ A mandate with regard to the core function of investment management cannot be given to the depositary

The delegate may sub-delegate, provided the management entity is properly informed. The requirements applicable to delegation apply to sub-delegation.

Investment companies that have not appointed a management entity are also subject to the delegation requirements of the respective fund Laws:

- ▶ Self-managed UCITS are required to comply with requirements on delegation applicable to Chapter 15 management companies (see Section 6.3.3.1.G.)
- ▶ Investment companies under Part II of the 2010 Law are required to comply with requirements on delegation similar to those applicable to Chapter 16 management companies (see Section 6.3.3.1.I.); if they are full AIFM regime AIF, they are also required to comply with AIFM requirements on delegation (see Section 6.3.3.1.H.)

SIFs or their management companies that delegate one or more of their own functions to third parties are subject to SIF Law delegation requirements (see Section 2.4.2.4.); if they are full AIFM regime AIF, they are also required to comply with AIFM requirements on delegation (see Section 6.3.3.1.I.).

B. Notification and reporting to the CSSF

Chapter 15 management companies and AIFMs must notify the CSSF in advance of the intention to delegate, to change the delegate or to carry out itself one or more of the following functions previously delegated: portfolio management, risk management, central administration of UCIs and valuation.

To this end, the update of the programme of activities must detail the functions delegated, the identities and the country of establishment of the delegates and, where applicable the name of their supervisory authority. The IFM is required to submit to the CSSF within five months from the end of the IFM's financial year an annual statement of all its delegates, including the due diligence procedures in place to monitor the activities of its delegates. The CSSF is also empowered to request at any time the due diligence files gathered when the IFM selected the delegates.

C. Obligation to conclude a contract

A written contract must be entered into between the delegate and the IFM. The mandate must not interfere with prudential supervision to which the IFM is subject and prevent the IFM from acting in accordance with the rules of conduct and, notably, the best interest of investors. The terms and conditions should specify under which circumstances the IFM is permitted to give additional instructions or withdraw the mandate when justified by the interests of the investors.

When the delegate is not precluded to do so under the legislation it is subject to, the IFM should be granted:

- ▶ A right of access, upon simple request, to documentation and data relating to the transaction carried out by the delegate for the account of the IFM
- ▶ A right to conduct an on-site visit for due diligence and ongoing monitoring purpose, at a frequency and in a manner specified in the contract

The IFM and the delegate must establish, implement and maintain operational a continuity plan which can be activated after a disaster.

D. Delegation Control Arrangement Procedure

The IFM is required to establish a Delegation Control Arrangement Procedure covering all aspects of delegation and including descriptions of, *inter alia*:

- ▶ The process for selecting or replacing a delegate
- ▶ The controls, which should be equivalent to the monitoring of the activities as if they were carried out internally, to ensure the delegate carries them out in compliance with applicable legal and regulatory provisions
- ▶ The reporting to the IFM
- ▶ The nature, scope and frequency (at least every three years) of the periodic due diligence, taking into account the risks associated to each delegation and the number of delegates
- ▶ The decision-making and the escalation procedure
- ▶ The department and staff members designated for the ongoing monitoring
- ▶ The measures ensuring business continuity in the event of withdrawal of the mandate
- ▶ The measures ensuring data protection at all times

The monitoring of delegated activities cannot be delegated. When specific or transversal skills existing within the group to which the IFM belong are used for the purpose of controlling delegates, the IFM must remain involved in the selection and relationship management process and ensure it has access to documents obtained during initial due diligence and ongoing monitoring.

E. Initial due diligence requirements

The IFM must be satisfied that each delegate is qualified, capable and has adequate human and technical resources to perform the delegated activity and provide the information the IFM requires for ongoing monitoring purposes.

The assessment of the risks arising from delegation must take into account at least the following criteria:

- ▶ The jurisdiction in which the delegate is located (the location must not be an obstacle to regular on-site visits), whether the delegate is a regulated and/or supervised entity and the nature of any authorization obtained
- ▶ The reputation of the delegate, the existence of sanctions imposed by a supervisory authority, the absence of money laundering and terrorist financing suspicions, the complaints and claims received by the delegate

- The shareholder, governance and organizational structures (including the organization of control functions) of the delegate
- The financial situation of the delegate
- The delegate's skills and abilities
- The quality of the delegate's computer systems, business continuity plan and disaster recovery plan
- The measures taken by the delegate to ensure data protection
- The risk of conflicts of interest between the IFM and the delegate and the management of these risks
- The existence of sub-delegation by the delegate and the ongoing monitoring measures
- The delegate's ability to provide sufficient and relevant reports and key performance indicators

Each due diligence must be formalized in a written report including:

- The description of the due diligence measures
- The description and critical analysis of the observations made
- The results of the analysis of the information and documents obtained
- The escalation measures taken where appropriate
- The conclusions adopted and validated, dated and signed by the body empowered to take decision with regards to the delegation, stating in particular the frequency and nature of subsequent periodic due diligence, before the entry into force of the contract

The IFM's Approval Committee must review the report and rule as a last resort. The due diligence must be retained at the IFM's registered office and available upon request from the CSSF.

F. Ongoing monitoring

The IFM must ensure that:

- The services provided by the delegate comply continuously with legal, regulatory and contractual provisions and that they meet satisfactory quality standard
- The delegate's organizational structure, procedures, qualification and capabilities remain adequate over time
- Risks arising from each delegation are reassessed and managed appropriately

Periodic due diligence consists of reassessing criteria analyzed during the initial due diligence and includes other criteria if necessary. It must be formalized in the same way as initial due diligence and must include:

- The follow up of observations noted during previous due diligences, the action plans and the agenda for their implementation, as well as the escalation measures carried out
- The conclusions from the body of the IFM empowered to decide to maintain or terminate the delegation as well as the conditions thereof

The due diligence must be retained at the IFM's registered office and available upon request from the CSSF.

A monitoring system must allow the IFM to access relevant data and the management information must also enable the monitoring of the delegate's activities.

Regular detailed reports including key performance indicators must be provided to the IFM conducting officers. In addition the IFM must define and establish a methodology for analyzing the results of the monitoring system and set up its own warning systems. Such analysis must be documented and available for inspection by the CSSF.

When the delegate respects an internal control framework, documented in a written report prepared by the delegate and reviewed and reported upon by an independent auditor in accordance with a professional standard such as ISAE 3402¹⁵⁷, or the requirements of MiFID, the management company may take this into account in the organization of its control.

G. Chapter 15 management companies

In addition to the general requirements, the following conditions must be met for Chapter 15 management companies:

- The management company's control arrangements must cover, *inter alia* monitoring:
 - The activities of the investment manager, including, for example, ensuring that assets of the UCITS are invested in accordance with the constitutional documents and the applicable requirements and the best execution policy is respected

¹⁵⁷ International Standards on Assurance Engagements (ISAE) 3402, Assurance Reports on Controls at Third Party Service Organization issued by the International Auditing and Assurance Standards Board.

- ▶ The risk exposures of the UCITS (see also Section 7.2.)
- ▶ The activities of the administrator, including the transfer agent. This includes verifying the existence of a second level monitoring system, covering, for example, the NAV calculation (see also Section 8.6.), or implementation of such a system itself
- ▶ The implementation of the marketing policy, covering, for example, registration in new countries and reimbursement of distribution fees (see also Chapter 12)
- ▶ The UCITS' prospectuses must list the delegated functions

The CSSF's Frequently Asked Questions (FAQ) concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment clarifies the conditions to comply with in case of delegation by a UCITS of the investment management function:

UCITS may delegate the function of investment management according to the requirements of Article 110 of the Law of 2010. The investment manager:

- ▶ Must be authorized or registered and subject to prudential supervision.
- ▶ If located in a third country, the cooperation between the CSSF and the supervisory authority of the investment fund manager must be ensured.

Investment fund managers located in an EEA or an OECD country and subject to prudential supervision of an authority fulfil in principle the above criteria. Investment fund managers located in another country are in principle acceptable if the CSSF has signed with the relevant supervisory authority, a Memorandum of Understanding covering UCITS.

The CSSF may also, when relevant, take into account the delegation provisions applicable to AIFM.

H. AIFM

In the context of delegation, it is important to distinguish between delegation of functions, which is subject to the AIFM delegation provisions, and other activities, such as provision of advice and the performance of certain preparatory tasks, which may not be subject to the AIFM delegation provisions.

In addition to the general requirements, the following conditions must be met for AIFMs:

- ▶ The AIFM must be able to justify its entire delegation structure on objective reasons, which may include:
 - ▶ Optimizing business functions and processes
 - ▶ Cost saving
 - ▶ Expertise of the delegate in administration or in specific markets or investments
 - ▶ Access of the delegate to global trading capabilities
- ▶ The delegation structure must not allow for the circumvention of the AIFM's responsibilities or liability
- ▶ The delegation must not prevent the effectiveness of supervision of the AIFM and, in particular, must not prevent the AIFM from acting, or the AIF from being managed, in the best interests of its investors. To this end, the AIFM and the competent authorities must have effective access to data related to the delegated functions and to the business premises of the delegate, the competent authorities must be able to exercise those rights of access, and the delegate must cooperate with the competent authorities of the AIFM in connection with the delegated functions
- ▶ The persons who effectively conduct the business of the delegate must be of sufficiently good repute¹⁵⁸. When the delegate is regulated in the EU and the relevant supervisory authority has reviewed the criterion of "good repute" within the authorization procedure, this criterion is deemed to be met
- ▶ The AIFM must ensure that the delegate discloses to the AIFM any development that may have a material impact on the delegate's ability to carry out the delegated functions effectively and in compliance with applicable laws and regulatory requirements

¹⁵⁸ Persons who effectively conduct the business of a delegate shall not be deemed of sufficiently good repute if they have any negative records relevant both for the assessment of good repute and for the proper performance of the delegated tasks or if there is other relevant information that affects their good reputation. Such negative records shall include but shall not be limited to criminal offences, judicial proceedings, or administrative sanctions relevant for the performance of the delegated tasks. Special attention shall be given to any offences related to financial activities, including but not limited to obligations relating to the prevention of money laundering, dishonesty, fraud or financial crime, bankruptcy, or insolvency. Other relevant information shall include information indicating that the person is not trustworthy or honest. Furthermore, when the delegate is regulated in respect of its professional services within the EU, the persons who conduct the business may be deemed to be of "good repute" when the relevant supervisory authority has reviewed the criterion of "good repute" within the authorization procedure, unless there is evidence to the contrary.

The delegate may sub-delegate any of the functions delegated to it provided that:

- The AIFM consented in writing prior to the sub-delegation
- The AIFM notified the CSSF before the sub-delegation arrangements become effective. The notification must contain details of the delegate, the name of the competent authority where the sub-delegate is authorized or registered, the delegated functions, the AIF affected by the sub-delegation, a copy of the written consent by the AIFM, and the intended effective date of the sub-delegation
- All the delegation requirements must be complied with in relation to the sub-delegation

Any further sub-delegation is subject to the same requirements.

The AIFM's liability towards the AIF and its investors is not affected by the fact that the AIFM has delegated functions to a third party or by any further sub-delegation.

An AIFM cannot delegate its functions to the extent that, in essence, it can no longer be considered to be the manager of the AIF and to the extent that it becomes a letter box entity. An AIFM is no longer considered to be the manager of the AIF and is deemed a letter box entity in any of the following situations:

- The AIFM no longer retains the necessary expertise and resources to effectively supervise the delegated tasks and manage the risks associated with the delegation
- The AIFM no longer has the power to take decisions in key areas that fall under the responsibility of senior management or no longer has the power to perform senior management functions
- The AIFM loses its contractual rights to inquire, inspect, have access, or give instructions to its delegates or the exercise of such rights becomes impossible in practice
- The AIFM delegates the performance of investment management functions (portfolio management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself. When assessing the extent of delegation, the CSSF is required to assess the entire delegation structure taking into account not only the assets managed under delegation but also the following qualitative criteria:
 - The types of assets the AIF or the AIFM acting on behalf of the AIF is invested in and the importance of the assets managed under delegation for the risk and return profile of the AIF
 - The importance of the assets under delegation for the achievement of the investment goals of the AIF
 - The geographical and sectorial spread of the AIF's investments
 - The risk profile of the AIF
 - The type of investment strategies pursued by the AIF or the AIFM acting on behalf of the AIF
 - The types of tasks delegated in relation to those retained
 - The configuration of delegates and their sub-delegates, their geographical sphere of operation, and their corporate structure, including whether the delegation is conferred on an entity belonging to the same corporate group as the AIFM

The CSSF may also, when relevant, take into account the delegation provisions applicable to UCITS management companies.

Both portfolio management and risk management are multi-faceted functions, each of which may be delegated in part or in whole. The multi-faceted nature of risk management is covered in Chapter 7 and, in the specific context of AIF, in Section 7.3.

As the delegation structure will be assessed by the CSSF as a whole, AIFM that manage multiple AIF are not, in principle, prevented from delegating the performance of both portfolio management and risk management for certain AIF they manage.

Furthermore, partial delegation of the multi-faceted investment management functions may offer AIFM a pragmatic alternative to wholly insourcing at least one of the functions, while remaining compliant with the letter box provisions.

Delegation of the risk management function is covered in Section 7.3.7.

AIFM must provide a description of any delegated management function to investors before they invest (see Section 10.3.4.).

1. Chapter 16 management companies

The permitted activities of a Chapter 16 management company are outlined in Section 6.1.3.F.

A Chapter 16 management company that is also authorized as an AIFM is subject to AIFM delegation requirements (see Section 6.3.3.1.H.).

A Chapter 16 management company that is not authorized as an AIFM may also designate another entity as AIFM; in this case, the AIFM will be subject to delegation requirements. However, as an AIFM is only required to perform the key functions of portfolio management and risk management, a Chapter 16 management company is permitted to delegate to another third party, for the purposes of more efficient conduct of business, the power to carry out on its behalf one or more of the functions of administration or marketing.

Chapter 16 management companies that manage AIF and other investment vehicles are permitted to delegate to third parties, for the purposes of more efficient conduct of business, the power to carry out on their behalf one or more of their functions.

The following general requirements must be met in case of delegation:

- The CSSF must be adequately informed of the delegation including:
 - Description of the activities delegated and of the activities performed internally by the management company
 - Draft contracts concluded with the delegates
 - Description of the controls performed by the management company on the delegates
- The mandate must not prevent effective supervision of the management company or prevent it from acting, or the UCI from being managed, in the best interests of its investors

6.3.3.2. Management entities as delegates

When authorized to do so, a UCITS management company or an AIFM, as a delegate, may provide services to other UCITS or their management companies or to other AIF or their AIFM. In such cases, the delegate management company or AIFM is not appointed as management company or AIFM of the UCITS or AIF.

For example, a UCITS management company, as a delegate, may provide portfolio management or administration services to an AIF or an AIFM.

In such cases, a UCITS management company will not need to seek additional authorization as an AIFM, or an AIFM as a UCITS management company.

Services that may be provided by management entities as delegates

Services provided to	UCITS management company	AIFM
A UCITS or its management company	✓	✓
An AIF or its AIFM	✓	✓

6.3.4. Cross-border management passport

6.3.4.1. General principles

A. Introduction

Both Chapter 15 management companies and authorized AIFM have two types of “passports”:

- A “Management” passport, permitting them to perform their authorized activities in other EU/EEA Member States without obtaining prior authorization in the host Member State. Management entities may manage UCIs cross-border either through free provision of services or the establishment of a branch. (see Section 6.5.)

Example: A Luxembourg UCITS management company may, in addition to managing Luxembourg UCITS, manage:

- A UCITS in Italy through a branch
- A feeder UCITS in Sweden directly through free provision of services

The scope of the “Management” passport depends on the management entity:

- ▶ A UCITS management company can perform its authorized activities in other EU/EEA Member States
- ▶ An AIFM can manage AIF in other EU/EEA Member States, but not perform the other activities for which it has been authorized
- ▶ A Chapter 16 management company that is not authorized as an AIFM does not benefit from a passport to perform outside Luxembourg the activities for which it has been authorized
- ▶ A “Product” passport, permitting them to market their managed UCITS or AIF in other EU/EEA Member States, following a notification (see Chapter 12)

Example: A Luxembourg authorized AIFM may, following notification sent to the CSSF, market its SIFs in Italy and Sweden, either directly or through an intermediary acting on its behalf. National private placement rules applicable to the marketing of AIF in these countries do not apply.

The functioning of the “Product” passport depends on the regime:

- ▶ Authorized UCITS benefit from a passport enabling the marketing of their shares or units to retail and professional investors in EU/EEA Member States. A notification procedure must be followed to market each UCITS in each Member State, excluding Luxembourg
- ▶ An AIFM benefits from a passport enabling it to market the AIF it manages to professional investors in EU/EEA Member States. A notification procedure must be followed to market each AIF in each Member State, including Luxembourg
- ▶ A Chapter 16 management company that is not authorized as an AIFM does not benefit from a product passport. However, the shares or units of the non-UCITS managed by a Chapter 16 management company may be marketed in Luxembourg and in other Member States under national private placement requirements

The following table summarizes the scope of the passports of management entities:

Brief summary of scope of passports of management entities

	Chapter 15 management company	AIFM	Chapter 16 management company (not authorized as an AIFM)
Scope of EU/EEA cross border “management” passport:			
▶ Managing UCIs	✓ UCITS	✓ AIF	X
▶ Other activities (e.g., discretionary portfolio management)	✓	X	X
Scope of EU/EEA cross-border “product” passport			
	✓ UCITS marketing passport	✓ AIF marketing passport	X Private placement only

Both Chapter 15 management companies and authorized AIFM have a “passport” permitting them to manage UCIs in other EU/EEA Member States¹⁵⁹.

The passport allows a management entity to manage UCIs (UCITS and AIF, respectively) in EU/EEA Member States other than their home Member State (“host” Member States) either through the “free provision of services” or the establishment of a branch.

The passport also allows a UCITS management company to perform in other EU/EEA Member States the other activities for which it has been authorized in its home Member State (e.g., providing discretionary portfolio management or investment advice).

¹⁵⁹ The European Economic Area (EEA) Member States are the European Union (EU) Member States plus Iceland, Liechtenstein, and Norway. The reference to the EEA is clarified in Section 1.3.1.B.

The management passport offers asset management groups flexibility at two levels:

- The management entity appointed to manage the UCIs: The passport is an opportunity for management companies to manage UCIs cross-border, both intra-group and as a third party
- The administration service provider appointed by the management company (see Section 8.2.2.)

The management company passport does not mean additional flexibility with regard to the choice of depository, which must be in the home Member State of the UCI.

The host Member State may not make the free provision of services, or the establishment of a branch, subject to any authorization requirement and cannot impose additional requirements on the management entity in relation to the matters covered by the relevant Directive - i.e., UCITS Directive or the AIFM Directive.

The host Member State of a UCI that is managed cross-border cannot, for example, require the performance of activities, such as administration, in the host Member State, or the delegation of an activity or function to an entity in the host Member State.

Any management entity is required to comply with its home Member State rules relating to any delegated activities or functions and, when applicable, the rules of the UCI home Member State regarding the constitution and functioning of the UCI.

The CSSF has clarified that a Chapter 15 management company that manages:

- Luxembourg UCITS is authorized to delegate the administration of the UCITS to an entity that is established in Luxembourg and that is authorized to provide administration services and has adequate organization in order to perform the administration
- UCITS domiciled in other Member States is authorized to delegate the administration of the UCITS to an entity that is established either in Luxembourg or the Member State of domicile of the UCITS and that is authorized to provide administration services and has adequate organization in order to perform the administration

A practical challenge for a management entity or a delegate of the management entity (such as an administrator or risk management service provider) operating cross-border is complying with local requirements of the host Member State in relation to the UCIs it manages. For example, administrators serving UCITS in another Member State will need to comply with the accounting requirements of the UCITS home Member State.

The following section provides an overview of the operation of the management passport and the applicable regulatory requirements, focusing on EU/EEA management entities managing EU/EEA UCIs. The taxation implications of cross-border management are covered in Section 6.5.3. This section concludes with a brief overview of the EEA - non-EEA situations: EEA AIFM managing non-EEA AIF and non-EEA AIFM managing EEA AIF.

B. *The free provision of services*

The management entity manages UCIs in the host Member States directly.

Under the free provision of services, a management entity can provide its services cross-border without establishing a presence in the host Member State.

For example, a Luxembourg management company will be able to manage a Polish UCITS, a Luxembourg master UCITS, and a Portuguese feeder UCITS.

C. *The establishment of a branch*

A management entity may manage UCIs in host Member States by establishing branches. Branches do not themselves benefit from the management company passport.

Branches are a way of having a local presence without establishing a full management entity.

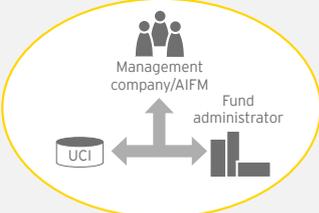
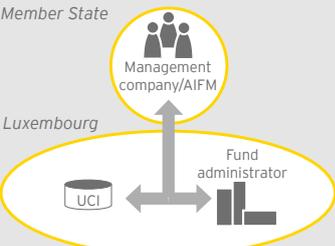
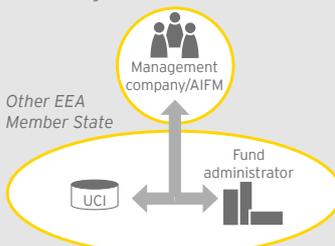
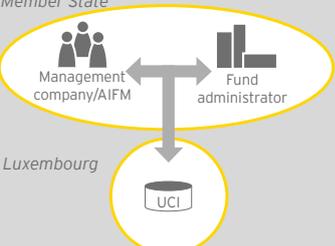
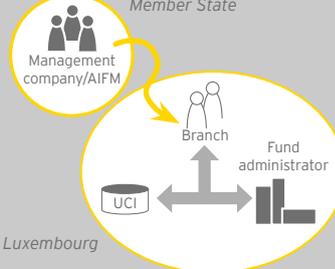
For example, the Luxembourg AIFM may also manage French or Italian AIF by establishing branches in those countries.

For existing management companies, cross-border status can be achieved by converting an existing management company into a branch or by transferring activities via mergers, acquisitions, or liquidations.

D. Possible cross-border management scenarios

The following illustrates some of the possible cross-border management scenarios.

Illustration of possible cross-border management scenarios

Scenario 1 No cross-border management	<p>Luxembourg</p>  <p>The Luxembourg management entity manages Luxembourg UCIs. A Luxembourg administrator is appointed. The management passport is not used for the management of these UCIs.</p>	
Scenario 2 Cross-border management through free provision of services; UCI and administrator in same Member State	<p>Other EEA Member State</p>  <p>Luxembourg UCIs are managed cross-border by a management entity established in another EU/EEA Member State through the free provision of services. A Luxembourg administrator is appointed.</p>	<p>Luxembourg</p>  <p>A Luxembourg management entity manages UCIs established in another EU/EEA Member State cross-border through the free provision of services. An administrator in the host Member State is appointed.</p>
	Scenario 3 Cross-border management through free provision of services; management entity and administrator in same Member State	<p>Other EEA Member State</p>  <p>Luxembourg UCIs are managed cross-border by a management entity established in another EU/EEA Member State through the free provision of services. An administrator in the host Member State is appointed.</p>
Scenario 4 Cross-border management through a branch; branch, UCI and administrator in same Member State		<p>Other EEA Member State</p>  <p>Luxembourg UCIs are managed cross-border by a management entity established in another EU/EEA Member State through a Luxembourg branch. A Luxembourg administrator is appointed.</p>

6.3.4.2. Notification of cross-border management

A UCITS management company or AIFM intending to carry out activities in another Member State must notify its intention to its home Member State competent authority and provide it with the following information:

- ▶ The host Member State in which it intends to operate or establish a branch
- ▶ The program of operations, including a description of the planned activities
- ▶ In the case of a UCITS management company:
 - ▶ The risk management process put in place by the management company
 - ▶ The measures put in place to properly deal with investor complaints and the exercise of their rights
 - ▶ The program of operations should also cover, when applicable, discretionary portfolio management mandates
- ▶ In the case of branches:
 - ▶ The organizational structure of the branch
 - ▶ The address in the host Member State from which documents may be obtained
 - ▶ Address and names of conducting officers
- ▶ In the case of management of UCITS through free provision of services: a description of the main marketing techniques that it intends to use (e.g., regular trips to the host Member State, distance marketing)

The notification should be submitted in a language mutually acceptable to the CSSF and the competent authority of the host Member State.

A UCITS management company must also provide the authorities of the host Member State with a copy of the agreement with the depositary (see Section 6.3.4.2.) and information on the delegation arrangements regarding the functions of investment management and administration (unless it has already provided such information to the authorities for the same type of UCITS – see also Section 6.3.3.).

The management entity home Member State competent authority will communicate the information received to the host Member State competent authority within one month in the case of free provision of services and two months in the case of branches. In the case of collective portfolio management, the management entity home Member State competent authority will also include an attestation confirming the management entity's authorization, including a description of the scope of this authorization, and, if applicable, any restriction on the types of UCIs the management entity is authorized to manage¹⁶⁰.

In the case of cross-border management of UCITS, the management company can start the free provision of services in the host Member State as soon as the required information has been communicated to the host Member State competent authority. Branches may start business on receipt of a communication from the host Member State competent authority or on the expiration of a further two-month period.

In the case of cross-border management of AIF, the AIFM's home Member State competent authority must immediately notify the AIFM about the communication. Upon receipt of the notification, the AIFM may start to provide services in the host Member State.

6.3.4.3. Regulatory requirements

A. Introduction

UCITS management companies and AIFM are subject to the requirements applicable to their setting up and operation.

In addition, the regulations lay down requirements, and provide clarifications, on the cross-border management of UCITS.

¹⁶⁰ The communication in relation to any restrictions on the activity of the management entity is explicitly stated in the UCITS Directive and the 2010 Law; however, as the CSSF may restrict the scope of authorization of an AIFM, it seems reasonable to assume that information on any restriction will be provided to the host Member State also in the case of AIFM.

B. Cross-border management of UCITS

The management company (and its branches, if applicable) is subject to its home Member State's organizational requirements, including, *inter alia*:

- Delegation arrangements and risk management
- The implementation of sound administrative and accounting processes
- Control arrangements for electronic data processing
- Internal control requirements to ensure conflicts of interest are minimized
- Reporting

It is the responsibility of the home Member State competent authority to ensure compliance with these matters.

ESMA clarified in its *Questions and Answers on the Application of the UCITS Directive*, that when a UCITS management company or an AIFM provides investment services through a branch established in a host Member State, the supervisory powers in relation to such branches are shared between the home and host country competent authorities. The host Member State competent authority is responsible for the supervision of the branch's compliance with rules of conduct and the home Member State competent authority for the other requirements.

When the management company manages UCITS cross-border, the host Member State competent authority (i.e., the UCITS home Member State competent authority) must approve the choice of management company. Management companies must ensure that each host Member States' requirements regarding the constitution and functioning of the UCITS are met, as well as the specific requirements of the UCITS' fund rules or instruments of incorporation, prospectuses, and offering documents. The activities on the constitution and functioning of a UCITS include:

- Set up and authorization
- Issuance and redemption of shares or units
- Investment policies and limits, including the calculation of the global risk exposure and leverage
- Borrowing, lending, and short selling restrictions
- Valuation of assets and accounting
- Calculation of the issue and redemption price, the NAV computation errors, and related investor compensation
- Distribution and reinvestment of income
- Disclosure and reporting requirements of the UCITS, including the prospectus, KII, and periodic reports
- Marketing arrangements
- Relationship with shareholders or unitholders
- Merging and restructuring of the UCITS
- Dissolution and liquidation of the UCITS
- Content of the shareholder or unitholder register, when applicable
- Authorization and supervision fees of the UCITS
- Exercise of the shareholders' voting rights

In addition, the UCITS home Member State competent authority must approve the fund rules or instruments of incorporation and the choice of depositary. The depositary must either have its registered office or be established in the UCITS home Member State.

The management company and depositary must enter into a written agreement on the flow of information between them to enable the depositary to carry out its duties. The minimum content of the agreement is covered in Section 6.3.5.1.

When delegating activities or functions to a third party, the management company must perform due diligence to establish whether the third party is qualified and capable of undertaking the activity or function in question. The delegation is subject to the requirements of the home Member State of the management company. The management company must verify that the third party fulfills all the organizational and conflicts of interest requirements related to the delegated activity or function, and monitor its compliance with these requirements. Such delegation does not affect the management company's liability with respect to the activity delegated by the management company (see also Section 6.3.3.).

The management company must implement procedures and arrangements to enable the host Member State to monitor the UCITS' compliance with the rules under the responsibility of the host Member State. The depositary must make available to the UCITS home Member State competent authority, on request, all the information, obtained during the exercise of its duties, that is necessary for the authority to perform its supervisory duties in relation to the UCITS.

6.3.4.4. Third countries

A. Introduction

Further situations that are relevant from a cross-border management perspective include EEA AIFM managing non-EEA AIF and non-EEA AIFM managing EEA AIF and non-EEA AIFM marketing EEA and non-EEA AIF.

The extension of the “passport” regimes to non-EEA AIF and non-EEA AIFM is dependent on ESMA issuing a positive opinion on the functioning of the passport for EU AIFM marketing EU AIF and the European Commission adopting the required delegated act in light of ESMA’s advice.

In July 2016, ESMA advised that according to its second round of assessments Canada, Guernsey, Jersey, Japan, and Switzerland may be allowed to distribute alternative funds across the EU. To date, no third country passports have been attributed.

Marketing of AIF is covered in Chapter 12.

B. EEA AIFM managing non-EEA AIF

In summary, the provisions of the AIFM Directive apply to AIFM in relation to the management of non-EU AIF.

EEA AIFM may manage non-EEA AIF that are not marketed in the EEA if the following conditions are fulfilled:

- ▶ The EEA AIFM complies with all of the relevant requirements of the AIFMD except the requirements on depositary (see Chapter 9) and annual report (see Section 10.5.2.) in respect of those AIF
- ▶ There must be appropriate cooperation arrangements between the EEA AIFM home Member State competent authority and the supervisory authority of the non-EEA AIF third country, to ensure at least an efficient exchange of information (see Section 6.3.4.4.C.)

C. Non-EEA AIFM managing EEA AIF

Non-EEA AIFM may continue to manage EEA AIF, subject to national requirements, until the implementation of the management and product “passports” for non-EU AIFM.

Following introduction of the passports for non-EEA AIFM, a non-EEA AIFM wishing to benefit from the passport will have to comply with the requirements of the AIFM Directive and receive prior authorization from the competent authority of an EEA “Member State of reference” if it intends to:

- ▶ Manage EEA AIF (following the phasing in of the passport for non-EEA AIFM). Authorized non-EEA AIFM may manage AIF in their Member State of reference once they are authorized in that Member State. They may also manage AIF in EEA Member States other than their Member State of reference. The procedures to be followed are similar to those applicable to EEA AIFM intending to manage an AIF established in another Member State
- ▶ Market with a passport the EEA and/or non-EEA AIF they manage in the EEA (once the passport has been phased in for non-EEA AIFM – see Section 12.5.3.)

To obtain such authorization in an “EEA Member State of reference”, the AIFM must comply with the requirements of the AIFM Directive or equivalent rules.

The “Member State of reference” is determined in accordance with a complex series of rules. In summary, it is generally the Member State where the applicant AIFM carries out most management or marketing. The non-EEA AIFM cannot select its “Member State of reference”.

The following conditions must also be met:

- ▶ The non-EEA AIFM must appoint a legal representative in the Member State of reference, which will, alongside the AIFM itself, have the role of a contact person for investors and EEA authorities. The legal representative must also jointly perform with the AIFM the compliance functions relating to the management and marketing activities of the AIFM under the AIFM Directive
- ▶ There must be appropriate cooperation arrangements between the Member State of reference competent authority, EEA AIF competent authority (if relevant), and the non-EEA AIFM supervisory authority at least for efficient exchange of information (see Section 12.5.3.)
- ▶ The non-EEA AIFM country must not be listed as a non-cooperative country and territory (NCCT) by the Financial Action Task Force (FATF)¹⁶¹

¹⁶¹ An intergovernmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

- The non-EEA AIFM country must have signed an Organisation for Economic Co-operation and Development (OECD) Model Article 26 compliant tax convention¹⁶² with the AIFM Member State of reference and any other Member State in which the non-EU AIF will be marketed
- The effective exercise by the competent authority of its supervisory functions must neither be prevented by laws, regulations, or administrative provisions of the third country governing the AIFM nor by limits on the supervisory and investigatory powers of the third-country regulator

6.3.5. Appointment of third parties

6.3.5.1. Depositary appointment

For each Luxembourg UCI, a depositary must be appointed. Furthermore, an AIFM is required to ensure that, for each AIF it manages, a single depositary is appointed.

The UCITS management company or the investment company shall have in place a decision-making process for choosing and appointing the depositary, which shall be based on objective pre-defined criteria and meet the sole interest of the UCITS/AIF and the investors of the UCITS/AIF.

When the management company or the investment company appoints a depositary to which it has a link or a group link, it shall keep documentary evidence of the following:

- An assessment comparing the merits of appointing a depositary with a link or a group link with the merits of appointing a depositary which has no link or no group link with the management company or the investment company, taking into account at least the costs, the expertise, financial standing, and the quality of services provided by all depositaries assessed
- A report, based on the assessment referred to above, describing the way in which the appointment meets the objective pre-defined criteria and is made in the sole interest of the UCITS/AIF and the investors of the UCITS/AIF

The management company or the investment company shall demonstrate to the competent authority of the UCITS/AIF home Member State that it is satisfied with the appointment of the depositary and that the appointment is in the sole interest of the UCITS/AIF and the investors of the UCITS/AIF. The management company or the investment company shall make the documentary evidence available to the competent authority of the UCITS/AIF home Member State.

The management company or the investment company shall justify to investors, upon request, the choice of the depositary.

The depositary shall have in place a decision-making process for choosing third parties to whom it may delegate the safekeeping functions in accordance with Article 22a of Directive 2009/65/EC or Article 19 (11) of the Law of 12 July 2013, which shall be based on objective pre-defined criteria and meet the sole interest of the UCITS/AIF and the investors of the UCITS/AIF.

The required qualifications and role of the depositary are outlined in Chapter 9.

The appointment of the depositary should be evidenced by a written contract. The minimum content of the written agreement/contract between the depositary and the management entity and/or the UCI (UCITS or AIF) is laid down in the delegated acts of the AIFM Directive and the UCITS V Directive. CSSF Circular 16/644 and CSSF Circular 18/697 are largely aligned with UCITS Directive/AIFMD delegated acts as regards to the minimum content of the contract for the appointment of a UCITS/AIF depositary.

¹⁶² Article 26 of the OECD Model Tax Convention creates an obligation to exchange information that is foreseeably relevant to the correct application of a tax convention as well as for purposes of the administration and enforcement of domestic tax laws of the contracting states.

The contract has to cover at least the following elements:

Summary of particulars of the depositary agreement

	UCITS	Full AIFM regime AIF
Safekeeping and oversight duties	<p>Description of the services to be provided by the depositary and the procedures to be adopted for each type of asset in which the UCI may invest and which are entrusted to the depositary</p> <p>Description of the way in which the safekeeping and oversight functions are to be performed depending on the types of assets and the geographical regions in which the UCI plans to invest. With respect to the custody duties this description shall include country lists and procedures for adding or, as the case may be, withdrawing countries from that list. This shall be consistent with the information provided in the UCI rules, instruments of incorporation, and offering documents regarding the assets in which the UCI may invest</p>	
Information to be provided by the depositary to the management entity	<p>Description of the means and procedures by which the depositary provides to the IFM or the UCI all relevant information that it needs to perform its duties, including the exercise of any rights attached to assets, and in order to allow the IFM and the UCI to have a timely and accurate overview of the accounts of the UCI</p>	
Information to be provided to the depositary	<p>The means and procedures by which the IFM or the UCI provides all relevant information or ensures the depositary has access to all the information it needs to fulfill its duties, including the procedures ensuring that the depositary will receive information from other parties appointed by the UCI or the IFM</p>	
Information on cash accounts	<p>Information on all cash accounts opened in the name of the UCI or in the name of the IFM acting on behalf of the UCI and the procedures ensuring that the depositary will be informed when any new account is opened</p>	
Subscriptions and redemptions	<p>All necessary information that needs to be exchanged between the UCI or the IFM, or a third party acting on behalf of the UCI, on the one hand, and the depositary, on the other hand, related to the sale, subscription, redemption, issue, cancellation, and re-purchase of units of the UCI</p>	
Prevention of ML/FT (see Section 8.7.4.)	<p>Tasks and responsibilities of the parties regarding obligations on the prevention of money laundering and the financing of terrorism</p>	
Modification of UCI documentation	<p>The procedures to be followed when an amendment to the constitutional document or offering documents is being considered, detailing the situations in which the depositary has to be informed, when the depositary should be informed, and when the depositary's prior agreement is necessary</p>	
Depositary monitoring of management entity	<p>The procedures ensuring that the depositary, regarding its duties, has the ability to enquire into the conduct of the IFM and, as the case may be, the UCI, and to assess the quality of information provided, including having access to the books of the UCI and/or the IFM or on-site visits</p>	
Management entity monitoring of depositary	<p>The procedures ensuring that the IFM and/or the UCI can review the performance of the depositary regarding its contractual obligations</p>	
Depositary escalation procedures	<p>Details regarding the depositary's escalation procedures, including the identification of the persons to be contacted within the UCI and/or the IFM when the depositary launches such a procedure</p>	
Segregation by sub-custodian issue notification	<p>A commitment by the depositary to notify the IFM when it becomes aware that the segregation of assets is not adequate to ensure protection from insolvency of sub-custodian</p>	
Appointment of third parties by either party (management entity or depositary)	<p>Commitment to provide, on a regular basis, details of any third party appointed and, upon request, information on the criteria used to select the third party and the steps to monitor the activities carried out by the selected third party</p>	

	UCITS	Full AIFM regime AIF
Right of pledge	Where the depositary benefits from a general or specific right of pledge over the deposited assets of UCI, the exceptions to such rights and the extent of the depositary's right to use the pledged assets must be specified. The parties may agree on a set-off clause at the level of the UCI (or, where relevant, the compartment).	
Asset re-use	Not permitted	Information on whether or not the depositary or a third party to whom safekeeping functions are delegated may re-use the assets it has been entrusted with and, if any, the conditions attached to any such re-use
Liability in case of delegation of custody	A statement that a depositary's liability is not affected by any delegation of its custody functions	A statement that the depositary's liability is not affected by any delegation of its custody functions, unless the depositary has discharged itself of its liability in accordance with the relevant requirements. In case of discharge of liability, the contract must expressly permit the discharge of the depositary's liability and establish the objective reason to contract such a discharge
Confidentiality	Confidentiality obligations applicable to the parties, which must not impair the ability to have access to relevant documents and information	
Amendments and termination of the agreement	Period of validity, conditions under which the contract may be amended or terminated, and transition arrangements in case of change of depositary	
Applicable law	The law of the UCITS home Member State	Applicable law must be specified
Scope of agreement	List of all UCIs covered by the agreement	

The details to the elements of the depositary contract described above may be included in a subsequent amendment to the contract such as a service level agreement or other separate written agreement.

In addition to meeting the requirements laid down in the depositary contract, the management entity is required, *inter alia*, to:

- Ensure that all instructions and relevant information related to the UCI's assets and operations are sent to the depositary (see Section 9.4.5.1.)
- Provide the depositary, upon commencement of its duties and on an on-going basis, with all relevant information it needs in order to perform the oversight duties including information to be provided to the depositary by third parties
- Provide the depositary with all information relating to any reservations on the UCI's financial statements expressed by the auditor

6.3.5.2. Prime brokers and counterparties

AIFM must exercise due skill, care, and diligence in the selection of prime brokers and counterparties before appointing them and, thereafter, on an ongoing basis, taking into account the full range and quality of their services. When selecting prime brokers or counterparties of an AIFM or an AIF in an over-the-counter (OTC) derivatives transaction, securities lending, or repurchase agreement, AIFM must ensure that those prime brokers and counterparties:

- Are subject to ongoing supervision by a public authority
- Are financially sound, taking into account the applicable prudential regulation, including capital requirements and effective supervision
- Have the necessary organizational structure and resources to perform the services to be provided by them to the AIFM or the AIF

The list of selected prime brokers must be approved by the AIFM's senior management.

When an AIFM uses a prime broker, the arrangement must be set out in a written contract, which must cover the terms under which the prime broker may transfer and re-use AIF assets. The contract must also provide that the depositary, if separate from the prime broker, be informed of the contract.

In its application for authorization, the AIFM is required to provide details of the workflows of the processes and interactions between the prime broker, the AIFM, and other related parties.

AIFM must ensure that from the date of the appointment of a prime broker there is an agreement that requires the prime broker to make available to the depositary daily statements providing detailed information on the assets of the AIF. The AIFM must also ensure that the depositary has a right of refusal with respect to the selection and appointment of a prime broker by the AIF or its IFM where the prime broker is required, in the performance of its duties, to hold in custody assets owned by the AIF. The relationship between the prime broker and the depositary is covered in Section 9.8.

Information that must be disclosed to investors before they invest is covered in Section 10.3.3.

6.4. Operating a management entity

6.4.1. Conflicts of interest

A. Introduction

Management entities should take all reasonable steps to identify, prevent, manage, and monitor conflicts of interest in order to prevent them from adversely affecting the interests of the UCIs and their investors. When the arrangements made by the management entity to identify, prevent, manage, and monitor conflicts of interest are not adequate to ensure, with reasonable confidence, that risks of damage to investors' interests will be prevented, the management entity must disclose the general nature or sources of conflicts of interest to the investors.

Specific conflicts of interest requirements apply to SIFs (see Section 2.4.2.3.).

B. Applicable general rules

The wording of the general requirements on conflicts of interest differs between UCITS management companies and AIFM:

General requirements on conflicts of interest applicable to management entities

Chapter 15 management	AIFM
A UCITS management company is required to try to avoid conflicts of interest and, when they cannot be avoided, to ensure that the UCITS it manages are fairly treated.	An AIFM is required to take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, to identify, manage and monitor and, when applicable, disclose those conflicts of interest in order to prevent them from adversely affecting the interests of the AIF and their investors and to ensure that the AIF they manage are fairly treated.
A UCITS management company is structured and organized in such a way as to minimize the risk of UCITS' or clients' interests being prejudiced by conflicts of interest between the management company and its clients, between two of its clients, between one of its clients and a UCITS or between two UCITS.	AIFM are required to maintain and operate effective organizational and administrative arrangements that take all reasonable steps designed to identify, prevent, manage, and monitor conflicts of interest in order to prevent them from adversely affecting the interests of the AIF and their investors.
	AIFM are required to segregate, within their own operating environment, tasks and responsibilities that may be regarded as incompatible with each other or that may potentially generate systematic conflicts of interest. AIFM must assess whether their operating conditions may involve any other material conflicts of interest and disclose them to the investors of the AIF.
	When organizational arrangements to identify, prevent, manage, and monitor conflicts of interest are not adequate to ensure, with reasonable confidence, that risks of damage to investors' interests will be prevented, the AIFM must clearly disclose the general nature or sources of conflicts of interest to the investors before undertaking business on their behalf, and develop appropriate policies and procedures.

Chapter 16 management companies are required to submit a description of how they manage potential conflicts of interest in their application for authorization.

C. Types of conflicts of interest

For the purpose of identifying the types of conflicts of interest that arise in the course of their business, UCITS management companies and AIFM must take into account, in particular, whether the management entity, a relevant person, or a person directly or indirectly linked by way of control, in any of the following situations:

- ▶ Is likely to make a financial gain or avoid a financial loss at the expense of the UCI or its investors
- ▶ Has an interest in the outcome of a service or an activity provided to the UCI or its investors or to a client or of a transaction carried out on behalf of the UCI or a client, which is distinct from the UCI's interest in that outcome
- ▶ Has a financial or other incentive to favor the interest of a UCITS, a client or group of clients, or another UCI over the interest of the UCI or, in the case of AIFM, the interest of one investor over the interest of another investor or group of investors in the same AIF
- ▶ Carries out the same activities for the UCI and for another UCI or other client
- ▶ Receives or will receive from a person other than the UCI or its investors an inducement in relation to collective portfolio management activities provided to the UCI, in the form of monies, goods, or services other than the standard commission or fee for that service (see also Section 6.4.2.C.)

Conflicts of interest identification requirements applicable to management entities

Chapter 15 management	AIFM
<p>UCITS management companies, when identifying the types of conflicts of interest, must take into account the following:</p> <ul style="list-style-type: none"> ▶ The interests of the management company, including, if relevant, those deriving from its belonging to a group or from its services and activities and those of other group members ▶ The interests of investors ▶ The duties of the management company towards the UCITS ▶ The interests of two or more UCITS its manages 	<p>An AIFM is required to take all reasonable steps to identify conflicts of interest that arise in the course of managing AIF between:</p> <ul style="list-style-type: none"> ▶ The AIFM, including its managers, employees, or any person directly or indirectly linked to the AIFM by control, and the AIF managed by the AIFM or the investors in that AIF ▶ The AIF or the investors in that AIF and another AIF or the investors in that AIF ▶ The AIF or the investors in that AIF and another client of the AIFM ▶ The AIF or the investors in that AIF and any UCITS it manages (when the AIFM has also been authorized as a UCITS management company) or the investors in any such UCITS ▶ Two clients of the AIFM

Potential conflicts of interest may exist between, for example:

- ▶ Risk management and operations: the functional and hierarchical separation of the functions of risk management and the operating units, including portfolio management, is covered in Chapter 7. The functional and hierarchical separation requirements for AIFM are set out in more detail in Section 7.3.5.
- ▶ Internal audit function and risk management function: the roles of internal control functions are covered in Section 6.3.2.1. The role of the internal audit function of an AIFM in reviewing the performance of the risk management function is covered in Section 7.3.5.
- ▶ Internal audit function and compliance function: the roles of internal control functions are covered in Section 6.3.2.1.
- ▶ Valuation and portfolio management: the functional independence of the valuation function from the portfolio management function is covered in Section 7.6.
- ▶ Depositary and portfolio management or risk management functions: requirements to be met in case of delegation of portfolio management or risk management to an entity that is part of the group of the depositary or part of the group of a delegate of the depositary is covered in Section 7.2.2.

Potential conflicts of interest may also arise when:

- ▶ The parent company, another group company, or a related party is appointed as portfolio manager, investment adviser, or service provider
- ▶ Related parties play an influential role within the management entity, for example when a service provider represented in the Board or an investment adviser represented in the portfolio management function or the Board
- ▶ The UCI challenges the portfolio management decisions of the management entity or portfolio manager
- ▶ A deal could be allocated to several UCIs
- ▶ In the interests of investors and in accordance with the relevant UCI's valuation rules, an asset held by two different UCIs managed by the same management entity may be valued differently (see also Section 7.6.)
- ▶ Different decisions need to be taken for different UCIs, in order to act in the best interests of each, for example, in the exercise of voting rights attached to the assets of the AIF or in exiting the investment
- ▶ The interests of investors subscribing shares or units *versus* those of existing shareholders or unitholders or those of shareholders or unitholders redeeming shares or units *versus* those remaining in the UCI diverge

Delegates may be subject to conflicts of interest requirements, as described in Section 6.3.3. Transparency requirements on conflicts of interest that may arise from delegation are covered in Chapter 10.

D. Conflicts of interest policy

Management companies and AIFM must establish, implement, and apply an effective conflicts of interest policy. The policy must be set out in writing and be appropriate to the size and organization of the management entity and the nature, scale, and complexity of its business.

When the management entity is a member of a group, the policy must also take into account any circumstances that may give rise to a conflict of interest resulting from the structure and business activities of other members of the group.

The conflicts of interest policy must cover the following:

- ▶ With reference to the activities carried out by or on behalf of the management entity, identification of the circumstances that constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of the UCI or its investors or one or more other clients
- ▶ Procedures to be followed and measures to be adopted in order to prevent, manage, and monitor such conflicts

The CSSF can request a copy of these written procedures at any time.

E. Procedures and measures preventing or managing conflicts of interest

The procedures and measures established for the prevention or management of conflicts of interest must ensure that the relevant persons engaged in different business activities involving a risk of conflict of interest carry out these activities having a degree of independence that is appropriate to the size and activities of the UCITS management company or AIFM and of the group to which it belongs and to the materiality of the risk of damage to the interests of the UCI, its investors, or other clients.

F. Monitoring conflicts of interest

The UCITS management company or AIFM must keep and regularly update a record of the types of activities undertaken by or on behalf of the management entity in which a conflict of interest entailing a material risk of damage to the interests of one or more UCIs or its investors has arisen or, in the case of an ongoing activity, may arise.

The conflict of interest register must include at least a description of the conflict of interest, the person or unit concerned, the date it was discovered, the potential or actual impacts, the solutions or measures envisaged and, where applicable, the procedures for informing investors.

In the case of AIFM, senior management must receive on a frequent basis, and at least annually, written reports on such activities.

The IFM must transmit a copy of the register to the CSSF upon request.

G. Managing conflicts of interest

When the organizational or administrative arrangements made by the UCITS management company or AIFM are not adequate to ensure, with reasonable confidence, that risks of damage to the interests of the UCI or investors in the UCI are prevented, senior management or other competent internal body of the management entity must be promptly informed in order to take any necessary decision or action to ensure that the management entity acts in the best interests of the UCIs or its investors.

H. Disclosure of conflicts of interest

Management entities are required to disclose to investors information on conflicts of interest that cannot, with reasonable confidence, be prevented (see Section 10.4.).

I. Investor liquidity

An AIFM that manages open-ended AIF must identify, manage, and monitor conflicts of interest arising between investors wishing to redeem their investments and investors wishing to maintain their investments in the AIF and any conflicts between the AIFM's incentive to invest in illiquid assets and the AIF's redemption policy.

J. Voting rights

UCITS management companies and AIFM must develop measures and procedures to prevent or manage conflicts of interest arising from the exercise of voting rights linked to instruments held in the portfolio.

6.4.2. Rules of conduct

A. General rules

Chapter 15 management companies and AIFM must at all times comply with similar rules of conduct.

General rules of conduct applicable to management entities

Chapter 15 management	AIFM
<ul style="list-style-type: none">▶ Act honestly and fairly in conducting its business activities in the best interests of the UCITS it manages and the integrity of the market▶ Act with due skill, care, and diligence, in the best interests of the UCITS it manages and the integrity of the market▶ Have and employ effectively the resources and procedures that are necessary for the proper performance of its business activities▶ Try to avoid conflicts of interests and, when they cannot be avoided, ensure that the UCITS it manages are fairly treated▶ Comply with all regulatory requirements applicable to the conduct of its business activities to promote the best interests of its investors and the integrity of the market	<ul style="list-style-type: none">▶ Act honestly, fairly, and with due skill, care, and diligence in conducting their activities▶ Act in the best interests of the AIF or the investors of the AIF they manage and the integrity of the market▶ Have and employ effectively the resources and procedures that are necessary for the proper performance of their business activities▶ Take all reasonable steps to avoid conflicts of interest and, when they cannot be avoided, identify, manage and monitor and, when applicable, disclose those conflicts of interest in order to prevent them from adversely affecting the interests of the AIF and their investors and to ensure that the AIF they manage are fairly treated▶ Comply with all regulatory requirements applicable to the conduct of their business activities to promote the best interests of the AIF or the investors of the AIF they manage and the integrity of the market▶ Treat all AIF investors fairly

B. Acting in the best interests of the UCI and its investors

All actions undertaken by the management entities should be directed towards acting in the best interests of the UCI and its investors. The rules of conduct envisage the interests of the investors in their specific capacity as investors of the UCI, and not their individual interest. Investors' interests comprise, but are not limited to, their pecuniary interest.

The following table outlines the main requirements:

	Chapter 15 management company	AIFM
Treating investors fairly	Management companies must ensure that shareholders or unitholders of managed UCITS are treated fairly. Management companies cannot place the interests of any group of shareholders or unitholders above the interests of any other group of shareholders or unitholders.	AIFM must treat all AIF investors fairly. A description of how the AIFM ensures fair treatment of investors must be provided to them before they invest. Any preferential treatment accorded by an AIFM to one or more investors ¹⁶³ must not result in an overall material disadvantage to the other investors. When investors obtain preferential treatment, this must be disclosed in the relevant AIF's constitutional document. Whenever an investor obtains preferential treatment or the right to obtain preferential treatment, the AIFM must provide to investors before they invest a description of that preferential treatment, the type of investors who obtain such preferential treatment, as well as, when relevant, their legal or economic links with the AIF or AIFM.
Market malpractices	Management entities must apply appropriate policies and procedures for preventing malpractices that might reasonably be expected to affect the stability and integrity of the market.	
Valuation (see also Section 7.6.)	Without prejudice to any other provisions of Luxembourg law, IFMs are required to ensure that fair, correct, and transparent pricing models and valuation systems are used for the UCIs they manage, in order to comply with the duty to act in the best interests of the shareholders or unitholders. IFMs must be able to demonstrate that the UCIs' portfolios have been accurately valued.	
Costs	Management entities must ensure that the UCIs they manage and their investors are not charged undue costs.	

C. Fees and inducements

Management companies and AIFM will not be regarded as acting fairly, honestly, and professionally in the best interests of the UCIs they manage and their investors if, in relation to the management of UCIs¹⁶⁴, they pay, or are paid, any fee or commission, or provide or are provided with any non-monetary benefit other than:

- ▶ A fee, commission, or non-monetary benefit paid or provided to or by the UCI or a person on behalf of the UCI
- ▶ A fee, commission, or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party when:
 - ▶ The existence, nature, and amount of the fee, commission, or non-monetary benefit is clearly disclosed to the investors in the UCI in a comprehensive, accurate, and understandable manner prior to provision of the relevant service. The management entity is permitted to disclose the essential terms when it undertakes to disclose further details at the request of the investor, and fulfills that commitment
 - ▶ The payment of the fee or commission, or provision of the non-monetary benefit, is designed to enhance the quality of the service and not impair compliance with the management entity's duty to act in the best interests of the UCI or the investors in the UCI
- ▶ Proper fees that enable or are necessary for the provision of the relevant service (such as custody costs, settlement and exchange fees, regulatory levies, or legal fees) and that by their nature do not give rise to conflicts with the management entity's duties to act honestly, fairly, and in the best interests of the UCI it manages or the investors in the UCI

¹⁶³ Such as side letters.

¹⁶⁴ The inducements provisions applicable to UCITS management companies specifically cover the activities of investment management and administration, whereas inducements provisions applicable to AIFM cover all management activities (i.e., including marketing). See also Section 6.1.2.

In practice, any new monetary or non-monetary benefit paid or received by the management company (or its outsourced service providers) should be identified, and classified as proper fees or inducements. Management entities should determine whether benefits identified as inducements comply with these criteria and terminate non-compliant agreements. Such classification and assessment should be adequately documented.

See also Sections 6.3.3., 6.4.1. and 6.4.3.

D. Portfolio management

UCITS management companies and AIFM are required to comply with rules of conduct related to their portfolio management activities including in:

- ▶ Investment due diligence in the selection and ongoing monitoring of investments
- ▶ Adequate knowledge and understanding of the assets in which the UCIs are invested
- ▶ Investment decisions carried out in compliance with the objectives, investment strategy and risk limits of the UCIS
- ▶ Best execution of decisions to deal on behalf of the UCIs:
 - ▶ Placing of orders: acting in the best interest of the UCI when placing orders to deal on behalf of the UCI with other entities for execution
 - ▶ Handling of orders: ensuring prompt, fair, and expeditious execution of portfolio transactions on behalf of the UCI

Where AIFMs invest in assets of limited liquidity and where such investment is preceded by a negotiation phase, they are required to:

- ▶ Set out and regularly update a business plan consistent with the duration of the AIF and market conditions
- ▶ Seek and select possible transactions consistent with that business plan
- ▶ Assess the selected transactions in consideration of opportunities, if any, and overall related risks, all relevant legal, tax-related, financial or other value affecting factors, human and material resources, and strategies, including exit strategies
- ▶ Perform due diligence activities related to the transactions prior to arranging execution
- ▶ Monitor the performance of the AIF with respect to the business plan

AIFMs must retain records pursuant to these activities for at least five years.

E. Subscriptions and redemptions

UCITS management companies and AIFM are required to comply with reporting and recordkeeping requirements regarding execution of subscription and redemption orders (see Section 8.7.3.).

F. Personal transactions

UCITS management companies and AIFM are required to establish, implement, and maintain adequate arrangements designed to prevent any relevant person from:

- ▶ Entering into a personal transaction that is prohibited by the Market Abuse Directive or the Market Abuse Law and/or implies the misuse or improper disclosure of confidential information
- ▶ Outside the normal scope of its employment, advising any person to enter into a transaction that would constitute misuse of information relating to pending orders
- ▶ Outside the normal scope of its employment, disclosing to any person information or opinion that may lead any person to enter into a transaction that fulfills these conditions

Any relevant person must be aware of the restrictions on personal transactions and the measures established by the management entity in connection with personal transactions and disclosure.

The management company must be informed promptly of any personal transaction entered into by a relevant person (by means of notification or by other measures) and the transaction must be recorded, including any authorization or prohibition of the transaction.

Exemptions are granted for:

- Personal transactions carried out in the context of discretionary portfolio management, if there is no prior communication between the relevant person and the manager
- Personal transactions on UCITS and other European regulated funds, if the relevant person is not involved in their management

See also Section 6.4.1.

IFMs must have written procedures regarding personal transactions. The procedures must enable the IFM to ensure that a delegate carrying on activities on behalf of the IFM maintains a record of the personal transactions of any persons concerned. A list of all personal transactions notified to or identified by the IFM must be available at its head office in Luxembourg and provided to the CSSF upon request.

6.4.3. Remuneration policy

The key regulations on remuneration that may be applicable in the context of Luxembourg management companies, AIFM, and investment companies are summarized in the following table:

Key remuneration regulations

	CSSF Circular	AIFM	UCITS Management companies
Title	<i>CSSF Circular 10/437 (as amended) re Guidelines concerning the remuneration policies in the financial sector¹⁶⁵</i>	<i>AIFM Law</i> <i>ESMA's Guidelines on sound remuneration policies under the UCITS Directive and AIFMD (2016/411)</i> <i>ESMA Guidelines on sound remuneration policies under AIFMD (2016/579)</i> <i>ESMA Q&A on the application of AIFMD</i>	<i>2010 Law as amended by the law of 10 May 2016, transposing the UCITS V Directive</i> <i>ESMA's Guidelines on sound remuneration policies under the UCITS Directive and AIFMD (2016/411)</i> <i>ESMA Guidelines on sound remuneration policies under the UCITS Directive (2016/575)</i> <i>ESMA Q&A on application of the UCITS Directive</i>
Entities in scope	All entities under the supervision of the CSSF ("financial undertakings"), including management entities and, in some cases, investment companies	AIFM and internally managed AIF	Management companies and investment companies that have not designated a management company authorized pursuant to the UCITS Directive

¹⁶⁵ The Circular implements European Commission Recommendation 2009/384/EC on remuneration policies in the financial services sector.

The following table outlines the main requirements of the CSSF Circular, and the AIFM and UCITS management company provisions which are very similar.

	Circular 10/437	Key AIFM and UCITS provisions
Key principles	<p>The Circular requires financial undertakings to establish, implement, and maintain a remuneration policy that is consistent with and promotes sound and effective risk management and does not induce excessive risk-taking. The policy must be in line with the business strategy, objectives, values, and long-term interests of the financial undertaking and be consistent with the principles relating to the protection of clients and investors when providing services.</p>	<p>IFM is required to have remuneration policies that:</p> <ul style="list-style-type: none"> ▶ Are consistent with and promote sound and effective risk management ▶ Do not encourage risk-taking which is inconsistent with the risk profiles, rules, or instruments of incorporation, or constitutional documents of the UCI it manage ▶ Are in line with the business strategy, objectives, values, and interests of the UCIs that they manage and of the investors in such UCI and includes measures to avoid conflicts of interest
Staff in scope	<p>The Circular applies to the remuneration of members of the Board and management bodies of financial undertakings, as well as those categories of staff whose professional activities have a material impact on the risk profile of the financial undertaking. However, when the remuneration of these individuals is fixed, the financial undertaking is exempted from applying the Circular.</p>	<p>IFM's remuneration policies and practices must cover those categories of staff whose professional activities have a material impact on the risk profiles of the IFM or of the UCI it manages including:</p> <ul style="list-style-type: none"> ▶ Executive and non-executive members of the governing body of the IFM, such as Directors, the chief executive officer, and executive and non-executive partners ▶ Senior management ▶ Staff responsible for heading the investment management, administration, marketing, and human resources ▶ Control functions ▶ Other risk takers, such as staff whose professional activities, either individually or collectively, can exert material influence on the IFM's risk profile or on a UCI it manages, including persons capable of entering into contracts/positions and taking decisions that materially affect the risk positions of the IFM or the UCI it manages - for example, sales persons, traders, and trading desks personnel ▶ Any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers whose activities have a material impact on the risk profile of the IFM or the UCI it manages <p>IFM should define what constitutes materiality within the context of the IFM or the UCI it manages, including an analysis of the impact on the IFM's results and/or balance sheet and/or performance of the UCI and job functions and responsibilities.</p>

	Circular 10/437	Key AIFM and UCITS provisions
Applicability to delegates	<p>The Circular is applicable to entities under the supervision of the CSSF. It does not apply to fees and commissions received by intermediaries and external service providers in case of outsourced activities¹⁶⁶.</p>	<p>The provisions apply to categories of staff of the entity or entities to which investment management activities have been delegated by the IFM, whose professional activities have a material impact on the risk profiles of the UCI that the IFM manage.</p> <p>When delegating investment management activities (including risk management), IFM should ensure that either of the following criteria are met:</p> <ul style="list-style-type: none"> ▶ The entities to which portfolio management or risk management activities have been delegated are subject to regulatory requirements on remuneration that are equally as effective as those applicable under ESMA's guidelines ▶ Appropriate contractual arrangements are put in place with entities to which investment management activities have been delegated in order to ensure that there is no circumvention of the remuneration rules set out in the UCITS Directive, AIFM Directive, the AIFM Law, and ESMA's guidelines. These contractual arrangements should cover any payments made to the delegates' identified staff as compensation for the performance of investment management activities on behalf of the IFM

¹⁶⁶ CSSF Circular 10/437 (as amended) is applicable to entities under the supervision of the CSSF. Entities not under the supervision of the CSSF, for example delegates, may be subject to certain remuneration provisions of the UCITS and AIFM Directives: Please refer to *ESMA's Questions and Answers on the application of the UCITS Directive and ESMA's Questions and Answers on the application of the AIFMD*

Key requirements on remuneration

When remuneration includes a variable component or a bonus, the remuneration policy should be structured with an appropriate balance of fixed and variable remuneration components. The remuneration policy must set a maximum limit on the variable component. The fixed component of the remuneration should represent a sufficiently high proportion of the total remuneration allowing the financial undertaking to operate a fully flexible bonus policy.

When a significant bonus is awarded, the major part of the bonus should be deferred with a minimum period of deferral. The deferred element of the bonus should take into account the outstanding risks associated with the performance to which the bonus relates.

When remuneration is performance related, its total amount should be based on a combination of the assessment of the performance of the individual, of the business unit concerned, and of the overall results of the financial undertaking. The assessment of performance should be set in a multi-year framework (e.g., three to five years) in order to ensure that the assessment process is based on longer term performance and that the actual payment of bonuses is spread over the business cycle of the company.

In particular, the financial undertaking should be able to withhold bonuses entirely or partly when performance criteria are not met by the individual concerned, the business unit concerned, or the financial undertaking in its entirety.

IFM are required to comply with a series of principles set out in Annex II of the AIFM Law or Article 14b of the UCITS Directive in a way that is appropriate to their size, internal organization, and the nature, scope, and complexity of their activities. For example:

- ▶ When remuneration is performance related, the total amount of remuneration must be based on a combination of the assessment of the performance of the individual, and of the business unit or UCI concerned, and of the overall results of the IFM. When assessing individual performance, financial as well as non-financial criteria must be taken into account
- ▶ The assessment of performance must be set in a multi-year framework appropriate to the life-cycle of the AIF/to the holding period recommended to the investors of the UCITS managed by the IFM
- ▶ Fixed and variable components of total remuneration must be appropriately balanced and the fixed component must represent a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy, on variable remuneration components, including the possibility to pay no variable remuneration component
- ▶ In general, at least 50% of any variable remuneration must consist of shares or units of the UCI concerned or equivalent non-cash instruments¹⁶⁷
- ▶ At least 40% of the variable remuneration component must be deferred over a period that is appropriate to the life-cycle/holding period recommended to the investors and redemption policy of the UCI concerned and is correctly aligned with the nature of the risks of the UCI in question (generally three to five years for AIF, at least three years for UCITS)
- ▶ Staff engaged in control functions must be compensated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control

Group remuneration policy

ESMA's guidelines apply in any case to any IFM. In particular, there should be no exception to the application to any of the IFMs that are subsidiaries of a credit institution of the sector-specific remuneration principles set out in the AIFMD, the UCITS Directive and in the ESMA guidelines (2016/579).

It may be the case that in a group-context, non-IFM sectorial prudential rules applying to group entities may lead certain staff of the IFM that are part of that group to be "identified staff" for the purpose of those sectorial remuneration rules.

¹⁶⁷ ESMA clarified in the report on UCITS remuneration guidelines that this requirement does not apply where the management of UCITS, in terms of net asset value, accounts for less than 50% of the total portfolio managed by the management company.

Proportionality – general principles

IFM should comply with remuneration principles in a way and to the extent that is appropriate to their size, internal organization, and the nature, scope, and complexity of their activities. Not all IFM will have to comply with the remuneration requirements in the same way and to the same extent. Proportionality should operate both ways: some IFM will need to apply more sophisticated policies or practices in fulfilling the requirements; other IFM may meet the requirements in a simpler way. The IFM has the responsibility to assess its own characteristics and to develop and implement remuneration policies and practices that appropriately align the risks faced and provide adequate and effective incentives to its staff.

Proportionality in respect of the characteristics of the IFM¹⁶⁸

The criteria relevant to the application of the proportionality principle are:

- ▶ Size: the criterion relates to the value of the IFM capital and to the value of the assets of the UCI it manages; liabilities or risk exposures of the IFM and of the UCI managed; the number of staff, branches, or subsidiaries of an IFM. The full remuneration principles apply when the aggregate set of the UCI it manages becomes potentially systemically important (e.g., in terms of total assets under management) or leads to complex investment management activities
- ▶ Internal organization: the assessment should take into consideration the entire organization of the IFM, including the legal structure, the complexity and internal governance structure, all the UCI managed, and the listing on a regulated market of the IFM or UCI it manages
- ▶ Nature, scope, and complexity of the activities: the underlying risk profile of the business activity should be taken into account. Such elements could include the type of authorized activities, the type of investment policies and strategies of the UCI the IFM manages, the cross-border nature of the business activities, and, where applicable, the additional management of UCITS by AIFMs or AIFs by UCITS management companies

¹⁶⁸ On 31 March 2016 ESMA wrote a letter to the European Commission, European Council, and European Parliament on the proportionality principle and remuneration rules in the financial sector (ESMA/2016/412), stating that it would be inappropriate for (i) smaller fund managers, (ii) fund managers with simpler internal organization or nature of activities, or (iii) fund managers whose scope and complexity of activities is more limited to be subject in all circumstances to the requirements on the pay-out process. ESMA also considers that it would be disproportionate to apply the requirements to relatively small amounts of variable remuneration and to apply certain requirements to certain staff when this would not result in an effective alignment of interests between the staff and the investors in the funds. ESMA is of the view that legislative changes in the relevant asset management legislation could be one way to further clarify the applicable regulatory framework and ensure consistent application of the remuneration requirements in the asset management sector.

Disapplication of certain requirements in application of the proportionality principle

For AIFM only:

Proportionality may apply, on an exceptional basis and taking into account specific facts, to the disapplication of some requirements if this is consistent with the risk profile, risk appetite, and the strategy of the AIFM and the AIF it manages. AIFM should be able to explain to competent authorities, if requested, the rationale for each requirement that is disapplied. AIFM should perform an assessment for each of the remuneration requirements to determine whether proportionality allows them not to apply each individual requirement. The following are the only requirements that may be disapplied if it is proportionate to do so:

- Pay-out process - some AIFM, either for the total of their identified staff or for some categories within their identified staff, may not apply the requirements on:
 - Variable remuneration in instruments
 - Retention
 - Deferral
 - *Ex-post* risk adjustment of variable remuneration
- The requirement to establish a remuneration committee

If not applied, the minimum deferral period of three to five years, the minimum portion of 40 to 60% of variable remuneration that should be deferred, and the minimum portion of 50% of variable remuneration that should be paid in instruments must be disapplied in its entirety; it is not possible to apply lower thresholds based on proportionality.

Risk alignment

An IFM's remuneration policy should encourage the alignment of the risks taken by its staff with those of the UCI it manages, the investors of such UCI, and the IFM itself. The general requirements on risk alignment should be applied by the IFM only to the individual remuneration packages of the identified staff, but a voluntary IFM-wide application is strongly recommended.

The key provisions on risk alignment include:

- Fully flexible policy on variable remuneration
 - a fully flexible policy implies not only that the variable remuneration should decrease as a result of negative performance but also that it can go down to zero in some cases.
- Risk alignment of variable remuneration
 - variable remuneration should be performance-based and risk adjusted. The risk alignment process should include performance and risk measurement, award, and payout processes.
 - The remuneration system should start by defining the objectives of the IFM, the unit, as well as the staff and the investment strategy of the UCI concerned. The right to receive the variable remuneration is earned ("awarded") at the end of the accrual period or during the accrual period, which should be at least one year, but may be longer.

When assessing the risk and performance, IFM should take into account both current and future risks that are taken by the staff member, the business unit, the UCI concerned, or the IFM as a whole. The risk alignment process should use a mix of quantitative and qualitative approaches. IFM should take into account all risks, whether on or off balance sheet, differentiating among risks affecting the IFM, the UCI it manages, business units, and individuals. In order to take into account all material risks, IFM should use the same risk measurement methods as those used in the risk management policy established for the UCI managed by the IFM (see Sections 7.2. and 7.3.). IFM should also take into account, if relevant, the risks arising from the management of UCITS by AIFMs or AIFs by UCITS management companies, and, where applicable, from additional services. AIFMs should take into consideration the risk arising from the potential professional liability risks that the AIFM has to cover.

In order to align the actual payment of remuneration to the life-cycle and redemption policy (AIFM) or holding period recommended to the investors (UCITS) of the UCI managed by the IFM and their investment risks, the variable remuneration should partly be paid upfront (short-term) and partly deferred (long-term):

- ▶ The short-term component should be paid directly after the award and should reward staff for performance delivered in the accrual period.
- ▶ The long-term component should be awarded to staff during and after the deferral period. It should reward staff for the sustainability of the performance in the long term, which is the result of decisions taken in the past.
- ▶ Before paying out the deferred portion, a reassessment of the performance and, if necessary, a risk adjustment should be required in order to align variable remuneration to risks and errors in the performance and risk assessments that have appeared since the staff members were awarded their variable remuneration component (*ex-post* risk adjustment).

	Circular 10/437	Key AIFM and UCITS provisions
Governance	<p>Under the Circular, the remuneration policy should include measures to avoid conflicts of interest. The procedures for determining remuneration within the financial undertaking should be clear and documented and should be internally transparent.</p> <p>The Board of Directors is responsible for:</p> <ul style="list-style-type: none"> ▶ Determining the remuneration of the members of the Board of Directors and management bodies of the financial undertaking ▶ Establishing the general principles of the remuneration policy of the financial undertaking and supervising its implementation <p>A remuneration committee may assist the Board of Directors in its duties. The implementation of the remuneration policy should be subject to central and independent internal review, at least annually, by control functions, for compliance with policies and procedures defined by the Board. The report of the internal control review must be sent to the Board of Directors and be available to the CSSF.</p>	<p>The management body of the IFM must adopt and at least yearly (UCITS) or periodically (AIFM) review the general principles of the remuneration policy and is responsible for its implementation. There must be at least annual, central, and independent internal reviews of compliance with remuneration policies and procedures.</p> <p>IFM that are significant in terms of their size or the size of the AIF they manage, their internal organization, and the nature, scope, and complexity of their activities are required to establish a remuneration committee¹⁶⁹. The remuneration committee is responsible for the preparation of decisions regarding remuneration. It is required to directly oversee and provide recommendations in relation to the remuneration of the senior officers in the risk management and compliance functions. The remuneration committee must exercise independent judgment. It must be chaired by, and composed of, non-executive Directors^{170 171}.</p>
Disclosure and internal communication	<p>Relevant information on the remuneration policy, and any updates in case of policy changes, should be disclosed by the financial undertaking in a clear and easily understandable way to relevant stakeholders. Such disclosure may take the form of an independent remuneration policy statement, a periodic disclosure in annual financial statements, or any other form (see Section 10.4.3.).</p>	<p>The annual report of the UCI must disclose (see Sections 10.5.1. and 10.5.2.):</p> <ul style="list-style-type: none"> ▶ The total amount of remuneration for the financial year, split into fixed and variable, paid by the IFM, number of beneficiaries, and, when relevant, carried interest paid by the UCI ▶ The aggregate amount of remuneration broken down by senior management and staff impacting the risk profile of the UCI ▶ A description of the manner in which the remuneration and benefits have been calculated (UCITS only) ▶ Each significant modification to the adopted remuneration policy (UCITS only) <p>The remuneration policy of an IFM should be accessible to all staff members of that AIFM. The staff members should know in advance the criteria that will be used to determine their remuneration. The appraisal process should be properly documented and should be transparent to the member of staff concerned</p>

¹⁶⁹ The following are examples of IFM that may not need to establish a remuneration committee:

- ▶ IFM for which the value of the portfolios of UCIs that they manage does not exceed EUR1.25 billion and not having more than 50 employees, including those dedicated to the management of UCIs and the provision of non-core services other than the management of UCIs
- ▶ IFM that are part of banking, insurance, investment groups, or financial conglomerates within which an entity is obliged to set up a remuneration committee that performs its tasks and duties for the whole group, subject to equivalent governing rules and the existing remuneration committee takes responsibility for checking the compliance of the IFM with the rules set out in ESMA's guidelines.

¹⁷⁰ Directors who are not members of the management body.

¹⁷¹ If the management body of a UCITS management company includes an employee representation, the remuneration committee shall include one or more employee representatives

ESMA clarified in its *Questions and Answers on the application of the UCITS Directive*, that the remuneration-related disclosure requirements under Article 69(3)(a) of the UCITS Directive also apply to the staff of the delegate of a management company to whom portfolio management or risk management activities have been delegated. More precisely, and in line with the approach followed under the UCITS Remuneration Guidelines, management companies can ensure compliance in one of the following two ways:

- ▶ Where the delegate is subject to regulatory requirements on remuneration disclosure for its staff to whom portfolio management (including risk management) activities have been delegated that are equally as effective as those under Article 69(3)(a) of the UCITS Directive, the management company should use the information disclosed by the delegate for the purposes of fulfilling its obligations under Article 69(3)(a) of the UCITS Directive; or
- ▶ In other cases, appropriate contractual arrangements should be put in place with the delegate allowing the management company to receive (and disclose in the annual report for the relevant UCITS that it manages) at least information on the total amount of remuneration for the financial year, split into fixed and variable remuneration, paid by the management company, the investment company and, where relevant the UCITS itself to the identified staff of the delegate - and number of beneficiaries, and, where relevant, performance fee - which is linked to the delegated portfolio. This means that the disclosure should be made on a prorated basis for the part of the UCITS' assets which are managed by the identified staff within the delegate.

Equivalent clarification is included in ESMA's *Questions and Answers on the application of the AIFMD*.

6.4.4. Complaints handling

IFMs are required to establish, implement, and maintain effective and transparent procedures for the reasonable and prompt handling of complaints received from investors.

The IFM must ensure that each complaint and the measures taken for its resolution are recorded.

The IFM must designate among its staff one person responsible for the handling, centralization, and follow-up of complaints. A specific mandate for the handling of complaints can be given to a specialized third party.

The name of the person responsible must be communicated to the CSSF in the application for authorization. The IFM must also communicate a list of third parties authorized to handle complaints.

The IFM is required to submit to the CSSF, within five month following the end of the IFM's financial year, annual information on the investor complaints, the reasons for the complaints, and the status of their handling.

The information regarding complaints handling procedures must be made available to investors free of charge by UCITS management companies¹⁷² who must also communicate a description of the complaint handling procedures to the CSSF in the application for authorization.

On 11 November 2016, the CSSF published Regulation 16-07 relating to *out-of-court complaint resolution* replacing Regulation 13-02. The Regulation specifies the obligations of financial sector entities on the handling of complaints, including:

- ▶ Complaints handling policy, procedure, and responsibility for complaints handling:
 - ▶ The complaints management policy should be defined, endorsed, and implemented by the management of the entity. It should be set out in a document and available to all relevant staff members
 - ▶ The procedure must be efficient and transparent and reflect the need for objectivity and search for truth. It must enable the identification and mitigation of any conflict of interest
 - ▶ The person responsible for the complaints must ensure that every complaint as well as each measure taken is properly registered. It is his responsibility to inform the complainant of the name and contact details of the person in charge of his file
 - ▶ Entities must provide clear, precise, and up-to-date information on the complaints procedure to be followed
 - ▶ Entities must acknowledge receipt of a complaint within 10 working days and provide an answer without undue delay, in any case within one month
- ▶ Communication of information to the CSSF:
 - ▶ The entity must cooperate with the CSSF and provide the CSSF with comprehensive answers to any query that they have

¹⁷² | CSSF recommends also that AIFMs make such procedures available to investors free of charge

- ▶ The person responsible for complaints must communicate to the CSSF on an annual basis indicating the number of complaints registered, sorted by type of complaints, a summary report, and the measures taken to deal with them

The Regulation also covers the rules applicable to the request for the out-of-court resolution of complaints filed with the CSSF. The procedure aims to facilitate the resolution of complaints against professionals without judicial proceedings. The procedure is not a mediation procedure within the meaning of the Luxembourg Mediation Law.

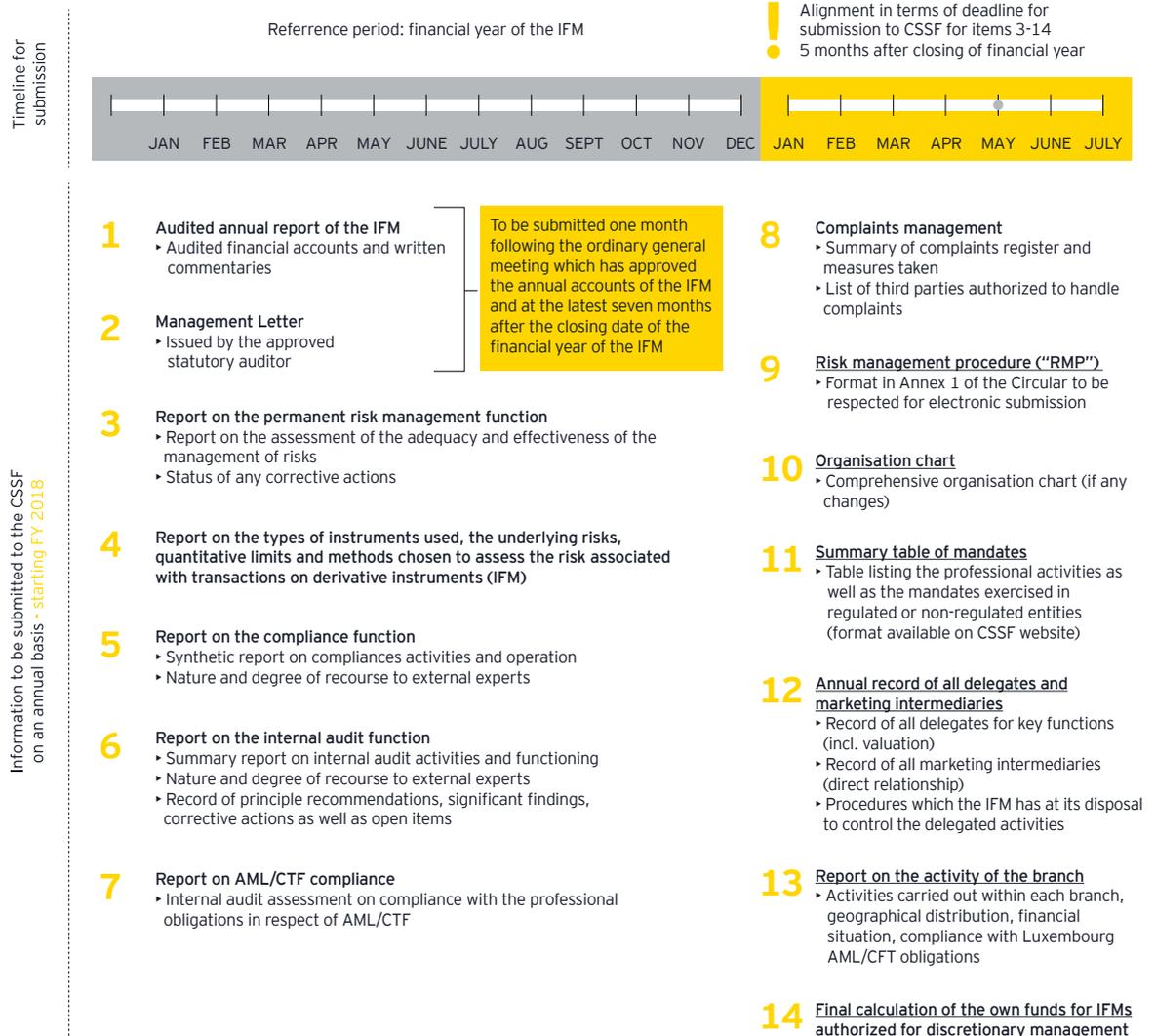
CSSF Circular 17/671 provides specifications regarding CSSF Regulation 16-07 and further develops the content of CSSF Circular 14/589.

6.5. Reporting, expenses and taxation

6.5.1. Regulatory reporting duties and communication with the CSSF

The CSSF Circular 18/698 largely formalizes existing best practices in the market, but also outlines new regulatory and reporting requirements, including:

- ▶ Mandates of the board members and the conducting officers
- ▶ Annual risk management reporting and adequacy assessment
- ▶ Annual and ad-hoc submission of up-to-date Risk Management Procedures (pre-defined format)
- ▶ Annual record of delegates, marketing intermediaries and control activities
- ▶ Annual AML/CTF compliance reporting



Required communication with the CSSF relating to modifications are either subject to CSSF authorization, or notification.

Modifications subject to authorization from the CSSF

- ▶ Amendments to the constitutional documents
- ▶ Change of shareholding structure and any cases of exceeding and falling below thresholds
- ▶ Changes affecting the conditions of compliance of eligible own funds
- ▶ Acquisition of holdings/creation of subsidiary
- ▶ Authorization of members of the governing/management/supervisory body and directors
- ▶ Amendment of the distribution of responsibilities between directors
- ▶ Approval to exercise (partially) internally the function of UCI administration
- ▶ Approval for UCI administration function and delegation of certain related tasks
- ▶ Permanent presence of directors in Luxembourg
- ▶ Application for derogation for sharing of staff
- ▶ Delegation or amendment of the delegation model or decision to perform internally a function which was previously delegated
- ▶ Appointment/change of the external valuer
- ▶ Decision to delegate the internal control functions or amendment of the program of operations to perform functions internally which were previously delegated
- ▶ Initial decision of the IFM to invest part of its non-regulated own funds in units of UCIs
- ▶ Change of the independent auditor
- ▶ Application of proportionality principle for the organization of its control functions
- ▶ Extension of the investment strategies of AIFs
- ▶ Intention to manage AIFs qualifying as money market funds

Case of branches:

- ▶ Notification in accordance with the directives applicable
- ▶ Change of director responsible for the follow-up of the activity of the branch

Case of free provision of services (FPS): notification in accordance with the directives applicable

Modifications subject to notification to the CSSF

- ▶ Change in the shareholder structure not subject to authorization (i.e. entry of a shareholder representing less than 10% of the shareholding structure, including at the level of indirect shareholders, certain group restructuring, the fact of exceeding or falling below thresholds for an AIFM, etc.)
- ▶ Delegation of the performance of the accounting function or the IT function
- ▶ Resignation of the members of the governing body/management body and/or directors and, if applicable, of the members of the supervisory board
- ▶ Delegation of the handling of complaints
- ▶ Substantial modification of the programme of operations
- ▶ Change in the identity of the following persons:
 - ▶ Compliance Officer
 - ▶ Person responsible for the follow-up of the work of third parties responsible for the compliance function when the performance of the compliance function is delegated
 - ▶ Person in charge of the internal audit function
 - ▶ Person responsible for the follow-up of the work of the internal auditor when the performance of the function is delegated
 - ▶ Person responsible for the permanent risk management function
 - ▶ Person responsible for compliance with professional obligations as regards AML/CFT at the level of the senior management
 - ▶ Person responsible for the control of compliance with professional obligations as regards AML/CFT
 - ▶ Person responsible for the accounting function of the IFM
 - ▶ Person responsible for the accounting administration of UCIs
- ▶ Change affecting consolidated prudential supervision
- ▶ Change of premises (when it is not subject to amendment of the articles of association)
- ▶ Substantial modification made to the risk management procedure
- ▶ Application of proportionality principle in the remuneration policy

Case of branches:

- Change in the organization of the branch
- Substantial change affecting the number of staff employed in the branch and the nature and volume of activities carried out from the branch

UCITS management companies are required to establish, implement, and maintain accounting policies and procedures that enable them, at the request of the CSSF, to deliver in a timely manner financial reports that reflect a true and fair view of their financial position and comply with all applicable accounting standards and rules.

UCITS management companies and self-managed investment companies are required to send financial information to the CSSF on a quarterly basis in accordance with CSSF Circular 18/698 and CSSF Circular 10/467, supplemented by CSSF Circular 15/633.

The head of the compliance function is required to prepare a summary report on its activities and operations once a year. The report must be approved by the management/governing body, the specialized committees, where appropriate, and sent to the CSSF no later than five months after the end of the financial year of the IFM.

The report should cover at least the following information:

- The description and the appreciation of the organization of the permanent compliance function, and, if applicable, a description of the nature and the degree of the reliance on external experts as well as the appreciation of eventual related problems
- The description of main objectives and work carried out by the compliance function during the financial year, including an update on new procedures, regulatory watch and analyses of legal and regulatory texts
- The description of the compliance monitoring plan adopted using a risk-based approach, including the monitored activities, the risk assessed for each activity and the timetable adopted for carrying out the monitoring provided for in the Compliance Monitoring Plan following a multi-year programme
- A list of the main recommendations addressed to the IFM senior management, the existing or emerging problems, significant deficiencies and irregularities which have occurred since the last report and the measures taken, significant deficiencies and irregularities identified in the last report but which have not been subject to corrective actions, in particular with regard to AML/CFT, the monitoring of delegates and the compliance of the activities carried out within branches and subsidiaries

The head of compliance must take into account, where relevant, the following elements:

- Governance of the IFM
- Compliance with legal and regulatory requirements regarding own funds and their use
- Management of conflicts of interest
- Errors in the net asset value
- Non-compliance with the investment policy and restrictions
- Personal transactions
- Best execution
- Complaints handling and third-party claims
- Treatment of whistleblowing reports
- Failure to comply with applicable reporting deadlines
- Fraud and cyber attacks
- Update of the procedures manual
- Approval of new business relationships and products
- Update of contracts
- Follow-up carried out following interaction with the supervisory authorities (on-site reviews, meetings, written correspondence, telephone, communications, etc.)
- Staff training
- Changes to the compliance policy and to the compliance charter

The compliance officer for AML/CFT obligations at senior management level is required to provide to the CSSF a summary report on compliance with professional AML/CFT obligations, approved by the managing body/governing body and sent to the CSSF annually within five months following the end of the IFM's financial year.

The report should cover at least the following information:

- ▶ The results of the identification, assessment and mitigation of ML/FT risks and the IFM's ML/FT risk tolerance level
- ▶ The results of due diligence carried out on clients, UCI initiators, portfolio management to whom it has delegated the management, investment advisors, including ongoing due diligence
- ▶ The results of enhanced due diligence carried out on politically exposed persons acting on behalf of their clients, including ongoing due diligence
- ▶ The results of due diligence measures carried out on the assets of UCIs, including ongoing due diligence The monitoring of positions blocked for AML/CFT reasons in the registers of unitholders of UCIs and/or intermediaries involved in the marketing of UCIs
- ▶ The periodic review of all business relationships according to their level of risk
- ▶ The results of the monitoring carried out on the compliance of services provided by delegates with legal, regulatory and contractual provisions; where applicable, the reasons why the IFM chose new parties during the year
- ▶ The statistical history of suspicious transactions detected, providing information on the number of suspicious transaction reports made by the IFM to the Financial Intelligence Unit and the amount of funds involved
- ▶ The statistical history of transactions reported in the context of financial sanctions relating to terrorist financing as well as the amount of funds involved
- ▶ The number of breaches to AML/CFT professional obligations identified
- ▶ The number of AML/CFT actions initiated by the AML/CFT compliance officer, internal audit, the external auditor and the CSSF to be implemented, with a description of the main actions, as well as their implementation period

The report must be accompanied by documentation relating to the identification, assessment and mitigation of the ML/FT risks.

Where the IFM has established branches, the IFM must draw up a report describing the activities carried out by each branch, their geographical distribution and their financial situation. This report describes the organization implemented within the branches to fight money laundering and terrorist financing, as well as the controls carried out and the compliance of each branch with Luxembourg's AML/CFT requirements. Any non-compliance must be explained and the remediation actions and their time limits must be included. The report must specify whether policies and procedures have been implemented at group level.

The head of the internal audit function is required to provide to the CSSF a summary report on its activities and operations, approved by the managing body/governing body and sent to the CSSF annually within five months following the end of the IFM's financial year.

This summary report must state:

- ▶ The nature and extent of the use of external experts and problems that have arisen in this context
- ▶ A list of the main recommendations addressed to senior management
- ▶ Significant deficiencies and irregularities that have arisen since the last report and the corrective actions taken
- ▶ Deficiencies and irregularities identified in the last report which have not been subject to appropriate corrective measures

The report must cover a multi-year period (in principle three years) and include at least the following information:

- ▶ The portfolio management, administration and marketing functions for IFMs, and any activities related to the assets of AIFs for AIFMs
- ▶ The discretionary management and ancillary services permitted for both UCITS management companies and AIFMs
- ▶ The valuation function
- ▶ The compliance and risk management functions
- ▶ The follow-up of delegated activities
- ▶ The accounting function
- ▶ The IT function
- ▶ The functioning of the senior management and the managing / governing body
- ▶ The rules of conduct
- ▶ The management of conflicts of interest
- ▶ The complaints and claims handling
- ▶ The remuneration policy
- ▶ The approval of new business relationships and new products
- ▶ The branches and subsidiaries, where applicable

A. Chapter 15 management companies

They are required to report information on:

- The financial situation
- The profit and loss account
- The management of Luxembourg and foreign UCIs:
 - UCIs managed by the management company
 - UCIs managed under delegation
- Additional activities
- Staff

In addition to the tables related to the activities of the registered office, management companies that have one or more branches are required to submit tables regarding activities of each individual branch, as well as global figures, totaling those of the registered office and of the branches (see also Section 6.3.4.).

The report formats are included as appendices to CSSF Circular 10/467. The Circular also covers the secure transmission requirements and the transmission channels.

Both of the transmission channels commonly used by the CSSF - *e-file* and *Sofie* - include a secure transmission module.

e-file (*e-file.lu*) is a communication platform for the transmission of data, documents, and regulatory and statistical reports between financial institutions and the Luxembourg authorities. The *e-file* system is a joint initiative of the Luxembourg Stock Exchange and its subsidiary, Fundsquare. Fundsquare also provides a database of Luxembourg investment funds.

Sofie - *SORT* is a reporting tool offered by CETREL Securities, a subsidiary of CETREL specialized in financial data processing.

Reports have to be received by the CSSF by the 20th day of the following month.

Management companies are also required to submit, within one month of the general meeting, information that reflects the figures audited by the independent auditor at the end of each financial year.

Management companies are required to communicate their risk management process to the CSSF (see Section 7.2.8.).

Management companies are required to communicate annual information on investor complaints (see Section 6.4.4.).

Disclosures to investors are covered in Chapter 10 (e.g., on fees, conflicts of interest, and voting policies).

Reporting to the authorities in relation to UCIs is covered in Section 10.8.

B. AIFM

AIFM, including simplified registration regime AIFM, are required to report to the CSSF on a regular basis information on their activities and those of the AIF they manage or market in the EU/EEA, including:

- Principal markets in which it trades on behalf of the AIF it manages
- Principal instruments in which it trades on behalf of the AIF it manages
- Values of assets under management for all AIF managed
- AIF name
- Fund manager
- Fund identification codes
- Inception date
- Domicile
- Identification of the prime broker(s)
- Base currency
- Jurisdictions of three main funding sources

- ▶ Predominant AIF type (hedge fund, private equity fund, real estate fund, fund of funds, other) and breakdown of investment strategies
- ▶ Main instruments in which the AIF is trading (type of instrument, value, long/short position)
- ▶ Geographical focus (by region) as a percentage of the NAV
- ▶ 10 principal exposures of the AIF at reporting date
- ▶ 5 most important portfolio concentrations
- ▶ Typical deal/position size
- ▶ Principal markets in which the AIF trades
- ▶ Investor concentration (percentage of AIF shares or units held by five largest beneficial owners (implementing look-through when possible), breakdown by MiFID status: professional and retail)

ESMA clarified in its *Questions and Answers on the application of the AIFMD*, that, *inter alia*,

- ▶ When a non-AIFM reports information to national competent authorities of a Member State, only the AIFs marketed in the Member State have to be taken into account for the purpose of reporting
- ▶ When information on the breakdown between retail and professional investors is not available, AIFMs should report "0" for each question and use the assumption boxes to indicate that the information is not available.

For each of the EEA AIF they manage and for each of the AIF they market in the EEA, AIFM (not including simplified registration regime AIFM) must provide the CSSF with:

- ▶ Detailed list of all AIF which it manages
- ▶ Identification of the AIF:
 - ▶ AIF name
 - ▶ Fund manager
 - ▶ Fund identification codes
 - ▶ Inception date
 - ▶ Domicile
 - ▶ Identification of the prime broker(s)
 - ▶ Base currency
 - ▶ Jurisdictions of three main funding sources
- ▶ Instruments traded and individual exposures:
 - ▶ Individual exposures in which it is trading and the main categories of assets in which the AIF invested as at the reporting date (securities by category and sub-category, derivatives by category and sub-category, physical assets by category and sub-category, UCIs by category and sub-category, other asset classes)
 - ▶ Value of turnover in each asset class over the reporting months (securities by category, derivatives by category, physical assets by category, UCIs by category, other asset classes)
 - ▶ Total long and short value of exposures (before currency hedging) by currency group
 - ▶ Private equity funds:
 - ▶ Typical deal/position size
 - ▶ Name of each company over which the AIF has a dominant influence (including name, percentage of voting rights, and transaction type)
- ▶ Risk profile of the AIF:
 - ▶ Market risk profile:
 - ▶ Expected annual investment return/IRR in normal market conditions (in percent) (Net Equity Delta, Net DVO1, Net CS01)
- ▶ Counterparty risk profile:
 - ▶ Estimated percentage (in terms of market value) of securities and derivatives traded (on a regulated exchange and OTC) and derivatives transactions cleared (by a central clearing counterparty (CCP) and bilaterally)
 - ▶ Value of collateral and other credit support that the AIF has posted to all counterparties (in the form of cash and cash equivalents, securities, letters of credit, and similar instruments)
 - ▶ Percentage of the amount of collateral and other credit support that the AIF has posted to counterparties and that has been re-hypothecated by counterparties

- ▶ Identity of top five counterparties:
 - ▶ To which the AIF has the greatest mark-to-market net counterparty credit exposure, measured as a percentage of the NAV of the AIF
 - ▶ That have the greatest mark-to-market net counterparty credit exposure to the AIF, measured as a percentage of the NAV of the AIF
- ▶ Direct clearing through CCPs, including, when relevant, identity of the top three CCPs in terms of net credit exposure
- ▶ Liquidity profile:
 - ▶ Portfolio liquidity profile:
 - ▶ Percentage of portfolio capable of being liquidated within specified periods
 - ▶ Value of unencumbered cash
 - ▶ Investor liquidity profile:
 - ▶ Percentage of investor equity that can be redeemed within specified periods (as a percentage of the NAV of the AIF)
 - ▶ Investor redemptions:
 - ▶ Whether AIF provide investors with withdrawal/redemption rights in the ordinary course of business
 - ▶ Frequency of investor redemptions (if multiple classes of shares or units, report for the largest share class by NAV)
 - ▶ Notice period in days required by investors for redemptions (asset weighted notice period if multiple classes or shares or units)
 - ▶ Investor lock up period in days (asset weighted notice period if multiple classes or shares or units)
 - ▶ Special arrangements (percentage of the AIF's NAV subject to arrangements by category, the percentage of NAV of the AIF's assets that are currently subject to the special arrangements arising from their illiquid nature)
 - ▶ Whether any investors receive preferential treatment or right to preferential treatment and, when relevant, type of preferential treatment
 - ▶ Breakdown of the ownership of units in the AIF by investor group (percentage of the NAV of the AIF; look-through to the beneficial owners when known or possible)
 - ▶ Financing liquidity:
 - ▶ Aggregate amount of borrowing by and cash financing available to the AIF (including all drawn and undrawn, committed and uncommitted lines of credit as well as any term financing) and breakdown by length of period for which the creditor is contractually committed to provide such financing
- ▶ Borrowing and exposure risk:
 - ▶ Value of borrowings of cash or securities represented by unsecured cash borrowing and breakdown of collateralized/secured cash borrowing
 - ▶ Breakdown of value of borrowing embedded in financial instruments
 - ▶ Value of securities borrowed for short positions
 - ▶ Gross exposure of financial and/or legal structures controlled by the AIF
 - ▶ Leverage of the AIF as calculated under the gross method and the commitment method
- ▶ Operational and other risk aspects:
 - ▶ Total number of open positions
 - ▶ Historical risk profile:
 - ▶ Gross investment returns or IRR of the AIF over the reporting period (in percent, gross of management and performance fees)
 - ▶ Net investment returns or IRR of the AIF over the reporting period (in percent, net of management and performance fees)
 - ▶ Change in NAV of the AIF over the reporting period (in percent, including the impact of subscriptions and redemptions)
 - ▶ Subscriptions over the reporting period
 - ▶ Redemptions over the reporting period
- ▶ Results of stress tests:
 - ▶ Stress tests on risks associated with each investment position of the AIF and their overall effect on the AIF's portfolio
 - ▶ Assessment and monitoring of the liquidity risk of the AIF under normal and exceptional liquidity conditions

- ▶ Additional reporting by AIFM managing AIF employing leverage on a substantial basis (i.e., above three times the NAV calculated according to the commitment method – see Section 7.3.6.A.):
 - ▶ Percentage of the amount of collateral and other credit support that the reporting AIF has posted to counterparties and that has been re-hypothecated by counterparties
 - ▶ Borrowing and exposure risk
 - ▶ Value of borrowings of cash or securities represented by unsecured cash borrowing and breakdown of collateralized/secured cash borrowing
 - ▶ Breakdown of value of borrowing embedded in financial instruments
 - ▶ Five largest sources of borrowed cash or securities (short positions)
 - ▶ Value of securities borrowed for short positions
 - ▶ Gross exposure of financial and/or legal structures controlled by the AIF
 - ▶ Leverage of the AIF as calculated under the gross method and the commitment method

When necessary for the effective monitoring of systemic risk, the CSSF may require additional information, on a periodic as well as on an ad hoc basis. Additional information would cover:

- ▶ Information on the total number of transactions carried out using high frequency algorithmic trading, together with the corresponding market value of buys and sells in the base currency of the AIF over the reporting period
- ▶ Information on geographical focus based on the domicile of investments expressed as a percentage of the total value of assets under management
- ▶ When the five most important instruments in which the AIF is trading includes short positions, the extent of the hedging
- ▶ Information on the Value at Risk (VaR) of the AIFs and, when relevant according to the investment strategy of the AIF, the portfolio's sensitivity to changes in FX rates or commodity prices
- ▶ Information on non-EU master AIF not marketed in the EU, in so far as one of the feeder AIF of these master AIF is an EU AIF or is marketed in the EU and is managed by the same AIFM as the master AIF

The minimum frequency of the reporting is as follows:

- ▶ On a semi-annual basis by AIFM managing portfolios of AIF whose assets under management calculated in total exceed the applicable EUR 100 million or EUR 500 million threshold (see Section 6.1.3.D.) but do not exceed EUR 1 billion, for each of the EU AIF they manage and for each of the AIF they market in the EEA
- ▶ On a quarterly basis by AIFM, for each AIF whose assets under management, including any assets acquired through use of leverage, in total exceed EUR 500 million, in respect of that AIF
- ▶ On a quarterly basis by AIFM managing portfolios of AIF whose assets under management in total exceed EUR 1 billion, for each of the EU AIF they manage and for each of the AIF they market in the EEA
- ▶ On an annual basis by AIFM in respect of each managed unleveraged AIF that, in accordance with its core investment policy, invests in non-listed companies and issuers in order to acquire control

In addition, AIFM (not including simplified registration regime AIFM) are required at the end of each quarter to provide the CSSF with a detailed list of all the AIF that they manage (EU and non-EU AIF) including:

- ▶ AIF name
- ▶ Fund identification codes
- ▶ Inception date
- ▶ AIF type (hedge fund, private equity fund, real estate fund, fund of funds, other)
- ▶ NAV
- ▶ Whether the AIF is an EU AIF

Registered and authorized AIFMs must inform the CSSF by completing forms appended to CSSF Circular 15/612 for each additional AIF they start to manage, meaning each unregulated AIF (e.g. RAIF) and each regulated AIF established in a third country that was not communicated to the CSSF either during the initial application process of the AIFM or on update of its authorization file. AIFMs need also to inform the CSSF as soon as they stop managing an unregulated AIF and/or a regulated AIF established in a third country. If the AIF comprises several compartments, the obligations regarding information apply at compartment level.

Requirements applicable to specific types of AIF include:

- ▶ Master-feeder AIF:
AIFM should treat feeder AIF of the same master fund individually. AIFMs should not aggregate master-feeder structures in a single report.
When reporting information on feeder AIF, AIFM should identify the master AIF in which each feeder invests but should not look through the master AIF(s) to its(their) holdings. If applicable, AIFMs should also report detailed information on investments that are made at feeder AIF level, such as investments in financial derivative instruments.
- ▶ Funds of funds: When reporting information on funds of funds, AIFM should not look through the holdings of the underlying funds in which the AIF invests
- ▶ Multiple compartment AIF: If an AIF takes the form of an umbrella AIF with several compartments, AIF-specific information should be reported at the level of the compartments

In cases when AIFM do not have any information on AIF to report, such as when there is a delay between the authorization or registration being granted to a new AIFM and the actual start of activity or between the creation of an AIF and the first investments. In such a scenario, AIFM should still provide a report to the CSSF by indicating that no information is available by using a specific field.

AIFM should generally start reporting from the first day of the following quarter after they have information to report until the end of the first reporting period.

The deadline for submitting the reporting is the last day of the month following the end of the period. When the AIF is a fund of funds, this deadline is extended to the 15th day of the following month.

The reporting to the CSSF should be transmitted to the CSSF via e-file system or via *Sofie - SORT*.

6.5.2. Annual accounts

The annual accounts of management companies are subject to the provisions of the Law of 19 December 2002 on the *Trade and Companies Register and the accounting and annual accounts of companies*, as amended.

A company may prepare its annual accounts under Luxembourg generally accepted accounting principles ("Lux GAAP"), International Financial Reporting Standards (IFRS), as adopted by the EU, or Lux GAAP with the fair value option.

The annual report of a management company should, in addition to the annual accounts, also include a management report¹⁷³ which should cover, *inter alia*:

- ▶ A fair review of the development and performance of the company's business and of its position, including financial and non-financial key performance indicators relevant to the business and information relating to environmental and employee matters
- ▶ A description of the main risks and uncertainties that the company faces
- ▶ Any important events that have occurred since the end of the financial year
- ▶ The company's likely future development
- ▶ Activities in the field of research and development
- ▶ Information on the acquisition of its own shares, if applicable
- ▶ Existence of branches of the company
- ▶ Transactions carried out under art-32-3 (5bis) of the 1915 Law in relation to the allocation of free shares to staff
- ▶ With respect to the use of financial instruments and when such instruments are material for the assessment of the company's assets, liabilities, financial position, and profits or losses:
 - ▶ Financial risk management objectives and policies
 - ▶ Exposure to price risk, credit risk, liquidity risk, and cash flow risk

The management report should also, where appropriate, include references to, and additional explanations of, amounts reported in the annual accounts.

The layout of the annual report and the contents of the notes will depend on the size of the company and the legal form, as well as the accounting principles chosen.

¹⁷³ Mandatory for management companies that are not considered of small size. A management company is of small size if on its balance sheet date it does not exceed two of the following three criteria:

- ▶ Balance sheet total of EUR4.4 million
- ▶ Net turnover of EUR8.8 million
- ▶ Average number of full-time staff during the year of 50

Annual accounts of the management entity must be audited by an independent auditor. Any change of independent auditor must be previously approved by the CSSF. The duties and obligations of the independent auditor of a management company are similar to those of the independent auditor of a UCI, as outlined in Section 10.5.10.

The IFM is required to spontaneously submit, within one month following the ordinary general meeting which approved the annual accounts of the IFM and at the latest seven months after the closing date of the financial year of the IFM, the audited annual accounts and management letter issued by the approved statutory auditor in the context of its audit of the annual accounting documents.

The annual accounts of the management entity should be transmitted to the CSSF via the *e-file* system (see Section 6.5.1.).

The independent auditor's management letter relative to the audit of the annual accounts of the management entity should be transmitted to the CSSF via the *e-file* system.

6.5.3. Expenses and taxation of management entities

6.5.3.1. Introduction

This section covers:

- The formation and operating expenses incurred by management entities
- The taxation of Luxembourg management entities

Advisory companies are also covered in this section.

Management companies are commercial companies, therefore, they are subject to normal corporate taxes in Luxembourg.

Fees that management companies are required to pay to the CSSF in relation to their application for authorization and ongoing supervision are covered in Section 11.2.

6.5.3.2. Expenses

Formation expenses of a Luxembourg management entity, or a Luxembourg general partner, excluding own funds and professional liability cover (see Section 6.2.3.2.), may include the following:

- Notary fees
- Legal fees
- Advisory fees on initial structuring and product marketing
- CSSF initial management entity authorization fee:
 - Chapter 15 management company that is not an AIFM: EUR 15,000
 - Chapter 15 management company and AIFM: EUR 15,000
 - Chapter 16 management company that is not an AIFM: EUR 8,000
 - Chapter 16 management company and AIFM: EUR 15,000
 - AIFM: EUR 15,000
 - Formation expenses of UCIs they manage, or a portion thereof (if applicable) (see Section 11.2.1.)

Ongoing expenses of a Luxembourg management entity, or a Luxembourg general partner, may include the following:

- Staff costs (e.g., wages, pensions, benefits, social security)
- Office-related costs (e.g., rent, furniture)
- IT infrastructure costs (e.g., hardware, software, maintenance, internet, and telephone)
- Legal and audit fees
- Directors fees and expenses
- Accounting fees
- Insurance

- CSSF annual fees for a management company:
 - Chapter 15 management company that is not an AIFM: EUR 35,000
 - Chapter 15 management company and AIFM: EUR 35,000
 - Chapter 16 management company that is not an AIFM: EUR 15,000
 - Chapter 16 management company and AIFM: EUR 35,000
 - AIFM: EUR 35,000
 - An additional EUR 15,000 for each branch
- UCI management-related costs (if applicable) (see Section 11.2.2.)
- UCI reorganization costs (if applicable)

6.5.3.3. Registration duty

Luxembourg companies are subject to a registration duty of EUR 75 on incorporation and in case of:

- Modification of the articles of incorporation
- Transfer of the effective place of management or registered office to Luxembourg

In the case of management companies of single common funds, although the registration duty is payable by the management company, it may be charged to the common fund.

6.5.3.4. Annual taxation

A. General

Luxembourg resident commercial companies are fully taxable entities. Their worldwide taxable income is subject to corporate income tax (CIT) plus an employment fund surcharge and municipal business tax. As from the 2019 fiscal year on, the nominal rate of corporate income tax has been reduced from the previous 18% to 17% (18.19% including the contribution to the employment fund). The global tax rate, including municipal business tax, for a company with its statutory seat in Luxembourg-city is thus 24.94%. Companies are subject to the annual Luxembourg NWT at a rate of 0.5% on the adjusted net asset value (the "unitary value") up to EUR 500 million and 0.05% on the part of adjusted net asset value exceeding EUR 500 million at the beginning of the year. This net worth tax, however, under certain conditions, can be (partially) credited against the corporate income tax due. All Luxembourg resident entities in corporate form that are subject to Luxembourg CIT and whose financial assets (transferable securities, bank deposits, receivables held against related parties/companies in which the corporation holds participations, and shares or units held in a tax transparent entity) exceed 90% of their net assets and exceed EUR 350,000 are subject to a flat annual minimum NWT of EUR 4,815 (EUR 4,500 plus contribution to employment fund of 7%). Luxembourg resident entities in corporate form that do not meet the above conditions are subject to a variable annual minimum NWT, which ranges from EUR 535 to EUR 32,100, depending on the balance sheet total at the beginning of the year.

It is possible, under certain conditions, to reduce this minimum NWT to nil.

B. Management companies of a single common fund

The Luxembourg tax authorities have clarified that all Luxembourg management companies, including management companies managing a single common fund, are considered as fully taxable entities.

C. Tax regime for carried interest

The Luxembourg AIFM Law defines "carried interest" as a share in the profits of the AIF accrued to the AIFM as compensation for the management of the AIF (See Section 11.3.5.2.).

D. VAT

Management companies are considered as taxable persons for Luxembourg VAT purposes but may be relieved from the obligation to register for Luxembourg VAT (subject to certain conditions being met). Management services provided to UCIs, including AIF and other investment vehicles, are VAT exempt (See Section 11.4.).

6.5.3.5. Dividends and interest

For commercial companies, withholding tax (WHT) on dividends amounts to 15% of the gross amount¹⁷⁴. Under Luxembourg domestic law, a full WHT exemption applies to dividends if they are paid to qualifying entities established in EU/European Economic Area (EEA) Member States, Switzerland, or a country with which Luxembourg has entered into a double taxation treaty (DTT) and if certain conditions are met.

Management or advisory companies are subject to the normal authorization procedures for paying interim dividends and are also required to create a legal reserve. The interim dividend authorization procedures include specific authorization in the articles of association and the preparation of interim financial statements. The independent auditor must issue a report stating whether the conditions of the 1915 Law¹⁷⁵ on the payment of interim dividends have been satisfied. The legal reserve requirement is 5% of net profit until the accumulated reserve equals 10% of subscribed capital.

Luxembourg does not levy any WHT on interest payments made by Luxembourg resident companies except in very specific cases (e.g., if interest is paid to Luxembourg resident individuals or if interest is paid on specific profit participating bonds. (See Section 11.3.4.1.)).

6.5.3.6. Dissolution

Liquidation proceeds distributed by normal taxable companies are not subject to WHT in Luxembourg. Nevertheless, the liquidation triggers the realization of all the assets of the company; consequently the liquidation profit will include all unrealized capital gains and will be subject to corporate income tax.

6.5.3.7. Management passport

A UCITS management company or AIFM may manage UCIs in other EU/EEA Member States. A UCITS management company may also perform the other activities for which it has been authorized in its home Member State in other EU/EEA Member States (see Section 6.3.4.). However, a careful evaluation is recommended in order to understand the tax implications before deciding to make use of the management company passport.

The main types of tax implications include:

- ▶ Transformation: one-off tax cost of the restructuring:
 - ▶ Taxation related to the transfer of the management entity's business (client base, etc.) to another management entity (cross-border or within the same country)
 - ▶ Taxation issues relating to the merger, relocation, or liquidation of a management entity, or conversion into a branch
 - ▶ Transfer pricing including cross-border transfer pricing
 - ▶ Payroll taxes and expatriation
- ▶ Ongoing direct and indirect tax impacts for the management entity and group going forward:
 - ▶ Corporate taxation
 - ▶ Access to DTTs
 - ▶ Group tax filing requirements
 - ▶ VAT on services provided to, and by, the management entity (see Section 11.4.)
- ▶ The direct and indirect tax impacts on the UCIs and their investors, *inter alia* including:
 - ▶ Tax residency of UCIs: the management company passport may raise the question of the tax residency and treatment of a UCI established under the law of an EU/EEA Member State and managed by a management company located in another EU/EEA Member State. In certain cases, this could lead to one or more of the following:
 - ▶ Taxation of the UCI income in the Member State of the management entity
 - ▶ Additional WHT on distribution from the UCI
 - ▶ Taxation of unrealized gains in the hands of the investor

The 2010 Law and the AIFM Law have introduced provisions into Luxembourg tax law whereby UCIs established under foreign law whose place of effective management or central administration is in Luxembourg are exempt from CIT, municipal business tax, and NWT in Luxembourg. With regard to Luxembourg common funds, and in particular common funds managed cross-border, the 2010 Law clarifies that the management regulations are subject to Luxembourg law (see also Section 11.3.7.).

- ▶ Access to DTTs (see also Section 11.3.3.1.)
- ▶ VAT on services provided to the UCIs by the management entity and the service providers (see Section 11.4.)

¹⁷⁴ A 17.65% rate applies on the net dividend if the withholding tax is not charged to the recipient.

¹⁷⁵ Article 72-2 of the Law of 10 August 1915 on commercial companies, as amended.

7

Risk management and valuation

EY supports asset managers, traditional and alternative investment fund houses and service providers in defining or reviewing their risk management processes, performing risk management reporting, with specific risk areas (e.g., stress testing, liquidity risk management, back testing), valuation model reviews, and independent valuation.



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7.1. Introduction

This chapter covers the risk management and valuation requirements applicable to UCIs, management companies, and AIFM:

- ▶ UCITS management companies and self-managed UCITS
- ▶ AIFM and internally managed AIF that are subject to the AIFM Directive
- ▶ SIFs
- ▶ RAIFs
- ▶ MMFs

The following sections provide a brief summary of the risk management and valuation requirements, and some practical perspectives thereon.

A. Risk management

The risk profile developed for each UCI plays a central role in the mission of the permanent risk management function. It is expected to be comprehensively documented prior to launching the UCI, ensuring that all material risks are identified, captured in regular monitoring tasks with assigned limits or triggers as well as subsequently updated as appropriate. Finally, it should be disclosed to investors before they invest. The management entity¹⁷⁶ should implement a risk management system to ensure that the UCI complies with the risk profile disclosed to investors and, where relevant, take remedial action in the best interests of investors.

The remainder of this section provides a brief overview of how these objectives should be achieved.

Management entities should:

- ▶ Ensure that the risk profile of the UCI corresponds to the objectives of the UCI as laid down in the UCI's constitutional document, prospectus, and offering documents
- ▶ Establish and implement quantitative or qualitative risk limits, or both, for each UCI it manages, taking into account all relevant risks. The risk limits define the risk appetite of the UCI and ensure compliance with the risk profile
- ▶ Implement an adequate risk management system (the "risk management process" for UCITS; the "risk management system" for AIF) in order to identify, measure, manage, and monitor appropriately all risks relevant to each UCI's investment strategy and to which each UCI is or may be exposed. The risk management system should be reviewed at an appropriate frequency and at least once a year and updated where necessary
- ▶ Establish, implement, and maintain an adequate and documented risk management policy that:
 - ▶ Identifies all the relevant risks to which the UCIs it manages are or may be exposed
 - ▶ Describes the procedures necessary to enable the management entity to assess, for each UCI it manages, the exposure of the UCI to each risk that may be material
- ▶ Ensure that risks are assessed in relation to each investment:
 - ▶ Implement a documented and regularly updated due diligence process when investing on behalf of the UCI. Such due diligence process should be appropriate to the investment strategy, objectives, and risk profile of the UCI
 - ▶ Ensure that the risks associated with each investment position of the UCI and their overall effect on the UCI's portfolio can be properly identified, measured, managed, and monitored on an ongoing basis
- ▶ Implement a risk management function that should:
 - ▶ Be functionally and hierarchically separate from the operating units, including from the functions of portfolio management, unless this is not proportional, in which case, the management entity should be able to demonstrate that specific safeguards have been taken against conflicts of interest to allow the independent performance of risk management activities, and that the risk management process is effective
 - ▶ Implement the risk management policies
 - ▶ Ensure that the risk profile disclosure to investors is consistent with the risk limits
 - ▶ Monitor compliance with the risk limits
 - ▶ Provide to the governing body regular updates on compliance with the risk limits and the adequacy and effectiveness of the risk management process (see also Section 5.1.6.1.)
 - ▶ Provide to senior management regular updates on the current levels of risk and any foreseeable or actual breaches of risk limits (see also Section 5.1.6.2.)

¹⁷⁶ In the case of a UCI that has not appointed a management entity, the Board of Directors of a UCI.

- ▶ Test the risk management system by conducting periodic back tests in order to review the validity of risk measurement arrangements, which include model-based forecasts and estimates
- ▶ Assess the impact of changes in market conditions that might adversely impact the UCI by conducting periodic appropriate stress tests and scenario analyses, including extreme scenarios
- ▶ Provide the CSSF with a description of the risk management system
- ▶ Regularly disclose information on the risk profile of the UCI both to the investors in the UCI and the CSSF

The definitions of the risks which should be covered by adequate risk management systems, and for which risk limits should be set, may vary according to the asset classes in which the UCI invests. The following are indicative descriptions of selected types of risk:

- ▶ Market risk: the risk of loss for the UCI resulting from fluctuations in the market value of positions in its portfolio, such as fluctuations attributable to changes in market variables such as interest rates, exchange rates, equity, and commodity prices
- ▶ Credit risk: the risk of loss that could arise from a credit event, such as a credit downgrade or a counterparty's inability to repay some or all of a debt
- ▶ Counterparty risk: the risk of loss for the UCI resulting from the fact that the counterparty to a transaction may default on its obligations prior to the final settlement of the transaction's cash flow
- ▶ Issuer risk: the risk of loss resulting from the default of an issuer of securities
- ▶ Concentration risk: the risk of loss arising from a significant exposure, for example to a group of issuers and/or counterparties, an asset class, geographic region or market
- ▶ Liquidity risk¹⁷⁷: the risk that a position in the portfolio of the UCI cannot be sold, liquidated or closed at a limited cost in a sufficiently short time frame and that the ability of the UCI to comply at any time with the terms and forms of redemption laid down in the constitutional document of the UCI is thereby compromised
- ▶ Operational risk: the risk of loss for the UCI resulting from the inadequate internal processes and failures in relation to people and systems, or entailed by delegated activities, or resulting from external events, including legal and documentation risk, and risk resulting from trading, settlement, and valuation procedures executed on behalf of the UCI

The risk management function will play a key role in ensuring that the management entity is compliant with these requirements. The risk management function will generally also, *inter alia*, oversee or perform:

- ▶ Implementation of risk modeling and risk aggregation techniques
- ▶ Calculation of investment risk exposures (at portfolio and aggregate level), working in collaboration with the portfolio management function, including:
 - ▶ Calculation of market risk using the commitment approach or advanced risk measurement techniques (model-based approaches - value-at-risk (VaR) and/or more appropriate model - including stress testing scenario analysis and back testing)
 - ▶ Calculation of counterparty risk/issuer concentration measures (ultimate risk exposure)
- ▶ Calculation of liquidity risk exposure (at portfolio and investor level)
- ▶ Monitoring of the leverage levels (at portfolio and aggregate level)
- ▶ Interaction with the pricing and valuation of over-the-counter (OTC) derivative instruments (e.g., data sources, illiquid assets)

The functional and hierarchical separation of the risk management function must be implemented at senior management level to avoid conflicts of interest.

The same conducting officer cannot be responsible for both portfolio management and risk management (see Section 5.1.6.2.).

For UCITS, the risk management requirements focus in detail on risk measurement, in particular on market risk measurement, whereas the AIFM Directive lays down an overall risk management framework, with a particular focus on liquidity risk management.

¹⁷⁷ The AIFM Directive exempts unleveraged closed-ended AIF from some of the liquidity risk management requirements.

For AIFM, the portfolio management and risk management functions are classified together as “investment management” functions. The risk management function is considered to be one of the two essential functions of an AIFM (see also Sections 6.1.3. and 7.3.).

Management entities are permitted to delegate the risk management activity (entirely or a part thereof) to specialist third parties. In this case, they are required to exercise due skill, care, and diligence when entering into, managing, and terminating any such arrangements. The management entity remains responsible for the delegated risk management activity. The specific requirements on delegation are covered in more detail in the following sections:

- ▶ UCITS and their management companies: Section 7.2.7.
- ▶ AIFM and internally managed AIF: Section 7.3.7.
- ▶ SIFs: Section 7.4.4.

The general requirements on delegation are covered in Section 6.3.3.

Management entities are required to implement remuneration policies that cover, *inter alia*, staff whose professional activities have a material impact on the risk profiles of the UCIs they manage. The policies should promote sound and effective risk management and not encourage risk-taking that is inconsistent with the risk profiles or constitutional documents of the UCIs they manage (see Section 6.4.3.).

Management entities are also required to appropriately mitigate or manage the risks related to conflicts of interest and provide disclosures to investors on conflicts of interest (see Sections 6.4.1. and 10.4.1.1.).

Management entities are also required to comply with anti-money laundering and counter-terrorist financing (AML/CFT) requirements, *inter alia*, on documenting their risk management approach in relation to AML/CFT and the AML/CFT risk analysis report to be issued (see Section 8.7.4.).

Risk management activities comprise two levels of responsibilities: the risks of the management entity and the investment risks of the UCIs it manages. The risk management requirements focus primarily on the risks faced by the UCIs themselves, including the operational risks of the management entity.

In practice the risk management function may also play an important role in managing the risk of the management entity as a business.

Risks inherent in the business of the management entity itself are partially covered by the own funds requirements and, in the case of AIFM, the professional liability cover (see Section 6.2.3.2.). In addition, the shareholders of the management entity must be appropriately qualified. In the case of a UCITS (Chapter 15) management company, the CSSF may request a letter of sponsorship, in which the sponsor makes a commitment in relation to the management company's respect of the applicable prudential requirements in particular in relation to the own funds of the management company.

The following table summarizes most of the potential risks faced by UCIs and their management entities:

Risks faced by UCIs and their management entities ¹⁷⁸	
Potential risks impacting UCIs (Investment risks)	Potential risks impacting management entities
<ul style="list-style-type: none"> ▶ Market risk ▶ Credit risk ▶ Counterparty risk ▶ Issuer risk ▶ Concentration risk ▶ Liquidity risk 	<ul style="list-style-type: none"> ▶ Risks related to own investments ▶ Management entity liquidity risk ▶ Business/product risk
Potential risks impacting both UCIs and management entities	
Operational risks: <ul style="list-style-type: none"> ▶ Technical resources/IT related risks ▶ People risks ▶ Organizational/process risks ▶ Fraud risks ▶ Delegated function and outsourcing risks ▶ Other external factor risks 	Other risks: <ul style="list-style-type: none"> ▶ Legal/regulatory risk ▶ Model risk ▶ Tax risk ▶ Distribution risk ▶ Reputational risk

¹⁷⁸ Based on ALFI's Risk Management Guidelines, March 2012.

B. Valuation

The regimes covering the valuation of the assets of a UCI and the calculation of the net asset value (NAV) vary significantly:

- ▶ For 2010 Law UCIs, management companies are required to establish appropriate procedures to ensure the proper and accurate valuation of the assets and liabilities of the UCI. The valuation requirements are not set out in detail, but specific requirements cover, for example, the valuation of over-the-counter (OTC) derivatives
- ▶ AIFM are required to establish, maintain, implement, and review, for each AIF they manage, written policies and procedures that ensure a sound, transparent, comprehensive, and appropriately documented valuation process. The valuation requirements are set out in detail
- ▶ The rules for the valuation of assets must be disclosed to investors before they invest, in the prospectus of 2010 Law UCIs or in the disclosure to investors before they invest in the case of AIF
- ▶ For SIFs and RAIFs, the assets should be valued at fair value

7.2. Risk management of UCITS

7.2.1. Introduction

A UCITS management company or self-managed UCITS investment company (referred to collectively in this section as the management company) must employ a risk-management process that enables it to monitor and measure at any time the risk of the positions and its contribution to the overall risk profile of the portfolio. It must assess, monitor, and periodically review the adequacy and effectiveness of the risk management policy and any measures taken to address any deficiencies in the risk management process.

7.2.2. Key regulations

The fundamental risk management requirements are laid down in the 2010 Law. CSSF Regulation 10-4 lays down more detailed requirements, *inter alia*, on:

- ▶ The risk management function
- ▶ The risk management policy, its assessment, monitoring, and review
- ▶ The risk management processes including measurement and management of risk and calculation of global exposure, liquidity risk, counterparty risk exposure, and issuer concentration
- ▶ Procedures for the valuation of OTC FDI¹⁷⁹s

CSSF Circular 11/512 as amended details the risk management requirements applicable to Luxembourg UCITS management companies and UCITS (including self-managed UCITS). The Circular provides guidelines for the implementation of a risk management framework. It covers the main regulatory risk management requirements for UCITS, *inter alia*, covering:

- ▶ The risk management policy
- ▶ The risk management function
- ▶ The risk profile and limits
- ▶ The delegation of risk management
- ▶ The risk measurement techniques (including liquidity and operational risk)
- ▶ Risk management in relation to OTC derivatives and efficient portfolio management (EPM) transactions
- ▶ Risk-related disclosures in the prospectus and annual accounts
- ▶ The structure of the Risk Management Process (RMP)

CSSF Circular 18/698 of 23 August 2018 on the *authorization of investment fund managers incorporated under Luxembourg Law - specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent* also sets out some additional requirements in relation to the governance and implementation of the risk management function. The Circular repealed CSSF Circular 12/546 on the authorization and organization of Chapter 15 management companies and UCITS investment companies that have not designated a management company.

¹⁷⁹ Over-the-Counter Financial Derivative Instruments

In addition to Circular 11/512, the following ESMA guidelines are relevant in the context of the risk management framework:

- ▶ ESMA's¹⁸⁰ *Risk management principles for UCITS*, February 2009
- ▶ ESMA's *Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS*, July 2010
- ▶ ESMA's *Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS*, April 2011, updated in March 2012
- ▶ ESMA's *Guidelines on ETFs and other UCITS issues* of 18 December 2012, as amended
- ▶ ESMA's *Questions and Answers on the application of the UCITS Directive*, May 2017 (bringing together the following four ESMA Q&As on UCITS: *The Key Investor Information Document (KIID) for UCITS* (2015/631); Q&A on ESMA's *guidelines on ETFs and other UCITS issues* (2015/12); *Notification of UCITS and exchange of information between competent authorities* (2012/428); and *Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS* (2013/1950))
- ▶ ESMA *Guidelines on stress test scenarios under Article 28 of the MMF Regulation*, July 2019
- ▶ ESMA *Guidelines on liquidity stress testing in UCITS and AIFs*, September 2019

IOSCO, ESMA, the CSSF, and ALFI have issued documents providing additional recommendations, guidance and clarifications including:

- ▶ The Board of the International Organization of Securities Commissions (IOSCO)'s *Recommendations for Liquidity Risk Management for Collective Investment Schemes* (FR01/2018), February 2018.
- ▶ IOSCO's *Statement on IOSCO liquidity risk management recommendations for investment funds, 18 July 2019*. The IOSCO recommendations have been adopted in Luxembourg by CSSF Circular 19/733 published in December 2019.
- ▶ ESMA's *Questions and Answers on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS*, July 2012, the latest update of which is dated April 2016, covering, *inter alia*:
 - ▶ Hedging strategies
 - ▶ Disclosure of leverage by UCITS
 - ▶ Concentration rules
 - ▶ Calculation of global exposure for fund of funds
 - ▶ Calculation of counterparty risk for exchange-traded derivatives and centrally-cleared OTC transactions
- ▶ CSSF *Communiqué 12/29 UCITS*: Publication of the document "*Questions and Answers: Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS*" by ESMA and clarification by the CSSF for the Luxembourg UCITS covering, *inter alia*, the leverage to be included in the prospectus
- ▶ ALFI's *FAQ on CSSF Circular 11/512*, December 2011, covering, *inter alia*:
 - ▶ Risk disclosures, including leverage
 - ▶ Portfolio risk calculation methods, including stress testing
 - ▶ Content of risk management reporting to conducting officers and the Board of Directors
- ▶ ALFI's *Risk Management Guidelines*, March 2012, covering:
 - ▶ Good practices for the organization of the risk function of a UCITS management company or UCITS investment company
 - ▶ Guidance paper for the risk monitoring of functions outsourced/delegated by a management company or investment company
 - ▶ Collateral management
- ▶ ALFI's *practical guidelines on UCITS Liquidity Risk Management*, March 2013
- ▶ ALFI's *Principles for sound stress testing practices*, April 2013
- ▶ ALFI's *guidelines on Operational Risk Management within UCITS*, May 2014
- ▶ ALFI's *guidelines on Considerations for the Management of Operational Risks Associated with the Distribution of Funds*, June 2016, which presents to Board members and senior management those areas that they may wish to consider when looking at the management of operational risks associated with the marketing/distribution of funds, and covers:
 - ▶ Key sources of legal and regulatory guidance in relation to risk management
 - ▶ A potential approach to (i) the identification of relevant operational risks associated with distribution/marketing to which funds or their management companies may be exposed, (ii) the measurement and management of these identified operational risks and (iii) the reporting with regard to these risks and related information to senior management and the Board by the risk management function

¹⁸⁰ The Committee of European Securities Regulators (CESR) became the ESMA on 1 January 2011.

- ▶ ALFI's *Principles of the Oversight of Financial Intermediaries in Distribution of Funds*, May 2017, providing management companies with a set of high-level common principles for their considerations in the areas of Financial Intermediary oversight namely risk assessment of the distribution model, initial due diligence, ongoing due diligence/monitoring, governance of the intermediary and reporting.
- ▶ ALFI & ALRiM *guidelines on the ABC of VaR Model Backtesting*, A Practitioner's Guide, May 2017
- ▶ ALFI & ALRiM *guidelines on VaR Model Backtesting C.S.I., Practitioners' Thoughts*, May 2017

7.2.3. Risk profile and risk limits

The Board of Directors of the management company must define and approve a risk profile for each UCITS it manages. The risk profile will be defined on the basis of advice from the risk management function and result from the process of risk identification, which must take into account all the risks that may be material for the UCITS.

The risk profile of a UCITS could be defined as a measure of the risk aversion relative to the investment strategy (i.e., risk and reward trade-off given the material risks implied by the investment strategy).

The management company must establish, implement, and maintain a documented system of internal limits regarding risks that may be material to the UCITS and ensure compliance with the risk profile of the UCITS. The UCITS risk limit system should take into account applicable legal limits. Senior management must approve and review on a periodic basis the risk limit system for each managed UCITS.

Internal limits (stricter than regulatory limits) may be defined by the management company.

Management companies must implement appropriate procedures on remedial action to be taken, in the best interests of unitholders, in case of breaches or foreseeable breaches of the limits.

7.2.4. Risk management policy

Management companies are required to establish, implement and maintain an adequate and documented risk management policy that identifies the risks to which the UCITS are or might be exposed, taking into account the nature, scale and complexity of their business and of the UCITS they manage.

The risk management policy must comprise the procedures necessary to enable the management company to assess for each UCITS it manages the exposure of that UCITS to market risks (including global exposure), credit, liquidity, and counterparty risks as well as all other risks, including operational risks, that may be material for each UCITS it manages, considering the investment objectives and strategies, the styles or methods of management, and the process of assessment.

The risk management policy must cover:

- ▶ The techniques, tools, and arrangements to enable the management company to comply with its obligations regarding the measurement and management of risk
- ▶ The allocation of risk management responsibilities within the management company

The risk management policy must state the terms, contents, and frequency of reporting of the risk management function to the Board of Directors and to senior management and, where appropriate, to the supervisory function.

The risk management policy should detail the risk management process (RMP - see also Section 7.2.8.) implemented by the management company for the identification, measurement, monitoring, and reporting of the risks. This includes, *inter alia*, how the market risks (including global exposure), liquidity, counterparty and all other risks, including operational risks, must be measured. Guidance on the methodologies applied must be documented.

The policy should also detail techniques, tools, and resources. The measurement techniques should include both quantitative and qualitative methods and allow an adequate assessment of the concentration and interaction of risks at the level of the portfolios managed by the management company.

The risk management policy may take the form of a manual.

Senior management must approve and review on a periodic basis (at least once a year) the risk management policy and arrangements, processes, and techniques for implementing that policy.

Management companies must assess, monitor, and periodically (at least once a year) review:

- The adequacy and effectiveness of the risk management policy and of the arrangements, processes, and techniques implemented for the measurement and management of risk and the calculation of global exposure
- The level of compliance by the management company with the risk management policy and with arrangements, processes, and techniques for the measurement and management of risk and the calculation of global exposure
- The adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process

7.2.5. Risk management function

Management companies are required to establish and maintain a permanent risk management function.

The permanent risk management function is responsible for:

- Implementing the risk management policy and procedures
- Ensuring compliance with the UCITS risk limit system, including statutory limits concerning global exposure and counterparty risk
- Providing advice to the Board of Directors as regards the identification of the risk profile of each UCITS
- Providing regular reports to the Board of Directors and, where it exists, the supervisory function, on:
 - The consistency between the current levels of risk incurred by each managed UCITS and the risk profile agreed for that UCITS
 - The compliance of each managed UCITS with relevant risk limit systems
 - The adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies
- Providing regular reports to senior management outlining the current level of risk incurred by each managed UCITS and any actual or foreseeable breaches to their limits to ensure that prompt and appropriate action can be taken
- For UCITS using value-at-risk (VaR) to calculate global exposure, validating, implementing, and monitoring a system of VaR limits consistent with the risk profile approved by senior management and the Board of Directors and monitoring and control of the VaR limits
- Reviewing and supporting, where appropriate, the arrangements and procedures for the valuation of OTC derivatives

The main mission of the permanent risk management function is therefore to identify, measure and manage the risks of the UCITS which the management company is responsible for and to report to the management body/governing body and to the senior management. These written reports must include analyses which allow the addressees to verify the consistency between:

- The risk levels and the risk profile of each UCITS
- The risk levels and the limits set for each UCITS
- The risk profile and the limits set for each UCITS

and to ensure that no new risk arises.

The reports must also include the measures to address identified deficiencies and to report on the effectiveness of the measures taken.

In general, all interventions of the permanent risk management function must be documented.

The permanent risk management function should be in regular communication with the portfolio management function in order to enable the efficient conduct of risk management activities.

The permanent risk management function should be hierarchically and functionally independent from operating units. However, the CSSF may allow management companies to derogate from this obligation where the derogation is appropriate and proportionate in view of the nature, scale, and complexity of the management company's business and of the UCITS it manages. A management company must, in any case, be able to demonstrate that appropriate safeguards against conflicts of interest have been adopted to allow an independent performance of risk management activities and that its risk management process satisfies the requirements of the 2010 Law.

The permanent risk management function must have the necessary qualifications, knowledge, and expertise in this area. In addition it must have the necessary authority and access to all the relevant information which is necessary to fulfill its functions. The person must perform his/her mandate under the direct responsibility of the conducting officer who is responsible for the risk management function. By virtue of the principle of proportionality, one of the conducting officers may be directly appointed as a person responsible for the permanent risk management function where he has the necessary qualifications, knowledge, and expertise.

The tasks of the person responsible for the permanent risk management function cannot be exercised directly by a member of the management body/governing body of the management company, unless he/she is part of its senior management.

The management company must communicate beforehand to the CSSF the name of the person responsible for the permanent risk management function supplemented by the following pieces of information and any other document which might be subsequently requested by the CSSF:

- A recent curriculum vitae, signed and dated
- A copy of the passport/identity card
- A declaration of honor, as may be downloaded on the CSSF website (www.cssf.lu)
- A recent extract of the criminal record, if available, or any other equivalent document

In the event of a change of the person responsible for the permanent risk management function, the management company must communicate beforehand to the CSSF the name of the person succeeding him/her in office supplemented by the documents required (see above).

The same conducting officer cannot be responsible for both portfolio management and risk management, even if it is delegated to a third party (see Section 5.1.6.2.). The relationship between the internal control functions and the Board of Directors and between internal control functions themselves is covered in Section 6.3.2.1.

The independence of the risk management function is meant to avoid conflicts of interest and to be able to escalate issues to senior management and/or the Board of Directors.

ALFI's *Best Practice Proposals for the Organization of the Risk Function of a UCITS Management Company or UCITS Investment Company* are part of its *Risk Management Guidelines* issued in March 2012. They cover, *inter alia*:

- Risk management principles, risk management function, and other control functions:
 - Risk management function
 - Risk management and its relationship with other control functions
- Practical implementation of a risk management function:
 - Governance and organization
 - Identification of risks
 - Measurement and management of risks
 - Reporting
- Role of risk management in the life-cycle of a fund

In practice, the risk management function will also play a key role in the calculation of the synthetic risk and reward indicator (SRRRI) in the key investor information (KII) document (see Section 7.2.9.).

7.2.6. Risk measurement and management

A. Introduction

The techniques and resources dedicated to the measurement of risks should be commensurate to the nature and scale of the activities of the management company and to the complexity of the investment strategy of the UCITS, including, *inter alia*, the extent to which derivative instruments are used.

The risk categories listed hereafter are the minimum requirements set by the CSSF in terms of risk measurement. UCITS and their management companies may be exposed to other types of risks (e.g., tax risk, legal risk).

As part of the risk measurement process, management companies are required to use sound and reliable data and when appropriate, undertake periodic stress tests and scenario analysis to ensure the adequacy of the methodologies applied.

ALFI's guidelines on stress testing practice for UCITS entitled *Principles for sound stress testing practices*, issued in April 2013, are relevant for all types of risk and all types of UCITS products. They focus on:

- Use of stress testing and integration in UCITS risk governance
- Stress testing methodologies and scenario selection
- Specific areas of focus: specific risks and products
- Reporting and management actions
- Areas of development and improvement in stress testing practices

B. Global risk exposure (market risk)

Management companies are required to self-assess the individual risk profile of each UCITS and to determine, accordingly, the adequate global risk exposure methodology (commitment approach or value-at-risk (VaR)/internal model based approach).

In its *Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS, of July 2010*, ESMA indicates that the commitment approach should not be applied to UCITS:

- That engage in complex investment strategies that represent more than a negligible part of the UCITS' investment policy
- That have more than a negligible exposure to exotic derivatives
- For which the commitment approach may not adequately capture the related risks (e.g., non-directional risks like volatility risk, gamma risk or basis risk)

UCITS are expected to use a maximum loss approach to assess whether the complex investment strategy or the use of exotic derivatives represent more than negligible exposure.

Index tracking leveraged UCITS (and UCITS replicating leveraged indices) must comply with the limits and rules on global exposure, using either the commitment approach or the relative VaR approach.

Calculation, measurement, and monitoring of the global exposure need to be performed at least on a daily basis.

CSSF Circular 11/512 introduced the intra-day calculation concept, whenever required.

ESMA's guidelines also provide some clarifications on the extent to which intra-day market risk calculations would need to be performed: in case of exceptional market circumstances (e.g., on a particular day due to increased volatility) or on the basis of complex investment strategies for which the global exposure would change significantly from one day to the next.

Where FDIs are used and benefit only specific share classes (e.g., hedging, leverage), it is good practice to calculate global risk exposure (market risk) and leverage at share class level, although there are no specific requirements on calculations at share class level.

(a) Commitment approach

The total commitment is considered to be the sum of the absolute value of the commitment of each individual position, after taking into account netting and hedging.

The management company should convert each FDI position into the market value of an equivalent position in the underlying asset of that derivative (standard commitment approach). Management companies may apply other calculation methods that are equivalent to the standard commitment approach.

CSSF Circular 11/512 refers to the ESMA guidelines on the calculation methodologies to be adopted for the most common FDIs:

- Futures
- Plain vanilla options (bought/sold puts and calls)
- Swaps
- Forwards
- Financial instruments that embed derivatives

Non-standard (exotic) derivatives calculation methodologies are detailed for variance swaps, volatility swaps, and barrier (knock-in knock-out) options.

ESMA excludes an FDI from the calculation of the global exposure when it meets all of the following criteria:

- It swaps the performance of the assets held in the UCITS portfolio for the performance of other assets
- It totally offsets the market risks of the swapped assets held in the UCITS portfolio
- It includes neither additional optional features, leverage clauses, nor additional risks as compared to a direct holding in the reference financial assets

The management company may take account of netting and hedging arrangements when calculating global exposure, where these arrangements do not disregard obvious and material risks and result in a clear reduction in risk exposure.

Where the use of FDIs does not generate incremental exposure for the UCITS, the underlying exposure need not be included in the commitment calculation.

Temporary borrowing arrangements need not be included in the global exposure calculation.

An optional regime is available to structured UCITS that meet specific criteria. In such cases, based on the pay-off structure of the UCITS and the applicable scenarios for the investor, the commitment approach may be used to calculate the global exposure for each scenario. The global exposure of each individual scenario would need to comply with the limit set for the UCITS.

(b) Value-at-risk (VaR)/internal model approach

UCITS using the approach of estimating their maximum loss at a high confidence level should base the calculation of the market risk on an internal model taking into consideration general market risk as well as specific market risk. The most commonly accepted internal model is the VaR model supplemented by stress tests. Other models can be used provided they receive CSSF approval. The choice of the appropriate VaR model (e.g., parametric, historical simulation or Monte Carlo) remains the responsibility of the UCITS.

ESMA considers in particular that the VaR model selected should include all the positions of the UCITS portfolio and capture all the material risks associated with the portfolio positions.

Models need to be independently validated and back tested before being used for the first time. The validation should cover the implementation of the VaR model in the overall risk management framework, providing highlights on governance, data management, methodologies, reporting, and use.

The validation is expected to be performed by an independent business unit dedicated to internal controls or model validation or by an external entity (different to the entity providing the VaR model) that would be able to demonstrate sufficient knowledge and expertise on risk management (e.g., internal audit, external auditor).

Should a significant change be made to the model, independent validation must be repeated.

The validation of the VaR model to be undertaken by a party independent from that involved in the development process is intended to ensure the model is conceptually sound and adequately captures all material risks.

A model governance process should also be put in place to make sure that the model is fit for purpose.

CSSF Circular 11/512 introduces two concepts of VaR with different limits:

- If a reference portfolio (or “benchmark”) can be determined, the CSSF allows the use of a relative VaR where the portfolio VaR cannot be more than twice (200%) the reference portfolio VaR. The choice of the reference portfolio needs to be duly documented
- Where there is no reference portfolio, an absolute VaR figure must be calculated. Absolute VaR limit cannot exceed 20% of the NAV

ESMA guidelines in relation to the selection of a reference portfolio

Under the relative VaR approach, ESMA detailed the requirements related to the selection of a reference portfolio. The reference portfolio should comply with the following criteria:

- It should be unleveraged and not contain any derivatives (or embedded derivatives), except for UCITS investing in long/short investment strategies and UCITS that intend to have a currency hedged portfolio
- The risk profile of the reference portfolio should be consistent with the UCITS investment objectives
- The risk/return profile of the UCITS should not change frequently
- The process relating to the determination and maintenance of the reference portfolio should be documented

The risk management function must, for each UCITS, validate and implement a system of VaR limits consistent with the risk profile that is to be approved by senior management and the Board of Directors. This may be in the form of a separate document. The monitoring and control of the VaR limits must be undertaken by the risk management function on a daily basis and regular control over the level of leverage generated by the UCITS must be performed. Through regular reports, senior management must be informed of the current VaR measures.

The VaR model parameters to be used are the following:

- Confidence interval: 99%
- Holding period: equivalent to 1 month (20 days)
- Observation period of risk factors: at least 1 year (250 days), unless a shorter period is justified by a significant increase in price volatility
- Data update: quarterly (particularly relevant to parametric VaR models)
- Calculation frequency: at least daily

A different confidence interval or holding period may be used with prior approval of the CSSF provided a conversion is made to bring the VaR to an equivalent value. Additional details on the rescaling of the VaR limit are provided in ESMA’s guidelines.

The risk management function is responsible for sourcing, testing, maintaining and using internal models (e.g., VaR models) on a day-to-day basis. As part of its responsibility, the risk management function must ensure the model is adapted to the UCITS’ portfolio on a continuous basis and perform regular validations.

The VaR model should be fully integrated within the risk management function and be part of its daily work. The VaR process should be developed in coordination with the investment process led by the investment managers in order to keep the UCITS risk profile under control and consistent with the investment strategy.

The management company must adequately document the VaR model and the related processes and techniques. The documentation must cover, *inter alia*, the following:

- Risks covered by the model
- Model methodology
- Mathematical assumptions and foundations
- Data used
- Accuracy and completeness of the risk assessment
- Back testing process
- Stress testing process
- Validity range of the model
- Operational implementation

- (c) Additional techniques/measures to be implemented in case of the use of a VaR approach

Backtesting

In addition to the daily computation of the VaR, the accuracy and performance of the model (i.e., prediction capacity of risk estimates) need to be monitored by conducting a back testing program at least on a monthly basis.

ESMA guidelines in relation to back testing:

- ▶ The backtesting program should provide for each business day a comparison of the one-day VaR measure generated by the UCITS model for the UCITS' end-of-day positions to the one-day change of the UCITS' portfolio value by the end of the subsequent business day
- ▶ The UCITS should carry out the backtesting program at least on a monthly basis, subject to always performing retroactively the comparison for each business day in the previous bullet point
- ▶ The UCITS should determine and monitor the "overshootings" on the basis of this backtesting program. An "overshooting" is a one-day change in the portfolio's value that exceeds the related one-day VaR measure calculated by the model
- ▶ If the backtesting results reveal a percentage of "overshootings" that appears to be too high, the UCITS should review the VaR model and make appropriate adjustments
- ▶ The UCITS senior management should be informed at least on a quarterly basis (and where applicable the UCITS competent authority should be informed on a semi-annual basis) if the number of "overshootings" for each UCITS for the most recent 250 business days exceeds 4 in the case of a 99% confidence interval. This information should contain an analysis and explanation of the sources of "overshootings" and a statement of what measures, if any, were taken to improve the accuracy of the model. The competent authority may take measures and apply stricter criteria to the use of VaR if the "overshootings" exceed an unacceptable number.

The ALFI *guidelines related to VAR model backtesting* issued in May 2017 aim to help practitioners perform and interpret backtests and to find answers as to what they could do when faced with a risk model that fails regular backtests and analysis. As such, it goes through the impacts of varying market conditions and underlying assumptions that may bias the results generated by typical VaR models.

Stress testing

CSSF Circular 11/512 requires UCITS using a VaR model to complement the approach with a stress testing program. Stress tests aim at capturing extreme markets events (e.g., 9/11 attacks, Lehman default) with theoretical or historical scenarios. ESMA guidelines provide additional details on stress testing qualitative and quantitative requirements.

The stress testing program should capture the impact of unexpected changes in market parameters and correlation factors on the UCITS portfolio value. Results should be taken into account in the investment management and risk management process.

Under the quantitative requirements, stress tests must capture all the risks not adequately covered by the VaR model and those risks that, though not significant in normal circumstances, are likely to be significant in situations of stress (e.g., unusual correlation changes, illiquidity of markets in stressed market situations or the behavior of complex structured products under stressed liquidity conditions). Finally, stress tests should foresee scenarios exposing the UCITS portfolio to large downside risks leading to events such as the default of the UCITS (i.e., $NAV < 0$) in case of significant leverage.

Under the qualitative requirements, stress tests must be performed at least on a monthly basis. The design of the scenarios should be suitable to the UCITS portfolio composition and market conditions. The design of the program should be duly justified and documented.

Further guidance is provided in ALFI's *Principles for sound stress testing practices*.

Leverage ratio

Additional safeguards require regular monitoring of the UCITS leverage. Leverage should be calculated as the sum of the notional amounts of the derivatives used. The level of leverage may, for example, be the average of the levels of leverage observed during the financial year. The data must be at least bi-monthly.

CSSF *Communiqué 12/29* clarifies that, in line with ESMA's *Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS*, the leverage to be included in the prospectus (see also Section 10.3.1.) and the annual report (see also Section 10.5.1.) for those UCITS determining the global exposure using a VaR approach is to be calculated on the basis of the sum of the notionals of derivative instruments used, while allowing these UCITS to supplement this information using (a) leverage figure (s) calculated through the commitment approach.

UCITS employing high levels of leverage are required to provide additional information to the CSSF (see Section 7.2.8.).

The International Capital Market Association's (ICMA) Asset Management and Investors Council (AMIC) and the European Fund and Asset Management Association (EFAMA) issued a paper on 19 July 2017 analyzing how leverage is used, how the European legislative framework addresses leverage, and how the related risks are addressed from a technical perspective. In order to contribute to recent debates launched by regulators and supervisors, it also looks at the updates and improvements that could be proposed to ensure that the European regulation remains a cutting-edge framework at global level.

Additional risk indicators

ESMA guidelines indicate that UCITS should supplement the VaR and stress testing framework, where appropriate, by taking into account the risk profile and the investment strategy being pursued, with other risk measurement methods.

Conditional VaR (CVaR) or Extreme Value Theory (EVT) approaches might be considered together with basic risk indicators (e.g., Greeks).

C. Counterparty risk

The counterparty risk linked to over-the-counter (OTC) FDIs should be calculated as the positive mark-to-market value of the contract. The 2010 Law limits the OTC counterparty risk exposure to 10% of the NAV when the counterparty is an EU credit institution or a credit institution subject to prudential rules considered by the CSSF to be equivalent to that laid down in EU Law and 5% of the NAV in all other cases. Eligible counterparties must be subject to CSSF supervision or equivalent prudential supervision and specialized in this type of transaction.

The net exposures of UCITS to a counterparty arising from securities lending transactions or reverse purchase/repurchase agreement transactions should be taken into account within the limit of 20% provided for in Section 4.2.2.8.1.1.(6).

If there are no arrangements that protect UCITS against the risk of insolvency of the relevant broker, exposure in relation to the initial margins posted by UCITS to a broker and variation margins to be received by UCITS from the broker within the context of FDIs dealt in on a regulated market or OTC FDIs must be included within the counterparty risk limits of 5% and 10%.

ESMA guidelines set out general principles related to collateral eligibility for netting purposes (e.g., with respect to liquidity, valuation, and issuer credit rating).

ESMA's *Guidelines on ETFs and other UCITS issues* lay down rules on the management of collateral for OTC FDI transactions (see Section 4.2.2.3.F.) and efficient portfolio management (EPM) techniques (see Section 4.2.2.6.). These include, *inter alia*:

- ▶ Risk exposures to a counterparty arising from OTC FDI transactions and EPM techniques should be combined when calculating the counterparty risk limits
- ▶ Operational and legal risk related to the management of collateral need to be mentioned in the risk management process (RMP - see Section 7.2.8.)
- ▶ UCITS receiving collateral for at least 30% of its assets need to design a stress testing policy in order to assess the liquidity risk attached to the collateral
- ▶ UCITS need to define a clear haircut policy adapted for each class of assets received as collateral

Additionally, UCITS using EPM techniques need to:

- Adequately capture in the RMP the risks arising from these activities, with a focus on counterparty risk
- Ensure EPM does not add substantial supplementary risks in comparison to the original risk policy
- Consider the EPM usage when developing the liquidity risk management process, in order to comply at any time with redemption obligations

OTC FDI transactions may be excluded from the counterparty risk exposure, if all of the following requirements are met:

- Backing by an appropriate completion guarantee
- Daily valuation of the market values of the positions on FDIs
- Making margin calls at least once a day

ALFI issued practical guidelines in its *Industry work paper - collateral management* as part of its *Risk Management Guidelines* of March 2012.

According to ESMA's *Questions and Answers on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS*, when calculating the counterparty risk for exchange-traded derivatives and OTC transactions that are centrally cleared, UCITS should look at the clearing model used to determine the existence of counterparty risk and, if any, where the counterparty risk is located. When analyzing the clearing model used, UCITS should have regard to the existence of segregation arrangements of the assets and the treatment of claims on these assets in the event of bankruptcy of the clearing member or central counterparty.

D. Liquidity risk

Management companies are required to implement an appropriate liquidity risk management procedure supported by a stress testing program (if appropriate) in order to ensure that the liquidity profile of the investments of the UCITS is appropriate to the redemption policy.

Liquidity risk is the risk that a position in the UCITS portfolio cannot be sold, liquidated or closed at limited cost in an adequately short time frame or that the ability of a UCITS to proceed, at any time, with investor redemptions is compromised.

The liquidity risk framework should cover funding risk, market liquidity risk, reconciliation to other risk types and regulatory requirements, and operational issues and be integrated into the current global risk management framework.

ALFI's guidelines on *UCITS Liquidity Risk Management* published in March 2013 cover, *inter alia*:

- Principles of liquidity risk management for UCITS funds distinguishing between:
 - Market liquidity risk (also referred to as asset liquidity risk)
 - Funding liquidity risk (also referred to as investor behavior risk or subscription/redemption risk)
- Elements of a sound liquidity risk management framework

Liquidity risk management tools and techniques

In December 2019, the CSSF published CSSF Circular 19/733 implementing the IOSCO recommendations for *Liquidity Risk Management for Collective Investment Schemes* (FR01/2018), issued in February 2018, in Luxembourg with immediate effect.

The Circular emphasizes that there should be *an appropriate alignment between portfolio assets and redemption terms throughout the entire lifecycle of the fund* (design, pre-launch, launch and subsequent operations).

CSSF Circular 19/733 provides that:

- During the design phase, the responsible body in charge of the UCI should, *inter alia*:
 - Draw up an effective liquidity risk management process, effective in both normal and stressed conditions, compliant with local jurisdictional liquidity requirements
 - Have a liquidity risk management process, which is supported by strong and effective governance

- ▶ Set dealing frequency arrangements which are appropriate with regards to the investment strategy and underlying assets through the entire life cycle of the UCI.
 - i. On the asset side, current and historical liquidity of target assets and instruments must be considered
 - ii. On the liability side, UCIs should take reasonable steps to understand the target investor base, the concentration thereof and the expected redemption patterns
- ▶ Set appropriate liquidity thresholds which are proportionate to the redemption obligations and liabilities of the UCI
- ▶ Carefully determine a suitable dealing frequency for units in the UCI
- ▶ Ensure that the UCI's dealing (subscription and redemption) arrangements are appropriate for its investment strategy and underlying assets throughout the entire product life cycle, starting at the product design phase
- ▶ Consider liquidity aspects related to its proposed distribution channels
- ▶ Ensure to have access to, or can effectively estimate, relevant information for liquidity management. (IOSCO recommendation 5 suggests contractual arrangements with nominees to secure access to investor concentration data or other investor information as appropriate. As a matter of principle, UCIs should be able to access all information which is relevant for liquidity risk management.)
- ▶ Consider an appropriate range of liquidity management tools ("LMTs") built in the dealing policies or contingent to the occurrence of certain events such as redemption requests above a predetermined threshold. These include, *inter alia*, exit charges, limited redemption restrictions, gates, anti-dilution levies, swing pricing, in specie transfers, lock-up periods, contractual limitations of redemption rights, notice periods, side-pockets and suspensions
- ▶ Ensure that liquidity risk and its liquidity risk management process are effectively disclosed to investors and prospective investors in a manner which is effective, adapted to the nature of underlying assets, adapted to the degree of sophistication of the investors' profile and proportionate to the risks
- ▶ On a day-to-day basis, the UCI's governing body should, *inter alia*:
 - ▶ Effectively perform and maintain its liquidity risk management process
 - ▶ Regularly assess the liquidity of the assets held in the portfolio
 - ▶ In assessing the liquidity of portfolio assets, due care should be given to compliance with defined liquidity limits and the redemption policy (Indicators to monitor include, in particular, time-to-liquidate assets, price, financial settlement lags and interdependence with other market risks and factors)
 - ▶ Integrate liquidity management in investment decisions
 - ▶ Have a liquidity risk management process, which should facilitate the ability to identify an emerging liquidity shortage before it occurs, allowing prompt and appropriate remedial actions with the objective to protect investors' interests
 - ▶ Be able to incorporate relevant data and factors into the liquidity risk management process in order to create a robust and holistic view of the possible risks
 - ▶ Assess the liquidity quality of securities accepted as collateral and pay particular attention to temporary borrowing
 - ▶ Review the effectiveness of the LRM process on a regular basis and update as appropriate, notably in case of certain events such as an investment in a new type of asset
 - ▶ Conduct ongoing liquidity assessments in different scenarios, which could include fund level stress testing, in line with regulatory guidance
 - ▶ Ensure appropriate records are kept, and relevant disclosures made, relating to the performance of its liquidity risk management process
 - ▶ Put in place and periodically test contingency plans with the aim of ensuring that any applicable liquidity management tools can be used where necessary, and if being activated, can be exercised in a prompt and orderly manner
 - ▶ Consider the use of additional liquidity management tools to the extent allowed by local law and regulation, in order to protect investors from, *inter alia*, unfair treatment, or prevent the UCI from diverging significantly from its investment strategy

ESMA *Guidelines on liquidity stress testing ("LST") in UCITS and AIFs* were published on 2 September 2019 and are applicable as from 30 September 2020. They require UCIs to have, *inter alia*:

- ▶ A LST policy embedded in the UCI's risk management framework and subject to appropriate governance, oversight, reporting and escalation
- ▶ A validation of the LST model which is independent from the portfolio management function

- LST models adapted to each UCI using specific liquidity risk factors and including difficult-to-model parameters
- Sufficiently severe hypothetical and historical scenarios, including reverse stress testing where appropriate
- Combined testing of UCIs' assets and liabilities
- Appropriate oversight of third-party models
- LSTs carried out at least annually, when material risk must be addressed in a timely manner and during all stages of a UCI's lifecycle
- LST indicators which:
 - i. Facilitate liquidity management in the best interest of the investors and in compliance with the UCI rules
 - ii. Help identify potential liquidity weaknesses of an investment strategy
 - iii. Assist decision-making, including setting relevant limits by the manager
- At product development stage, a manager of a UCI which requires authorization from the CSSF should be able to demonstrate that its strategy and dealing frequency enable the UCI to remain sufficiently liquid in normal and stressed conditions. Where appropriate, managers should undertake LST, using a model portfolio and expected investor profiles at all stages of the UCI's lifecycle
- Managers should notify the CSSF of material liquidity risks and actions undertaken to mitigate them. NCA may also request managers to provide their LST models and their results.
- Depositories have a duty to ensure that a manager of a UCI has documented procedures for its LST program, but not to challenge the LST

E. Concentration risk

The issuer concentration risk must be calculated using the commitment approach, if this is appropriate, or the maximum potential loss approach. Netting is authorized, provided certain conditions are met. For concentration risk requirements, see Section 4.2.2.8.1.

F. Operational risk

Operational risk is defined as the risk of loss for the UCITS resulting from inadequate internal processes and failures in relation to people and systems of the management company or from external events, and includes legal and documentation risk and risk resulting from the trading, settlement, and valuation procedures operated on behalf of the UCITS.

A management company is required to cover operational risks in its risk management policy. The operational risk entailed by delegated activities is covered in Section 7.2.7.

ALFI's guidelines of April 2014 on *Operational Risk Management within UCITS* cover, *inter alia*:

- Legal and regulatory framework as well as European and Luxembourg industry guidelines
- The governance and management of operational risks, including examples of generic and specific operational risks to UCITS funds and recommended risk mitigants. The aim of these guidelines on operational risks is to present good practice proposals
- Tools to assist with the assessment, monitoring, and tracking of operational risks for UCITS. The tools include:
 - An operational risk monitoring table providing an overview of risk measurement and monitoring approaches for the categories of operational risk, focusing on the three main functions of a management company (investment management, administration, marketing/distribution)
 - Well-defined policies and procedures
 - Risk control self-assessments (RCSA)
 - Key risk indicators/key performance indicators
 - Risk management approval for new business
 - Due diligence on delegates
 - Maintenance of a risk event database (RED)
 - Additional recommended tools (Internal Capital Adequacy Assessment Process (ICAAP), scenario analysis, post implementation reviews)
- General principles on the effective reporting of risk management issues to senior management and the Board, covering to whom and when to effectively escalate operational risk issues
- Key risk indicators for operational risk

G. Reliance on external credit ratings

Directive 2013/14/EU on over-reliance on credit ratings sets out a general principle against the over-reliance on credit ratings that should be integrated into the risk management processes and systems of a UCITS management company or investment company.

A UCITS management company or investment company must not solely or mechanically rely on external credit ratings issued by credit rating agencies for assessing the creditworthiness of the UCITS' assets.

Taking into account the nature, scale, and complexity of the UCITS' activities, the national competent authority (i.e., CSSF) is required to monitor the adequacy of the credit assessment processes of the management company or investment company, assess the use of references to external credit ratings and, where appropriate, encourage mitigation of the impact of such references, with a view to reducing sole and mechanistic reliance on such external credit ratings.

ESMA publishes a list of registered and certified credit rating agencies.

7.2.7. Delegation of risk management activities

Where management companies delegate the risk management function to third parties, the responsibility for risk management remains with the management company.

Management companies are required to exercise due skill, care, and diligence when entering into, managing or terminating any arrangements with third parties in relation to the performance of risk management activities. Before entering into such arrangements, management companies must take the necessary steps in order to verify that the third party has the ability and capacity to perform the risk management activities reliably, professionally, and effectively. The management company must establish methods for the ongoing assessment of the standard of performance of the third party (see also Section 6.3.5.1.).

ALFI issued a *Guidance paper for the risk monitoring of functions outsourced/delegated by a management company or investment company* as part of its *Risk Management Guidelines* of March 2012.

The paper covers each phase of delegation of outsourcing relationships:

- ▶ Initiation (planning to outsource)
- ▶ Life (ongoing delegate monitoring)
- ▶ Termination

7.2.8. Communication to the CSSF

The CSSF requires management companies to provide certain information in relation to the risk management policy in order to identify, measure, manage, control, and report on the risks that may be material for the UCITS they manage.

CSSF Circular 11/512 lays down the required content and format of the risk management process document (RMP):

- | | |
|--|--|
| 1. Governance and risk management function organization | 2.2 Commitment approach |
| 1.1 Organization chart | 2.3 VaR approach |
| 1.2 Governance structure | 2.4 Back testing |
| 1.3 Independence of the risk management function | 2.5 Stress testing |
| 1.4 Risk management policy | 2.6 Disclosure |
| 1.5 Permanent risk management function | 3. Liquidity risk |
| 1.6 Adequacy and review of the risk management policy | 4. Counterparty risk of OTC FDIs |
| 1.7 Risk reporting | 5. Counterparty risk linked to EPM techniques |
| 1.8 IT tools and systems | 6. Operational risk |
| 1.9 Delegation | 7. Concentration risk |
| 1.10 New products approval process | 8. Pricing risk |
| 1.11 Interaction with compliance and internal audit | 9. Legal risk |
| 2. Global exposure | 10. OTC FDI valuation |
| 2.1 General description (frequency, self-assessment and methodology) | 11. Cover rules |
| | 12. Specific requirements for discretionary portfolio management |
| | 13. List of UCITS |
| | 14. Conclusion |

The RMP must be included in the application for authorization for a management company.

It must be updated at least on a yearly basis and it must be submitted to the CSSF within five months of the closing date of the management company's financial year or the self-managed UCITS financial year.

In case of any material modification to the risk management policy, the RMP must be updated promptly and communicated to the CSSF.

The documentation of the risk profile of the sub-funds managed and that of the analysis of the consistency with the set limits and identified risk levels must be immediately available upon the CSSF's request.

A copy of the report regularly established by the risk management function for the senior management and governing body relating to the adequacy and effectiveness of the method for risk management must be included with the RMP transmitted to the CSSF.

UCITS employing high levels of leverage should provide the CSSF with information on the ownership structure (e.g., target investors). The CSSF may request such UCITS to provide additional quarterly ad hoc reporting on performance and risks (e.g., leverage, VaR, stress tests).

As regards identification and reporting of breaches of VaR limit requirements to the CSSF, please refer to Section 8.8.3.1.

Reporting of UCI financial information to the CSSF is covered in Chapter 10.

7.2.9. Disclosures to investors

The risk and reward profile of a UCITS must be disclosed in the key investor information (KII), including guidance on the associated risks. This will take the form of:

- ▶ A synthetic risk and reward indicator (SRRI): The SRRI aims to provide potential investors with an indication of the overall risk and reward profile of a UCITS. The SRRI corresponds to an integer number designed to rank the UCITS, according to its increasing level of volatility, on a scale from 1 to 7
- ▶ A narrative explanation of the main limitations of the SRRI
- ▶ A narrative presentation of the material risks that are not fully captured by the methodology of the SRRI

For further information, see Section 10.3.2.1.

Prospectus disclosures in relation to market risk are required on:

- ▶ The method to calculate the global exposure
- ▶ Expected level of leverage as well as possibility of higher leverage levels, where relevant
- ▶ Information on reference portfolio for UCITS using a relative VaR approach

Additional risk-related prospectus disclosures are required, *inter alia*, for:

- ▶ Structured UCITS where the commitment approach is used for the calculation of global exposure
- ▶ UCITS using efficient portfolio management (EPM) techniques
- ▶ UCITS entering into total return swaps (TRS) or similar derivative instruments
- ▶ Management of collateral
- ▶ Index-tracking UCITS

For further information, see Section 10.3.1.

Annual report disclosures are required on:

- ▶ The method to calculate the global exposure
- ▶ Information on reference portfolio for UCITS using a relative VaR approach
- ▶ Information on the VaR limit – the lowest, highest and average levels
- ▶ The leverage level during the last financial year for UCITS using the VaR to determine the global exposure

Good practice would also be to disclose such information in the semi-annual report.

For further information, see Section 10.5.1.

7.3. Risk management for AIF

7.3.1. Introduction

In this section, reference to AIFM refers both to alternative investment fund managers and internally managed AIFs.

AIFM must implement adequate risk management systems in order to identify, measure, manage and monitor appropriately all risks relevant to each AIF investment strategy and to which each AIF is or may be exposed.

2010 Law Part II UCIs, ELTIFs and RAIFs automatically qualify as AIFs. SIFs, EuVECAs and EuSEFs may qualify as AIFs.

Risk management systems comprise relevant elements of the organizational structure of the AIFM, with a central role for a permanent risk management function, policies and procedures related to the management of risk relevant to each AIF's investment strategy, and arrangements, processes and techniques related to risk measurement and management employed by the AIFM in relation to each AIF it manages.

AIFM must review their risk management systems, and update them whenever necessary:

- With appropriate frequency, and at least once a year
- Where material changes are made to risk management policies, internal or external events indicate that a review is required or material changes are made to the investment strategy and objectives of the AIF

AIFM must, for each managed AIF that is not an unleveraged closed-ended AIF, employ an appropriate liquidity management system and adopt procedures that enable them to monitor the liquidity risk of the AIF and ensure that the liquidity profile of the investments of the AIF complies with its underlying obligations.

7.3.2. Key regulations

The risk and liquidity management requirements applicable to AIFM are laid down in the AIFM Law and the AIFM Level 2 implementing regulation.

In addition, CSSF Circular 18/698 of 23 August 2018 on the *authorization of investment fund managers incorporated under Luxembourg law - specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent* also sets out some additional requirements in relation to the governance and implementation of the risk management function.

In May 2014, ALFI published a document entitled *Risk Management under AIFMD*. The document outlines general principles on, and illustrates, the risk management function under AIFMD.

This guidance covers, *inter alia*:

- An overview of risk management areas addressed by AIFMD
- High level principles when implementing a risk management function:
 - Governance and organization of risk management
 - Risk management models
 - Risk management policy, procedures, and process
 - Identification of risks
 - Measurement and management of risks
 - Reporting of risks and related information
 - To the senior management or the Board
 - To the competent authorities
 - To investors

As each AIFM should tailor its risk management systems to its own structure and AIF, and taking into account the principle of proportionality where relevant, the document does not provide detailed rules on risk management under AIFMD.

In addition to the guidelines, ALFI also published the first edition of the Q&A document *Risk Management for AIF under AIFMD* in April 2014. The document covers, *inter alia*:

- Leverage:
 - The difference between the “sum of notional” approach for UCITS and the “gross” and commitment approaches under AIFMD
 - The meaning of “cash and cash equivalents”
- Risk governance and risk processes:
 - Comparison of UCITS and AIFMD risk limits
 - Reliance on data from private sources
 - Role and responsibilities of the conducting officer and of the permanent risk management function

7.3.3. Risk profile and risk limits

An AIFM's governing body is required to approve the risk profile of the AIF it manages. The AIFM must ensure that the risk profile of the AIF corresponds to the size, portfolio structure and investment strategies and objectives of the AIF as laid down in the constitutional document, prospectus and offering documents. The AIFM is required to periodically disclose to investors the current risk profile of the AIF and the risk management systems employed to manage those risks.

The AIFM is required to establish and implement quantitative or qualitative risk limits, or both, for each AIF it manages, taking into account all relevant risks. The qualitative and quantitative risk limits for each AIF must, at least, cover:

- Market risks
- Credit risks
- Liquidity risks
- Counterparty risks
- Operational risks

The risk management function is required to ensure that the risk profile of the AIF disclosed to investors is consistent with the risk limits. Senior management must approve and review on a periodic basis the risk limit system for each AIF.

AIFM must implement appropriate procedures on remedial action to be taken, in the best interests of shareholders or unitholders, in case of breaches or foreseeable breaches of the limits (see also Section 8.8.3.).

7.3.4. Risk management policy

An AIFM is required to establish, implement, and maintain an adequate and documented risk management policy that identifies all the relevant risks to which the AIF it manages are or may be exposed.

The risk management policy must comprise the procedures necessary to enable the AIFM to assess for each AIF it manages the exposure of that AIF to market, liquidity, and counterparty risks, and the exposure of the AIF to all other relevant risks, including operational risks, that may be material for each AIF it manages.

The risk management policy must cover:

- The techniques, tools, and arrangements that enable it to comply with its obligations regarding the measurement and management of risk
- The techniques, tools, and arrangements that enable liquidity risk of the AIF to be assessed and monitored under normal and exceptional liquidity conditions including through the use of regularly conducted stress tests
- The allocation of responsibilities within the AIFM pertaining to risk management
- The risk limits set and a justification of how these are aligned with the risk profile of the AIF disclosed to investors
- The terms, contents, frequency, and addressees of reporting by the permanent risk management function to the governing body and senior management

The risk management policy must include a description of the safeguards against conflicts of interest to allow for the independent performance of the risk management activities (see Section 7.3.5.).

The risk management policy must be appropriate to the nature, scale, and complexity of the business of the AIFM and of the AIF it manages.

Senior management must approve and review on a periodic basis the risk management policy and arrangements, processes, and techniques for implementing that policy.

AIFM must assess, monitor, and periodically, at least once a year, review:

- The adequacy and effectiveness of the risk management policy and of the arrangements, processes, and techniques implemented for the measurement and management of risk
- The degree of compliance by the AIFM with the risk management policy and with arrangements, processes, and techniques for the measurement and management of risk
- The adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process

7.3.5. Risk management function

An AIFM must establish and maintain a permanent risk management function.

The permanent risk management function is responsible for:

- Implementing effective risk management policies and procedures in order to identify, measure, manage and monitor on an ongoing basis all risks relevant to each AIF's investment strategy to which each AIF is or may be exposed
- Participating in the identification, development and monitoring of risk profiles of the AIFs
- Ensuring that the risk profile of the AIF disclosed to investors is consistent with the risk limits
- Monitoring compliance with the risk limits and notifying the AIFM's governing body and, where it exists, the AIFM's supervisory function in a timely manner when it considers the AIF's risk profile inconsistent with these limits or sees a material risk that the risk profile will become inconsistent with these limits
- Providing regular updates to the governing body of the AIFM and, where it exists, the AIFM's supervisory function at a frequency that is in accordance with the nature, scale, and complexity of the AIF or the AIFM's activities on:
 - The consistency between and compliance with the risk limits and the risk profile of the AIF as disclosed to investors
 - The adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been or will be taken in the event of any actual or anticipated deficiencies
- Providing regular updates to senior management outlining the current level of risk incurred by each managed AIF and any actual or foreseeable breaches of any risk limits set to ensure that prompt and appropriate action can be taken
- Assessing and, where appropriate, contributing to the effectiveness of asset valuation systems and procedures

The main mission of the permanent risk management function is therefore to identify, measure and manage the risks of UCIs and to report to the management body/governing body and to the senior management of the AIFM. These written reports must include analyses which allow the addressees to verify the consistency between:

- The risk levels and the risk profile of each AIF
- The risk levels and the limits set for each AIF
- The risk profile and the limits set for each AIF

and to ensure that no new risk arises.

The reports must also include the measures to address identified deficiencies and to report on the effectiveness of the measures taken to this end.

The risk management function must have the necessary authority and access to all relevant information necessary to fulfill its tasks.

In general, all interventions of the permanent risk management function must be documented.

Every AIFM must, in principle, designate a person among its staff who is responsible for the permanent risk management function and who possesses the necessary skills, knowledge and expertise in the area. This person must perform his/her function under the direct responsibility of the conducting officer in charge of the risk management function.

The AIFM must communicate beforehand to the CSSF the name of the person responsible for the permanent risk management function supplemented by the following pieces of information and any other document which might be subsequently indicated by the CSSF:

- A recent curriculum vitae, signed and dated
- A copy of the passport/identity card
- A declaration of honour, as may be downloaded on the CSSF website (www.cssf.lu)
- A recent extract of the criminal record, if available, or any other equivalent document

In the event of a change of the person responsible for the permanent risk management function, the AIFM must communicate beforehand to the CSSF the name of the person succeeding him/her in office supplemented by the documents required (see above).

The tasks of the person responsible for the permanent risk management function cannot be exercised directly by a member of the management body/governing body of the management company, unless he is part of its senior management.

The conducting officer in charge of the permanent risk management function or directly responsible for the permanent risk management function may not, at the same time, be the conducting officer responsible for investment management, even if this function is delegated to a third party. Furthermore, the conducting officer in charge of the permanent risk management function may not be in charge of the internal audit function.

The person responsible for the permanent risk management function cannot at the same time be responsible for the internal audit function. By contrast, it is permissible to combine the responsibilities for the compliance and the risk management functions.

AIFM must functionally and hierarchically separate the functions of risk management from the operating units, including from the functions of portfolio management. However, the CSSF may allow AIFM to derogate from this obligation in accordance with the principle of proportionality. The AIFM must, in any case, be able to demonstrate that specific safeguards against conflicts of interest allow for the independent performance of risk management activities and that the risk management process satisfies the requirements of the AIFM and is consistently effective.

The functional and hierarchical separation of the risk management function must be ensured throughout the whole hierarchical structure of the AIFM, up to its governing body, and must be reviewed by the governing body and, where it exists, the supervisory function of the AIFM.

The risk management function is considered as functionally and hierarchically separated from the operating units, including the portfolio management function, when all the following conditions are satisfied:

- Persons engaged in the performance of the risk management function are not supervised by those responsible for the performance of the operating units, including the portfolio management function, of the AIFM
- Persons engaged in the performance of the risk management function are not engaged in the performance of activities within the operating units, including the portfolio management function
- Persons engaged in the performance of the risk management function are compensated in accordance with the achievement of the objectives linked to that function, independently of the performance of the operating units, including the portfolio management function
- The remuneration of senior officers in the risk management function is directly overseen by the remuneration committee, where such a committee has been established (see also Section 6.4.3.)

The risk management policy must include a description of the safeguards against conflicts of interest to allow for the independent performance of the risk management activities, in particular:

- The nature of the potential conflicts of interest
- The remedial measures put in place
- The reasons why these measures should be reasonably expected to result in independent performance of the risk management function
- How the AIFM expects to ensure that the safeguards are consistently effective

The safeguards against conflicts of interest must ensure, at least, that:

- Decisions taken by the risk management function are based on reliable data that are subject to an appropriate degree of control by the risk management function
- The remuneration of those engaged in the performance of the risk management function reflects the achievement of the objectives linked to the risk management function, independently of the performance of the business areas in which they are engaged
- The risk management function is subject to an appropriate independent review to ensure that decisions are being arrived at independently

- The risk management function is represented in the governing body or the supervisory function, where it has been established, at least with the same authority as the portfolio management function
- Any conflicting duties are properly segregated
- Where proportionate, taking into account the nature, scale, and complexity of the AIFM:
 - The performance of the risk management function is reviewed regularly by the internal audit function or, if the latter has not been established, by an external party appointed by the governing body
 - Where a risk committee has been established, it is appropriately resourced and its non-independent members do not have undue influence over the performance of the risk management function

AIFM must assess, monitor, and periodically review:

- The performance of the risk management function
- The adequacy and effectiveness of measures aiming to ensure the functional and hierarchical separation of the risk management function

7.3.6. Risk measurement and management

AIFM are required to implement adequate and effective arrangements, processes, and techniques in order to identify, measure, manage, and monitor at any time the risks to which the AIF under their management are or might be exposed and in order to comply with the risk limits. This implies at least:

- Putting in place such risk measurement arrangements, processes, and techniques necessary to ensure that the risks of positions taken and their contribution to the overall risk profile are accurately measured on the basis of sound and reliable data, on an ongoing basis, and that the risk measurement arrangements, processes, and techniques are adequately documented
- Conducting periodic back tests in order to review the validity of risk measurement arrangements which include model-based forecasts and estimates
- Conducting appropriate periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the AIF
- Ensuring that the current level of risk complies with the risk limits
- Establishing, implementing, and maintaining adequate procedures that, in the event of actual or anticipated breaches of the risk limits of the AIF, result in timely remedial actions in the best interest of investors
- Ensuring that there are appropriate liquidity management systems and procedures for each AIF

The arrangements, processes, and techniques must be proportionate to the nature, scale and complexity of the business of the AIFM and of each AIF it manages and consistent with the AIF's risk profile as disclosed to investors.

Where FDIs are used and benefit only specific share classes (e.g., hedging, leverage), consideration should be given to calculate global risk exposure (market risk) and leverage at share class level, although there are no specific requirements on calculations at share class level.

A. Leverage

Leverage is defined as any method by which the AIFM increases the exposure of an AIF it manages whether through borrowing of cash or securities, or leverage embedded in derivative positions or by any other means. Leverage of an AIF is expressed as the ratio between the exposure of an AIF and its net asset value (NAV).

The AIFM is required to set a maximum level of leverage that the AIFM may employ on behalf of each AIF it manages as well as the extent of the right of the re-use of collateral or guarantee that could be granted under the leveraging arrangement.

The AIFM must demonstrate that the leverage limits for each AIF it manages are reasonable and that it complies at all times with the leverage limits set by it. The competent authority of the AIFM may impose limits on the use of leverage for systemic risk mitigation purposes.

ESMA clarifications:

ESMA clarified that an AIFM should calculate the leverage of each AIF that it manages as often as is required to ensure that the AIF is capable of remaining in compliance with leverage limits at all times. Consequently, leverage should be calculated at least as often as the NAV is calculated, or more frequently if required. Circumstances which may lead to increased frequency of leverage calculation include material market movements, changes to portfolio composition and any other factors the AIFM believes require calculation of leverage more frequently than the NAV calculation in order for the AIF to remain in compliance with leverage limits at all times.

Leverage is considered to be employed on a substantial basis when the exposure of an AIF as calculated according to the commitment method exceeds three times its NAV.

AIFM that employ leverage on a substantial basis are required to provide additional reporting to their competent authorities (See Section 6.4.3.). AIFM are required to calculate the exposure of the AIF managed in accordance with both the gross method and the commitment method.

(a) General rules

An AIFM must have appropriately documented procedures to calculate the exposure of each AIF under its management in accordance with the gross method and the commitment method. The calculation must be applied consistently over time.

The following general rules apply when calculating leverage:

- ▶ Private equity: for AIF whose core investment policy is to acquire control of non-listed companies or issuers, the AIFM should not include in the calculation of the leverage any exposure that exists at the level of those non-listed companies and issuers provided that the AIF or the AIFM acting on behalf of the AIF does not have to bear potential losses beyond its investment in the respective company or issuer
- ▶ Certain holding structures set up to increase the leverage of the AIF: Exposure contained in any financial or legal structures involving third parties controlled by the relevant AIF must be included in the calculation of the exposure where the structures referred to are specifically set up to directly or indirectly increase the exposure at the level of the AIF. For example, some Real Estate AIF may have to include certain holding structures in their leverage calculations
- ▶ Temporary borrowing: AIFM should exclude temporary borrowing arrangements if these are fully covered by contractual capital commitments from investors in the AIF

(b) Gross method for calculating the exposure of the AIF

The exposure of an AIF calculated in accordance with the gross method is the sum of the absolute values of all positions. The value of positions should be calculated in accordance with the AIFM Law valuation requirements (see Section 7.6.2.).

To calculate the exposure of an AIF according to the gross method, an AIFM must:

- ▶ Exclude the value of any cash and cash equivalents, which are highly liquid investments held in the base currency of the AIF
- ▶ Convert derivative instruments into the equivalent position in their underlying assets
- ▶ Exclude cash borrowings that remain in cash or cash equivalents
- ▶ Include exposure resulting from the reinvestment of cash borrowings
- ▶ Include positions within repurchase or reverse repurchase agreements and securities lending or borrowing or other arrangements

The AIFM Level 2 measures outline methods of increasing exposure of an AIF for:

- ▶ Derivative instruments: interest rate swaps, contracts for differences, futures contracts, total return swaps, forward contracts, options, and credit default swaps
- ▶ Arrangements: convertible borrowings, repurchase agreements, reverse repurchase agreements, securities lending arrangements, and securities borrowing arrangements

The Level 2 measures lay down calculation methodologies to be adopted for the most common financial derivative instruments:

- ▶ Futures contracts
- ▶ Plain vanilla options (bought/sold puts and calls)
- ▶ Swaps
- ▶ Forward contracts
- ▶ Financial instruments that embed derivatives

Non-standard (exotic) derivatives calculation methodologies are detailed for variance swaps, volatility swaps, and barrier (knock-in knock-out) options.

(c) Commitment method for calculating the exposure of an AIF

The exposure of an AIF calculated in accordance with the commitment method shall be the sum of the absolute values of all positions, after taking into account netting and hedging.

The value of positions should be calculated in accordance with the AIFM Law valuation requirements (see Section 7.6.2.).

To calculate the exposure of an AIF according to the commitment method, an AIFM must:

- Convert each derivative instrument position into an equivalent position in the underlying asset of that derivative, in accordance with the same methodologies and methods as those applied under the gross method (see 7.3.6.A.(b))
- Apply netting and hedging arrangements
- Calculate the exposure created through the reinvestment of borrowings where such reinvestment increases the exposure of the AIF
- Include positions within repurchase or reverse repurchase agreements and securities lending or borrowing or other arrangements (see 7.3.6.A.(a))

The AIFM Level 2 measures set out rules to be applied in relation to:

- Netting arrangements
- Hedging arrangements
- Instruments that should not be converted into an equivalent position in the underlying asset: swaps meeting certain criteria and derivatives equivalent to long positions
- Exclusion of derivative instruments used for currency hedging purposes meeting certain criteria

ALFI's Q&A document on *Risk Management for AIF under AIFMD* of 29 April 2014 provides further clarification on the difference between the gross approach and the commitment approach under AIFMD. The main difference stems from the inclusion in the leverage calculation under the commitment method, and exclusion under the gross method, of "cash and cash equivalents" in the fund currency.

"Cash and cash equivalents" are also explicitly defined in this Q&A document as being highly liquid, held in the AIF's base currency, readily convertible to a known amount of cash, subject to insignificant risk of change in value, and provide a return no greater than a three-month high quality (investment grade) government bond (in the base currency of the AIF).

AIFM managing AIF that, in accordance with their core investment policy, primarily invest in interest rate derivatives are required to make use of the specific duration netting rules in order to take into account the correlation between the maturity segments of the interest rate curve.

On 27 March 2020, ESMA launched a consultation on Guidelines on Art. 25 of Directive 2011/61/EU.

The ESMA guidelines under consultation aim to provide National Competent Authorities ("NCAs") enhanced supervisory tools to assess the extent to which the use of leverage within the AIF sector contributes to the build-up of systemic risk in the financial system, and impose macroprudential leverage limits on AIFs where and when needed to prevent that leverage might contribute to procyclicality, especially in times of economic cycle-downturn or increase in market volatility.

The ESMA guidelines under consultation provide, *inter alia*:

- Which risks should be considered by NCAs when deciding to impose leverage limits
- How the leverage limits should be implemented both in terms of timing and phasing in and out
- How NCAs should assess their effectiveness in addressing systemic risks
- Which criteria NCAs should consider in evaluating the efficiency of leverage limits

The deadline to submit contributions to ESMA was 1 September 2020.

B. Operational risk

AIFM are required to implement effective internal operational risk management policies and procedures in order to identify, measure, manage, and monitor appropriately operational risks including professional liability risks to which the AIFM is or could be reasonably exposed. It should implement effective measures for the treatment of non-compliance with these policies and for taking corrective action.

Professional liability risks include, *inter alia*, risks of:

- Loss of documents evidencing title to assets of the AIF
- Misrepresentations or misleading statements made to the AIF or its investors
- Acts, errors or omissions resulting in a breach of:
 - Legal and regulatory obligations
 - Duty of skill and care towards the AIF and its investors
 - Fiduciary duties

- Obligations of confidentiality
- AIF rules or instruments of incorporation
- Terms of appointment of the AIFM by the AIF
- Failure to establish, implement, and maintain appropriate procedures to prevent dishonest, fraudulent or malicious acts
- Improperly carried out valuation of assets or calculation of share or unit prices
- Losses arising from business disruption, system failures, failure of transaction processing or process management

Operational risk management must be performed independently, as part of the risk management policy.

Operational risk exposures and loss experience must be monitored on an ongoing basis and must be subject to regular internal reporting. The AIFM must set up a historical loss database, in which any operational failures, loss, and damage experience must be recorded. This database must record, *inter alia*, any professional liability risks that have materialized. The AIFM should make use of its internal historical loss data and, where appropriate, external data, scenario analysis, and factors reflecting the business environment and internal control systems.

See also Section 6.2.3.2.D.

ALFI's guidelines of June 2016 on *Considerations for the Management of Operational Risks Associated with the Distribution of Funds*, which provide Board members and senior management with areas that they may wish to consider when looking at the management of operational risks associated with the marketing/distribution of funds, and cover:

- Key sources of legal and regulatory guidance in relation to risk management
- A potential approach to (i) the identification of relevant operational risks associated with distribution/marketing to which funds or their management companies may be exposed, (ii) the measurement and management of these identified operational risks and (iii) the reporting with regard to these risks and related information provided to senior management and the Board by the risk management function

C. Liquidity risk

AIFM must, for each managed AIF that is not an unleveraged closed-ended AIF, employ an appropriate liquidity management system and adopt procedures that enable them to monitor the liquidity risk of the AIF and to ensure that the liquidity profile of the investments of the AIF complies with its underlying obligations.

AIFM must ensure that, for each AIF that they manage, the investment strategy, the liquidity profile and the redemption policy are consistent, i.e., when investors have the ability to redeem their investments in a manner consistent with the fair treatment of all AIF investors and in accordance with the AIF's redemption policy and its obligations.

The liquidity management system and procedures must at least ensure that:

- The AIFM maintains a level of liquidity in the AIF appropriate to its underlying obligations
- The AIFM monitors the liquidity profile of the AIF's portfolio of assets and the material liabilities and commitments, contingent or otherwise, that the AIF may have in relation to its underlying obligations. For these purposes the AIFM shall take into account the profile of the investor base of the AIF, including the type of investors, the relative size of investments, and the redemption terms to which these investments are subject
- Where the AIF invests in other UCIs, the AIFM monitors the liquidity management approach adopted by the managers of those other UCIs
- The AIFM implements and maintains appropriate liquidity measurement arrangements and procedures to assess the quantitative and qualitative risks of positions and of intended investments that have a material impact on the liquidity profile of the portfolio of the AIF's assets to enable their effects on the overall liquidity profile to be appropriately measured
- The AIFM considers and puts into effect the tools and arrangements, including special arrangements (e.g., side pockets, gates), necessary to manage the liquidity risk of each AIF under its management

AIFM must include appropriate escalation measures in their liquidity management system and procedures to address anticipated or actual liquidity shortages or other distressed situations of the AIF.

Where appropriate, considering the nature, scale, and complexity of each AIF they manage, AIFM must implement and maintain adequate limits for the liquidity or illiquidity of the AIF consistent with its underlying obligations and redemption policy and in accordance with the quantitative and qualitative risk limits. AIFM should monitor compliance with those limits and, where limits are exceeded or likely to be exceeded, determine the required (or necessary) course of action.

AIFM are required to regularly conduct stress tests, at least annually, under normal and exceptional liquidity conditions, which enable them to assess the liquidity risk of each AIF under their management. The stress tests must:

- ▶ Where appropriate, simulate a shortage of liquidity of the assets in the AIF and atypical redemption requests
- ▶ Cover market risks and any resulting impact, including on margin calls, collateral requirements or credit lines
- ▶ Account for valuation sensitivities under stressed conditions

ALFI issued *Liquidity Stress Testing Considerations for Real Estate Funds* in May 2018 which are aimed at supporting the practical implementation of stress testing arrangement for real estate investment funds.

In February 2018, IOSCO issued *recommendations for Liquidity Risk Management for Collective Investment Schemes* (FR01/2018). These recommendations complete the report issued in 2013 relating to the principles of Liquidity Risk Management for Collective Investment Schemes. Further details can be found in Section 7.2.6 D.

D. Securitization

Risk management requirements in relation to investments in securitization positions are covered in Section 4.5.

E. Reliance on external credit rating

Directive 2013/14/EU on over-reliance on credit ratings sets out a general principle against the over-reliance on credit ratings that should be integrated into the risk management processes and systems of AIFM.

An AIFM must not solely or mechanically rely on external credit ratings issued by credit rating agencies for assessing the creditworthiness of the AIF's assets.

Taking into account the nature, scale, and complexity of the AIF's activities, the national competent authority (i.e., CSSF) is required to monitor the adequacy of the credit assessment processes of the AIFM, assess the use of references to external credit ratings, and, where appropriate, encourage mitigation of the impact of such references, with a view to reducing sole and mechanistic reliance on such external credit ratings.

ESMA publishes a list of registered and certified credit rating agencies.

According to ALFI's Q&A document on *Risk Management for AIF under AIFMD*, data from external sources should be subject to qualitative checks. The risk data interpretation and management task should be performed by the risk management function of the AIFM.

7.3.7. Delegation of risk management activities

Delegation of the risk management function is subject to the general provisions on delegation. For example: the delegation arrangement must take the form of a written agreement between the delegate and the AIFM. The general provisions on delegation are covered in Section 6.3.3.

The AIFM is not permitted to delegate the performance of investment management functions (portfolio management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself. When assessing the extent of delegation, the CSSF is required to assess the entire delegation structure taking into account not only the assets managed under delegation but also the qualitative criteria. These are outlined in Section 6.3.3.

As well as the general provisions on delegation, specific provisions apply to the delegation of investment management functions, including risk management.

7.3.8. Communication to the CSSF

The CSSF requires AIFMs to provide certain information in relation to the risk management policy in order to identify, measure, manage, control, and report on the risks that may be material for the AIFs they manage.

CSSF Circular 18/698, in its Appendix I, lays down the required content and format of the risk management process document (RMP):

1. General section: Governance and risk management function organization
 - 1.1 Organization chart
 - 1.2 Governance structure
 - 1.3 Independence of the risk management function
 - 1.4 Risk management policy
 - 1.5 Permanent risk management function
 - 1.6 Adequacy and review of the risk management policy
 - 1.7 Risk reporting
 - 1.8 IT tools and systems
 - 1.9 Delegation
 - 1.10 New products approval process
 - 1.11 Interaction with compliance and internal audit
2. Specific complementary section to be created for each type of investment strategy of the AIFs as defined in Annex IV of Delegated Regulation (EU) 231/2013 (“Hedge Fund Strategy”, “Private Equity Strategy”, “Real Estate Strategy”, “Fund of Fund Strategy” and “Other Strategy”) (for Risk management policy in respect of strategies)
 - 2.1 Name of Strategy
 - 2.2 Description of the strategy and instruments used
 - 2.3 Description of the investment process and name of players involved
 - 2.4 Where appropriate, description of the elements regarding risk management differing from general section
 - 2.5 Market risk management policy
 - 2.6 Liquidity risk management policy
 - 2.7 Counterparty risk management policy
 - 2.8 Credit risk management policy
 - 2.9 Operational risk management policy
 - 2.10 Valuation policy of assets
 - 2.11 Policy on use of leverage
 - 2.12 List of AIFs covered by the complementary section
3. Specific complementary section on discretionary management

The IFM must briefly describe the manner in which it provides discretionary management services and services on an individual basis, in the framework of a mandate given by investors, complies with the risk management requirements under the MiFID II Regulation.¹⁸¹

The RMP must be included in the application for authorization for an AIFM.

It must be updated at least on a yearly basis and it must be submitted to the CSSF within five months of the closing date of the AIFM’s financial year.

In case of any material modification to the risk management policy, the RMP must be updated promptly and communicated to the CSSF.

Before launching a new UCI, the AIFM must particularly ensure that the risk management policy and thus the RMP is adequate.

The risk profiles of AIF must be communicated in the application for authorization of the AIFM.

The documentation of the risk profile and that of the analysis of the consistency with the set limits and identified risk levels must be immediately available upon the CSSF’s request.

AIFM are required to report to the CSSF information on the current risk profile of the AIF and the risk management systems employed by the AIFM to manage the market risk, credit risk, liquidity risk, counterparty risk, and other risks including operational risk (see Section 6.5.1.B.).

A copy of the report regularly established by the risk management function for the senior management and governing body relating to the adequacy and effectiveness of the method for risk management must be included with the RMP transmitted to the CSSF.

AIFM managing one or more AIF employing leverage on a “substantial basis” (i.e., exceeding three times the NAV) must make available to the CSSF information about the overall level of leverage employed by each AIF it manages, a breakdown between leverage arising from borrowing of cash or securities and leverage embedded in financial derivatives, the five largest sources of borrowed cash or securities, and the extent to which their assets have been reused under leveraging arrangements (see Section 6.5.1.B.).

¹⁸¹ MiFID II was applicable on 3 January 2018 and repeals MiFID. Some key elements of the new regime are

- ▶ Stronger investor protection
- ▶ Confirmation of ban of inducements
- ▶ Migrating derivatives trading to regulated platforms
- ▶ New market : the Organized Trading Facility (OTF)
- ▶ Limits on algorithmic trading and direct market access
- ▶ Position limits on commodity derivatives
- ▶ Broader scope of market transparency regime

7.3.9. Disclosures to investors

AIFM are required to disclose to investors, before they invest, a description of the AIF's liquidity risk management, including the redemption rights both in normal and in exceptional circumstances, and the existing redemption arrangements with investors (see also Section 10.3.3.).

AIFM are required to periodically disclose to investors:

- The percentage of the AIF's assets that are subject to special arrangements arising from their illiquid nature, and information on the arrangements
- Any new liquidity management arrangements, systems, and procedures
- The current risk profile of the AIF
- The main features of the risk management systems employed by the AIFM

See Section 10.4.2.

AIFM must disclose information on leverage to investors before they invest in an AIF (see Section 10.3.3.). AIFM managing leveraged AIF are also required to disclose information on leverage to investors on a regular basis (see Section 10.4.2.3.).

7.4. Risk management of SIFs

7.4.1. Introduction

SIFs are required to implement risk management systems to identify, measure, manage, and monitor appropriately the risks associated with the investment positions and their contribution to the overall risk profile of the portfolio. The Directors of the SIF or its management company¹⁸² must adopt the risk management system of the SIF and, subsequently, have it reviewed and documented on a regular basis.

SIFs qualifying as AIFs will also have to comply with the risk management provision of the AIFM Law.

7.4.2. Key regulations

The risk management requirements applicable to SIFs are outlined in the SIF Law and *CSSF Regulation No 12-01 laying down detailed rules for the application of Article 42a of the Law of 13 February 2007 relating to specialised investment funds concerning the requirements regarding risk management and conflicts of interest*.

ALFI issued *Recommendations on the Risk Management System for Specialised Investment Funds* in June 2012. They cover:

- The risk management function and implementation of appropriate risk management systems:
 - Responsibility for the maintenance of the risk management system
 - Interpretation of results
 - Ownership of the function within the decision making bodies
 - Independence of the function
- Risk identification, measurement, and monitoring:
 - Determining the material risks to which the SIF is or may be exposed
 - Determining the method to measure the risks identified
 - Approach to qualitative and quantitative risk limits and the monitoring frequency
 - Determining the process for reporting and escalation of breaches

¹⁸² "Directors" means, in the case of public limited companies and in the case of cooperatives in the form of a public limited company, the members of the Board of Directors, in the case of partnerships limited by shares, the general partner, in the case of private limited liability companies, the manager(s), and in the case of common funds, the members of the Board of Directors or the managers of the management company

7.4.3. Risk management function

SIFs are required to establish and maintain a risk management function.

The role of the risk management function includes:

- Implementing and maintaining an appropriate and documented risk management policy that allows adequate detection, measurement, management, and monitoring of exposure to market, liquidity, and counterparty risks, as well as of exposure to all other risks, including operational risk, that may be significant in the context of the activities of the SIF (or compartments thereof)
- Ensuring compliance with the risk limit system of the SIF

SIFs are required to take into account the nature, scale, and complexity of their activities, as well as their structure.

The risk management function must have the necessary authority and access to all relevant information that is necessary for the performance of its tasks.

The risk management function should be hierarchically and functionally independent from operating units. However, the CSSF may allow a SIF to derogate from this obligation of independence where this derogation is appropriate and proportionate in view of the nature, scale, and complexity of the activities and the structure of the SIF.

A SIF must be able to demonstrate that appropriate safeguards against conflicts of interests have been adopted to allow the independent performance of risk management activities and that its risk management system fulfills the SIF Law.

7.4.4. Delegation of risk management activities

SIFs are permitted to delegate all or part of the activities of the risk management function to third parties, provided that the third party has the necessary competence and capacity to exercise the activities of the risk management function in a reliable, professional, and efficient manner and in accordance with the applicable legal and regulatory requirements.

The delegation does not impact the liability of the Directors of the SIF or its management company in relation to the adequacy and efficiency of the risk management system and the monitoring of risks linked to the activities of the SIF.

7.4.5. Communication to the CSSF

SIFs must provide a description of the risk management system to the CSSF as part of their application for authorization.

This description must cover, *inter alia*:

- The risk management function (including the allocation of responsibilities), its independence or the specific protection measures implemented to avoid conflicts of interest and, ultimately, to allow independent execution of the risk management activities or procedures
- Processes and methods to appropriately measure and manage the risks arising from the investment strategies and the risk profile of the SIF (or compartments thereof)

Any subsequent major change to their risk management system must be notified to the CSSF.

See also Sections 3.3. and 3.4.

7.5. Risk management of MMFs

7.5.1. Introduction

On 30 June 2017, the final text of Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on *money market funds* was published in the Official Journal of the European Union. The Regulation applies to funds and sub-funds that qualify as money market funds ("MMF") as per the definition set out in article 1 of the Regulation.

This Regulation has been amended and supplemented by the Commission Delegated Regulation (EU) 2018/990 of 10 April 2018 with regard to simple, transparent and standardized (STS) securitizations and asset-backed commercial papers (ABCPs) and requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies.

On 21 March 2018, ESMA published its *Guidelines on stress test scenarios under Article 28 of the MMF Regulation*, in which they established common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of the MMF Regulation. These Guidelines apply to National Competent Authorities and to MMFs and their managers. These guidelines were updated on 19 July 2019.

With regard to risk management, in addition to the rules applicable to the portfolios of MMFs (see Section 4.8.) the key provisions of the Regulation include the following:

- An internal credit quality assessment procedure
- Stress testing
- “Know your customer” policy

7.5.2. Internal credit quality assessment

The manager of an MMF must establish, implement and consistently apply a prudent internal credit quality assessment procedure for determining the credit quality of money market instruments, securitizations and asset-backed commercial papers (ABCPs), taking into account the issuer of the instrument and the characteristics of the instrument itself and whether this credit quality receives a favorable assessment.

The manager must also ensure that the information used in applying the internal credit quality assessment procedure is of sufficient quality, up-to-date and from reliable sources.

The internal assessment procedure must be based on prudent, systematic and continuous assessment methodologies. The methodologies used must be subject to validation by the manager of an MMF based on historical experience and empirical evidence, including backtesting.

The manager of an MMF must ensure that the internal credit quality assessment procedure complies with all of the following general principles:

- a) An effective process must be established to obtain and update relevant information on the issuer and the instrument's characteristics
- b) Adequate measures must be adopted and implemented to ensure that the internal credit quality assessment is based on a thorough analysis of the information that is available and pertinent, and includes all relevant driving factors that influence the creditworthiness of the issuer and the credit quality of the instrument
- c) The internal credit quality assessment procedure must be monitored on an ongoing basis and all credit quality assessments must be reviewed at least annually
- d) While there must not be mechanistic over-reliance on external ratings, the manager of an MMF must undertake a new credit quality assessment for a money market instrument, securitizations and ABCPs when there is a material change that could have an impact on the existing assessment of the instrument
- e) The credit quality assessment methodologies must be reviewed at least annually by the manager of an MMF to determine whether they remain appropriate for the current portfolio and external conditions and the review must be transmitted to the competent authority of the manager of the MMF. Where the manager of the MMF becomes aware of errors in the credit quality assessment methodology or in its application, it must immediately correct those errors
- f) When methodologies, models or key assumptions used in the internal credit quality assessment procedure are changed, the manager of an MMF must review all affected internal credit quality assessments as soon as possible

The credit quality assessment must take into account at least the following factors and general principles:

- a) The quantification of the credit risk of the issuer and of the relative risk of default of the issuer and of the instrument
- b) Qualitative indicators on the issuer of the instrument, including in the light of the macroeconomic and financial market situation
- c) The short-term nature of money market instruments
- d) The asset class of the instrument
- e) The type of issuer distinguishing at least the following types of issuers: national, regional or local administrations, financial corporations, and non-financial corporations
- f) For structured financial instruments, the operational and counterparty risk inherent within the structured financial transaction and, in case of exposure to securitizations, the credit risk of the issuer, the structure of the securitization and the credit risk of the underlying assets
- g) The liquidity profile of the instrument

The internal credit quality assessment procedure and credit quality assessments must be adequately documented.

The documentation must include all of the following:

- a) The design and operational details of its internal credit quality assessment procedure in a manner that allows competent authorities to understand and evaluate the appropriateness of a credit quality assessment
- b) The rationale for and the analysis supporting the credit quality assessment, as well as the manager of the MMF's choice of criteria for, and the frequency of, the review of the credit quality assessment
- c) All major changes to the internal credit quality assessment procedure, including identification of the triggers of such changes
- d) The organization of the internal credit quality assessment procedure and the internal control structure
- e) Complete internal credit quality assessment histories on instruments, issuers and, where relevant, recognized guarantors
- f) The person or persons responsible for the internal credit quality assessment procedure

The manager of an MMF must keep all the documentation for at least three complete annual accounting periods.

All documents must be made available upon request to the competent authorities of the MMF and to the competent authorities of the manager of the MMF.

The internal credit quality assessment procedure must be detailed in the fund rules or rules of incorporation of the MMF.

The internal credit quality assessment procedure must be approved by the senior management, the governing body, and, where it exists, the supervisory function of the manager of an MMF. Those parties must have a good understanding of the internal credit quality assessment procedure and the methodologies applied by the manager of an MMF, as well as a detailed comprehension of the associated reports.

The manager of an MMF must report to the management of the MMF on the MMF's credit risk profile, based on an analysis of the MMF's internal credit quality assessments. Reporting frequencies depend on the significance and type of information and must be at least annual.

Senior management must ensure, on an ongoing basis, that the internal credit quality assessment procedure is operating properly. Senior management must be regularly informed about the performance of the internal credit quality assessment procedures, the areas where deficiencies were identified, and the status of efforts and actions taken to improve previously identified deficiencies.

Internal credit quality assessments and their periodic reviews by the manager of an MMF must not be performed by the persons performing or responsible for the portfolio management of an MMF.

The European Commission has adopted a delegated act in April 2018 (2018/990) in order to supplement the Regulation by, *inter alia*, specifying the following points relating to risk management aspects of the MMF regulation:

- a) The criteria for the validation of the credit quality assessment methodology
- b) The criteria for quantification of the credit risk, and of the relative risk of default of an issuer and of the instrument
- c) The criteria for establishing qualitative indicators on the issuer of the instrument
- d) The meaning of material change

On 10 April 2018, the European Commission issued the Delegated Regulation (EU) 2018/990 with regard to STS, ABCPs and requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies. The Delegated Regulation covers, *inter alia*:

Criteria for validating the internal credit quality assessment methodologies:

- (a) They must be applied in a systematic way with respect to different issuers and instruments
- (b) They must be supported by a sufficient number of relevant qualitative and quantitative criteria
- (c) Their qualitative and quantitative inputs must be reliable, using data samples of an appropriate size
- (d) Past assessments produced using the internal credit quality assessment methodologies should be properly reviewed to determine whether the credit quality assessment methodologies are a suitable indicator of credit quality
- (e) They must contain controls and processes for their development and related approvals that allow for suitable challenge

- (f) They must incorporate relevant factors to determine the credit quality of an issuer or an instrument
- (g) They systematically apply key credit quality assumptions and supporting criteria to produce all credit quality assessments, unless there is an objective reason for diverging from this requirement
- (h) They must contain procedures to ensure that the criteria referred to in points (b), (c) and (g) supporting the relevant factors in the internal credit quality assessment methodologies are of a reliable quality and relevant to the issuer or instrument being assessed

Criteria for quantifying credit risk, and the relative risk of default of the issuer and of the instrument:

- (a) Bond pricing information, including credit spreads and the pricing of comparable fixed income instruments and related securities
- (b) Pricing of money market instruments relating to the issuer, the instrument or the industry sector
- (c) Credit default swap pricing information, including credit default swap spreads for comparable instruments
- (d) Default statistics relating to the issuer, the instrument or the industry sector
- (e) Financial indices relating to the geographic location, the industry sector or the asset class of the issuer or instrument
- (f) Financial information relating to the issuer, including profitability ratios, interest coverage ratio, leverage metrics and the pricing of new issues, including the existence of more junior securities

Where necessary and relevant, additional criteria may be applied at the manager's discretion.

Criteria for establishing qualitative indicators in relation to the issuer of the instrument:

- (a) An analysis of any underlying assets, which, for exposure to securitization, must include the credit risk of the issuer and the credit risk of the underlying assets
- (b) An analysis of any structural aspects of the relevant instruments issued by an issuer, which for structured finance instruments shall include an analysis of the inherent operational and counterparty risk of the structured finance instrument
- (c) An analysis of the relevant market(s), including the degree of volume and liquidity of those markets
- (d) A sovereign analysis, including the extent of explicit and contingent liabilities and the size of foreign exchange reserves compared to foreign exchange liabilities
- (e) An analysis of governance risk relating to the issuer, including frauds, conduct fines, litigation, financial restatements, exceptional items, management turnover, borrower concentration and audit quality
- (f) Securities-related research on the issuer or market sector
- (g) Where relevant, an analysis of the credit ratings or rating outlook given to the issuer of an instrument by a credit rating agency registered with the ESMA and selected by the manager if suited to the specific investment portfolio of the MMF

Where necessary and relevant, additional criteria may be applied at the manager's discretion.

Criteria for establishing qualitative credit risk indicators in relation to the issuer of the instrument:

- (a) The financial situation of the issuer, or, where applicable, of the guarantor
- (b) The sources of liquidity of the issuer, or, where applicable, of the guarantor
- (c) The ability of the issuer to react to future market-wide or issuer-specific events, including the ability to repay debt in a highly adverse situation
- (d) The strength of the issuer's industry within the economy relative to economic trends and the issuer's competitive position in its industry

Material changes are deemed to occur when:

- (a) There are material changes in any of the following:
 - ▶ Bond pricing information, including credit spreads and the pricing of comparable fixed income instruments and related securities
 - ▶ Credit default swap pricing information, including credit default swap spreads for comparable instruments
 - ▶ Default statistics relating to the issuer or instrument
 - ▶ Financial indices relating to the geographic location, industry sector or asset class of the issuer or instrument
 - ▶ Analysis of underlying assets, in particular for structured instruments
 - ▶ Analysis of the relevant market(s), including their volume and liquidity
 - ▶ Analysis of the structural aspects of the relevant instruments
 - ▶ Securities-related research

- Financial situation of the issuer
 - Sources of liquidity of the issuer
 - Ability of the issuer to react to future market-wide or issuer-specific events, including the ability to repay debt in a highly adverse situation
 - Strength of the issuer's industry within the economy relative to economic trends and the issuer's competitive position in its industry
 - Analysis of the credit ratings or rating outlook given to the issuer or instrument by a credit rating agency or agencies selected by the manager of the MMF as being suited to the specific investment portfolio of the MMF
- (b) A money market instrument, securitization or ABCP is downgraded below the two highest short-term credit ratings provided by any credit rating agency regulated and certified in accordance with Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies

Managers of MMFs must assess the material change in the criteria referred to in (a) above by considering risk factors and the results of the stress tests scenarios.

Managers of MMFs must establish an internal procedure for the selection of credit rating agencies suited to the specific investment portfolio of the MMF concerned.

A downgrading referred to in (b) above should be taken into account when the manager of the MMF carries out its own assessment according to internal credit quality assessment methodology.

Finally, the revision of the internal credit quality assessment methodology must constitute a material change, except if managers of MMFs can substantiate that the change is not material.

7.5.3. Stress testing

Each MMF must have in place sound stress testing processes that identify possible events or future changes in economic conditions which could have unfavorable effects on the MMF. The MMF or the manager of an MMF must assess the possible impact that those events or changes could have on the MMF. The MMF or the manager of an MMF must regularly conduct stress testing for different possible scenarios.

The stress tests must be based on objective criteria and consider the effects of severe plausible scenarios. The stress test scenarios must at least take into consideration reference parameters that include the following factors:

- a) Hypothetical changes in the level of liquidity of the assets held in the portfolio of the MMF
- b) Hypothetical changes in the level of credit risk of the assets held in the portfolio of the MMF, including credit events and rating events
- c) Hypothetical movements of the interest rates and exchange rates
- d) Hypothetical levels of redemptions
- e) Hypothetical widening or narrowing of spreads among indices to which interest rates of portfolio securities are tied
- f) Hypothetical macro systemic shocks affecting the economy as a whole

In addition, in the case of public debt CNAV¹⁸³ MMFs and LVNAV¹⁸⁴ MMFs, the stress tests must estimate for different scenarios the difference between the constant NAV per unit or share and the NAV per unit or share.

Stress tests must be conducted at least bi-annually and at a frequency determined by the board of directors of the MMF, where applicable, or the board of directors of the manager of an MMF, after considering what an appropriate and reasonable interval in light of the market conditions is and after considering any envisaged changes in the portfolio of the MMF.

If the stress test reveals any vulnerability of the MMF, the manager of an MMF must draw up an extensive report with the results of the stress testing and a proposed action plan. Where necessary, the manager of an MMF must take action to strengthen the robustness of the MMF, including actions that reinforce the liquidity or the quality of the assets of the MMF and must immediately inform the competent authority of the MMF of the measures taken.

¹⁸³ Constant Net Asset Value

¹⁸⁷ Low Volatility Net Asset Value

The extensive report with the results of the stress testing and proposed action plan must be submitted for examination to the board of directors of the MMF, where applicable, or the board of directors of the manager of an MMF. The board of directors must amend the proposed action plan if necessary and approve the final action plan. The extensive report and the action plan must be kept for a period of at least 5 years. The extensive report and the action plan must be submitted to the competent authority of the MMF for review.

The competent authority of the MMF must send the extensive report referred to ESMA.

On 21 March 2018, ESMA issued *Guidelines on stress tests scenarios under Article 28 of the MMF Regulation* (ESMA 34-49-115). The guidelines were updated on 19 July 2019 (ESMA 34-49-164). These guidelines should be updated at least every year taking into account the latest market developments. These guidelines include practical examples and detailed guidance for the establishment of a stress test scenario framework for MMF funds. These guidelines cover, *inter alia*:

- ▶ Certain general features of the stress test scenarios of MMF
- ▶ The establishment of common reference parameters of the stress test scenarios (the result of which should not be included in the reporting template of the MMF regulation) in relation to:
 - ▶ Hypothetical changes in the level of liquidity of the assets held in the portfolio of the MMF
 - ▶ Hypothetical changes in the level of credit risk of the assets held in the portfolio of the MMF, including credit events and rating events
 - ▶ Hypothetical movements of the interest rates and exchange rates
 - ▶ Hypothetical levels of redemption
 - ▶ Hypothetical widening or narrowing of spreads among indexes to which interest rates of portfolio securities are tied
 - ▶ Hypothetical macro systemic shocks affecting the economy as a whole
- ▶ The establishment of additional common reference stress test scenarios the results of which should be included in the reporting template of the MMF Regulation. The result of the following stress tests should be provide in the reporting:
 - ▶ Liquidity
 - ▶ Credit
 - ▶ FX Rate
 - ▶ Interest Rate
 - ▶ Level of Redemption
 - ▶ Spread among indices to which interest rates of portfolio securities are tied
 - ▶ Macro
 - ▶ Multivariate
- ▶ The 2019 report includes an update of the previously published guidelines and in addition specifications on the types of the stress tests and their calibration, so that managers of MMFs have the information needed to complete the corresponding fields in the reporting template mentioned in article 37 of the MMF Regulation.

7.5.4. “Know your customer” policy

The manager of an MMF must establish, implement and apply procedures, and exercise all due diligence with a view to anticipating the effect of concurrent redemptions by several investors, taking into account at least the type of investor, the number of units or shares in the UCI owned by a single investor and the evolution of inflows and outflows.

If the value of the units or shares held by a single investor exceeds the amount of the corresponding daily liquidity requirement of an MMF, the manager of the MMF must consider, in addition to the factors set out in the preceding paragraph, all of the following:

- a) Identifiable patterns in investor cash needs, including the cyclical evolution of the number of shares in the MMF
- b) The risk aversion of the different investors
- c) The degree of correlation or close links between different investors in the MMF

Where investors route their investments via an intermediary, the manager of an MMF must request the information to comply with the preceding paragraphs from the intermediary in order to manage appropriately the liquidity and investor concentration of the MMF.

The manager of an MMF must ensure that the value of the units or shares held by a single investor does not materially impact the liquidity profile of the MMF where it accounts for a substantial part of the total NAV of the MMF.

7.6. Valuation

This section covers the rules applicable to the valuation of the assets and liabilities of 2010 Law UCIs, full AIFM regime AIFs (including RAIFs), and SIFs.

The net asset value (NAV) calculation is covered in Section 8.6. The role of the depositary in ensuring that the value of the shares or units is calculated in accordance with the applicable law and the constitutional document of the UCI is covered in Section 9.4.5.3.

7.6.1. 2010 Law UCIs

Management companies are required to establish appropriate procedures which are consistent with the constitutional document to ensure the proper and accurate valuation of the assets and liabilities of the UCI.

In order to comply with the duty to act in the best interests of the shareholders or unitholders, management companies are required to ensure that fair, correct, and transparent pricing models and valuation systems are used for the UCITS they manage. Management companies must be able to demonstrate that the UCITS' portfolios have been accurately valued.

The 2010 Law states that unless otherwise provided for in the constitutional document of the UCI, the valuation of the assets of the UCI must be based, in the case of officially listed securities, on the last known stock exchange price, unless such price is not representative. For securities not so listed and for securities which are so listed, but for which the latest price is not representative, the valuation must be based on the probable realization value, estimated with care and in good faith.

For UCITS, the net asset value (NAV) per share or unit must be calculated at least twice a month. For 2010 Law Part II UCIs, the NAV per share or unit must be calculated at least monthly (see Section 8.6.1.).

The rules for the valuation of assets must be described in the prospectus (see Section 10.3.1.).

The protective measures adopted by a UCI against late trading and market timing practices may include the valuation of securities at "fair value" (see Section 8.7.5.).

Detailed valuation rules or guidelines have been laid down for specific cases. These include the use of amortized cost as the valuation basis for sub-three month papers and valuation of OTC FDIs in the portfolios of UCITS.

CSSF Circular 18/698 mentions that the CSSF recommends that management companies also comply with sub-chapter 6.6. of CSSF Circular 18/698 *Organization of the valuation function (specific provisions applicable to IFMs authorized as AIFM)*.

A. *The use of amortized cost as the valuation basis for sub-three month papers (see also Section 4.2.2.7.5.)*

In February 2009, ALFI issued recommendations on the use of amortized cost as the valuation basis for sub-three month papers.

In accordance with Article 9(3) and Article 28(4) of the 2010 Law, the CSSF accepts that the Board of Directors of management companies or investment companies may permit the inclusion of sub-three month papers in the mark-to-market assessment at an amortized cost price, if they consider that amortized cost is the closest to the probable realization value, estimated with care and in good faith.

In such cases, ALFI recommends the following conditions be met:

- ▶ Fair valuation at amortized cost should be restricted to securities with the highest-level credit rating (A1/P1 and A1+/P1 or equivalent) and with a final residual maturity of less than three months. Where such securities are downgraded, full mark-to-market valuation should immediately be applied
- ▶ Full mark-to-market valuation should be applied to structured investment vehicles (SIVs)
- ▶ The decision to value the money market instruments (MMIs) on an amortized cost basis for the mark-to-market assessment must be approved by the Directors of the fund and the rationale underlying the decision documented
- ▶ The exclusion of MMIs from the mark-to-market valuation is based on the premise that such securities will be held to maturity or are realizable at par. If required to meet potential liquidity needs of the fund, these securities or a portion thereof should be reclassified within the full mark-to-market analysis. The reclassification process should be documented, reviewed, and approved on a periodic basis by the Board of Directors of the investment company or management company

B. OTC FDIs

A reliable and verifiable valuation is required for OTC FDIs (see also Section 4.2.2.7.6.(3)).

Management companies are thus required to establish, document, implement, and maintain arrangements and procedures that ensure appropriate, transparent, and fair valuation of OTC FDIs.

CSSF Circular 11/512 requires UCITS and management companies to draft policies and procedures for valuing OTC FDIs in a transparent, independent, and fair manner. Valuation principles should be presented in the format laid out in the Appendix to the Circular on the content of the risk management process to be communicated to the CSSF, including the following information: type of FDIs, volume, price provider, frequency of valuation, valuing system, independence of source, and valuation controls performed on the price.

A reliable and verifiable valuation is understood to refer to a valuation corresponding to the "fair value". "Fair value" is understood as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., an exit price). It should not rely only on the market quotations by the counterparty. The valuation should fulfill the following criteria:

- ▶ The valuation must be based on a current market value. If no such market value is available, then the valuation should be based on a valuation model that uses an appropriate and recognized methodology
- ▶ The verification of the valuation must be performed by one of the following:
 - ▶ An independent third party who performs the verification on a sufficiently frequent basis (in practice at a frequency at least equal to the NAV calculation frequency) and following a process that can be monitored by the UCITS
 - ▶ A unit independent of the portfolio management of the UCITS. The UCITS may use a third party valuation system or market data but must verify their adequacy. Models used by a party linked to the UCITS (such as a dealing room through which the UCITS settles its FDI transactions) are expressly prohibited if they have not been reviewed by the UCITS

The UCITS must be able to determine with reasonable accuracy the fair value of the OTC FDIs throughout their entire lifespan.

ESMA is of the view that a process must be developed that enables the UCITS, throughout the life of the FDI, to value the investment concerned with reasonable accuracy at its fair value on a reliable basis reflecting an up-to-date market value. This process must include organization and means of allowing for a risk analysis realized by a department independent from commercial or operational units and from the counterparty or, if these conditions cannot be fulfilled, by an independent third party.

In the latter case, the UCITS remains responsible for the correct valuation of the OTC FDIs and must, *inter alia*, check that the independent third party can adequately value the types of OTC FDIs it wishes to invest in.

Lastly, this organization of the UCITS implies that risk limits are to be defined.

ESMA believes that "independent" and "adequately equipped" means a unit that has the adequate means to perform the valuation. This implies that the UCITS uses its own valuation systems, which can however be provided by an independent third party - excluding the use of valuation models provided by a third party related to the UCITS (such as a dealing room with which OTC FDIs are concluded) which have not been reviewed by the UCITS and excluding the use of data (such as volatility or correlations) produced by a process that has not been qualified by the UCITS.

7.6.2. Full AIFM regime AIFs

AIFM are required to establish, maintain, implement, and review, for each AIF they manage, written policies and procedures that ensure a sound, transparent, comprehensive, and appropriately documented valuation process. The AIFM must ensure that fair, appropriate, and transparent valuation methodologies are consistently applied for the AIF it manages.

AIFM must ensure that the net asset value per share or unit is calculated, at each subscription or redemption of shares or units, and at least once a year, according to documented procedures and the methodology.

The AIFM is responsible for the proper valuation of the AIF assets, the calculation of the net asset value (NAV), and the publication of the NAV.

A description of the AIF's valuation procedure and of the pricing methodology for valuing assets, including the methods used in valuing hard-to-value assets, must be disclosed to investors before they invest (see Section 10.3.3.).

A. Implementation of valuation policies and procedures

The valuation policies must identify, and the procedures implement, the valuation methodologies used for each type of asset in which the AIF may invest in accordance with applicable national law and the AIF constitutional document. The AIFM cannot invest in a particular type of asset for the first time unless the valuation policy covers appropriate valuation methodology or methodologies for that specific type of asset. The selection process of a particular methodology must include an assessment of the available relevant methodologies, taking into account their sensitivity to changes in variables and how specific strategies determine the relative value of the assets in the portfolio. Prices must be obtained from independent sources whenever possible and appropriate.

The valuation policies and procedures must cover:

- ▶ Valuation methodologies covering, *inter alia*:
 - ▶ Inputs, including selection criteria for pricing and market data sources
 - ▶ Models: main features (see Section 7.6.2.B.)
- ▶ The obligations, roles, and responsibilities of all parties involved in the valuation process, including the senior management of the AIFM
- ▶ The competence and independence of personnel who are effectively carrying out the valuation of assets
- ▶ The specific investment strategies of the AIF and the assets the AIF might invest in
- ▶ The controls over the selection of valuation inputs, sources, and methodologies
- ▶ Review process for the individual values of assets and escalation channels for resolving differences in values for assets (see Section 7.6.2.F.)
- ▶ The valuation of any adjustments related to the size and liquidity of positions or to changes in the market conditions, as appropriate
- ▶ The appropriate time for closing the books for valuation purposes
- ▶ The appropriate frequency for valuing assets
- ▶ How a change to the valuation policy may be implemented (see Section 7.6.2.D.)

The valuation policies and procedures and the designated valuation methodologies must be applied consistently:

- ▶ To all assets within an AIF taking into account the investment strategy, the type of asset, and, if applicable, the existence of different external valuers
- ▶ Over time, where no update is required, and ensuring that valuation sources and rules remain consistent over time
- ▶ Across all AIF managed by the same AIFM, taking into account the investment strategies and the types of asset held by the AIF and, if applicable, the existence of different external valuers

B. Use of models to value assets

If a model is used to value the assets of an AIF, the model and its main features must be explained and justified in the valuation policies and procedures. The reason for the choice of the model, the underlying data, the assumptions used in the model and the rationale for using them, and the limitations of the model-based valuation must be appropriately documented.

The valuation policies and procedures must ensure that, before being used, a model is validated by a person with sufficient expertise who has not been involved in the process of building that model. The model must be subject to prior approval by the senior management of the AIFM.

C. Valuation function

The valuation function must be either performed by:

- ▶ The AIFM itself, provided that the valuation task is functionally independent from the portfolio management and the remuneration policy and other measures ensure that conflicts of interest are mitigated and that undue influence upon the employees is prevented.

In this case, the valuation policies must include a description of the safeguards for the functionally independent performance of the valuation task. Such safeguards must include measures to prevent or restrain any person from exercising inappropriate influence over the way in which a person carries out valuation activities.

The AIFM must also ensure the independence between the risk management and valuation activities.

The CSSF may require the AIFM to have its valuation procedures and/or valuations verified by an external valuer or, where appropriate, an auditor.

Where the AIFM establishes a valuation committee, it is recommended that the AIFM comply with the following conditions:

- ▶ The members of the committee as a whole have the necessary professional experience and skills having regard to the managed strategies
- ▶ The committee is (not necessarily exclusively) composed of members of the senior management and of the staff of the AIFM who are permanently located in Luxembourg or who have their domicile in a place allowing them, in principle, to come to Luxembourg every day; it is recommended that the conducting officer in charge of the valuation function be part of the valuation committee
- ▶ The operational arrangements of the committee including, in particular, the composition of the committee and the rules regarding the voting rights (majority, veto, etc.) in compliance with the legal provisions relating to the independence of the functions must be documented; this document must be made available to the CSSF upon request; the composition of the valuation committee and the rules regarding the voting rights must ensure an independent valuation of the AIF's assets; thus, for example, in order to ensure that the valuation is performed impartially and with all due skill, care and diligence in accordance with Article 17(8) of the 2013 Law, proof must be provided that the members of the valuation committee are functionally independent from the investment management process, including from the selection of investments; the AIFM must apply the above principle irrespective of the fact that the portfolio management function is performed internally, possibly relying on investment advisers, or is delegated
- ▶ The work of the committee must be documented. This documentation includes the agenda of the meetings, the minutes of the meetings documenting, in particular, the assessment of risks associated with the investments, the decisions and measures taken by the committee
- ▶ An external valuer subject to mandatory professional registration, independent from the AIF, the AIFM, and any other persons with close links to the AIF or the AIFM

In this case, the valuation policies and procedures must:

- ▶ Set out a process for the exchange of information between the AIFM and the external valuer to ensure that all necessary information required for the purpose of performing the valuation task is provided
- ▶ Ensure that the AIFM conducts initial and periodic due diligence on third parties that are appointed to perform valuation services

External valuers must provide upon request professional guarantees to demonstrate their ability to perform the valuation function.

The professional guarantees must contain evidence of the external valuer's qualification and capability to perform proper and independent valuation, including, *inter alia*, evidence of:

- ▶ Sufficient personnel and technical resources
- ▶ Adequate procedures safeguarding proper and independent valuation
- ▶ Adequate knowledge and understanding of the investment strategy of the AIF and of the assets the external valuer is appointed to value
- ▶ A sufficiently good reputation and sufficient experience with valuation
- ▶ If the external valuer is subject to registration, name of the authority and indication of the legal or regulatory provisions or rules of professional conduct to which the external valuer is subject

The CSSF's Frequently Asked Questions (FAQ) on Luxembourg's AIFM Law and on Commission Delegated Regulation (EU) No 231/2013 ("Level 2") (the FAQ on AIFM) clarifies that:

- ▶ The appointment of the depositary appointed for an AIF as external valuer of that AIF is subject to the condition that it has functionally and hierarchically separated the performance of its depositary functions from its tasks as external valuer and the potential conflicts of interest are properly identified, managed, monitored, and disclosed to the investors of the AIF
- ▶ A third party that has been appointed to perform administration for an AIF (i.e., the AIF's administrator), including calculation of the net asset value, can be considered as an external valuer for the purposes of the AIFMD if it provides tailor-made valuations for individual assets, specifically for those requiring subjective judgment on the value of the assets. However, it should be noted that the administrator should not be assumed to always be the external valuer. The administrator's appointment as the AIF's external valuer should clearly follow from the terms of the contract with the administrator
- ▶ The appointment of a third party as the AIF's external valuer has to be formalized by a written contract, which clearly states that the third party is appointed as external valuer

An AIFM must notify the CSSF of the designation of an external valuer.

D. Periodic review of valuation policies and procedures

Valuation policies must provide for a periodic review of the policies and procedures, including of the valuation methodologies. The review must be carried out at least annually and before the AIF engages with a new investment strategy or a new type of asset that is not covered by the existing valuation policy.

The valuation policies and procedures must cover how a change to the valuation policy, including a methodology, may be effected and in what circumstances this would be appropriate. Senior management must review and approve any changes to the policies and procedures.

E. Frequency of valuation of assets

The assets of an AIF must be valued and the net asset value (NAV) per share or unit calculated (see Section 8.6.) at least once a year.

For open-ended AIF, financial instruments held must be valued every time the NAV per share or unit is calculated.

Other assets held by open-ended AIF must be valued at least once a year, and every time there is evidence that the last determined value is no longer fair or proper.

For closed-ended AIF, such valuations and calculations must also be carried out in case of an increase or decrease of the capital by the relevant AIF.

F. Review of individual values of assets

AIFM must ensure that all assets held by the AIF are fairly and appropriately valued, and document the way the appropriateness and fairness of the individual values is assessed.

The valuation policies and procedures must set out a review process for the individual values of assets, where a material risk of an inappropriate valuation exists, including in the following cases:

- ▶ The valuation is based on prices only available from a single counterparty or broker source
- ▶ The valuation is based on illiquid exchange prices
- ▶ The valuation is influenced by parties related to the AIFM
- ▶ The valuation is influenced by other entities that may have a financial interest in the AIF's performance
- ▶ The valuation is based on prices supplied by the counterparty who originated an instrument, in particular where the originator is also financing the AIF's position in the instrument
- ▶ The valuation is influenced by one or more individuals within the AIFM

The review process must include sufficient and appropriate checks and controls on the reasonableness of individual values, including:

- ▶ Verifying values by a comparison among counterparty-sourced pricings and over time
- ▶ Validating values by comparison of realized prices with recent carrying values
- ▶ Considering the reputation, consistency, and quality of the valuation source
- ▶ A comparison with values generated by a third party
- ▶ An examination and documentation of exemptions
- ▶ Highlighting and researching any differences that appear unusual or any variations from valuation benchmarks established for the type of asset
- ▶ Testing for stale prices and implied parameters
- ▶ A comparison with the prices of any related assets or their hedges
- ▶ A review of the inputs used in model-based pricing, in particular of those to which the model's price exhibits significant sensitivity

The valuation policies and procedures shall include appropriate escalation measures to address differences or other problems in the valuation of assets.

G. Liability

The AIFM is responsible towards the AIF and its investors for the proper valuation of the assets of the AIF, the calculation of the NAV, and its publication (see Section 8.6.).

However, when an external valuer is appointed, the external valuer should be liable to the AIFM for any losses suffered by the AIFM as a result of its negligence or intentional failure to perform its tasks.

7.6.3. SIFs

The valuation of the assets of SIFs should be based on the fair value¹⁸⁵. This value must be determined in accordance with the rules set forth in the constitutional document and, in practice, disclosed in the offering document. These procedures could, for example, provide for valuation principles established by professional associations of a specific industry¹⁸⁶.

For SIFs that are not full AIFM regime AIFs (see Section 7.6.2.), there are no specific requirements on the independence of the valuation of the assets.

The minimum frequency of NAV calculation of a SIF is once a year (see Section 8.6.).

7.6.4. RAIFs

Unless otherwise provided for in the constitutional document of the RAIF the valuation of the assets of a RAIF should be based on fair value. The value must be determined in accordance with the rules set forth in the constitutional document.

The valuation of the assets of a RAIF should be performed in accordance with Article 17 of the AIFM Law and the related Delegated Acts (see Section 7.6.2.).

7.6.5. MMFs

On 30 June 2017, the final text of Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds was published in the Official Journal of the European Union. The Regulation applies to funds and sub-funds that qualify as money market funds (“MMF”) as per the definition set out in article 1 of the Regulation.

This Regulation, replaced ESMA’s *Guidelines on a common definition of European money market funds* issued in May 2010.

The Regulation introduced the following valuation rules to be applied by MMFs:

- ▶ The assets of a MMF must be valued on at least a daily basis
- ▶ The assets of a MMF must be valued by using mark-to-market whenever possible
- ▶ When using mark- to-market:
 - ▶ The asset of a MMF must be valued at the more prudent side of bid and offer unless the asset can be closed out at mid-market
 - ▶ Only good quality market data must be used; such data must be assessed on the basis of all of the following factors:
 - (i) The number and quality of the counterparties
 - (ii) The volume and turnover in the market of the asset of the MMF
 - (iii) The issue size and the portion of the issue that the MMF plans to buy or sell
- ▶ Where use of mark-to-market is not possible or the market data is not of sufficient quality, an asset of a MMF must be valued conservatively by using mark-to-model

The model must accurately estimate the intrinsic value of the asset of a MMF, based on all of the following up-to-date key factors:

 - ▶ The volume and turnover in the market of that asset
 - ▶ The issue size and the portion of the issue that the MMF plans to buy or sell
 - ▶ Market risk, interest rate risk, credit risk attached to the asset

When using mark-to-model, the amortized cost method may not be used
- ▶ The valuation method must be communicated to the competent authorities
- ▶ The assets of public debt constant NAV MMFs may additionally be valued by using the amortized cost method
- ▶ By way of derogation to the mark-to-market and the mark-to-model valuation referred to above, the assets of LVNAV MMFs that have a residual maturity of up to 75 days may be valued by using the amortized cost method.

The amortized cost method may only be used for valuing an asset of a LVNAV MMF in circumstances where the price of that asset calculated using the mark-to-market and the mark-to-model method does not deviate from the price of that asset calculated using the amortized cost method by more than 10 basis points. In the event of such a deviation, the price of that asset must be calculated using the mark-to-market or the mark-to-model method.

¹⁸⁵ Although the SIF Law states “The valuation of the assets of the SIF must be based on the fair value unless otherwise provided for in the constitutional document”, in practice assets should be valued at fair value.

¹⁸⁶ E.g., the International Private Equity and Venture Capital Guidelines for private equity/venture capital funds and the Royal Institution of Chartered Surveyors (RICS) Valuation Standards in the case of real estate funds.

8

Administration

EY supports fund administrators in defining or upgrading their operating models and business plans, including set up and application for authorization, with anti-money laundering and counter terrorist financing issues, benchmarking of fee structures, and reporting on controls.



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8.1. Introduction

This Chapter covers the administration function including:

- ▶ The roles and responsibilities of the administrator
- ▶ Entities that may perform administration of Luxembourg UCIs: management company, AIFM or third party administrator
- ▶ The authorization procedure for administrators
- ▶ The regulatory requirements applicable where administration is performed by the management company or AIFM, or delegated
- ▶ Organizational requirements covering, *inter alia*, policies, procedures, and systems
- ▶ UCI portfolio requirements on recording of portfolio transactions
- ▶ Net asset value (NAV) calculation, use of the NAV, and swing pricing
- ▶ The subscription and redemption of shares or units, anti-money laundering and counter terrorist financing (AML/CFT) procedures, protection against late trading and market timing practices, and payment of dividends
- ▶ The treatment of NAV computation errors and compensation of losses arising from non-compliance with applicable investment restrictions

8.2. Administration function

8.2.1. Scope of administration activities

The 2010 Law and the AIFM Law define the activities of administration of UCIs. These include:

- ▶ Legal and fund management accounting services
- ▶ Customer inquiries
- ▶ Valuation of the portfolio (see Section 7.6.) and pricing of the shares or units (i.e., calculating the NAV) (see Section 8.6.)
- ▶ Regulatory compliance monitoring
- ▶ Maintenance of shareholder or unitholder register
- ▶ Distribution of income
- ▶ Share or unit issues and redemptions
- ▶ Contract settlements (including certificate dispatch)
- ▶ Record keeping

In practice, the services provided by the administrator may include, *inter alia*, the following:

- ▶ Client due diligence and onboarding of new UCIs
- ▶ Domiciliation of the UCI
- ▶ Supporting the drawing up of the prospectus, financial reports, and all other documents intended for investors and other legal services to the UCI
- ▶ UCI investment portfolio:
 - ▶ Recording of trading activity from the investment manager(s)
 - ▶ Handling and processing of corporate actions and income from the investment portfolio
 - ▶ Valuation of the portfolio (See Section 7.6.)
- ▶ Pricing of the shares or units (i.e., calculating the NAV)
- ▶ Shareholder or unitholder relationship:
 - ▶ Maintenance of shareholder or unitholder register
 - ▶ Share or unit issues and redemptions
 - ▶ Distribution of income
 - ▶ Dispatching of financial reports and other documents intended for the shareholders or unitholders
 - ▶ Services related to tax reporting
 - ▶ Handling of restructuring events (e.g., mergers, conversions, liquidations - see Chapter 3)
 - ▶ Customer inquiries

- ▶ Fund accounting:
 - ▶ Valuation of UCIs' other assets and liabilities
 - ▶ Performance fee calculation
 - ▶ Recording of investment and other income
 - ▶ Recording of operating and other expenses
 - ▶ Recording of shares/units transactions (subscriptions and redemptions) (see Section 8.7.1. and 8.7.2.)
 - ▶ Recording of dividend distribution to share/unitholder(s) (see Section 8.7.6.)
 - ▶ Series accounting and equalization support
- ▶ Cash management
- ▶ Record keeping
- ▶ Regulatory compliance monitoring
- ▶ Reporting of financial information and electronic transmission of prospectus, Key Investor Information (KII) for UCITS, and financial reports (annual report, long form report, and other reports - see Chapter 10) to the CSSF

8.2.2. Entities performing administration of Luxembourg UCIs

Administration is one of the functions of the management company, the AIFM, the self-managed UCITS or internally managed AIF.

In practice, management companies, AIFM, self-managed UCITS or internally managed AIF generally delegate administration to a specialized third party administrator (hereafter referred to as an "administrator").

One service provider may be appointed to carry out the activities of:

- ▶ Fund administration (covering, for example, accounting services)
- ▶ Registrar and transfer agent (generally referred to as "transfer agent", covering, *inter alia*, the maintenance of the shareholder or unitholder register)
- ▶ Domiciliation agent

It is also possible to appoint different service providers to carry out these activities (e.g., registrar and transfer agent services), which may or may not be part of the same group.

In May 2015, ALFI issued a *Framework for Due Diligence Information Packs for service providers acting as central administrators and/or depositary/custodian with a view to simplify and facilitate initial and ongoing due diligence reviews*. This Framework seeks to provide a table of contents upon which service providers (delegates) to which a UCI's Board of Directors, Management Company or AIFM has delegated activities and services can base their preparation of documentation required to support the initial and ongoing due diligence reviews of a UCI and/ or its Management Company under Luxembourg regulations.

A Luxembourg administrator of UCIs may be one of the following entities:

- ▶ A credit institution
- ▶ An investment firm
- ▶ A financial sector professional (PSF) authorized as a registrar agent or an administrative agent of the financial sector
- ▶ A management company
- ▶ An AIFM

A registrar may be one of the following entities:

- ▶ A credit institution
- ▶ An investment firm
- ▶ A financial sector professional (PSF) authorized as a registrar agent or a distributor of units/shares of UCIs
- ▶ A management company
- ▶ An AIFM

A domiciliation agent may be one of the following entities:

- ▶ A credit institution

- An investment firm
- A financial sector professional (PSF) authorized as a corporate domiciliation agent

Management entities are permitted to provide domiciliary services (see Section 6.1.2.) to:

- The UCIs they manage
- Subsidiaries of the UCIs they manage

PSFs that offer administration services will generally be authorized as registrar agents. This authorization automatically permits them to also provide the services of client communication agents and financial sector administrative agents.

Luxembourg administrators are required to comply with the relevant laws and regulatory requirements, and to have adequate organization in order to obtain authorization from the CSSF and perform the administration (see Section 8.2.3.).

8.2.3. Authorization

Management companies, AIFM, and third party entities requesting authorization as administrators of UCIs are required to provide information to the CSSF including, *inter alia*, information on:

- UCITS, other UCIs, and other vehicles for which the administrator intends to provide administration services over the next three years and estimated budget
- Human resources, including curriculum vitae of responsible officers and organization chart
- Technical resources:
 - Administrative procedures
 - Accounting procedures
 - Related functions and responsibilities
- Details of office premises, including location, size, security arrangements, and document archiving protocols
- Internal control procedures:
 - Client acceptance
 - Registrar
 - Administration
 - Client communication
- Anti-money laundering and counter terrorist financing procedures (see Section 8.7.4.)
- Details on the execution of administrative tasks including:
 - Accounting, including NAV calculation (see Section 8.6.1.)
 - Holding of accounting and other essential documentation of the UCI
 - Holding of the shareholder or unitholder register, including measures taken against market timing and late trading (see Section 8.7.5.)
 - The issue and redemption of the shares or units (see Section 8.7.)
 - The drawing up of the prospectus, financial reports, and all other documents intended for investors
 - Dispatching of financial reports and other documents intended for the shareholders or unitholders
 - Reporting of financial information and electronic transmission of prospectus, KII, and financial reports to the CSSF (see Chapter 10)
 - Information on sub-delegation of activities
 - The information flow between the different departments of the administrator and between the administrator, the investment manager, the entity or person responsible for the administration, and the depositary

This information provided will be in addition to that included within a standard application for authorization. In the CSSF Press release of 7 November 2019, the CSSF has reminded professionals of the AML/CFT investment fund market entry form, created in May 2019, that must be provided in addition to the standard application. It has to be submitted for each licensing application for a new UCI supervised by the CSSF. A form has also been created for IFMs applying for authorized and registered status.

These forms must be renewed for each of the following situations:

- When requesting approval of an additional compartment
- When information previously submitted is updated
- When an additional license or a license extension is requested
- When there is a change in the shareholder structure of the IFM

Management company authorization is covered in Section 6.2.1.

8.3. Regulatory requirements

A UCITS management company, AIFM or the third party administrator acting on their behalf, is subject to the management company's or AIFM's home Member State's organizational requirements, including those on administration. These include, *inter alia*:

- Requirements to have and employ the human and technical resources and procedures that are necessary for the proper performance of their business activities
- Requirements on the implementation of sound administrative and accounting processes
- Control and security arrangements for electronic data processing
- Reporting requirements

In the case of UCITS, the management company or the third party administrator acting on their behalf, must ensure the UCITS home Member State's requirements regarding the constitution and functioning of the UCITS, as well as the specific requirements of the UCITS' fund rules or instruments of incorporation, prospectuses, and offering documents, including in cases where the UCITS is managed cross-border, are met. For example, the accounting and valuation must be performed in accordance with the UCITS' home Member State requirements (see Section 6.3.4.).

A Luxembourg UCITS management company may delegate the administration of the UCITS it manages to a third party that is authorized to provide administration services and has an adequate organization in order to perform the administration:

- A Luxembourg UCITS management company that manages a Luxembourg UCITS is authorized to delegate the administration of the UCITS to an entity established in Luxembourg
- A Luxembourg UCITS management company that manages a UCITS domiciled in another Member State is authorized to delegate the administration of the UCITS to an entity established in either:
 - Luxembourg, or
 - The Member State where the UCITS is domiciled

In the case of AIF, the AIFM and, where applicable, the third party administrator acting on its behalf, is required to comply with the relevant national AIF product rules.

The central administration of a Luxembourg AIF (2010 Law Part II UCIs, SIF, RAIF and other Luxembourg AIF) must be in Luxembourg.

Activities that should be carried out in Luxembourg are outlined in Section 8.4.6.

Delegation is discussed in more detail in Section 8.4.2.

The requirements applicable to administration are laid down in:

- For UCITS and other UCIs:
 - The 2010 Law
 - CSSF Regulation 10-4, *inter alia*, on organizational, conflicts of interest, conduct of business and risk management requirements applicable to Chapter 15 management companies
 - CSSF Circular 18/698 on the authorization and organization of investment fund managers (IFM)
- For AIF:
 - The AIFM Law
 - European Commission Delegated Regulation (EU) No 231/2013 supplementing Directive 2011/61/EU with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision
 - CSSF Circular 18/698 on the authorization and organization of investment fund managers (IFM)

IML Circular 91/75 provides some additional clarification¹⁸⁷.

¹⁸⁷ Circular 91/75 refers to the 1988 Law, the precursor to the 2002 Law, now the precursor to the 2010 Law. The CSSF has indicated its intention to review this Circular with a view to issuing a circular that complements and is compatible with the updated Laws (see Circular 03/87). Certain provisions of Circular 91/75 may still be relevant to UCIs created under the 2010 Law; some of these provisions may also be relevant to UCIs created under the SIF Law.

8.4. Organizational requirements

8.4.1. Accounting procedures

Management companies, AIFM, self-managed UCITS, and internally managed AIF are required to employ accounting policies and procedures to ensure the protection of investors.

The accounts of the UCI must be kept in such a way that all assets and liabilities of the UCI can be directly identified at all times. If a UCI has different investment compartments, separate accounts must be maintained for those compartments.

The IFM must ensure that, for UCIs with multiple compartments, separate information on each compartment is provided in their annual financial reports in order to allow the investor to have clear and accurate information on the compartment in which he/she invests.

Management companies must establish, implement, and maintain accounting policies and procedures in accordance with accounting rules of the UCITS' home Member States, so as to ensure that the calculation of the NAV of each UCITS is accurately carried out, on the basis of its accounts, and that subscription and redemption orders can be properly executed at that NAV.

AIFMs must establish, implement, and maintain accounting and valuation policies and procedures so as to ensure that the net asset value of each AIF is accurately calculated on the basis of the applicable accounting rules and standards.

IFM must establish appropriate procedures to ensure the proper and accurate valuation of the assets and liabilities of the UCIs, or, where appropriate, their compartments (see Section 7.6.). In the case of delegation, these procedures include, in particular, the implementation by the IFM of its own control and monitoring system.

The above principles must apply to all types of UCIs managed by the IFM, including any non-regulated UCIs managed by the IFM.

8.4.2. Delegation of the administration function

The administration function may be performed internally by the IFM, partially or entirely delegated to a third party.

Every IFM which intends to perform the administration function internally must inform the CSSF beforehand in order to get specific approval to act as UCI administration in addition to its authorisation as IFM. To apply for authorisation an IFM must complete and submit the questionnaire *Application for approval as administration of a UCI* available on the CSSF's website.

An IFM that performs the administration function internally, including the maintenance of the register of the share/unitholders must make the appropriate arrangements for suitable IT systems to permit the timely and proper recording of each subscription or redemption order.

If an IFM wishes to delegate part or all of the UCI administration function, it must inform the CSSF beforehand in order to get specific approval to act as UCI administration and delegate some tasks relating to the UCI administration function in addition to its authorisation as IFM. The IFM must complete and submit the questionnaire *Application in case of outsourcing of administration tasks for UCI* available on the CSSF website. The IFM must implement procedures and arrangements allowing it to ensure that the delegates comply with the relevant legal and regulatory provisions.

The IFM is, *inter alia*, required to ensure that the delegate has an internal organization and internal procedures that enable easy access to all necessary information permitting efficient control by the management company over the delegated activities.

If the administration function has been delegated to a Luxembourg administrator, the CSSF may permit, on a case-by-case basis, the performance of certain "preparatory tasks" outside Luxembourg subject to the overall responsibility of the appointed Luxembourg administrator.

CSSF Circular 18/698 includes specific provisions relating to the delegation of the administration function, in addition to the delegation outlined in Section 6.3.3.

Different rules of delegation in the area of UCI administration are applicable depending on the home Member State of the UCI.

Where a Luxembourg IFM manages a regulated Luxembourg UCI, it is authorised to delegate the administration of the UCI to a delegate established in Luxembourg.

Where a Luxembourg IFM intends to manage UCIs domiciled outside Luxembourg and to use an administrative agent established outside Luxembourg, the IFM must also inform the CSSF and must ensure that initial due diligence and ongoing monitoring of delegates, as described in CSSF Circular 18/698 are performed (see Section 6.3.3.). As part of its due diligence process, it must verify in particular that the delegate is organised in a manner which allows it to adequately perform the administration function. In essence, the third party must have all the necessary authorisations, if applicable in the country in question, and be qualified and capable of undertaking the function in question. In the notification to the CSSF, the IFM must demonstrate that the delegation complies with the legal and regulatory provisions in force in the country of domicile of the UCI and that the delegation is permitted by the supervisory authority of the UCI.

In all of the above cases, the IFM must ensure that the third party in charge of the administration employs accounting procedures and policies (i.e., application of the accounting rules of the home country of the UCI, separate accounting for UCIs with multiple compartments, means permitting the identification and measurement of assets and liabilities of the UCI) when applying due diligence measures.

Where an IFM has delegated the UCI administration, including the maintenance of the register of share/unitholders, to one or more third parties, it must, from the moment it enters into the relationship, monitor on an ongoing basis that each delegate has suitable IT systems.

Specifically referring to AIFM, where the administration function is delegated, by an AIF formed as an investment company, the AIFM must either be part of the delegation contract or ensure that bilateral contracts allow the AIFM to fulfil its responsibilities in accordance with the AIFM Law.

Due diligence and ongoing monitoring

With specific respect to delegation of the administration function, including the registrar function, and in addition to the requirements set out in Section 6.3.3. the following points should be covered, *inter alia*, in the due diligence assessment:

- ▶ The verification of the existence of a solid control system for calculating the net asset value
- ▶ The verification of the existence of an approval for the valuation source used for transferable securities, derivative instruments and unlisted instruments
- ▶ The review of the implemented AML/CFT operational controls and the assessment of the human resources allocated to these controls
- ▶ The assessment of the registrar agent's capacity to provide its service, taking into account the structure and complexity of the distribution network and the types of UCIs concerned
- ▶ The assessment of the development of the ML/TF risk
- ▶ The review of the registration process for subscriptions and redemptions
- ▶ The review of the procedure for the reconciliation of the number of units in circulation

In addition, the IFM must implement its own control and monitoring system covering at least the following:

- ▶ Monitoring the time of delivery of the net asset value
- ▶ Monitoring the net asset value calculation errors
- ▶ Monitoring the non-compliance with the investment policy and restrictions
- ▶ Monitoring the transactions which were not accounted for within the usual time limits
- ▶ Controlling the fees and commissions to be borne by UCIs
- ▶ Monitoring the reconciliation of the number of units in circulation

The "accounting administration" of management companies and AIFM is covered in Section 6.3.2.2.B.

8.4.3. Electronic data systems

The management company, AIFM or its administrator must have suitable electronic systems to permit a timely and proper recording of each portfolio transaction and subscription and redemption order.

For Chapter 15 management companies, the CSSF has clarified that the aforementioned requirements in relation to portfolio transactions and subscription and redemption orders may be ensured through either of the following:

- ▶ Equipping itself with suitable electronic systems
- ▶ Ensuring that its delegates are equipped, on an ongoing basis, with suitable electronic systems, through initial and ongoing due diligence

The management company, AIFM or its administrator must ensure a high level of security during electronic data processing as well as integrity and confidentiality of the recorded information, as appropriate. This would include, *inter alia*, enabling at least timely recovery of data and functions and resumption of activities (see Section 6.3.2.3.).

According to Chapter D of Circular 91/75, the IT system that processes the accounting records and the calculation of the NAV should meet the following conditions:

- The administrator and/or the management company should have the means to input and extract information, such access being immediate and unrestricted
- The administrator and/or the management company should have knowledge of the operation of the processing unit and authorize any program modifications
- The administrator and/or the management company should have the ability to intervene directly in the processing of information stored in the processing unit
- Where other parties use the computer unit, adequate protection should exist to prevent access to the UCI data

According to Chapter D of Circular 91/75, the following additional conditions should be met where the IT system is located abroad:

- Information stored in the processing unit must be transferred and downloaded on each valuation date and at least weekly
- The administrator and/or the management company must be able to continue normal operations in the event of an emergency, such as a breakdown in communications with the processing unit

It would be expected that investment advisers or other agents abroad may have immediate access to the IT system and may instigate accounting operations within the scope of their duties, provided that:

- Controls exist to ensure that only they have access to the data applicable to their duties
- The UCI has established management control procedures to ensure that the operations initiated by the portfolio managers comply with its regulations

On 17 May 2017, the CSSF published the Circular 17/654 on IT outsourcing based on a cloud computing infrastructure which is applicable to credit institutions and Professionals of the Financial Sector (PSFs) as well as payment institutions, and electronic money institutions. The CSSF defines cloud computing and specifies the criteria used to consider cloud computing infrastructure as IT outsourcing to a service provider.

8.4.4. Procedures and documents

According to Chapter D of Circular 91/75, the administrator and/or the management company should have at its/their disposal all accounting and other documentation of the UCI required for:

- The preparation of accounts and portfolio valuations
- The drawing up of certificates of title and indebtedness
- The allocation of shares or units in circulation
- The general protection of the interests of the UCI, including all agreements

These requirements imply that all documents relating to transactions initiated from abroad should be immediately forwarded to the domicile of the administrator and/or the management company.

8.4.5. Record keeping

The records of Chapter 15 management companies and AIFM should be kept at least five years, on a medium that must allow for:

- Easy reconstitution of all steps of each portfolio transaction (see also Section 8.5.)
- Easy identification of any correction or update to the original records, as well as having access to the original records
- No manipulation or alteration of the record content
- Ready access by the CSSF

8.4.6. Activities which should be carried out in Luxembourg

According to Chapter D of Circular 91/75, the activities of central administration that are to be carried out in Luxembourg comprise accounting and administrative functions, as follows:

- The accounts must be kept and the accounting documents must be available in Luxembourg
- Subscriptions and redemptions of shares or units must be carried out in Luxembourg
- The register of shareholders or unitholders must be kept in Luxembourg
- The prospectus, financial reports, and all other documents intended for investors must be established in cooperation with the central administration in Luxembourg
- Correspondence and the dispatch of financial reports and other documents intended for the shareholders or unitholders must be carried out from Luxembourg and in any case under the responsibility of the central administration in Luxembourg
- The calculation of the NAV must be carried out in Luxembourg

8.5. UCI portfolio requirements

8.5.1. Recording of portfolio transactions

The management company (for each portfolio transaction relating to UCITS), AIFM or its administrator must ensure that a record of information that is sufficient to reconstruct the details of the order and the executed transaction or of the agreement (in the case of AIF) is produced without delay.

The record must include:

- The name or other designation of the UCI and of the person acting on account of the UCI
- The details necessary to identify the instrument in question or, in the case of an AIF, the asset
- The quantity
- The type of the order or transaction
- The price
- For orders, the date and exact time of the transmission of the order and name or other designation of the person to whom the order was transmitted, or for transactions, the date and exact time of the decision to deal and execution of the transaction
- The name of the person transmitting the order or executing the transaction
- Where applicable, the reasons for the revocation of an order
- For executed transactions, the counterparty and execution venue identification

8.6. Net asset value (NAV)

8.6.1. Determining the NAV

The NAV of a UCI is defined as the value of its assets less the value of its liabilities.

NAV calculation is the result of the process of the accounting procedures performed by the UCI administration.

These accounting procedures are usually supported by computerized systems and involve a series of accounting tasks aimed at recording any change in a UCI's financial position including investor capital inflows and outflows, dividend distribution, purchases and sales of investments and related investment income, portfolio valuation, gains, losses, and operating expenses of the UCI.

Net asset value per share/unit is calculated by dividing the UCI NAV by the number of outstanding shares or units. Such a price may be increased in the case of subscriptions and reduced in the case of redemptions by a specified percentage to cover commissions and expenses. In certain cases, a swing factor may be applied to the NAV (see Section 8.6.3.).

The procedures and the methodology for calculating the NAV per share or unit must be documented.

The NAV calculation methodology used depends on accounting principles, Luxembourg or international regulations that may apply, and the specific rules that apply to the UCI in question.

The frequency of NAV per share or unit calculation is specified in the UCIs constitutional document. The NAV must, in general, be calculated each time the shares or units are issued or repurchased, and at least twice a month for a UCITS, at least monthly for 2010 Law Part II UCIs and at least annually for SIFs and RAIFs.

For AIF managed by authorized AIFM, the AIFM is required as a minimum to:

- Ensure that for each AIF they manage the NAV per share or unit is calculated on the occasion of each issue or subscription or redemption or cancellation of shares or units, and at least once a year
- Regularly verify the NAV calculation procedures and methodologies and their application
- Ensure that the number of shares or units in issue is subject to regular verification, at least as often as the share or unit price is calculated

The valuation of the assets of UCI is covered in Section 7.6.

An AIFM is responsible towards the AIF and its investors for the proper valuation of the assets of the AIF, the calculation of the NAV, and its publication.

The requirement for the depositary to ensure that the value of the shares or units is calculated in accordance with the applicable law and the constitutional document of the UCI is covered in Section 9.4.5.3.

Remedial procedures must be implemented in the event of an incorrect calculation of the NAV (See Section 8.8.).

8.6.2. Use of NAV in subscriptions and redemptions

The NAV per share/unit is generally the price at which shares/units can be bought (subscriptions) and sold (redemptions) by investors.

For 2010 Law UCIs, shares or units must be issued and repurchased at a price that corresponds to the NAV of the relevant share or unit class.

The price must be determined and made public each time the shares or units are issued or repurchased and at least twice a month for a UCITS and at least monthly for 2010 Law Part II UCIs.

Under the SIF Law and the RAIF Law, there is significant flexibility regarding subscription and redemption of shares or units. The subscription and redemption of shares or units must be carried out in accordance with the rules laid down in the constitutional document. These rules could provide, for example, for shares or units to be subscribed or redeemed at a price other than the NAV. The subscription and redemption conditions, including the determination of the price and the frequency, are specified in the constitutional document.

Subscriptions and redemptions are covered in Section 8.7.

8.6.3. Swing pricing

8.6.3.1. Definition - a method of counteracting dilution

Swing pricing has been identified as a possible means of protecting a UCI's performance and thus the interest of existing investors from the dilution effect of frequent trading, which is also a characteristic of market timing activity.

Swinging a UCI's NAV price is an attempt to pass on the cost of underlying capital activity to the active shareholders or unitholders and thus to protect investors from costs associated with capital activity. However, it must be understood that swing pricing affords protection against dilution at the UCI level and is not designed to address specific shareholder or unitholder transactions.

The swing pricing policy should be approved by the UCI's Board of Directors and reviewed at least annually.

The prospectus should disclose the swing pricing policy, including, *inter alia*, the possibility for the UCI to swing the NAV, a short description of the swing pricing mechanism, the maximum swing factor as a percentage of a UCI's NAV, and appropriate wording explaining that swing pricing is designed to prevent the dilution of existing investors.

8.6.3.2. The operational process

The primary operational considerations associated with swing pricing comprise:

- Whether to adopt full or partial swing
- If a partial swing is adopted, the appropriate swing threshold for a particular UCI
- Once the decision is made to swing the NAV, the appropriate swing factor for a particular UCI
- Determination of the frequency of review

ALFI issued a guidance paper on Swing Pricing, updated in December 2015.

Full or partial swing

Generally, the NAV is swung using one of the following methods:

- ▶ Full swing: The NAV is swung on every dealing date on a net deal basis regardless of the size of the net capital activity. No threshold is therefore applied in the full swing model
- ▶ Partial swing: The process is triggered, and the NAV swung, only when the net capital activity exceeds a predefined threshold known as the “swing threshold”

Determination of the “swing threshold”

In principle, the swing threshold should reflect the point at which net capital activity triggers the investment manager to trade a UCI's securities. As an example, the policy would state that a net capital activity greater than X% of the UCI's NAV would trigger swing pricing. Factors influencing the determination of the swing threshold ordinarily include:

- ▶ The size of the UCI
- ▶ The UCI's client base and its concentration
- ▶ The type and liquidity of securities in which the UCI invests
- ▶ The costs, and hence the dilution impact, associated with the markets in which the UCI invests
- ▶ The investment manager's investment policy and the extent to which a UCI can retain cash (or near cash) as opposed to always being fully invested
- ▶ Consistency considerations within a UCI complex
- ▶ Soft closure measures on capacity constrained UCIs

Ideally the application of swing pricing should be mechanical and triggered on a consistent basis.

Determination of the appropriate swing factor

The swing factor is the amount (normally expressed as a percentage) by which the NAV is adjusted in order to protect existing investors in a UCI from the cost of trading securities as a result of capital activity.

Generally, once the net capital activity is known for a given dealing date and the swing pricing process is triggered, the NAV of all of the UCI's share or unit classes (in the case of a multi-share or unit class UCI) is swung on the following basis:

- ▶ Net inflows: the price used to process all transactions is adjusted upwards by the swing factor to a notional offer price
- ▶ Net outflows: the price used to process all transactions is adjusted downwards by the swing factor to a notional bid price

The most commonly adopted approach is to calculate the NAV and then apply the swing factor.

The swing factor is determined by assessing those transactions and market impacts expected to be incurred as a result of investing or disinvesting the net capital activity for that day. A key item in the determination of the swing factor is the bid offer spread. Other items influencing the determination of the appropriate swing factor include:

- ▶ Broker commissions paid by the UCI
- ▶ Custody transaction charges
- ▶ Fiscal charges
- ▶ Share class specific items
- ▶ Market impact
- ▶ Swing factors or spread applied to the underlying investment funds or derivative instruments

Periodic verification of the swing factor

It is recommended that the swing factor should be monitored to ensure reasonability when compared to the charges incurred and should be revised as and when necessary. The objective is to ensure that the swing factor is consistent with the UCI's security and investment profile, the markets in which it invests, and the various cost components. This should be undertaken by a swing pricing committee under the supervision of the UCI's Board of Directors or equivalent responsible body.

Additional topics covered by the guidelines

The guidelines also cover, *inter alia*:

- ▶ The pros and cons of swing pricing
- ▶ Governance and transparency around swing pricing
- ▶ Operational considerations including capital activity, other operational issues to consider, recording the swing factor, fund mergers, contributions and redemptions in kind, launch of a new fund, launch of a new share class and liquidating funds

- ▶ The different investment fund structures to which swing pricing can be applied: funds with a single share class, funds with multiple share classes, master feeder fund structures, fund of fund structures and pooling
- ▶ Performance considerations: pricing and the impact on performance, risk assessment, competitor and peer performance analysis, fund performance reporting, internal fund performance reporting and performance fee calculations
- ▶ Regulatory and tax considerations including financial reporting, swing errors, prospectus disclosure, articles of incorporation and the Key Investor Information Document

On 30 July 2019, the CSSF published its *Frequently Asked Questions (FAQ) - Swing Pricing Mechanism*. This FAQ applies to all Luxembourg regulated UCIs (UCITS, Part II 2010 Law UCIs and SIFs) which apply swing pricing.

The FAQ provided the following clarifications:

- ▶ The use of a swing pricing mechanism, being adjustments to the net asset value in order to counter the dilution effects of capital activity, should be provided for in the articles of incorporation or the management regulations
- ▶ The prospectus of a UCI applying a swing pricing mechanism should describe, at a minimum:
 - ▶ The swing pricing mechanism, including details on the NAV adjustment mechanism in case of net subscriptions (inflows) or redemptions (outflows), the use of any specific subscription/redemption threshold before the swing pricing mechanism becomes applicable (i.e., whether partial or full swing pricing mechanism is utilized)
 - ▶ The reasons for applying the swing pricing mechanism, including notably the benefits for the investors
 - ▶ The impacts of using the swing pricing mechanism, including the impact on the subscribing and redeeming investors and the fact that the swing pricing mechanism is applied on the capital activity at the level of the UCI and does not address the specific circumstances of each individual investor transaction
 - ▶ The maximum swing factor applicable (as a percentage of the NAV or in monetary value); UCIs can differentiate in this context between normal and unusual market conditions if they provide a precise definition of unusual market conditions (e.g., higher market volatility)
 - ▶ An indication of the components underlying the swing factor, e.g., the bid/ask spread, transaction costs, transaction taxes and other tax related matters, market impact, etc.
 - ▶ An indication of the decision process and the decision makers approving the swing factor to be applied
 - ▶ The compartments of a UCI in scope of the swing pricing mechanism (this information may be shared as well through a reference to a website)
 - ▶ That any performance fee will be charged on the basis of the unswung NAV
- ▶ Annual and semi-annual reports of UCIs should describe the swing pricing mechanism and cover as a minimum:
 - ▶ Details on the NAV adjustment mechanism in case of net subscriptions or redemptions, the use of any specific subscription/redemption threshold before the swing pricing mechanism becomes applicable (i.e., whether a full or partial swing is used)
 - ▶ The maximum swing factor applicable
 - ▶ The list of compartments that have applied the mechanism (whether swung or not) during the financial period (this may be mentioned either in the annual/semi-annual report or by referencing, in the annual/semi-annual report, a website where the information is available)
- ▶ In case of a material NAV error arising as a result of an administrative error (i.e., application of the incorrect swing factor, or the NAV was swung in the wrong direction) in the application of the swing pricing mechanism, the procedures set out in CSSF Circular 02/77 (refer to Section 8.8.) must be followed. If the impact of the error is below the materiality threshold, the CSSF considers that the UCI should still be compensated when it was not protected from the level of dilution it should have been, had the swing pricing mechanism policy been applied properly. The FAQ provides illustrative examples of such types or errors.
- ▶ A detailed swing pricing mechanism policy approved by the Board of Directors of the IFM and, where applicable, the Board of Directors of the UCI, should be established and implemented, as well as specific operational procedures over the day-to-day application of the swing pricing mechanism. Such policies and procedures should be in place before the use of the swing pricing mechanism. The policy and procedures should cover, *inter alia*,:
 - ▶ The governance process, together with the different stakeholders involved, applied in relation to the application of the swing pricing mechanism
 - ▶ The oversight of the delegate in case of delegation of activities pertaining to the application of the swing pricing mechanism
 - ▶ The methodology applied for the determination and the periodic review of the swing factors and thresholds

- ▶ The maximum swing factor applicable (as a percentage of the NAV or in monetary value) - a differentiation in this context between normal and unusual market conditions can be performed if a precise definition of unusual market conditions (e.g., higher market volatility) is provided for in the policy
- ▶ The review process, together with the related frequency and the related triggers (e.g., market circumstances, portfolio composition), of the swing factors as well as the operational implementation of potential swing factor changes
- ▶ The situations which may result in the non-application of swing pricing mechanism (e.g., grace period on initial launch)
- ▶ The treatment of corporate actions concerning the UCI (mergers, liquidations, contributions in kind)
- ▶ The ongoing monitoring of the application of the swing pricing mechanism
- ▶ The periodic review of the adequacy and the effectiveness of the swing pricing mechanism policy, processes and procedure

Should changes be required to the UCI's prospectus or management regulations as a result of the FAQ, these should be made at the next update.

On 20 March 2020 and 7 April 2020, the CSSF published its *Frequently Asked Questions (FAQ) - COVID-19* and provided the following clarifications on swing pricing:

The CSSF confirmed that UCIs using Swing Pricing as an anti-dilution mechanism can increase the swing factor:

- (i) Up to the maximum laid down in the prospectus without prior notification to the CSSF
- (ii) Beyond the maximum laid down in the prospectus where the prospectus offers this possibility to the Board of Directors of the UCI, provided that such decision is duly justified and takes into account the best interests of the investors. Investors must be informed and the CSSF provided with a detailed notification of the resolution, including a specific explanation of the reasons
- (iii) Beyond the maximum laid down in the prospectus, on a temporary basis, given the exceptional market circumstances arising from COVID-19, where the prospectus does not offer this possibility to the Board of Directors of the UCI, provided that conditions laid down in (ii) are met and that the prospectus is updated to offer this possibility during the next update. In this case, the investors and the CSSF must be informed prior to applying the increased swing factors

The CSSF does not set a quantitative maximum but the revised swing factors must be the result of a robust internal governance process and must be based on a robust methodology. The CSSF may request justification for the revised swing factors on an *ex-post* basis.

8.7. Subscriptions and redemptions of shares or units and payment of dividends

This section covers:

- ▶ The specific requirements applicable to subscriptions and redemptions
- ▶ The recording and reporting to investors of subscription and redemption orders
- ▶ Prevention of money laundering and terrorist financing
- ▶ Prevention of late trading and market timing
- ▶ Payment of dividends

The use of the NAV in subscriptions and redemptions is covered in Section 8.6.2.

8.7.1. Subscriptions (issues)

Shares or units are represented by certificates in registered or bearer form or by a confirmation of registration. Fractions of shares or units are permitted. Shares or units are to be issued in accordance with the conditions laid down in the constitutional document and may be denominated in any currency. In the case of a common fund, the management company and the depositary are required to sign the certificates and securities representing one or more portions of the common fund.

SIFs and RAIFs must implement procedures to ensure that the shares or units are only distributed to well-informed investors (see Sections 2.4.2. and 2.4.3.).

In July 2014, a law on unlisted bearer shares or units was voted by the Luxembourg Parliament.

The law introduces the requirement to deposit bearer shares or units with a depositary (which is not necessarily a bank). The depositary should be appointed by the Board of Directors or management of the UCI or its management company.

The depositary is required to maintain a register of bearer shares or units containing, *inter alia*, information on each shareholder or unitholder. Each bearer shareholder or unitholder will be permitted to request a certificate listing all inscriptions in the register that concern themselves.

Companies that have outstanding bearer shares or units and, in the case of common funds, their managers were required to appoint a depositary by 18 February 2015 at the latest. Bearer shares or units had to be deposited with the depositary by 18 February 2016. Bearer shares or units not deposited by that time were cancelled.

Subscriptions are routinely made in exchange for cash; however, the UCI, at the discretion of the Board of Directors, may accept payment for shares by an in kind subscription of suitable investments.

For in kind subscriptions (contributions in kind), an independent auditor is required to review the valuation of the assets and liabilities subscribed.

Marketing is covered in Chapter 12.

8.7.1.1. Master-feeder UCITS

In master-feeder UCITS structures, the agreement between the master UCITS and the feeder UCITS or, where the master and feeder are managed by the same management company, the management company's internal conduct of business rules must cover the following in relation to subscriptions and redemptions (see also Section 2.3.4.1.):

- ▶ Basis of investment and divestment by the feeder UCITS:
 - ▶ A statement of which share or unit classes of the master UCITS are available for investment by the feeder UCITS
 - ▶ The charges and expenses to be borne by the feeder UCITS, and details of any rebate or retrocession of charges or expenses by the master UCITS
 - ▶ Where applicable, the terms on which any initial or subsequent transfer of assets in kind may be made from the feeder UCITS to the master UCITS
- ▶ Standard dealing arrangements including:
 - ▶ Coordination and frequency of NAV calculation process and the publication of prices of shares or units
 - ▶ Coordination of transmission of dealing orders by the feeder UCITS, including, where applicable, the role of transfer agents or any other third party
- ▶ Events affecting dealing arrangements:
 - ▶ The manner and timing of a notification by either UCITS of the temporary suspension and the resumption of redemption or subscription of shares or units of that UCITS
 - ▶ Arrangements for notifying and resolving pricing errors in the master UCITS

Conversion of UCITS into feeder UCITS and change of master UCITS are covered in Section 3.6.3.

8.7.1.2. Venture capital UCIs

The shares or units of venture capital UCIs under Part II of the 2010 Law, which may be in registered or bearer form, must have a minimum value of EUR 12,400 at the time of issue.

8.7.1.3. Futures contracts and options UCIs

The shares or units of futures contracts and options UCIs under Part II of the 2010 Law, which may be in registered or bearer form, must have a minimum value of EUR 12,400 at the time of issue.

8.7.1.4. Real estate UCIs

The NAV of real estate UCIs under Part II of the 2010 Law must be calculated at the year-end and on each day when the UCI's shares or units are issued or repurchased.

Property valuations at the year-end may be used in the determination of the NAV during the following year, unless a change of circumstances renders such valuation inappropriate.

8.7.2. Redemptions (repurchases)

Redemptions of shares or units have to take place in accordance with the conditions laid down in the constitutional document.

UCITS are required to repurchase their shares or units at the request of investors. However, a UCITS may, if it can be justified, provide in its constitutional document that management is able, in specific circumstances (e.g., temporary liquidity shortage) or when requests in a single dealing day exceed a certain set level in relation to the number of shares or units in circulation, to arrange for a delay in settlement of redemption requests for a specific time or for a proportional reduction of all redemption requests so that the set level is not exceeded.

Redemptions may be suspended under the conditions specified in the constitutional document or, in certain circumstances, at the request of the CSSF.

Redemptions are routinely made in exchange for cash; however, the UCI or the investor, in certain circumstances, may request payment by an in kind distribution of investments, in lieu of cash. An in kind distribution can be derived using a proportional or non-proportional basis. A proportional basis requires that the in kind redemptions comprise an equal share of all of the UCI's investments. In certain circumstances, in kind redemptions may also be performed on a non-proportional basis whereby the investor receives different weightings of the portfolio holdings.

For in kind redemptions, an independent auditor is required to review the valuation of the assets and liabilities redeemed. Unless stipulated by the prospectus or offering document of the UCI, the CSSF may permit an exemption from the requirement for a review by the independent auditor where the redemption is performed on a proportional basis.

Such reviews are conducted in accordance with the professional guidance issued by the Luxembourg Institute of Auditors (*Institut des Réviseurs d'Entreprises* - IRE). The valuation, together with the NAV of the share or unit class, determines the investments to be distributed.

8.7.2.1. Master-feeder UCITS

See Section 8.7.1.1.

8.7.2.2. Venture capital UCIs

Where investors have the right to redeem their shares or units in a venture capital UCI under Part II of the 2010 Law, the UCI may provide for certain restrictions to this right. Any such restrictions must be stated in the prospectus.

8.7.2.3. Real estate UCIs

Where investors have the right to redeem their shares or units in a real estate UCI under Part II of the 2010 Law, the UCI may provide for certain restrictions to that right. Any such restrictions must be stated in the prospectus. See also Section 8.7.1.4.

8.7.3. Subscription and redemption orders

A. Recording

The management company, AIFM or its administrator must take all reasonable steps to ensure that the subscription and redemption orders received are centralized and recorded immediately after receipt of any such order in the case of UCITS or without undue delay after receipt of any such order in the case of AIF.

That record includes information on the following:

- The relevant UCI
- The person giving or transmitting the order
- The person receiving the order
- The date and time of the order
- The terms and means of payment
- The type of the order
- The date of execution of the order
- The number of shares or units subscribed or redeemed

- ▶ The subscription or redemption price for each share or unit or, in the case of AIF, the amount of capital committed and paid
- ▶ The total subscription or redemption value of the shares or units
- ▶ The gross value of the order including charges for subscription or net amount after charges for redemption

B. Reporting to investors

UCITS management companies and AIFM are subject to similar although not identical requirements on reporting of subscription and redemption orders to investors.

Management companies are required to notify investors, no later than the first business day following execution of a subscription or redemption, by means of a durable medium, confirming execution of the order. The notice should contain the following information:

- ▶ Management company identification
- ▶ Designation of the shareholder, unitholder or client
- ▶ Date and time of the receipt of the order and method of payment
- ▶ Date of execution
- ▶ UCITS identification
- ▶ Order type (subscription or redemption)
- ▶ Number of shares or units involved
- ▶ NAV per share/unit
- ▶ Value date
- ▶ Gross value of the order including charges for subscription or net amount after deduction of charges for redemptions
- ▶ Total sum of commission and expenses charged and, if requested by the investor, an itemized breakdown

If the UCITS management company does not execute the order itself, it should confirm execution of the order no later than one day after reception of the third party's notice.

Where shareholders' or unitholders' orders are executed periodically on their behalf, the UCITS management company may provide investors with periodic disclosure, at least every six months.

UCITS management companies must, on request, provide investors with information about the status of their orders.

Where AIFMs have carried out a subscription or, where relevant, a redemption order from an investor, they must promptly provide the investor, by means of a durable medium, with the essential information concerning the execution of that order or the acceptance of the subscription offer, as the case may be.

The essential information must include the following:

- ▶ The identification of the AIFM
- ▶ The identification of the investor
- ▶ The date and time of receipt of the order
- ▶ The date of execution
- ▶ The identification of the AIF
- ▶ The gross value of the order including charges for subscription or the net amount after charges for redemptions

8.7.4. Prevention of money laundering and terrorist financing

8.7.4.1. Legal framework

The Law of 12 November 2004 on *the fight against money laundering and terrorist financing*, ("the AML Law") as amended by the Law of 17 July 2008, the Law of 27 October 2010, the Law of 13 February 2018, the Law of 10 August 2018, and the Law of 25 March 2020 is the principal law with respect to anti-money laundering and terrorist financing. Two other important texts are the Grand-Ducal Regulation of 1 February 2010, and CSSF Regulation 12-02. In general, these documents set out the legal framework on the fight against money laundering and terrorist financing and the obligations applicable to persons and entities in Luxembourg.

The Law of 27 October 2010 reinforces and clarifies the Luxembourg anti-money laundering and counter terrorist financing (AML/CFT) framework. It covers:

- Scope of entities subject to AML/CFT obligations
- Scope of operations subject to AML/CFT requirements
- Standard, simplified, and enhanced due diligence
- Politically exposed persons (PEPs)
- Cooperation with the authorities and sanctions

The law of 13 February 2018 partially transposes the 4th EU AML Directive, *inter alia*, aligning the European regulations with the latest recommendations from the Financial Action Task Force (FATF¹⁸⁸) of 2012, and EU Regulation 2015/847 on information accompanying transfers of funds. The main changes are, *inter alia*:

- Substantial increase of criminal sanctions and administrative fines by supervisory authorities
- Reshaped risk assessment
- Extension of the definition of beneficial owners regarding trusts
- Strengthening of the definition of PEP (local and foreign)

The Law of 10 August 2018 partially transposes Article 31 of the 4th EU AML Directive, introducing new obligations for fiduciary arrangements, *inter alia*, changes for fiduciary agents to obtain and hold adequate, accurate and up-to-date information on the beneficial owner. This Law allows supervisory authorities to have, *inter alia*, access to all documents and to carry out on-site inspections or investigations.

The Law of 10 July 2020 establishes a register of beneficial owners for Luxembourg fiduciary arrangements.

The Law of 13 January 2019 establishes a register of beneficial owners of companies and similar entities registered with the Luxembourg trade and companies register (“RBE”). The objective of the register is to make available information on the ultimate beneficiaries of the entities registered.

All entities registered with the “*Registre de Commerce et des Sociétés*” (“RCS”) are required to provide information about their beneficial owners and keep the information in an internal file.

All registered entities need to make available the following information:

1. Surname(s)
2. First name(s)
3. Nationality/ies
4. Birth date (day, month and year)
5. Place of birth
6. Country of residence
7. Exact home or professional address
8. National Natural Persons Registry (“*Registre national des personnes physiques*”) number, as applicable
9. Foreign identification number, as applicable
10. Type(s) of interest(s) beneficially owned
11. Extent of interest(s) beneficially owned

Listed entities are only required to register the name of the regulated market on which they are admitted to trading.

On 25 March 2020, the Luxembourg legislator published two new laws:

- 1) The 1st Law of 25 March 2020 transposing certain provisions of Directive (EU) 2018/843 (the 5th EU AML Directive);
- 2) The 2nd Law of 25 March 2020 establishing a central electronic data retrieval system concerning IBAN accounts and safe-deposit boxes.

The aim of the 1st Law of 25 March 2020 is to implement the majority of the 5th EU AML Directive (certain sections of the Directive have already been implemented via the law of 13 January 2019) and to expand the scope of the amended Law of 12 November 2004 on the fight against money laundering and terrorist financing.

The 2nd Law of 25 March 2020 introduces a Luxembourg central electronic data retrieval system which gathers data about payment and bank accounts identified by an IBAN number and safe deposit boxes.

¹⁸⁸ An intergovernmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

The 1st Law of 25 March 2020

Modifications brought about by this Law include, *inter alia*:

- ▶ The scope of professionals subject to AML/CFT obligations has been extended with the inclusion of, *inter alia*, real estate developers, exchange platforms for virtual currencies (including exchanges dealing with fiat currency and virtual currency), custodian wallet providers, rental brokers (when the value of the monthly rent is equal or superior to EUR 10,000), art dealers (or persons who act as intermediaries in the trade in works of art including galleries and auction houses (when the amount of the value of the transaction(s) is equal to or exceeds EUR 10,000) in the scope of the AML Law;
- ▶ Clarification and extensions of customer due diligence (CDD) measures and enhanced due diligence (EDD) measures to be applied, most notably, regarding high-risk countries
- ▶ Further specifications clarifying the methodology for identification and verification of beneficial owners (following CSSF Circular 19/732)
- ▶ Additional details regarding internal management requirements and group-wide policies and procedures
- ▶ Enhanced cooperation framework between the various competent authorities and self-regulated bodies

Customer and Enhanced due diligence measures

- ▶ *PEP*: The notion that institutions should not consider persons who have ceased to be entrusted with a prominent public function for over one year as a Political Exposed Person (PEP) has been erased, therefore institutions now need to continue to take risk-sensitive measures for each PEP and preceding PEP for at least 12 months and evaluate accordingly the continuing risk posed by that person. The risk-sensitive measures have to be taken until that person does not pose any further risk related to his/her PEP status.

Furthermore, the definition of PEPs has been extended to include natural persons appearing on the list published by the European Commission (the "EU PEP List"). This list has not yet been published at the date of this publication. Institutions will thus be obliged to consider this new EU PEP List in their customer screening processes.

- ▶ *High-risk Jurisdictions*: The definition of a high-risk country has evolved. The current definition now considers that a high-risk country should at least include countries considered to be:
 - a) High-risk third countries by the European Commission
 - b) Higher risk by the International Financial Action Task Force (FATF)
 - c) High-risk by the Luxembourg supervisory authorities.

Additionally, the professional must take into consideration reports established in the area by international organizations and standard-setting bodies responsible for preventing money laundering and combating the financing of terrorism, with regards to the risks certain countries hold

Furthermore, it has now been made clear that for each country considered as high risk, enhanced due diligence measures should be applied which include, at least:

1. Obtaining additional information on the Beneficial owner(s) and more frequent updating of the identification data
2. Obtaining additional information on the envisaged nature of the business relationship
3. Obtaining information on the origin of funds/assets of the client and beneficial owner
4. Senior management authorization
5. Obtaining information on the reasons for planned or already performed transactions
6. Enhanced monitoring of the business relationship (incl. increasing number and frequency of checks and determining transaction patterns that require further examination)

The Law also foresees that professionals apply to persons and entities that execute transactions involving high-risk countries, where appropriate, a serie of enhanced countermeasures.

- ▶ *New factors* evidencing high risk are added to Annex IV of the AML Law:
 - ▶ A third-country national customer applying for residence rights or citizenship through capital transfers, the purchase of property or government bonds, or investments in private companies
 - ▶ Transactions relating to petroleum, arms, precious metals, tobacco products, cultural goods and other objects of value archaeological, historical, cultural and religious, or of rare scientific value, as well as ivory and protected species

Customer due diligence measures

The Law clarifies the measures which are related to any person acting on behalf of the customer/investor specifically related to the authorization required to act in place of this person as well as the identity and verification requirements that apply.

Secondly, a framework has been introduced to provide flexibility in the electronic identification and verification of the customer/investor (EU Regulation 910/2014 on electronic identification and trust services for electronic transactions in the internal market).

Lastly, the Law also has introduced measures that are in line with the CSSF Circular 19/732 for the identification and verification of beneficial owner information. This also includes obtaining proof of beneficial ownership through an extract of the relevant Beneficial Owner ('BO') register in Luxembourg or abroad (where accessible).

Third-party due diligence

A clarification has been introduced relating to when a third party can be used to perform due diligence. This clarification states that third parties must be able to provide, without delay, upon request, the necessary documents concerning CDD, including identification and verification data obtained by electronic means. To act as a third party, the same eligibility criteria as set out under the AML Law still apply including that the third party should be subject to regulations and uphold document retention mechanisms that are compatible with the AML Law.

Lastly, the Law provides that professionals using their group policies and procedures should, in addition to complying with conditions specified in the Law, mitigate risks linked to countries classified as high-risk pursuant to the AML Law.

Grand-Ducal Regulation of 1 February 2010 clarifies certain provisions of the amended Law of 12 November 2004 on the fight against money laundering and terrorist financing, covering, *inter alia*:

- The different types of customer due diligence:
 - Standard customer due diligence
 - Simplified customer due diligence
 - Enhanced customer due diligence
- Customer due diligence performed by third parties
- Obligations of branches and subsidiaries in foreign countries

Grand-Ducal Regulation of 15 February 2019 *on the arrangements regarding registration, payment of administrative costs, and access to the information contained in the Register of Beneficial Owners* covering, *inter alia*, the arrangements for access to the register, which is free of charge and accessible to the general public. Searches can be performed on "entity name" and "registration number". A search by beneficial owner name is not possible for the general public.

CSSF Regulation 12/02 *on Combating money laundering and terrorist financing and prevention of the use of the financial sector for the purpose of money laundering and terrorist financing* of 14 December 2012 makes existing anti-money laundering and counter terrorist financing (AML/CFT) professional obligations legally binding. It clarifies certain elements of the Law of 12 November 2004, as amended, and the Grand-Ducal Regulation of 1 February 2010 with regard to the following topics:

- Risk-based approach
- Client due diligence
- Internal organization
- Cooperation with authorities
- Review by the external auditor

The Regulation takes into account some of the features of the FATF recommendations released in February 2012.

CSSF Circular 17/650 of 17 February 2017 *on Combating money laundering and terrorist financing providing details of certain provisions of the Law of 12 November 2004, as amended, and of the Grand-Ducal Regulation of 1 February 2010 with regard to primary tax offences*. The Circular is part of the penal provisions provided by the law of 23 December 2016, relating to the 2017 Luxembourg Tax Reform, and was issued as an advance text of the 4th EU AML Directive. It added 2 tax offences to the rank of primary offences for money laundering from 1 January 2017: serious tax offence ("*fraude fiscale aggravée*") and tax fraud ("*escroquerie fiscale*"). Simple offences (offences which are neither serious tax offences or tax fraud) will be sanctioned via administrative courts.

The Circular puts the emphasis on tax offences and potential indicators of tax offences for Luxembourg resident and non-resident customers. The Circular requires professionals of the financial sector to declare suspected, including suspected attempted, tax offences.

The CSSF Circular 20/744 issued on 3 July 2020 has extended the list of 21 indicators to detect money laundering relating to aggravated tax fraud or tax evasion from the Annex 1 of CSSF Circular 17/650 to include:

- ▶ Complex investment structuring: recourse to one or several interposed entities or structures located in jurisdictions not complying with international transparency standards
- ▶ Tax base erosion: use of cross-border transfers to significantly erode the tax base of the investment manager
- ▶ Investment transactions:
 - ▶ Use of transactions on unregulated market with intermediaries located in jurisdictions not subject to the automatic exchange of information
 - ▶ Use of transactions that do not have apparent rationale in a specific context
 - ▶ Recurring use of loss-making transactions
- ▶ Efficient portfolio management techniques: recourse to securities lending transactions which may create tax arbitrage or tax refunds that have been or could be considered as aggravated tax fraud or tax evasion
- ▶ SICAR: illegal recourse to the SICAR status that would not be in line with the “risk capital” concept and the requirements of Circular 06/241 in this field
- ▶ Subscription tax: the UCI or the IFM is not able to file subscription tax returns that are in line with the Luxembourg requirements, due to the lack of information on the investors
- ▶ Investor tax reporting: the UCI or the IFM does not comply with the local laws of the country of distribution

Ministerial Regulation of 16 November 2018 amending the Ministerial Regulation of 9 July 2009 establishes the Committee for the Prevention of Money Laundering and the Financing of Terrorism.

The following EU Directives and Regulation have yet, at the date of writing, to be fully transposed into local Luxembourg law:

- ▶ Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on *combating money laundering by criminal law* - the 6th EU AML Directive. This directive on money laundering establishes minimum standards for offences and penalties. The directive sets out specific obligations regarding predicate offences, money laundering offences, liability of legal persons and double criminality requirement restrictions. The directive should be transposed into national law by 3 December 2020.
- ▶ Directive (EU) 2019/1153 *laying down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences*. The directive should be transposed into national law by 1 August 2021.
- ▶ Regulation (EU) 2018/1672 on controls on cash entering or leaving the EU. This Regulation will apply in Member States from 3 June 2021.

Future developments

The 6th EU AML Directive establishes minimum rules concerning the definition of criminal offences and sanctions in the area of money laundering.

The main points of the directive are:

1) Definitions of 22 categories of criminal activities, including, *inter alia*:

- | | |
|--|---|
| a. Participation in an organised criminal group and racketeering | m. Murder, grievous bodily injury |
| b. Terrorism | n. Kidnapping, illegal restraint and hostage-taking |
| c. Human trafficking and migrant smuggling | o. Robbery or theft |
| d. Sexual exploitation | p. Smuggling |
| e. Drug trafficking | q. Tax crimes relating to direct and indirect taxes |
| f. Illicit arms trafficking | r. Extortion |
| g. Illicit trafficking in stolen goods | s. Forgery |
| h. Corruption | t. Piracy |
| i. Fraud | u. Insider trading and market manipulation |
| j. Counterfeiting currency | v. Cybercrime |
| k. Counterfeiting and piracy of products | |
| l. Environmental crimes | |

- 2) "Self-laundering" (money laundering committed by the perpetrator of the criminal activity that generated the financial gain) becomes punishable
- 3) Not only will the committing of money laundering qualify as a criminal offence but in addition the aiding and abetting, inciting and attempting of such offence will also
- 4) Increase of the sanction regime by providing legal provisions for effective, proportionate and dissuasive sanctions
- 5) Prison sentences for individuals will be increased in relation to money laundering-offences by a maximum term of imprisonment of at least four years (from 1 year)
- 6) The provision for more severe additional sanctions and measures such as:
 - a. Exclusion from entitlement to public benefits or aid
 - b. Temporary or permanent exclusion from access to public funding, including tender procedures, grants and concessions
 - c. Temporary or permanent disqualification from the practice of commercial activities
 - d. Placing under judicial supervision
 - e. A judicial winding-up order
 - f. Temporary or permanent closure of establishments which have been used for committing the offence
- 7) Clarification of the rules defining which Member State that has jurisdiction and the resolution of conflicts between jurisdictions

EU Regulation 2018/1672

The regulation establishes a series of controls over the European Union's cash inflows and outflows.

The following CSSF Circulars may also be applicable:

- Circular 10/486 and 10/484, both relating to the role of external auditor
- Circulars 11/519 and 11/529 on *the risk analysis regarding the fight against money laundering and terrorist financing*, applicable to credit institutions and other financial sector professional entities under the supervision of the CSSF
- Circular 11/528 on *the abolition of the transmission to the CSSF of suspicious transaction reports regarding potential money laundering or terrorist financing*
- Circular 13/556 on the entry into force of CSSF Regulation 12-02 and repealing the CSSF Circulars 08/387 and 10/476
- Circular 15/609 on *the developments in automatic exchange of tax information and anti-money laundering in tax matters*
- Circular 18/680 relating to *the joint Guidelines of the three European Supervisory Authorities on the measures payment service providers should take to detect missing or incomplete information on the payer or the payee*
- Circular 18/684 relating to *entry into force of the Law of 13 February 2018 amending, inter alia, the Law of 12 November 2004 on the fight against money laundering and terrorist financing*
- Circular 18/690 on *the Guidelines of the European Securities and Markets Authority (ESMA) on the management body of market operators and data reporting services providers*
- Circular 18/698 relating to *Specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent*
- Circulars issued in light of Financial Action Task Force (FATF) statements regarding jurisdictions whose AML/CFT regime:
 - Has substantial and strategic deficiencies
 - Is not making sufficient progress in remedying the deficiencies
 - Is not satisfactory
- Circular 19/732 on *the clarifications on the identification and verification of the identity of the Ultimate Beneficial Owner(s)*
- Circular 20/740 on *Financial Crime and AML/CFT implications during the COVID-19 pandemic*

8.7.4.2. Industry practice

In July 2013, AML/CFT guidance for the Luxembourg fund industry entitled *Practices and Recommendations aimed at reducing the risk of money laundering and terrorist financing in the Luxembourg Fund Industry* was issued by the Association of the Luxembourg Fund Industry (ALFI), in association with the Luxembourg Bankers' Association (ABBL), the Association of Luxembourg Compliance Officers (ALCO), and the Association of Professionals in Risk Management, Luxembourg (ALRiM).

The *Practices and Recommendations* cover:

- AML/CFT responsibilities
- Risk-based approach
- Due diligence process
- Suspicious transaction reporting
- Direct investor due diligence
- Correspondent relationship due diligence
- Third party introducer
- Performance of identification and verification of identity by outsourced third parties and delegation arrangements

The *Practices and Recommendations* have been updated to align them with international standards, including the Financial Action Task Force (FATF) “40 Recommendations” updated in February 2012 entitled *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*. The guidelines include, *inter alia*:

- Guidance on a risk-based approach in relation to customer identification and transaction monitoring, in line with international standards, including FATF
- A methodology for assessing the equivalence of legal and regulatory know your customer (KYC) requirements of foreign jurisdictions by comparing them to FATF standards

The updated *Practices and Recommendations* introduce new notions, such as the notion of “correspondent relationships” representing the business relationship between the UCI (or a third party acting on behalf of the UCI, such as service providers) and any intermediary, for which specific due diligence must be performed and documented.

These guidelines may not be used to overrule any provision of the Luxembourg legislation on the fight against money laundering and terrorist financing or any Circular on this topic.

In January 2014, the CSSF responded to specific questions from the ABBL in relation to Luxembourg AML/CFT requirements, and in particular CSSF Regulation 12/02, covering, *inter alia*:

- Distribution channels
- Risk-based approach
- Customer due diligence
- Correspondent bank relationships
- Adequate internal organization

8.7.4.3. Scope of the AML/CFT legal framework

A. AML/CFT offences

Money laundering and terrorist financing offences are defined in Articles 506-1 to 506-7 of the Luxembourg Criminal Code. In general terms, the offences consist of any of the following:

- Helping to justify the untrue origin of the subject or the proceeds of certain criminal activities
- Helping to place, convert or hide the subject or proceeds of such activities
- Acquiring, detaining or using the proceeds of such activities

The underlying criminal activities concerned include, for example, drug trafficking, tax offences, organized crime, kidnapping of minors, sexual offence against minors, and prostitution.

The definition of money laundering offences includes any crime punished by a prison sentence of more than six months.

The 6th EU AML Directive which should be implemented in Luxembourg Law by the end of 2020 has defined a list of 22 essential money laundering offences. Article 2 of the directive contains a list of categories of offences considered as “criminal activities”. Furthermore, “self-laundering” becomes an offence.

B. Entities in scope

The scope of application of the legal framework is as follows:

- (1) Entities covered by prevention of money laundering and terrorist financing obligations (referred to in this section as “Entities”) include, *inter alia*:
 - Banks and Professionals of the Financial Sector (PSF) entities that are authorized to exercise their activities in Luxembourg on the basis of the 1993 Law. These include, for example, banks, investment advisers, distributors of shares or units of UCIs, and domiciliation agents

- 2010 Law UCIs and SIFs
- Management companies that market shares or units of UCIs or perform additional activities (see Section 6.1.2.)
- Managers and advisers of UCIs, and pension funds
- Securitization vehicles where they provide services to companies
- Foreign firms providing services into Luxembourg on a cross-border basis (without establishing a branch)
- Real estate developers
- Exchange platforms for virtual currencies (including exchanges dealing with fiat currency and virtual currency)
- Custodian wallet providers
- Rental brokers (when the value of the monthly rent is equal or superior to EUR 10,000)
- Art dealers (or persons who act as intermediaries in the trade in works of art including galleries)

(2) Branches and subsidiaries of Luxembourg Entities:

All Entities within the scope of the Law of 12 November 2004, as amended, are required to ensure that their AML/CFT obligations are also complied with by their branches and subsidiaries located abroad (paying particular attention to branches and subsidiaries in countries that do not apply equivalent AML/CFT standards).

The branches and subsidiaries of foreign Entities established in Luxembourg are also in scope of Luxembourg AML/CFT obligations and must comply with them.

8.7.4.4. Professional AML/CFT obligations applicable to financial services Entities

8.7.4.4.1. Introduction

Entities are required to implement appropriate AML/CFT policies, procedures, and controls that are tailored to the specific situation of the Entity.

Entities are required to perform customer due diligence or to ensure that customer due diligence is duly performed. The customer due diligence must be adapted to the client AML/CFT risks:

- Identification of the client – i.e., the investor (potential shareholder or unitholder) – generally referred to in AML/CFT terms as the “beneficial owner”
- Verification of the client identity

There are three types of customer due diligence:

- Standard customer due diligence
- Simplified customer due diligence
- Enhanced customer due diligence

The customer due diligence may be performed by:

- The Entity itself
- A third party, such as the entities that are part of a financial group. Third parties may be:
 - An Entity that introduces the client
 - A delegate of the Entity that performs the AML/CFT risk assessment

The type of customer due diligence method will depend on a number of factors including:

- Geographical origin of the client
- Type of client (e.g., individual, corporate entity)
- Evidence of AML/CFT framework applicable to and implemented by third parties:
 - The AML/CFT regulatory and supervisory regime applicable to any third party
 - The AML/CFT measures implemented by the third party

Entities are required to perform ongoing monitoring of:

- Their book of clients against AML/CFT blacklists
- Client transactions in order to identify potentially suspicious transactions
- Third parties acting on their behalf
- Related stakeholders (including directors, shareholders owning more than 25% of the shares of an entity, and proxies)

Entities are required to:

- Appoint an officer responsible for AML/CFT
- Keep adequate records of AML/CFT documentation for a required period of time
- Establish a written AML/CFT risk analysis report
- Take appropriate AML/CFT measures in relation to hiring and training employees
- Integrate AML/CFT reviews into the tasks of the internal audit function

The remainder of this section summarizes the professional AML/CFT obligations applicable to financial services Entities.

8.7.4.4.2. Internal organization

A. *Obligation to establish adequate internal organization*

Entities must implement adequate and appropriate policies and procedures on customer due diligence, reporting, record keeping, internal control, risk assessment, risk management, compliance management, and communication in order to meet their AML/CFT legal obligations.

Policies, controls, and procedures must be validated by the person in charge of AML/CFT and approved by management and, for credit institutions and investment firms, by the Board of Directors. AML/CFT procedures must include, *inter alia*:

- Procedures to follow in case of account opening before the achievement of the verification of identify of the client and when required of the ultimate beneficial owner
- Procedures to follow in case of numbered account opening (i.e., accounts where the name of the client or beneficial owner is replaced by numbers)
- Procedures to follow to respect the obligations included in the European Regulation (EC) 1781/2006 in relation to transfers of funds (see Section 8.7.4.4.7.B.) repealed by Regulation EU 2015/847 of May 2015 that applies from 1 January 2017
- AML/CFT hiring and training procedures

Entities are also required to coordinate their AML/CFT procedures with their branches and subsidiaries in foreign countries.

B. *Appointment of an AML/CFT officer*

Each Entity must designate a person specifically in charge of ensuring compliance with AML/CFT obligations. This may be the compliance officer. This person must ensure implementation of internal policies and procedures relating to customer acceptance, identification, monitoring, and risk management.

The AML/CFT officer must not only have the professional experience and the knowledge of the legal and regulatory framework in force in Luxembourg, but also the access to the identification data and other relevant documents and information and the necessary availability required to efficiently and autonomously perform his functions.

It is possible to delegate the AML/CFT activities, although responsibility remains with the AML/CFT officer, senior management, and the governing body.

The AML/CFT officer is required to report regularly, and on an *ad hoc* basis if necessary, to authorized management and, where relevant, to the Board of Directors or specialized committees. The report must cover the follow-up of recommendations, issues, deficiencies, and exceptions identified in the past and new matters identified. Each report must specify the related risks and their degree of importance (measurement of impact) and remediation action proposed. These reports must enable the evaluation of the significance of suspicions of money laundering or terrorist financing and provide an opinion on the adequacy of the AML/CFT policy.

Once a year, the AML/CFT officer must produce a summary report on its activities and its operations. This report must be submitted to the Board of Directors for approval and provided, for information, to authorized management (see also Section 8.7.4.4.7.E.).

One or more other functions held by the AML/CFT officer must not jeopardize his independence, objectivity, and independent decision-making. His workload must be adapted in order not to jeopardize the effectiveness of the AML/CFT framework.

8.7.4.4.3. Risk-based approach

Entities must define and implement a "risk-based approach" in relation to customer identification and transaction monitoring. The concept of risk based approach implies therefore that entities should concentrate their efforts on clients assessed as higher risk because of, for example, their country, sector of activity or level of regulation. Entities are required to adapt their practices and processes to the assessed level of risk of money laundering and terrorist financing.

Entities are required to perform an assessment of the AML/CFT risk exposure related to their activities (see Section 8.7.4.4.7.E.).

The level of due diligence will depend upon factors including whether the client is an individual or a legal entity and, in the latter case, whether or not the Entity is regulated (authorized and supervised by a competent authority) and located in an EEA Member State or “FATF-identified” jurisdiction (see Section 8.7.4.4.6.D.).

Each Entity should design questionnaires for prospective clients appropriate to the situation (e.g., the communication medium used and the nature of the business relationship with the prospective client, including the types of services) and the associated risks.

Standard customer due diligence must be applied systematically. However, the level of customer due diligence must be adapted depending on the risk. In specific cases, simplified customer due diligence will be sufficient (see Section 8.7.4.4.5.). When there is a higher risk of money laundering or terrorist financing, enhanced customer due diligence must be applied in addition to the standard measures - for example, in case the client is located in a non-equivalent country or located in an equivalent country but is not regulated (see Section 8.7.4.4.6.).

Any refusal to enter into a relationship must be documented. The refusal must be documented even if the refusal is not related to a suspicion of money laundering or terrorist financing.

8.7.4.4.4. Customer due diligence

A. Performed by the Entity

The Entity must identify its client and verify his identity by means of documentary evidence at the outset of a business relationship and, in particular, when opening an account.

(1) Required identification documentation

The identification and verification of physical persons must be based on a valid document issued by a competent authority, bearing a photo and signature. Passports, identity cards, and other official documents, such as residential permits, can be accepted.

The identification and verification of the identity of corporate (legal entity) clients must be based on the latest and coordinated articles of association (or equivalent) and a recent extract from the Trade and Companies Register.

For prospective corporate clients, the Entity must at least identify and verify the identity of the members of management and of the Board of Directors (including those having no power to operate the account) with whom it is in contact. This principle also applies to well-known prospective institutional clients.

For physical and corporate clients, supplementary verification measures to be applied based on the risk assessment of the client may include, for example:

- For corporate entities, review of latest annual report, on-site visit to the company
- For physical clients, the verification of the address indicated by the client by evidence of domicile

The obligation to maintain the client documentation, data or information, up-to-date is an integral part of the professional AML/CFT obligations. The Entity must conduct a periodical review, especially of documents that are essential to the business relationship and knowledge of the client, at a frequency that depends on the client risk assessment and the risk associated to this business relationship. Documents must be updated in case of any change since the previous review.

(2) Persons to be identified

Client identification and verification must cover both the direct customer, which may be a representative, and the persons on whose account the direct customer is acting - i.e., the “beneficial owner(s)”.

A beneficial owner is always to be considered as a natural person.

The principle of identifying beneficial owners applies both to individuals and legal persons. Identification of both the persons in whose names an account is opened and the persons for whose account these clients are acting is mandatory when the customers do not act on their own behalf.

For companies, identifying the ultimate beneficial owner implies identifying the individuals with a “controlling interest and the individuals who comprise the mind and management of the company”.

As a minimum the following should be considered:

In case of general companies - a threefold “cascading” approach has been clarified by CSSF Circular 19/732:

- i. Any individual who, ultimately, owns or controls a legal entity, by direct or indirect control of a sufficient number of shares over the entity, including bearer shares or other means, other than a company listed on a regulated market that is subject to obligations similar to the European Union directives or equivalent international standards which guarantee adequate transparency for ownership information. A shareholding of 25% plus one share, voting rights, ownership, or a participation in the capital of the client of more than 25%, held by an individual, is an indicator of direct ownership.

A shareholding of 25% plus one share, voting rights, ownership, or a participation in the capital of the client of more than 25%, owned by a legal entity which is controlled by one or more individuals is an indicator of indirect ownership.

- ii. If no individual can be identified via the procedure under i), the individual who controls the legal entity via other means where other means should be interpreted broadly, namely having the power to exercise or actually exercise dominant influence or control by any means over the customer. Such other means can be, *inter alia*:
 - Individuals granted control through shareholders agreements
 - Individuals with the ability to *de facto* control the customer
 - Personal relationships with the customer, for example family members
 - Individuals possessing a significant minority interest whereas the other shareholders have significantly lower participations
- iii. Having exhausted all other possibilities and provided that there is no ground of suspicion, no individual has been identified as per the previous points and it is not clear whether the persons identified are the effective beneficial owners, a senior managing official (*dirigeant principal*) should be identified.

If a step is skipped, it should be duly documented on file why information for such a step could not be obtained.

In case of fiduciaries or trusts, the following parties should be identified:

- Settlor, if any
- Any trustee or fiduciary
- Protector (if any)
- Beneficiaries or when not yet designated, the category of persons in whose main interest the construction or the entity has been established or operates
- Any other individual exercising ultimate control or influence over the Trust or Fiduciary by direct or indirect ownership or otherwise

In case of legal entities like foundations and legal constructions like trusts or fiduciaries, any individual holding the same or similar function as in the case of fiduciaries or trusts.

A beneficial owner can be someone who owns less than 25% of a company structure but nevertheless controls the company. Hence, all individuals who, ultimately, own or control the client or any individuals on whose behalf a transaction has been executed or an activity realized is considered a beneficial owner.

In case no ultimate beneficial owner is identified as required by the laws and regulations, the business relationship cannot be established.

A person holding less than 25% of a company can be the ultimate beneficial owner if he/she otherwise exercises control over the legal entity, even if another person has a participation exceeding this 25% threshold.

It is therefore important that Entities look beyond the 25% threshold and take reasonable measures to enable them to fully understand the structure of ownership and control of the company.

The 25% threshold is purely indicative and may, in some cases, not be sufficient to determine the correct ultimate beneficial owner.

A beneficial owner declaration should be signed by the client (the account holder) or by the beneficial owner himself. However, the client must inform the Entity of any change related to the beneficial owner.

The notion of representative also covers legal representatives of physical persons who are incapable of managing their own affairs and representatives of physical or corporate persons authorized to act on behalf of clients based on a proxy.

(3) Information to be collected/verification

For the purposes of the identification and verification of the ultimate beneficial owner(s), Entities are required to collect and store at least the following information:

- For Physical persons:
 - Surname
 - First name
 - Nationality
 - Date and place of birth
 - Address
- For legal persons or arrangements (for example a trust) that exist between the customer (legal owner - for example the trustee in the case of a trust) and the natural person (beneficial owner - for example trust beneficiaries) the following information shall be recorded:
 - Denomination
 - Legal Form
 - Address of the registered office and, if different, a principal place of business
 - Where appropriate, official national identification number
 - Directors (dirigeants) (for the legal persons) and directors (administrateurs) or persons exercising similar positions (for the legal arrangements).

When establishing a relation with a client, the information on the origin of funds must form part of the initial customer due diligence, whatever the risk level of the client.

When verifying the ultimate beneficial owner(s) of their customers, professionals should collect proof of registration or an excerpt of the RBE register or similar registers abroad. Similar measures should be taken with respect to customers that are foreign legal persons or arrangements and where such type of registers are available for consultation without restrictions to foreign financial institutions.

Professionals must not rely exclusively on the central registers referred to in the Law of 13 January 2019 to fulfil their customer due diligence requirements.

(4) Electronical identification and verification

The AML Law foresees rules for electronic identification and verification of identity via trusted services as set out in Regulation (EU) No 910/2014 (eIDAS Regulation). The eIDAS regulation:

- Ensures that businesses can use their own national electronic identification schemes (eIDs) to access public services in other EU countries where eIDs are available
- Creates a European internal market for electronic Trust Services - namely electronic signatures, electronic seals, time stamp, electronic delivery service and website authentication - by ensuring that they will work across borders and have the same legal status as traditional paper based processes

Transactions:

Professionals are required to retain documents, data and information regarding the supporting evidence and records of transactions which are necessary to identify or reconstruct transactions, for a period of five years after the end of a business relationship with their customer or after the date of an occasional transaction.

The CSSF Circular 20/740 also foresees the following points regarding the Customer Due Diligence (CDD):

- a. CDD measures can be strengthened to mitigate the impact of a lack of face-to-face contact with customers in line with a risk-based approach. Measures could include performing more frequent checks against lists of Politically Exposed Persons (PEPs) and conducting additional or more detailed checks as part of enhanced due diligence processes.

It is particularly important to employ appropriate CDD processes when approving applications for government support, due to the short timelines often associated with such requests and the possible additional associated ML/TF risk.

- b. The CSSF encourages professionals to consider that digital ID systems should rely upon technology, processes, governance and other safeguards, that provide an appropriate level of trustworthiness.
- c. The verification of customer identity via live video-chat, or the use of electronic identification means, could be considered an appropriate safeguard in view of the lack of face-to-face contact. The CSSF highlights that other mitigation measures in such situations may include: (1) the collection of additional documents; (2) the certification of documents; (3) the reliance on a third party having already identified the customer (e.g., other professionals of the financial sector, or service providers offering document verification services); and (4) the check by means of a first transfer of funds from a bank account in the name of the customer with a credit institution established in Luxembourg, in the EU, or in any other country respecting equivalent AML/CFT obligations and being supervised for that purpose.

B. Performed by a third party introducer

A specific introductory regime is foreseen where the client is identified through a Luxembourg financial institution or a foreign financial institution subject to customer identification requirements equivalent to those provided under Luxembourg law.

A UCI, its management company or AIFM that markets its shares or units via an intermediary (distributor) that is a regulated domestic or foreign financial institution subject to equivalent AML/CFT obligations will be exempt from the requirement to identify the underlying investors as they may rely on identification performed by the intermediary.

The third party introduction regime avoids the duplication of know your customer (KYC) procedures.

In this case, the intermediary must be:

- ▶ A Luxembourg credit or financial institution, a Luxembourg auditor, notary or lawyer
- ▶ A credit or financial institution established in a foreign Member State that:
 - ▶ Is subject to mandatory professional registration, recognized by law
 - ▶ Applies customer due diligence and record keeping requirements laid down or equivalent to those laid down in Luxembourg law, in the Directive (EU) 2015/849 or equivalent rules (3rd EU AML Directive)
 - ▶ Is supervised in compliance with the requirements of Luxembourg law, the Directive (EU) 2015/849 or the law of a Third Country that imposes equivalent requirements to those laid down in the Directive (EU) 2015/849 or equivalent rules

Entities must assess the equivalence of third countries' AML/CFT requirements and establish their own risk-based approach.

In practice, this means that the Entity must perform due diligence on the countries of the distributor/investors to assess the equivalence of each third country's AML/CFT requirements and keep their knowledge of the third countries' AML/CFT requirements up to date.

Such assessment should be updated, in particular when relevant new information becomes available on the country in question.

The third party must be in a position to provide immediately, upon request, relevant copies of identification and verification data and other relevant documentation on the identity of the customer or the beneficial owner.

The Entity may be guided by information contained in official reports on corruption and AML/CFT published by the FATF, the Organization for Economic Co-operation and Development (OECD), the World Bank, and the International Monetary Fund, as well as lists of countries quoted in CSSF Circulars.

Entities are also referred to the *Common Understanding between Member States on third country equivalence under the Anti-Money Laundering Directive (Directive 2005/60/EC)* published by the European Commission.

The agreement between the UCI and the intermediary must include an AML/CFT provision requiring the intermediary to perform due diligence measures from the beginning of the relationship, towards underlying investors, so that the UCI obtains the necessary assurance that documents and information have been obtained towards investors and are available upon request.

Where shares or units of UCIs are subscribed by intermediaries acting on behalf of clients, the UCI, its management company or AIFM, or its representative is required to apply enhanced due diligence to the intermediary in order to ensure that the intermediary applies AML/CFT measures that can be considered as equivalent to Luxembourg's (see Section 8.7.4.4.6.). This check must be documented and the record kept.

Lastly, when the third party introducer is part of the same group, the professional should ensure that any risk related to a high-risk third country is efficiently mitigated and that the group applies customer due diligence measures, rules relating to the preservation of documents and exhibits and anti-money laundering and anti-terrorist financing programs in accordance with Directive (EU) 2015/849 (3rd EU AML Directive) or equivalent rules and that the effective implementation of these obligations is monitored at group level by a supervisory authority, a self-regulatory body or one of their foreign counterparts.

C. *Performed by a third party delegate*

Entities may under certain conditions, contractually outsource the execution of the identification requirements to national or foreign firms subject to equivalent identification requirements. The Entity remains, however, responsible for compliance with the identification requirements.

The following conditions must be met when the material process of identifying customers is outsourced:

- ▶ The delegation must be formalized in an agreement
- ▶ The contract must precisely define the delegated tasks and list in detail the documents and information to be requested and verified by the delegate
- ▶ The delegation agreement should foresee that at least a copy of the identification documents be transmitted to the Entity each time
- ▶ Copies have to be duly certified by the delegates or authorized persons in case of a client who is not physically present for identification purposes (see Section 8.7.4.4.6.A.). The professional cannot rely on a certificate issued by a third party that confirms that it knows the client, has verified the client's identity, and has received the required documentation
- ▶ The contract grants the Entity the right to access at any time the identification documents during a defined period
- ▶ Entities must have a monitoring framework to ensure that delegates comply with AML/CFT terms of contracts

Entities cannot outsource identification to delegates in "FATF-identified" countries (see Section 8.7.4.4.6.D.).

The *Practices and Recommendations for the Luxembourg Fund Industry* (see Section 8.7.4.2.) provide guidance on the respective roles and responsibilities of the transfer agent and global distributor in terms of customer due diligence (KYC obligations):

▶ *Role and responsibilities of the transfer agent*

Where the UCI's transfer agent and the global distributor are different entities, the KYC obligations of the transfer agent are limited to the verification of the identity of the investors whose instructions (subscription forms, transfer and redemption orders) have not been submitted by a regulated and supervised financial professional subject to equivalent AML/ CFT obligations.

While transfer agents have no responsibility over the due diligence process to be performed on appointed distributors, they are obliged to identify the distributor to ensure that the distributor is subject to equivalent AML/CFT obligations.

▶ *Role and responsibilities of the global distributor*

The global distributor is responsible for developing and maintaining a distribution network that complies with Luxembourg and FATF standards. It should be responsible for the due diligence process at both the country and distributor level.

▶ *Role and responsibilities of the Board of Directors of the UCI or of its management company*

The Board of Directors of the UCI or of its management company is responsible for monitoring the distributors and should take all appropriate measures to ensure compliance with Luxembourg AML/CFT obligations and standards.

CSSF Circular 18/698 sets out the general framework and obligations applicable to each investment fund manager (IFM)¹⁸⁹ as well as the detailed obligations applicable to IFMs and registrar agents which include, *inter alia*:

- ▶ IFMs must comply with AML/CFT legislation in force including the Law of 12 November 2004, as amended, CSSF Regulation 12-02 and the CSSF Circulars on AML/CFT
- ▶ The IFM is also subject to the Law of 27 October 2010 enhancing the anti-money laundering and counter terrorist financing legal framework; organising the controls of physical transport of cash entering, transiting through or leaving the Grand Duchy of Luxembourg; implementing United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing
- ▶ EU regulations directly applicable in national law or via the adoption of ministerial regulations also apply to every IFM
- ▶ IFMs must follow *Guidance for the Securities Sector* issued by the FATF (released in October 2018). Additionally, they are urged to follow other publications of the FATF. Furthermore, they must comply with Circular CSSF 17/661 adopting the joint guidelines issued by the three European Supervisory Authorities
- ▶ Every IFM must take appropriate measures to identify, assess and mitigate ML/FT risks using risk factors, including those linked to customers, countries or geographical areas, products, services and transactions or delivery channels
- ▶ IFMs are required to implement due diligence measures in particular, on clients, initiators of UCIs, portfolio managers to whom it delegates the management and on investment advisers including due diligence on the assets of the UCIs it manages
- ▶ The UCI, its IFM or, where appropriate, the respective proxies of these professionals, must put in place enhanced due diligence measures on intermediaries subscribing units on behalf of clients (nominees and other intermediaries)
- ▶ An IFM will not be exempt from its AML/CFT responsibility when it delegates its tasks

On 25 November 2019, the CSSF has published a Frequently Asked Questions document in order to clarify the requirements in article 4 (1) of the Law of 12 November 2004 as amended to appoint two different persons in charge of AML/CFT for supervised UCIs and IFMs, and their obligations, *inter alia*:

- ▶ The person responsible for AML/CFT compliance at the level of the Board of Directors/ governing body ("*Responsable du respect des obligations or RR*") can be the board of directors (or other governing body depending of the legal structure of the entity) acting as a collegial body, or can be one of the members of such board of directors (or other governing body)
- ▶ The compliance officer at the appropriate hierarchical level ("*Le responsable du contrôle du respect des obligations or RC*"):
 - ▶ For investment funds, the RC can be a member of the board with appropriate experience, a contractually appointed third party or a staff member of the appointed IFM, mandated in a personal capacity by the board of directors (or other governing body) of the fund
 - ▶ For IFMs, the RC should be the compliance officer at appropriate hierarchical level in charge of AML/CFT aspects for the IFM. The RC should be available in Luxembourg, except where the IFM and the relevant staff member are not domiciled in Luxembourg. The RR can be the entire Board of Directors acting as a collegiate body
- ▶ These persons must (i) have sufficient experience and knowledge of the Luxembourg legal and regulatory framework on AML/CFT, (ii) allocate sufficient time for their function, (iii) be permanently located in Luxembourg (or have their domicile in a place allowing them, in principle, to come to Luxembourg every day), (iv) be employed by the IFM. Any change in the aforementioned persons must be communicated in advance to the CSSF. If the RR is a collegial body, at least one of its members must fulfill the availability requirement. The RC should have access to all internal documents and systems which are necessary to perform its tasks and comply with skills & duties requirements from articles 40 (3) to 43 of CSSF regulation 12-02
- ▶ The AML/CFT Compliance Officer at the management level must draw up a summary report on compliance with AML/CFT professional obligations at least once a year
- ▶ The Circular specifies the items to be covered in this report, including, most notably:
 - ▶ The results of the identification and assessment of ML/TF risks and measures taken to mitigate them
 - ▶ The results of due diligence
 - ▶ Results of enhanced due diligence performed on PEPs

¹⁸⁹ CSSF Circular 18/698 defines investment fund managers (IFMs) as: Chapter 15 and 16 management companies set up under the 2010 Law, Luxembourg branches subject to Chapter 17 of the 2010 Law, self-managed UCITS, AIFMs, and internally managed AIFs.

The number of identified breaches of AML/CFT professional obligations.

The Circular sets out 4 scenarios, linked to the 4th EU AML Directive, and the respective IFM obligations depending on the manner in which the relationships with the marketing intermediaries and the registrar agent are organized:

- i. The IFM is in a direct relationship with the intermediaries conducting marketing and which act on behalf of clients and /or with direct investors, and ensures by itself the function of registrar agent.
 - a. Implement and perform due diligence measures on those intermediaries and/or direct investors
 - b. Enter into a written agreement to establish responsibilities
 - c. Provide a list of all intermediaries to the CSSF on an annual basis
 - d. The IFM should create and establish measures to ensure that their intermediaries comply with the rules set out
 - e. The IFM should conduct Know Your Intermediary (KYI) / Know Your Customer
 - i. Initial due diligence
 - ii. Ongoing monitoring of the delegates
 - f. The IFM must establish internal policies, controls and procedures
- ii. The IFM is in a direct relationship with the intermediaries conducting marketing and which act on behalf of clients and /or with direct investors, and the function of registrar agent has been delegated to one or more registrar agent(s).
 - a. A written contract between the IFM and the registrar agent to provide for the registrar agents obligation to make available to the IFM any information necessary for the performance by the IFM of its initial due diligence and ongoing monitoring of this registrar agent as well as complying with all their AML/CFT obligations.
 - b. The contract must allow the IFM and registrar agent to determine their respective responsibilities with respect to AML/CFT obligations including those mentioned in (i) above.
 - c. The IFM must ensure it also complies with the requirements set out in CSSF Circular 18/698 with respect to specific organizational provisions, obligations to conclude a contract, initial due diligence and ongoing monitoring obligations
- iii. The IFM is not in a direct relationship with the intermediaries conducting marketing and which act on behalf of clients and /or with direct investors, and the function of registrar agent has been delegated to one or more registrar agent(s).
 - a. An agreement between the IFM and the registrar agent must, most notably, allow the IFM and registrar agent to determine their respective responsibilities with regard to AML/CFT obligations including those mentioned in relevant points of (i) above.
 - b. The IFM must ensure it also complies with the requirements set out in CSSF Circular 18/698 with respect to specific organizational provisions, obligations to conclude a contract, initial due diligence and ongoing monitoring obligations
- iv. The AIFM performs neither an additional function of marketing of UCIs under its management nor the function of registrar agent.
 - a. The members of the board of directors or the members of any other managing body, respectively, which represent the UCI pursuant to the instruments of incorporation must make available any necessary information to the AIFM so that the latter can comply with its AML/CFT obligations outlined in (i)

8.7.4.4.5. Simplified customer due diligence

Entities may, in certain cases, and taking into consideration Appendix III of the Law of 12 November 2004, as amended, apply simplified due diligence measures when the customer is:

- A public company listed on a stock exchange and subject to disclosure requirements (either by stock exchange rules or through law or enforceable means), which impose to ensure adequate transparency of beneficial ownership
- Public administration or enterprises from country or territory having a low level of corruption
- Resident in geographical areas of lower risks

The factors to take into account when assessing the risks of money laundering and terrorist financing include types of customers, geographic areas, and particular products, services, transactions or delivery channel. These factors need to be understood as potential factors of lower risk and not to be understood as a blanket approach to apply a lower risk regime. However, in any case, it is not mandatory to apply the simplified customer due diligence regime.

Before implementing simplified due diligence and before relying on performance of client due diligence by third parties, Entities are required to perform a risk assessment of the country in question (be it an EU Member State or a third country) and document, at the time when the decision is taken, the reasons justifying why they deem the country's AML/CFT regime to be equivalent to Luxembourg's. Such decisions must be based on relevant and up to date information. This country risk assessment must be updated on a regular basis and should, at least, take into consideration the list of high-risk third countries set out by the European Union, countries designated as presenting a higher risk by the International Financial Action Task Force as well as any other higher risk identified by the CSSF or FIU.

However, even where an EU Member State or a third country has a regime equivalent to Luxembourg's, this does not free Entities from the obligation to apply enhanced due diligence measures in situations that, by their nature, can present high ML/FT risks. Enhanced due diligence must be applied in any business relationship and transactions where the client, representative or beneficial owner is a resident of a country which is deemed higher risk as per the professional's evaluation of the country.

Entities are required to ensure that simplified due diligence requirements continue to be fulfilled by the customers on an ongoing basis. This entails that, outside the customer review periods, professionals need to ensure that the criterion and reasons for performing simplified due diligence are still valid. Furthermore, when applying simplified due diligence, other obligations such as monitoring of clients and transactions must still be performed by Entities.

In practice, comfort letters provided by parent companies subject to equivalent AML/CFT requirements are used by branches and subsidiaries in relation to the implementation of customer identification requirements. Comfort letters enable Entities to apply simplified due diligence to their subsidiaries located in non-equivalent countries and subsidiaries in equivalent countries that are not regulated.

8.7.4.4.6. Enhanced customer due diligence

Enhanced vigilance and due diligence measures have to be applied in situations considered to be higher risk, including non-face-to-face relationships without certain safeguards, politically exposed persons, transactions with Entities holding third party funds, and any business relationship or transaction where the client, Directors or beneficial owner lives in a high risk third country.

A. *Non-face-to-face relationships*

Where a client is not physically present for identification purposes, the Entity must take the specific and additional verification measures necessary to be able to effectively face the higher risks of money laundering or terrorist financing.

The Entity must choose between the following types of additional verification measures to be applied before entering into a business relationship, but may decide, based on its risk assessment of the customer, to apply several of them:

- ▶ Scrutiny of the most recent management report and of the most recent accounts, as the case may be, certified by an authorized auditor
- ▶ Verification, after consultation of the trade and companies register or any other source of professional data, that the company has not been, or is not in the process of being, dissolved, removed from the register, in bankruptcy proceedings or liquidated
- ▶ Verification of information gathered from independent and reliable sources, such as notable public and private databanks
- ▶ Electronic signatures within the legal framework
- ▶ A visit to the company, to the extent possible, or via contact with the company, notably by registered letter with acknowledgement of receipt

B. *Politically exposed persons (PEPs)*

Enhanced customer due diligence must be carried out on PEPs. PEPs are individuals who hold or have been appointed to prominent public functions, their family members, and close associates.

The law of 25 March 2020 removes the concept of automatic exclusion of PEPs who do not have public mandates for more than 1 year. Instead, it is required to perform a risk based approach for each such PEP and evaluate the risk of that person in relation to his/her PEP function and continue to apply such scrutiny until that particular person no longer poses a risk in relation to that function. In any case, professionals will need to keep treating a person as PEP for a minimum period of twelve months after the date the person leaves his PEP position.

PEPs include:

- ▶ Heads of State or of government, ministers, and deputy and assistant ministers
- ▶ Members of Parliament or of similar legislative bodies
- ▶ Members of supreme courts, of constitutional courts or of other high-level judicial bodies whose decisions are not subject to further appeal except in exceptional circumstances
- ▶ Members of courts of auditors or of the boards of central banks
- ▶ Ambassadors, *chargés d'affaires*, and high-ranking officers in the armed forces
- ▶ Members of the administrative, management or supervisory bodies of State-owned enterprises
- ▶ Important political party officials and members of their governing bodies
- ▶ Directors, deputy directors and the board members of an international organization or persons who occupy a similar position within the organization
- ▶ Natural persons exercising the functions appearing on the list published by the European Commission

People holding an intermediate or lower function within the above categories are not considered to be PEPs.

PEPs also include such positions at European Community and international levels.

Immediate family members of PEPs who should also be treated as if they were PEPs include all the following individuals:

- ▶ The spouse
- ▶ Any partner considered by national law as equivalent to the spouse
- ▶ The children and their spouses or partners or persons considered by domestic law as the equivalent of a spouse
- ▶ The parents
- ▶ Their brothers and sisters

Persons known to be close associates who should be treated as if they were PEPs include the following:

- ▶ Any individual who is known to have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations, with a PEP
- ▶ Any individual who has sole beneficial ownership of a legal entity or legal arrangement which is known to have been set up for the benefit, *de facto*, of the PEP

Specific attention must be paid by Entities when seeking to enter into a business relationship with, or accepting custody of assets belonging to PEPs residing abroad, whether directly or indirectly.

In addition to normal due diligence measures, Entities are required to:

- ▶ Implement appropriate procedures to determine whether the investor or the beneficial owner is a PEP (foreign or local)
- ▶ Take all appropriate measures to verify the source of funds and the origin of the assets regarding the business relationship or the transaction and request documentary evidence if there is the slightest doubt
- ▶ Involve the compliance officer in the acceptance process and, obtain authorization of one of the authorized executive managers (or equivalent at a senior level in the Entity) before entering into a business relationship or, where justified, maintaining a business relationship with a PEP. The business relationship must continue to be closely monitored.

Where a customer has been accepted and the customer or beneficial owner is subsequently found to be, or subsequently becomes a PEP, Entities must obtain approval to continue the business relationship from senior management.

Enhanced due diligence must be applied not only when the client is a PEP, but also when the effective beneficial owner is such a person. Finally, enhanced due diligence must be applied to clients, transactions and beneficial owners when they later become PEPs.

C. Transactions with Entities holding third party funds

For clients having a professional activity that implies the transfer of third party funds (e.g., lawyers and notaries), the Entity must determine whether the relevant client acts for its own account or on behalf of third party clients. In the latter case, the Entity must identify not only his client but also the beneficial owner for whom such client acts and request as such all the required identification documents of the ultimate beneficial owner(s).

D. Clients or transactions involving high risk countries

Any client or transaction from a jurisdiction identified by the European Commission, the FATF or by the supervisory authorities or professionals as part of their AML-CTF risk assessment (8.7.4.4.7. E.) must be subject to enhanced due diligence at the time the relationship is entered into and throughout the relationship.

8.7.4.4.7. Other professional AML/CFT obligations

A. Monitoring of client relationship and transactions

Blacklists, sanctions, PEPs, and country screening needs to be performed for all clients, their directors, authorized signatures, beneficial owners, proxies for all accounts and all transactions. In the case of legal persons or arrangements (for example a trust) that exist between the customer (legal owner - for example the trustee in the case of a trust) and the natural person (beneficial owner - for example trust beneficiaries), the directors and names of these companies will need to be screened.

The CSSF recently reminded professionals that transaction monitoring must be performed on all investors with a view to detecting unusual transactions that must be investigated for potential suspicion of ML/FT. Where the monitoring is delegated, the delegating professional, who retains responsibility, must conduct appropriate oversight.

Professionals are required to examine, as far as is reasonable, the context and the purpose of any transaction which fulfills at least one of the following conditions:

- a) It is a complex transaction
- b) It is an unusually large transaction
- c) It is operated according to an unusual scheme
- d) It has no apparent economic or apparent lawful objective

Any transaction which meets the criteria set out above must be subject to enhanced due diligence by the professional.

The screening must cover all accounts and transactions.

Entities are required to monitor the payer for incoming transfers and the payee for outgoing transfers. Monitoring of transfers implies monitoring the recipient of the funds; this control is currently limited to the screening of names against the official blacklists.

It is expected that the obligation to monitor payments will be extended to require the detection of PEPs (for the payee). Entities should take adequate measures to cover such risks.

In case of payments made by financial institutions, the screening of the signatories of orders is not required.

The Entity must have a complete overview of its business. Based on its risk-based approach, the Entity may reduce the monitoring of certain operations if it considers that the risk of money laundering and terrorist financing is low, however, the monitoring should remain sufficient in order to detect all unusual or suspicious transactions.

All results of these controls must be evidenced and documented, whether the result is positive or negative.

In case of positive sanction screening, the case must be reported to the Luxembourg prosecutor and to the CSSF.

CSSF Circular 20/740 sets out the following emerging ML/TF threats and vulnerabilities for the financial sector in the context of the COVID-19 pandemic and lockdown:

1. Online payment services
2. Clients in financial distress due to the possibility to create opportunities for them to be exploited by criminals seeking to launder illicit proceeds
3. Mortgages and other forms of collateralized lending (same type of risk as for 2)
4. Credit backed by government guarantees (misusing of those schemes by criminals)
5. Distressed investment products (opportunity for criminals offering to purchase or re-finance such distressed assets using the backing of illicit funds)
6. Delivery of aid through non-profit organizations: As there are increased financial flows through NPOs to higher risk countries, there may be an increased risk of illicit activity and special attention should be paid to the risks of terrorist financing. There may also remain the potential for tax advantages afforded by charitable donations to be misused by those seeking to launder illicit funds

B. Obligation in relation to transfers of funds

The name or account number of the transferor must be incorporated in fund transfer and associated messages, as required by the EU Regulation (EU) 2015/847.

The name of the beneficiary must be mentioned along with the name of the customer in any transaction document.

Entities must have automatic controls to detect incomplete incoming or outgoing payments, for which information required by EU Regulation (EU) 2015/847 is missing, unless Entities can evidence that automatic systems are not compulsory based on the volume of business of the Entities.

C. Obligation to keep certain documents

Documents relating to identification and transactions must be kept by the Entity:

- Identification documents must be kept for five years from the end of the business relationship with the customer
- Transaction documents must be kept for five years following the carrying-out of the transaction; the different components of transaction records must, when brought together, provide, at least, the following information: customer's and beneficiary's name, address or other identification information normally recorded by the intermediary, the nature and date of the transaction, the type and amount of currency involved, and the type and number of any account involved in the transaction

Personal data can be held for an additional five years if necessary to effectively implement internal measures for the prevention or detection of money laundering or to counter terrorist financing.

Without prejudice to longer retention periods prescribed by other laws, professionals must delete the personal data at the end of the retention period.

Records can be kept on any medium, as long as the documents meet the criteria allowing them to serve as evidence in the context of a judicial procedure or of an investigation on money laundering or terrorist financing.

D. Obligation to co-operate with the authorities and obligation to inform

The Luxembourg Financial Investigation Unit (*Cellule de Renseignement Financier* – FIU) is the direct contact partner of Entities on AML/CFT matters.

Entities must inform the FIU, on their own initiative, of any suspicion or proof of money laundering or terrorist financing. Declarations of suspicion must be made even when the person who is suspicious is not able to identify an underlying offence. Prior formal consent must be obtained from the FIU before a professional can report the existence of a freezing order to the clients, in order to justify the non-execution of a transaction.

The initial duration of the freezing order of three months to six months can be extended; extensions are granted for each additional month up to a maximum of six months.

The no “tipping-off” rule does not prohibit communication of information on suspicious cases with other Entities of the financial sector; under certain specific conditions, Entities are authorized to communicate to other Entities information on suspicious cases notified to the authorities.

Entities must document the procedures, conditions, deadlines, and steps for the communication of reports of potential suspicious transactions or facts in relation to their clients to the AML/CFT officer. The analysis of these reports and the decision taken by the AML/CFT officer on whether or not to inform, on his own initiative, the State Prosecutor of the Court of Luxembourg of a suspicion or certitude of money laundering or terrorist financing must be documented.

In case of a business relationship for which a declaration to the authorities has already been made, a complementary declaration must be made in case of new evidence of money laundering or terrorist financing.

The disclosure to the FIU does not constitute a breach of any restriction on disclosure of information imposed by contract, by professional secrecy or a legislative, regulatory or administrative provision and should not involve such persons in liability of any kind.

Entities, their Directors, and employees are obliged to respond and co-operate as comprehensively as possible in response to any legal request received from the FIU. Professionals must be registered on the “goAML” Platform of the Ministry of Justice to be able to comply with their obligation to communicate without delay their suspicions of ML/FT to the FIU.

The FIU may order systematically and at any time the total or partial withdrawal of the order not to carry out the operations of declared entities or persons.

E. Obligation to establish a written AML/CFT risk analysis report

Entities are required to perform an analysis of the AML/CFT risks inherent to their business activities, and the functioning of the AML/CFT officer, and to document the findings of this analysis. This implies:

- ▶ Identifying the AML/CFT risks to which it is exposed: the features to be considered in order to identify the AML/CFT risks, with regard to and with respect to the nature of:
 - ▶ The clients of the Entity including, *inter alia*:
 - ▶ Geographical origin of customers (residential/non-residential customers, customers coming from countries that do not or insufficiently apply AML/CFT measures, customers coming from countries subject to international sanctions)
 - ▶ Activity sector/customers' profession
 - ▶ Means of entering into business relationship with the customer (business providers, non-face-to-face entry into business relationship, execution of customer due diligence by third parties, etc.)
 - ▶ Degree of complexity of the structure implemented for the benefit of a customer (use of shell companies, trusts, etc.)
 - ▶ Customers who require the application of enhanced due diligence measures, notably in case of PEPs
 - ▶ The products and services offered, including, *inter alia*:
 - ▶ Volume and frequency of transactions, application or non-application of relevant limits
 - ▶ Transfers from or to countries that do not or insufficiently apply AML/CFT measures and/or are subject to international financial sanctions
 - ▶ Product/service offers facilitating anonymity (holding numbered accounts).
- ▶ Classify the risks according to its own methodology: the importance given to each type of risk (individually or in combination) will be different for every institution. Each institution must carry out the identification and categorization of money laundering and terrorist financing risks to which it considers itself to be exposed according to its own methodology
- ▶ Define and implement measures to mitigate the identified risks: the description must include, *inter alia*, the following features:
 - ▶ Number of clients to which simplified due diligence is applied
 - ▶ Number of clients to which enhanced due diligence is applied
 - ▶ Process of client acceptance
 - ▶ Process of completion of incomplete client files
 - ▶ System of identification of complex, unusual, and suspicious transactions
 - ▶ System of name and country matching
 - ▶ Employee training process
 - ▶ Corporate governance measures

The AML/CFT risk analysis report must be prepared at least annually.

Where statistics are presented, the statistics must be accompanied by analysis.

In order to help Entities to set up their own risk based approach, Entities are referred to the FATF *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing - High Level Principles and Procedures*.

F. AML/CFT requirements in relation to hiring

Entities are required to implement appropriate screening procedures to ensure that all employees have the necessary honorability and appropriate experience of AML/CFT for the tasks and functions. In particular, the AML/CFT officer must have the necessary experience and appropriate honorability according to the AML/CFT risk depending of the tasks and function to exercise.

For management, information regarding the judicial past of the persons must be obtained by requesting an extract of the criminal record or equivalent document.

G. AML/CFT requirements in relation to training

All the employees must be provided with AML/CFT training, at least once per year, tailored to the specificities of their functions and the business operations of the entity. Training materials must be provided, and the implementation of the training program must be documented.

Any employees must receive ongoing training, and staff in direct contact with the customer must also attend specific training.

When they are hired, new employees must follow an AML/CFT training course that makes them aware of AML/CFT policy and requirements.

Training must take into account the evolution of AML/CFT techniques including business specific examples and reflect the latest AML/CFT legal and regulatory requirements.

H. Internal audit

The review of the AML/CFT policy must be part of the tasks of the internal audit function. The internal audit function is required to report at least annually on whether the AML/CFT policy has been respected.

I. External audit

The long form report, where required, (see also Section 10.5.10.2.) must cover:

- ▶ Number of declarations made by the UCI to the FIU, specifying the ones related to a client and the ones related to a transaction
- ▶ Amounts, corresponding to the amount reported on the forms sent by the Entity to the FIU
- ▶ Historical statistics of detected suspicious transactions related to the current fiscal year

J. Whistleblowing

Persons, including employees and representatives of the professional, having reported to the FIU suspicions of money laundering or terrorist financing must not be the subject of threats, reprisals or hostile acts, and in particular harmful or discriminatory measures in matters of employment.

Furthermore, any contractual stipulation which would enable threats, reprisals, hostile acts or harmful or discriminatory employment measures or, explicitly any termination of contract against people reporting a suspected money laundering or terrorist financing to the FIU, is automatically void.

8.7.4.4.8. Sanctions

Laundering money from, or linked to, any of the underlying criminal activities (see Section 8.7.4.3.A.) is punishable by one to five years of imprisonment and/or a fine of up to EUR 1,250,000.

The 6th EU AML Directive foresees the increase in penalties for money laundering offences by, *inter alia*, increasing the maximum term of imprisonment to at least four years.

8.7.5. Protection against late trading and market timing practices

8.7.5.1. Introduction

On 17 June 2004, the CSSF issued Circular 04/146 on the *Protection of UCIs and their investors against Late Trading and Market Timing practices*. The Circular:

- ▶ Clarifies the protective measures to be adopted by UCIs and certain of their service providers
- ▶ Fixes more general rules of conduct to be complied with by all professionals subject to the supervision of the CSSF
- ▶ Extends the role of the independent auditor of the UCI, as described in CSSF Circular 02/81 (see Section 10.5.10.3.), regarding the verification of the procedures and controls established by the UCI to protect it against late trading and market timing practices

Following the Circular, ALFI issued in 2004 its report entitled *Fair Value Pricing & Arbitrage Protection*. The report aims to provide a reference document collating the reports and recommendations that emerged following accusations of late trading and market timing in the international mutual fund industry. This includes the Guidelines issued by ALFI to its members and the complete Report of the ALFI Working Group on fair value pricing and arbitrage protection.

8.7.5.2. Definitions

A. Late trading

Late trading is the acceptance of a subscription, conversion or redemption order after the time limit fixed for accepting orders (cut-off time) on the relevant day and the execution of such order at the price based on the NAV applicable to such same day.

Through late trading, an investor may take advantage of knowledge of events or information published after the cut-off time that are not yet reflected in the price that will be applied to such an investor. This investor is therefore privileged compared to the other investors who have complied with the official cut-off time. The advantage of this practice to the investor is increased even more if he is able to combine late trading with market timing.

The late trading practice is not acceptable as it violates the prospectuses of the UCIs, which include provisions that an order received after the cut-off time is dealt with at a price based on the next applicable NAV.

The acceptance of an order is not considered as a late trading transaction where the intermediary in charge of the marketing of the UCI transmits to the transfer agent after the official cut-off time an order to be dealt at the NAV applicable on such day if the order has been issued by the investor before the cut-off time. To limit the risk of abuse, the transfer agent of the UCI must ensure that such an order is transmitted to him within a reasonable timeframe.

The acceptance of an order dealt with or corrected after the cut-off time, by applying the NAV applicable on such day, is also not considered as a late trading transaction if such order has been issued by the investor before the cut-off time.

B. Market timing

Market timing is an arbitrage method through which an investor systematically subscribes and redeems or converts shares or units of the same UCI within a short time period, by taking advantage of time differences and/or imperfections or deficiencies in the method of determining the NAV of the UCI.

Opportunities arise for the market timer either if the NAV of the UCI is calculated on the basis of market prices that are no longer up-to-date ("stale prices") or if the UCI is already calculating the NAV when it is still possible to issue orders.

The practice of market timing is not acceptable as it may affect the performance of the UCI through an increase in the costs and/or entail a dilution of the profit.

C. Master-feeder UCITS

In case of master-feeder structures, the master and the feeder UCITS are required to take appropriate measures to coordinate the timing of their NAV calculation and publication, in order to avoid market timing in their shares or units, preventing arbitrage opportunities.

8.7.5.3. Prevention of late trading and market timing practices

As late trading and market timing practices are likely to affect the performance of the UCI and are likely to harm investors, the preventive measures presented hereafter should be applied with great care.

The Board of Directors should analyze such solutions with care and is responsible for implementing them or making certain that they are implemented.

8.7.5.3.1. Protective measures to be adopted by the UCI and by certain of its service providers

A. Late trading

The investor must, in principle, subscribe, redeem or convert the shares or units of a UCI at an unknown NAV. This implies that the cut-off time must be fixed in a manner to precede or to be simultaneous to the moment when the NAV, on which the applicable price is based, is calculated ("forward pricing"). A non-precise cut-off time such as, for example, "until the close of business" is to be avoided. The prospectus must specifically mention that subscriptions, redemptions, and conversions are dealt with at an unknown NAV and must indicate the cut-off time.

The transfer agent of the UCI is required to ensure that subscription, redemption, and conversion orders are received before the cut-off time as set forth in the UCI's prospectus in order to process them at the price based on the NAV applicable on that day. In respect of orders received after such cut-off time, the transfer agent applies the price based on the next applicable NAV. The transfer agent is required to ensure that it receives within a reasonable time period the orders that have been issued by investors before the cut-off time but have been forwarded to the transfer agent by intermediaries in charge of the marketing of the UCI only after such time limit.

In order to be able to ensure the compliance with the cut-off time, the transfer agent of the UCI must adopt appropriate procedures and undertake to perform the necessary controls. The transfer agent undertakes either to provide the UCI on an annual basis with a confirmation from its auditor on its compliance with the cut-off time or to authorize the independent auditor of the UCI to perform a review of the transfer agent's controls on the compliance of the cut-off time.

If intermediaries in charge of marketing the UCI have been appointed by the UCI to ensure the collection of orders and to control the cut-off time with regard to the acceptance of the orders, the UCI must ensure that it obtains from each intermediary concerned a contractual undertaking pursuant to which the intermediaries undertake towards the UCI to transmit to the transfer agent of the UCI, for the processing at the NAV applicable on such day, only such orders that it has received before such cut-off time.

The cut-off time, the time at which the prices of securities are taken into account for the calculation of the NAV, and the time at which the NAV is calculated must be combined in a manner so as to minimize any arbitrage possibilities arising from time differences and/or imperfections/deficiencies in the method of determining the NAV of the UCI.

B. Market timing

UCIs that, due to their structure, are exposed to market timing practices must put in place adequate measures of protection and/or control to prevent and avoid such practices. The introduction of appropriate subscription, redemption, and conversion charges, increased monitoring of dealing transactions, and the valuation of the portfolio securities at "fair value" (see Section 7.6.) may constitute possible solutions for such UCIs.

The UCI should ensure that transactions it knows to be, or it has reasons to believe to be, related to market timing are not permitted and use its best available means to avoid such practices.

If formal contractual relationships exist between the UCI and intermediaries in charge of its marketing, the UCI should ensure it obtains from each intermediary a contractual undertaking not to permit transactions that the intermediary knows to be, or has reasons to believe to be, related to market timing.

The prospectus of the UCIs concerned must include a statement indicating that the UCI does not permit practices related to market timing and that the UCI reserves the right to reject subscription, conversion, and redemption¹⁹⁰ orders from an investor who the UCI suspects of using such practices and to take, if appropriate, the necessary measures to protect the other investors of the UCI.

Particular attention has to be paid to subscription, conversion or redemption orders from employees of the service providers to the UCI or from any person who holds or is likely to hold privileged information (e.g., knowledge on the exact composition of the portfolio of the UCI). Accordingly, adequate measures must be taken by the service providers of the UCIs to avoid the risk that any such person could take advantage of his privileged situation either directly or through another person.

8.7.5.3.2. Rules of conduct to be followed by all professionals subject to the supervision of the CSSF

The CSSF prohibits any express or tacit agreement that permits certain investors to undertake late trading or market timing practices.

The CSSF requires that any professional subject to its supervision refrains from using late trading or market timing practices when investing in a UCI or from processing a subscription, conversion or redemption¹⁹¹ order of shares or units of a UCI that he knows to be, or has reasons to believe to be, related to late trading or market timing.

The CSSF requires that any professional subject to its supervision that detects or is aware of a case of late trading or market timing informs, as soon as possible, the CSSF by providing to the latter the necessary information to enable it to make a judgment on the situation.

¹⁹⁰ Redemptions are not specifically mentioned in the Circular in this context, but, in practice, the measures should also cover redemptions.

¹⁹¹ Idem.

8.7.5.4. Compensation and sanctions

Any person who is guilty of knowingly undertaking or supporting late trading or market timing practices as defined by CSSF Circular 04/146 exposes himself to sanctions and, in addition, to the obligation of repairing the damage caused to the UCI.

In case of indemnification of investors harmed by late trading or market timing practices during the accounting year, the independent auditor must give, in the long form report, an opinion as to whether investors have been adequately indemnified. CSSF Circular 04/146 provides details of the role of the independent auditor in relation to late trading and market timing. For further information, see Section 8.7.5.1.

8.7.6. Payment of dividends

There are no restrictions on distributions made by UCIs except that the net assets of the UCI after distribution must exceed the minimum capital of EUR 1,250,000. However, many UCIs or their management companies may choose to include additional restrictions with respect to distributions; any such restrictions including, if relevant, the fact that capital may be used to pay dividends, should be prominently disclosed in the offering document.

A SICAF, however, is subject to the normal authorization procedures for paying interim dividends and is also required to create a legal reserve. The interim dividend authorization procedures include specific authorization in the articles of association and the preparation of interim financial statements. The independent auditor must issue a report stating whether the conditions relating to the payment of interim dividends outlined in Article 461-3 of the Law of 1915 have been satisfied. SICAFs are also subject to the legal reserve requirement, which is 5% of net profit until the accumulated reserve equals 10% of subscribed capital. The legal reserve cannot be distributed.

8.8. Errors, materiality and compensation to investors

8.8.1. Introduction

This section covers the treatment of NAV computation errors and compensation of losses arising from non-compliance with applicable investment restrictions.

CSSF Circular 02/77, entitled *Protection of investors in case of NAV calculation error and correction of the consequences resulting from non-compliance with the investment rules applicable to undertakings for collective investment*, establishes guidelines for the Luxembourg fund industry when dealing with errors. It introduced a simplified reporting procedure for material errors and active breaches (i.e., breaches for reasons that are not beyond the control of the UCITS) where the total compensation does not exceed EUR 25,000 and the amount payable to a single investor does not exceed EUR 2,500.

Errors generally relate to NAV errors or instances of breaches of the investment policy on investment or borrowing limits as specified in either the prospectus or the law.

It is the responsibility of the sponsor or promoter of the UCI to ensure that any errors are properly dealt with in accordance with the Circular.

The Circular distinguishes the procedures to be followed between NAV computation errors and breaches of investment restrictions, as outlined in Sections 8.8.2. and 8.8.3.

On 7 July 2020, the CSSF issued a Frequently Asked Questions document (“FAQ”) to assist investment fund managers (“IFMs”, i.e., UCITS management companies, authorized alternative investment fund managers, self-managed UCITS and internally-managed AIFs) with the application of CSSF Circular 02/77 requirements.

The FAQ clarifies the scope of application of the Circular, the process to select the method of correction for NAV errors and the circumstances in which tolerance thresholds are applicable.

General clarifications on the scope of the Circular

- ▶ In the case of an active investment breach that corrects itself through market evolution or new subscriptions, the unrealized loss generated by the holding of the excess security position during the breach period should be compensated to the UCI
- ▶ Intraday active investment breaches and breaches that occur between two official NAVs should be notified to the CSSF and compensated in accordance with the provisions of the Circular
- ▶ CSSF notification or remedial action plan are not required in case of investment breaches beyond the control of the UCI (“passive breaches”) but the remediation of the investment breach should be a priority for the IFM
- ▶ In cases where (i) there are no subscriptions and redemptions occurring during the NAV error period, or (ii) the corrective action resulted in a gain for the UCI, only a notification including the financial impact calculation, and not a Remedial Action Plan, is required to be sent to the CSSF. However, the notification should include corrective measures to avoid the recurrence of the same type of error/breach and the external auditor of the UCI should review the correction process during its annual audit of the UCI and provide the related results in the Long Form Report and/or the Management letter
- ▶ In case of an active investment breach where the compensation amount for the UCI exceeds EUR 25,000 and no compensation is due to investors, both the notification and the Remedial Action Plan are required. The external auditor of the UCI has to report on the Remedial Action Plan pursuant to the Circular
- ▶ When the UCI makes use of the *de minimis* amount for compensating the investors which are financially impacted by a material NAV error calculation, prior approval from the CSSF is not required but the CSSF may request the UCI, on an *ex-post* basis, to provide documentary evidence that such amount represented the bank charges necessary to transfer the compensation amount to investors (notably where the “*de minimis*” amount exceeds EUR 25). The IFM’s internal policy should provide for the use and the level of the “*de minimis*” amount
- ▶ The FAQ clarifies that the CSSF will not confirm in writing closure of an incident based on the action taken as disclosed in the notification, but may, on an *ex-post* basis, raise additional questions or require further remedial action if the corrective actions are not deemed sufficient or compliant with the Circular
- ▶ The FAQ also clarifies that a breach of UCITS and AIFs leverage limits does not need to be notified to the CSSF in the context of the Circular. However, adequate monitoring and correction in accordance with applicable internal procedures is expected
- ▶ The CSSF clarifies that specialized investment funds (“SIFs”) may either opt for the application of the Circular or set specific internal rules. In the absence of specific internal rules, the Circular applies. All material NAV errors and active investment breaches have to be notified to the CSSF, whether the SIF applies the Circular or specific internal rules. When SIFs opt for the application of the Circular, a remedial action plan is not required but the external auditor should review the correction process and the related compensation and confirm in the management letter that they complied with the provisions of the Circular

Clarification on certain types of investment rules

- ▶ In case of a breach of compliance with the UCITS 5/40% rule, the UCITS does not necessarily have to sell the securities that caused the breach. The FAQ describes three acceptable methods to calculate the impact (impact by reference to security which caused the breach (use of accounting method), impact by reference to other security sold to correct the breach (use of accounting method) or impact by reference to the performance of the reference portfolio (economic method)). However, where the method is not laid down in writing in the internal policy of the IFM, the impact should be calculated by reference to the security which caused the breach, by applying the accounting method in proportion to the amount in breach
- ▶ A breach of the UCITS 20% deposit limit is considered to be active every time the event which caused the breach, such as a settlement date mismatch (between the capital activity and the portfolio transactions or between several portfolio transactions) or the maturity of security, is predictable and avoidable. The organization of the portfolio management function by the IFM at the level of the UCITS (i.e., the investment operations, the cash management and subscription/redemption flows) should provide for ongoing compliance with the 20% deposit limit
- ▶ Where the UCITS 20% deposit limit is breached and the deposit returns negative interest, the UCITS should be indemnified in relation to the interest rate and other charges borne by the UCITS. Financial impact cannot be derived from a comparison with interest rates between different bank accounts
- ▶ The CSSF also confirmed that the Circular applies in case of breach of the UCITS collateral diversification rules and other criteria that the collateral has to observe, but a financial impact calculation is only necessary in case of a counterparty default

Governance and organizational requirements

- ▶ The CSSF considers that the organization of IFMs managing Luxembourg domiciled UCIs should provide for robust policies, processes and procedures governing the treatment of NAV calculation errors and investment breaches and, in particular, a detailed policy approved by the Board of Directors of the IFM and, if applicable, by the Board of Directors of the UCI
- ▶ The policy and related procedure should cover, *inter alia*:
 - ▶ The governance process, together with the different stakeholders involved, applied in relation to NAV calculation errors and investment breaches
 - ▶ The oversight of the delegates where NAV calculation and investment compliance are delegated
 - ▶ The definition of active *versus* passive investment breaches and applicable criteria (considering notably which events are or are not beyond the control of the UCI)
 - ▶ The different steps and the timeline in relation to the correction of errors and breaches
 - ▶ The NAV error threshold applicable for each sub-fund
 - ▶ The use and the level of *de minimis* amounts
 - ▶ The methodology used by the sub-fund for the financial impact calculation: accounting (e.g., Average Weighted Cost, LIFO, FIFO) *versus* economic method (setting the comparative reference index etc. to be used by sub-fund)
 - ▶ The application of the compound or non-compound method used by the sub-fund for the financial impact calculation
 - ▶ The periodic review of the adequacy and the effectiveness of the policy, processes and procedures.
- ▶ SIFs which are not managed by an AIFM should also establish and implement such a policy. The CSSF also recommends UCIs subject to Part II of the Law of 17 December 2010 which are not managed by an AIFM to establish and implement such a policy

Conditions required for the application of the economic method to determine the financial impact

- ▶ As per CSSF Circular 02/77 the economic method calculates the compensation by reference to the performance which would have been realized in case the non-compliant investments would have had the same fluctuations as the portfolio invested in compliance with the investment policy and the investment restrictions provided for by law or the prospectus
- ▶ The use of the economic method is only permitted if it is defined in the internal policy that governs the UCI, approved by the Board of Directors of the IFM and, if applicable, by the Board of Directors of the UCI. This policy must include the reference benchmark index etc. used to measure the comparative performance against the non-eligible asset. The reference benchmark index should be a fair representation of the investment policy, or a part thereof laid down in the UCI prospectus. IFMs should be able to demonstrate and to evidence with necessary documentation that the comparative performance and the method does not prejudice the investors and has not been selected with the objective of minimizing compensation payments.
- ▶ The CSSF confirmed that it is not acceptable to compare the performance of the non-eligible asset with a corresponding eligible asset having the same characteristics
- ▶ In case of an umbrella fund, the choice of the methodology is possible at the entity level or at sub-fund level.
- ▶ It is possible, within the same UCI, to use different methods (accounting/economic) for different types of active investment breaches if this is formally laid down in the internal policy of the IFM and applied on a consistent basis.
- ▶ Any change of the method used to correct investment breaches is only possible if there is an adequate justification and if it has been approved by the Board of Directors of the IFM and, if applicable, by the Board of Directors of the UCI. It is in principle not permitted to change the correction method applied when it has been previously determined to use a given method for a certain type of breach. It is only possible, upon approval by the Board of Directors of the IFM and, if applicable, the Board of Directors of the UCI, to change the method prospectively, i.e., for the next investment breach of the same type.

Tolerance thresholds

- ▶ The overcharging of fees/costs to the UCI must be reimbursed to the UCI in all cases, irrespective of the materiality threshold laid down in the Circular. However, the recalculation of NAV is only necessary where the reimbursed fees/costs exceed the materiality threshold.
- ▶ Where a zero tolerance threshold is applied by an UCI or the tolerance threshold defined in the internally approved policy is lower than the threshold laid down in the Circular, NAV calculation errors should be notified to the CSSF and all provisions of the Circular apply based on the lower thresholds as determined for the UCI
- ▶ In order to determine the materiality threshold applicable to a fund of funds, an index tracker or a feeder fund, a UCI should consider the investment policy of the target investments on a look-through basis, i.e., the investment policy of the target funds or master fund or the investment policy of the assets/funds in the tracking index.

8.8.2. Treatment of NAV computation errors

8.8.2.1. Definition of a NAV computation error

A NAV computation error occurs where there are one or more factors or circumstances that lead to the computation process producing an inaccurate result. As a general rule, such factors or circumstances may be put down to inadequate internal control procedures, management deficiencies, failings or shortcomings in computer systems, accounting systems or communication systems, or to non-compliance with the valuation rules laid down in the UCI's constitutional document or prospectus.

8.8.2.2. Concept of materiality in the context of NAV computation errors

It is generally acknowledged that the NAV computation process is not an exact process and that the result of the process is the closest possible approximation of the actual market value of a UCI's assets. It is accepted practice in the majority of leading fund administration centers to recognize only those computation errors with a material impact on the NAV.

The Circular introduces the concept of materiality to Luxembourg UCIs and sets the acceptable tolerance limits for the different types of UCIs. This differentiated approach is warranted by the fact that the degree of inaccuracy inherent in a given NAV computation may vary from one type of UCI to another due to external factors, such as market volatility.

The tolerance limits provided for in the Circular for the different types of UCIs are as follows:

	As % of NAV
Money market funds/cash fund	0.25%
Bond funds	0.50%
Equity and other funds	1.00%
Mixed funds	0.50%

In the case of a UCI investing through FDIs, the CSSF has clarified that the tolerance level may be defined according to the underlying assets of FDIs (look-through principle) where the yield of the underlying assets account for at least 80% of the performance of the UCI.

The management company, sponsor or promoter of the UCI are free to set lower tolerance levels or even to adopt a policy of zero tolerance. The procedures to be followed in the Circular, however, are only obligatory for material errors using the tolerance levels set out in the Circular. It is a matter for the Board of Directors of a UCI (or its management company in the case of a common fund) to ensure that where the UCI's shares or units are distributed in a foreign jurisdiction, the proposed tolerance levels do not conflict with local requirements.

A material error may not just be an isolated error but also several errors that in aggregate exceed the materiality limit.

The obligation to compensate losses applies only to those valuation days affected by a material NAV computation error.

The CSSF FAQ of 30 July 2019 on *Swing Pricing Mechanism* outlined in Section 8.6.3. clarified that in case of a material NAV error arising as a result of an administrative error (i.e., application of the incorrect swing factor, or the NAV was swung in the wrong direction) in the application of the swing pricing mechanism, the procedures set out in CSSF Circular 02/77 must be followed. If the impact of the error is below the materiality threshold, the CSSF considers that the UCI should still be compensated when it was not protected from the level of dilution it should have been, had the swing pricing mechanism policy been applied properly. The FAQ provides illustrative examples of such types or errors.

The same applies within the context of investment or disinvestment operations in underlying or related UCIs where the UCI experienced duplication of certain fees while the sales prospectus specifically excludes such duplication.

8.8.2.3. Corrective action for material NAV computation errors

8.8.2.3.1. Reporting to the management company, sponsor or promoter, depositary, CSSF and independent auditor

The UCI's administrator must notify, immediately upon discovery of a material error, the management company, its sponsor or promoter, the depositary, the CSSF, and the independent auditor and must submit to the management company, sponsor or promoter, and the supervisory authority a remedial action plan dealing with the corrective action proposed or already taken to resolve the problems that caused the error, and must make appropriate improvements to existing administrative and control structures to avoid a recurrence of the failure. The remedial action plan should further detail the action proposed or already taken in order to:

- ▶ Determine categories of investors affected by the error
- ▶ Recompute NAVs used for subscriptions and redemptions during the period the error became material and the date of correction ("error period")
- ▶ Determine on the basis of the recomputed NAVs the amounts to be paid as compensation to the UCI and to the investors
- ▶ Notify the supervisory authorities in those foreign jurisdictions where the shares or units are sold, where so required by such authorities
- ▶ Advise impacted investors of the error and the arrangements for compensation

However, a “simplified procedure” may be adopted where the amount of compensation does not exceed EUR 25,000 or the amount payable to an investor does not exceed EUR 2,500. Such a procedure requires that the administrator notifies the CSSF; however, no remedial action plan needs to be prepared.

In the case of nominee accounts the determination of the amount payable to an investor not exceeding EUR 2,500 remains at the level of the beneficial owner and not at the level of the nominee account.

The limit of EUR 25,000 is an aggregate compensation amount due to investors and due to the UCI.

On 3 January 2017 the CSSF published a press release introducing a notification form in Excel format that should be sent electronically to the CSSF to report all NAV calculation errors and non-compliance with investment rules.

8.8.2.3.2. Quantifying the financial impact of a computation error

The administration must remedy the error as swiftly as possible.

For the purpose of quantifying the financial impact of a computation error, the UCI’s administrator should make a distinction between:

- ▶ Investors existing prior to the error period who redeemed during the error period
- ▶ New investors during the error period who held their shares or units beyond the end of the error period

The following gives an overview of the position of a UCI and its investors where the NAV is understated or overstated:

A. NAV understated

- ▶ Investors existing before the error period who redeemed their shares or units during the error period must be compensated for the difference between the recomputed NAV and the original understated NAV used as the basis for their redemption transaction
- ▶ The UCI must be compensated for the difference between the recomputed NAV and the original understated NAV as applied to shares or units subscribed during the error period and still held beyond the end of the error period

B. NAV overstated

- ▶ The UCI must be compensated for the difference between the original overstated NAV as applied to shares or units held prior to the error period and redeemed during the error period and the recomputed NAV
- ▶ New investors during the error period who held their shares or units beyond the end of the error period must be compensated for the difference between the original overstated NAV as applied to such subscriptions and the recomputed NAV

Investors incurring a loss as a result of an error may be compensated out of the assets of the UCI where such payments represent the refund of excess receipts by the UCI. Alternatively, the management company, its sponsor, or the UCI’s promoter or administrator may, as appropriate, elect to bear the cost of such compensation.

A question arises as to whether a UCI which has sustained a loss as a result of a computation error has the right to look to investors who have unknowingly benefited from the error to compensate any underpayment for a subscription based on an understated NAV or any excess receipt from a redemption based on an overstated NAV. As this is a somewhat controversial issue to which no clear answer may be given in the absence of a judicial ruling on the matter, the Circular does not advocate recourse to investors for compensation of losses sustained by the UCI, except where institutional or other expert investors are concerned and where such investors have explicitly and knowingly agreed to indemnify the UCI for such losses.

In principle, the administrator or, as appropriate, the management company, its sponsor, or the UCI’s promoter compensates the UCI for any loss.

As soon as the misstated NAVs have been recomputed, the appropriate accounting entries to record the compensation payments receivable and/or payable must be entered in the UCI’s accounting records.

8.8.2.3.3. Payment of compensation for losses incurred

The obligation to compensate losses incurred by the UCI and/or its investors applies only to those valuation days affected by a material NAV computation error.

The UCI's administrator must expedite the compensation payments to the UCI and/or the impacted investors subject to completion of the independent auditor's review (see Section 8.8.2.3.4.). In order to speed up the correction process, the UCI's administrator may begin work on the various steps involved without prior authorization from the CSSF who may be informed of action taken after the event.

Where, as a result of a NAV computation error, the amount of compensation does not exceed EUR 25,000 and the amount payable to an investor does not exceed EUR 2,500, the administrator must expedite the release of the amounts of compensation due to the UCI and/or impacted investors as soon as such amounts of compensation have been quantified.

The CSSF may, however, intervene if it deems appropriate.

In the majority of leading investment fund centers, fund managers are permitted by the supervisory authority to apply *de minimis* (minimum amount) rules to compensation amounts due to individual investors. This procedure avoids the situation of investors who are entitled to relatively modest amounts of compensation seeing the payment effectively nullified by bank and other expenses incurred by them. Luxembourg UCIs are permitted to apply *de minimis* rules. The CSSF has not set a fixed *de minimis* as the appropriate amount may vary from UCI to UCI depending on where its shares or units are sold. It is for each UCI to set its proposed *de minimis*. The CSSF may request from the UCI, on an *ex-post* basis, documentary evidence to support the *de minimis* amount. The *de minimis* rule may not be used to refuse compensation to investors who have specifically requested compensation.

In the case of investors who still hold shares or units in the UCI, the UCI may elect to credit them (without charge) with new shares or units rather than by payment. In such circumstances, there is no justification to apply a *de minimis*.

Where impacted investors subscribed via a nominee, the investor compensation will be remitted to the nominee, who must give an undertaking to the UCI's administrator to forward the amounts to the beneficial owner.

The CSSF's position is that the UCI must be reimbursed for losses incurred due to fees charged incorrectly to the UCI, even when such fees may not be considered to be material.

8.8.2.3.4. The role of the independent auditor in reviewing the correction process

As stated in Section 8.8.2.3.1., when notifying the management company, its sponsor or promoter, the depository, and the CSSF of the occurrence of a material computation error, the UCI's administrator must also advise the UCI's independent auditor and, if the simplified procedure cannot be applied, commission a (first) special report on the appropriateness of the methods intended to be used in order to:

- Determine in the most appropriate manner which categories of investors are affected by the error
- Recompute the NAVs used as the basis for subscription and redemption orders received during the period between the date at which the error became material and the date at which it was corrected
- Determine on the basis of the recomputed NAVs the amounts to be paid to the UCI and to investors by way of compensation for losses sustained as a result of the error

The conclusions of the independent auditor on the proposed methods should be attached to the compensation arrangements document referred to in Section 8.8.2.3.1.

Where the calculation error is detected by the independent auditor, it should be reported to the UCI's administrator immediately together with a request that the management company, sponsor or promoter, depository, and the CSSF be notified forthwith. Where the independent auditor finds that the administration has failed to comply with this request, the CSSF should be advised accordingly.

Once the UCI's administrator has completed the correction process to the extent of making the appropriate entries in the UCI's accounting records, the independent auditor should carry out procedures and produce a (second) special report stating whether, in their opinion, the correction process is appropriate and reasonable in the circumstances. The report should deal with:

- The methods referred to in the first paragraph of this section
- The recomputed NAVs as originally misstated
- The loss sustained by the UCI and/or its investors

The administrator should forward a copy of the (second) special report of the independent auditor to the CSSF and, if requested, to the supervisory authorities of those jurisdictions in which the UCI's shares or units are registered for distribution.

The independent auditor should issue a final (third) special report certifying that the amounts of compensation due to the UCI and/or impacted investors have been effectively paid.

A copy of this (third) special report should also be forwarded to the CSSF and, where applicable, to the authorities of foreign jurisdictions where the shares or units are sold.

In practice, the three special reports may be combined into one or two reports.

Under the simplified procedure, the independent auditor is required to review the correction process and declare in the long form report whether, in its opinion, the correction process is relevant and reasonable.

8.8.2.3.5. Communicating with impacted investors entitled to compensation

Material computation errors must be reported to investors entitled to compensation.

This may be either by individual notification or announcement in the press, giving particulars of the computation error and the action taken to correct the error and compensate the UCI and/or investors affected.

8.8.2.3.6. Liability for expenses incurred in remedying a computation error

Expenses incurred as a result of remedial action taken to correct a computation error, including the cost of the special report(s) of the independent auditor, must not be borne by the UCI. In practice they are borne by the party responsible for the investment breach/NAV calculation error.

It is the duty of the independent auditor to ensure, as part of his statutory review of the accounting information contained in the UCI's annual report, that such expenses have not been met out of the assets of the UCI.

8.8.2.4. Master-feeder UCITS

For master-feeder UCITS, NAV computation errors detected that may have a negative impact on the feeder UCITS include, but are not limited to:

- Errors in the NAV calculation of the master UCITS
- Errors in transactions for or settlement of subscription or redemption by the feeder UCITS of shares or units in the master UCITS
- Errors in the payment or capitalization of income arising from the master UCITS or in the calculation of any related withholding tax

8.8.3. Compensation for losses arising from non-compliance with investment restrictions

8.8.3.1. Rectification of non-compliance

Immediately upon discovery of an instance of non-compliance with applicable investment restrictions, the management of the UCI should take all appropriate measures to rectify the situation in which the UCI finds itself as a consequence of the non-compliance. In particular:

- ▶ Where the nature of the non-compliance is the making of investments in contravention of the investment policy stated in the UCI's prospectus, the UCI should arrange to dispose of such investments
- ▶ Where the investment limits stipulated by law or by the UCI's prospectus have been breached in circumstances other than those provided for by Article 49 of the 2010 Law (see Section 4.2.2.8.1.V.), the UCI should arrange to dispose of the excess positions. However, where there is a breach of Article 43(2) of the 2010 Law (see Section 4.2.2.8.1.I.(2)), the UCI may also dispose of a position other than those that caused the breach
- ▶ Where the borrowing limits stipulated by the law or by the UCI's prospectus have been breached, the UCI should arrange to reduce the excess borrowing within the applicable limit

On 16 April 2020, the CSSF published its *Frequently Asked Questions (FAQ) - COVID-19* and provided the following clarifications on passive investment breaches and breaches of the VaR limits for UCITS :

Passive investment breaches of the global exposure limit (and more generally of applicable investment restrictions) do not need to be notified to the CSSF.

The CSSF considers that breaches of the VaR limit (either the maximum limit laid down in regulation (20% for absolute VaR or 200% for relative VaR as the case may be) or any other more restrictive internal limit set below the above regulatory thresholds, as laid down in the sales prospectus) by UCITS as a result of the increase of volatility in financial markets (in the absence of any new positions increasing the risk of the portfolio) may be considered as passive breaches.

Upon occurrence of a passive breach, any subsequent additional risk exposure taken by the UCITS increasing the overall level of risk of the portfolio (i.e., VaR usage increasing) should be viewed as an active investment breach.

Investment fund managers should take reasonable steps to meet the limit within a reasonable time period, thereby taking due account of the prevailing market conditions and of the best interests of investors. For that purpose, they have to closely monitor the situation of the UCITS as well as the defined remediation plan.

Question 16.D) of the FAQ also clarifies the content of the notification to the CSSF in relation to an active breach of the VaR limit.

8.8.3.2. Calculation of compensation

In the three cases referred to in Section 8.8.3.1., the UCI should seek compensation for any loss sustained by it.

The CSSF FAQ on Circular CSSF 02/77 mentioned in Section 8.8.1. clarifies certain elements of the compensation calculations applicable to the above scenarios.

Where multiple investment restriction compliance failures occur, compensation should be sought for any aggregate net loss arising as a result of the rectifications as a whole.

Where such rectifying transactions produce an aggregate net profit to the UCI, the UCI should be entitled to recognize and retain such profit. In these circumstances, the UCI's administrator only needs to notify the CSSF and the independent auditor.

By way of exception, where warranted in all the circumstances, alternative methods other than those outlined may be adopted to determine the amount of the loss, including, in particular, the so-called "economic" method whereby the loss is quantifiable in terms of the performance differential had the unauthorized investments sustained the same movements as the authorized portfolio invested in accordance with the investment policy and investment limits stipulated by the law or by the prospectus.

8.8.3.3. Application of materiality levels

In July 2004, the CSSF clarified the applicability of the materiality levels (see Section 8.8.2.2.) in the case of non-compliance with investment restrictions, as follows:

- ▶ The UCI must always be compensated for losses resulting from selling the unauthorized investment or the excess position of this investment or the expenses attributable to the unauthorized portion of the borrowing, whatever the impact of the breach; no materiality levels may be applied to these situations
- ▶ If the realized loss shows that the impact on the NAV exceeds the materiality levels, the NAV must be recomputed for the breach period and the UCI and its investors that have suffered a loss must be compensated.

The impact on the UCI and/or underlying investors during the breach period may also have to be considered.

8.8.3.4. Responsibility for compensation

It is the responsibility of the party that caused the breach through a failure to fulfill its obligations to compensate the loss. In all other circumstances, the management company, its sponsor or the UCI's promoter should be responsible for rectifying the loss.

8.8.3.5. Remedial action procedures

The same procedure for determining what remedial action is required in cases of NAV computation error should apply, as is appropriate in the circumstances, to cases of non-compliance with investment restrictions (see Section 8.8.2.). Specific reference is made in this context to the mandatory procedures that deal with:

- ▶ Reporting to the management company, sponsor or promoter and the depositary of the UCI and to the CSSF
- ▶ Determining which categories of investor have been impacted by the loss sustained by the UCI
- ▶ Quantifying the financial impact of the loss for individual investors and making arrangements for their compensation
- ▶ The role of the independent auditor in reviewing the correction process
- ▶ Communicating with impacted investors entitled to compensation
- ▶ With respect to investor compensation arrangements, the procedure set out in Section 8.8.2.3.3. applies

8.8.3.6. Master-feeder UCITS

For master-feeder UCITS, a non-compliance with investment restrictions detected that may have a negative impact on the feeder UCITS includes, *inter alia*:

- ▶ Breaches of the investment objectives, policy or strategy of the master UCITS, as described in its fund rules or instrument of incorporation, prospectus or KII
- ▶ Breaches of investment and borrowing limits set out in national law or in the fund rules or instruments of incorporation, prospectus or KII

8.8.4. Applicability to SIFs

The CSSF FAQ on Circular CSSF 02/77 mentioned in Section 8.8.1. clarifies that SIFs may either opt to apply CSSF Circular 02/77 or set other specific internal rules in the context of NAV calculation errors and active investment breaches.

In the absence of specific internal rules, the Circular applies. All material NAV errors and active investment breaches have to be notified to the CSSF, whether the SIF applies the Circular or specific internal rules. When SIFs opt for the application of the Circular, a remedial action plan is not required but the external auditor has to review the correction process and the related compensation and confirm in the management letter that they complied with the provisions of the Circular.

When applying internal rules, SIFs must apply appropriate thresholds taking into due account the investment policy of the SIF.

9

Depository

EY supports depositaries in the following tasks:

- Definition and review of operating models and business plans
- Application for authorization as a depository
- Process design and documentation
- Compliance solution and support
- Selection and due diligence support of delegates and outsourcing agents
- Review of fee structures and benchmarking
- Assurance reporting on depository controls (e.g., ISAE 3402, US Attestation Standard AT-C section 320)



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9.1. Introduction

This Chapter summarizes key points related to the depositary function of Luxembourg based UCIs. It covers:

- ▶ The qualifications of the depositary
- ▶ The duties of the depositary
- ▶ Conduct of business rules
- ▶ Depositary liability
- ▶ Delegation by the depositary to third parties

In this chapter, the term:

- ▶ “Full AIFM regime AIF” refers to AIF managed by authorized AIFM and internally managed AIF that are subject to the AIFM Law. If the term AIF is used in this chapter and not further specified, reference is made to full AIFM regime AIF
- ▶ “Simplified AIFM registration regime AIF” means AIF whose manager is not subject to the full provisions of the AIFM Law (or the AIFM Directive) and internally managed AIF that are not subject to the full provisions of the AIFM Law

In the context of this chapter, the term “full AIFM regime AIF” includes reserved alternative investment funds (RAIF) subject to the law of 23 July 2016. Article 5 of the law of 23 July 2016 requires depositaries of RAIF to comply with the depositary regime in accordance with the AIFM Law.

The regulatory regime applicable to depositaries in Luxembourg has been subject to significant change originated by the AIFMD and the UCITS V Directive. The most recent, ongoing, and future regulatory changes impacting depositaries are summarized below:

1. The law of 12 July 2013 (the “2013 Law”) transposed the Directive 2011/61/UE and established the general regime applicable to the depositaries of full AIFM regime in chapter 3, Section 4. Section 3 of the Delegated Regulation 231/2013 provides further details as to the requirements for depositaries including, *inter alia*, due diligence duties and asset segregation obligations.
2. The EU UCITS V Directive (“UCITS V”) aligned, in general, the regime applicable to the depositaries of UCITS with the regime applicable to the depositaries of full AIFM regime AIF. The UCITS V Directive (2014/91/EU) amending Directive 2009/65/EC was transposed into Luxembourg law effective 1 June 2016 by amending the Luxembourg law of 17 December 2010 (the “2010 Law”). The adopted law is, with respect to the depositary rules, mainly a transposition of the text of the UCITS V Directive. The UCITS V delegated acts (Delegated Regulation 2016/438) were published in the official journal of the EU on 24 March 2016 and are applicable since 13 October 2016.
3. In October 2016, the CSSF issued Circular 16/644 (the “Circular”) which repealed and replaced CSSF Circular 14/587 as amended by CSSF Circular 15/608. The new Circular closely aligned the previous requirements of CSSF Circular 14/587 to the requirements of UCITS V as well as the related Delegated Regulation 2016/438 and provides further clarifications and additional information regarding obligations applicable to depositaries of UCITS in Luxembourg. Overall, the Circular is broadly aligned with the provisions of the AIFM Law and related delegated acts, as well as UCITS V and its delegated acts. However, there are some important differences between the various texts.
4. The law of 27 February 2018 introduced important changes to UCIs governed by Part II of the 2010 Law (2010 Law Part II UCIs). Since transposition of the UCITS V Directive into Luxembourg Law, 2010 Law Part II UCIs were subject to the more stringent depositary rules as defined by UCITS V. The Law of 27 February 2018 amends the Law of 17 December 2010 on UCIs and the Law of 12 July 2013 on AIFMs and introduces different depositary regimes (UCITS V, AIFM and the depositary regime defined by the Law of 13 February 2007 on specialized investment funds) for 2010 Law Part II UCIs, subject to certain conditions. The Law of 27 February 2018 entered into force on 5 March 2018.
5. On 23 August 2018, the CSSF issued CSSF Circular 18/697 clarifying the requirements applicable to depositaries of UCIs which are not subject to Part I of the Law of 17 December 2010 (2010 Law) relating to undertakings for collective investments, and, where appropriate, to their branches.

This circular provides, *inter alia*, additional clarifications regarding the admission criteria and process for depositaries of non-UCITS, specific requirements for non-bank depositaries (investment firms within the meaning of the 1993 Law and professional depositaries of assets other than financial instruments in accordance with Article 26-1 of the 1993 Law), eligibility criteria, additional guidance as to the application of safeguarding, due diligence and oversight principles for specific asset classes and clarifications on record keeping, asset valuation and segregation rules.

6. Delegated Regulation (EU) 2018/1618 of 12 July 2018 amending Delegated Regulation (EU) No 231/2013 related to safe-keeping duties of depositaries of AIFs and Delegated Regulation (EU) 2018/1619 of 12 July 2018 amending Delegated Regulation (EU) 2016/438 related to safe-keeping duties of depositaries of UCITS (the “Revised UCITS V and AIFMD regulations”). Guided by the ESMA opinion to the EU Parliament published on 20 July 2017 on clarifications of legislative provisions under the AIFMD and UCITS Directive regarding *asset segregation and the application of depositary delegation rules to CSDs*, the Revised UCITS V and AIFMD regulations implemented a number of new requirements to foster asset protection, including for example, the requirements related to the reconciliation process, the books and records to be kept by depositaries, and the identification of all the parties included in the custody chain (refer also to Section 9.7.2.A.). The revised UCITS V and AIFMD regulations were published on 30 October 2018 in the Official Journal of the EU and have been applicable since 1 April 2020.
7. Another European regulatory development that will impact depositaries is the *Regulation on securities settlement and on central securities depositaries* (CSDs). The CSD Regulation is designed to increase the safety and efficiency of securities settlement in the EU, promote greater choice for issuers and users by enhancing the single market, and harmonize settlement periods for transferable securities traded on EU markets. The CSD Regulation provides, *inter alia*, for shorter settlement periods, measures to promote settlement discipline, access rights requirements for CSD services, prudential and conduct of business rules for CSDs, and increased prudential and supervisory requirements for CSDs and other institutions providing banking services ancillary to securities settlement.

The CSD Regulation, as amended by EU Regulation 2016/1033, entered into force in September 2014, with staged implementation from 1 January 2015 and full implementation by 1 January 2025. The EU Commission published on 10 March 2017 Commission Delegated Regulations 2017/389, 2017/390, 2017/391, 2017/392, 2017/393 of 11 November 2016 amending the Regulation and providing Regulatory and Implementing Technical Standards, complementing the obligations defined under the Regulation. The RTS have been effective since 10 March 2019.

8. ESMA issued Question and Answer documents on the *Application of the UCITS Directive and the AIFMD Directive*, which clarify certain aspects of UCITS V and AIFMD. Also the CSSF Press Release 16/10 of 2 March 2016 addresses *Practical issues in relation to the UCITS V regime*.
9. On 10 June 2020, the European Commission provided a report on the assessment of AIFMD which is contemplated as a basis for future amendments to the AIF depositary regime in order to add clarity to:
 - Situations where AIFMs use tri-party collateral management
 - Instances where a CSD acts as a custodian in a depositary’s custody chain
 - Concentration risks in smaller markets due to the lack of depositary passport

Legislative proposals are expected to be formulated in this respect by the European Commission during the first quarter of 2021.

10. During the last year, the ABBL/ALFI Depositary Bank Forum has issued several important guidelines for depositaries:
 - *ABBL/ALFI Guidelines on Financial instruments held in custody* issued in January 2020: These guidelines summarize key responsibilities for depositaries of custodial assets, obligations in relation to the set-up of accounts and segregation obligations, the appointment and monitoring of sub-custodians, considerations in relation to target funds, collateral arrangements and relationships with prime brokers.
 - *ABBL/ALFI Guidelines on Look through and control* issued in March 2020: These guidelines provide an overview of the application of the look through approach with respect to cash and ownership verification depending of various situations of control.
 - *ABBL/ALFI Guidelines on the new AIFM/UCITS CDRs on delegated regulation*: These guidelines include an impact assessment and recommendations for implementation following the changes introduced by the Delegated Regulations (EU) 2018/1618 and 2018/1619 related to safekeeping duties of depositaries of AIFs and UCITS (refer to point 6 above).

9.2. Appointment

A single depositary must be appointed for each Luxembourg UCI. The appointment and any replacement of the depositary must be approved by the CSSF.

There is no specific “depositary banking license” to be obtained to operate as a depositary. However, Circulars 16/644 and 18/697 provide detailed rules regarding the content of an application file to be submitted, the conditions to be met, and the procedures to be put in place by the depositary in order to be granted approval to act as depositary by the CSSF. The information to be provided to the CSSF is described in Section 9.9. *Other reporting and disclosure obligations*.

The appointment of the depositary must be evidenced by a written contract. Circular 16/644 makes reference to the requirements of chapter 1 of the UCITS V Delegated Regulation which includes in article 2.2 a detailed list of the points which must be addressed in the written contract. The content of the written contract is very much aligned with the depositary contract requirements of the AIFMD and its delegated acts and CSSF Circular 18/697. The written contract should, *inter alia*, regulate the flow of information deemed necessary to allow the depositary to perform its function for the UCITS and/or AIF to which it has been appointed.

The minimum content of the depositary contracts for UCITS and AIF is covered in Section 6.3.5.1. Neither a management company nor an AIFM can act as depositary.

9.3. Eligible entities

The entities eligible to act as a depositary depend on the regime applicable to the UCI.

9.3.1. Depositary of a UCITS and 2010 Law Part II UCIs

The depositary of a UCITS must be a credit institution with its registered office in Luxembourg or a branch of a credit institution established in Luxembourg with its registered office in another EU/EEA Member State.

The UCITS V Directive in principle also allows national central banks and other legal entities authorized by the competent authority under the laws of the Member State to carry on depositary activities under the UCITS Directive, subject to specific conditions (*inter alia*, meeting certain capital adequacy requirements).

According to the rules applied in Luxembourg, a Luxembourg branch of a non-EU/EEA credit institution may not act as depositary of a UCITS.

The Law of 10 May 2016 implementing UCITS V into Luxembourg law extended the UCITS V depositary regime to 2010 Law Part II UCIs, thus, superseding the rules on depositaries provided for under the AIFM Law applicable to 2010 Law Part II UCIs. The law of 27 February 2018, however, changed that approach and allows the application of different depositary regimes under certain conditions. In summary, the various depositary regimes introduced by the law of 27 February 2018 for 2010 Law Part II UCIs can be summarized as follows:

- ▶ 2010 Law Part II UCIs marketed to retail investors in Luxembourg are subject to the UCITS depositary regime (irrespective of whether they are managed by an EU authorized/registered AIFM¹⁹² or by a non-EU AIFM)
- ▶ 2010 Law Part II UCIs where the offering documents do not allow marketing to retail investors in Luxembourg and which are managed by an authorized AIFM are subject to the AIFMD depositary regime
- ▶ 2010 Law Part II UCIs where the offering documents do not allow marketing to retail investors in Luxembourg and which are managed by a registered AIFM or by a non-EU AIFM are subject to the SIF depositary regime¹⁹³

¹⁹² AIFMs which benefit and use the exemption of Article 3 (2) of the Law of the AIFM Law

¹⁹³ The depositary regime defined by the Law of 13 February 2007 on specialized investment funds

9.3.2. Depositary of AIF (according to the AIFM Law)

The depositary of an AIF subject to the AIFM Law must, in general, be a credit institution or an investment firm (often referred to as a MiFID¹⁹⁴ firm). The depositary must either have its registered office in Luxembourg or have a branch established in Luxembourg with its registered office in another EU/EEA¹⁹⁵ Member State.

Under certain conditions as described in Section 9.3.2.2., a specialized professional of the financial sector (PSF) qualifying as “Professional depositary of assets other than financial instruments” may act as depositary of a full AIFM regime AIF or a simplified AIFM registration regime AIF.

Reference is made to Section 9.3.1. for the depositary applicable to 2010 Law Part II UCIs.

9.3.2.1. Investment firms as depositaries

Where an investment firm wishes to act as depositary, it must notify the CSSF prior to commencing depositary activities. The CSSF may object within a period of up to two months, explaining its reasons. An investment firm that intends to act as depositary must, *inter alia*:

- ▶ Be authorized to provide the ancillary service of safekeeping and administration of financial instruments for the account of clients
- ▶ Have capital of EUR 730,000
- ▶ Have an internal governance structure, including an organizational, administrative, and internal control structure that is appropriate to the activity of a depositary

Subject to obtaining the required authorizations, investment firms may also act as:

- ▶ Agent for the reception and transmission of orders relating to one or more financial instruments
- ▶ Collateral agent
- ▶ Collateral manager
- ▶ External valuer

An investment firm acting as the single depositary of an AIF must appoint a delegate to safekeep assets other than financial instruments. In such case, the first accounts relating to the assets to be held in custody with the delegate must be opened in the name of each client (or, where applicable, of each AIF compartment) at the level of the delegate.

Also, investment firms which act as depositaries must ensure the appointment of one or more entities with which all cash of the AIF should be booked in cash accounts in accordance with Article 19(7) of the 2013 Law.

9.3.2.2. Professional depositaries of assets other than financial instruments (“PDAOIFs”)

A specialized PSF “Professional depositary of assets other than financial instruments” must obtain authorization from the CSSF prior to starting its activities. It must have minimum capital of EUR 500,000.

Also, the specialized PSF must have an appropriate administrative and accounting organization in place and dispose of effective internal procedures and controls. The organization and internal procedures and controls need to be complete and reflect the nature, scale and complexity of the operations of the specialized PSF.

PDAOIFs can only act as depositaries for AIFs, SIFs and SICARs (which do not qualify as AIFs) with no exercisable redemptions rights during five years from the date of the initial investments and which, pursuant to their main investment policy, generally do not invest in assets which must be held in custody.

Also, PDAOIFs cannot act as depositary for entities with an investment policy to invest in issuers or non-listed companies in order to acquire control thereof.

A PDAOIF cannot act as custodian of cash deposits or of financial instruments to be held in custody. In case a PDAOIF acts as the single depositary of an AIF, it must appoint a delegate to maintain cash deposits or safekeep financial instruments to be held in custody on its behalf (“mandatory delegates”).

¹⁹⁴ Markets in Financial Instruments Directive (MiFID), Directive 2004/39/EC, as amended.

¹⁹⁵ European Union (EU) Member States plus Iceland, Liechtenstein, and Norway.

9.3.3. Summary of qualifications

The eligibility of depositaries for UCITS, other UCIs, and SIFs can be summarized in the following table:

Entities eligible to act as depositaries by UCI regime

	UCITS/ 2010 Law Part II UCI ¹⁹⁶	Full AIFM regime AIF		Simplified AIFM registration regime AIF
		AIF/SIF/ 2010 Law Part II UCI ¹⁹⁷	RAIF	AIF/SIF/ 2010 Law Part II UCI ¹⁹⁸
Luxembourg credit institution	Yes	Yes	Yes	Yes
Luxembourg branch of an EU/EEA credit institution	Yes	Yes	Yes	Yes
Luxembourg branch of a non-EU credit institution	No	No	No	Yes
Luxembourg investment firm	No	Yes	Yes	Yes
Luxembourg branch of an EU/EEA credit institution	No	Yes	Yes	Yes
Luxembourg branch of a non-EEA investment firm	No	No	No	Yes
Professional depositaries of assets other than financial instruments	No	Yes	Yes	Yes
Applicable core regulations	UCITS V CSSF Circular 16/644	AIFMD CSSF Circular 18/697	AIFMD CSSF Circular 18/697	SIF Law CSSF Circular 18/697 Part I Chapter V

9.4. Duties

9.4.1. General

In general, the depositary of a UCI should perform the following duties:

- The safekeeping of financial instruments and other assets belonging to the UCI
- Cash flow monitoring
- Carrying out a number of other monitoring and oversight duties

There are currently certain differences between the duties of the depositary of a UCITS, a full AIFM regime AIF, and a simplified AIFM registration regime. UCITS V, AIFMD and CSSF Circulars 16/644 and 18/697 have extensively harmonized the existing differences in duties as described hereafter and have, in particular, addressed the differences in depositary duties in relation to common funds and investment companies.

¹⁹⁶ 2010 Law Part II UCIs marketed to retail investors in Luxembourg are subject to the depositary regime of the UCITS V Directive (irrespective of whether they are managed by an EU authorized/registered AIFM or by a non-EU AIFM).

¹⁹⁷ 2010 Law Part II UCIs where the offering documents do not allow marketing to retail investors in Luxembourg and which are managed by an authorized AIFM are subject to the AIFMD depositary regime.

¹⁹⁸ 2010 Law Part II UCIs where the offering documents do not allow marketing to retail investors in Luxembourg and which are managed by a registered AIFM or by a non-EU AIFM are subject to the depositary regime for SIFs.

The duties of the depositary in relation to the applicable depositary regimes can be summarized as follows:

Overview of depositary duties

	UCITS		Full AIFM regime AIF						Simplified AIFM registration regime AIF			
			AIF		SIF		RAIF		AIF		SIF	
	Common fund	Investment company	Common fund	Investment company	Common fund	Investment company	Common fund	Investment company	Common fund	Investment company	Common fund	Investment company
Safekeeping of the UCI's assets	X	X	X	X	X	X	X	X	X	X	X	X
Cash flow monitoring	X	X	X	X	X	X	X	X	X	X		
Oversight duties	Ensuring that the subscription and redemption of shares or units of the UCI are carried out in accordance with the law and the constitutional document											
	X	X	X	X	X	X	X	X	X	X	X	X
	Ensuring that the value of the shares or units is calculated in accordance with the law and the constitutional document											
	X	X	X	X	X	X	X	X	X	X	X	X
	Carrying out the instructions of the management company or AIFM, unless they conflict with the constitutional document											
Ensuring that in transactions involving the UCI's assets, any consideration is remitted to it within the usual time limits												
X	X	X	X	X	X	X	X	X	X	X	X	
Ensuring that the UCI's income is applied in accordance with the constitutional document												
X	X	X	X	X	X	X	X	X	X	X	X	

The depositary regime applicable to a 2010 Law Part II UCI will depend on various factors such as its targeted distribution and the qualification of the entity which manages it. As to the applicable depositary regime, please refer to Section 9.3.1.

The depositary is also required to provide the CSSF, on request, with all the information that it has obtained in the exercise of its duties and that is necessary to enable the CSSF to monitor compliance by the UCI with the law.

9.4.2. Safekeeping

The depositary's safekeeping duties will generally entail:

- Holding in custody:
 - All financial instruments belonging to the UCI, that may be registered in a financial instruments account, maintaining segregated accounts (i.e., separately from the depositary's own assets), and opened in the name of the UCI (or of the management company acting on behalf of the UCI), so that they can at all times be clearly identified as belonging to the UCI or the respective compartment, if applicable.

Financial instruments are generally held in custody through a custody network. They may include, for example, listed equities, bonds, and selected money market instruments.

- All financial instruments that can be physically delivered to the depositary
- For all other assets of the UCI, verifying ownership and maintaining a record of the assets for which it is satisfied that they belong to the UCI. The assessment of ownership is determined on the basis of information and documentation provided by the UCI or on behalf of the UCI, or any other evidence the depositary can rely on

Other assets not held in custody may include, for example, over-the-counter (OTC) derivatives, foreign exchange derivatives, equities in non-listed companies, real estate, physical assets such as luxury goods, and intellectual property.

The depositary is permitted to delegate its safekeeping duties under certain conditions (see Section 9.7.).

9.4.2.1. Safekeeping of UCITS, 2010 Law Part II UCIs, and AIF assets

For UCITS, 2010 Law Part II UCIs, and full AIFM regime AIF, a distinction is made between the depositary's safekeeping duties relating to financial instruments that can be held in custody and those relating to other assets. The requirements for UCITS, 2010 Law Part II UCIs, and AIF are largely identical, however certain differences exist.

A.1. Assets held in custody - UCITS, 2010 Law Part II UCIs and AIF

The depositary must hold in custody:

- ▶ All financial instruments belonging to the UCITS, 2010 Law Part II UCI, or AIF where both of the following requirements are met:
 - ▶ They are transferable securities, including those that embed derivatives (see Section 4.2.2.7.3.), money market instruments, or units of UCIs¹⁹⁹
 - ▶ They are capable of being registered or held in an account directly or indirectly in the name of the depositary

Financial instruments that, in accordance with applicable national law, are only directly registered in the name of the UCITS, 2010 Law Part II UCI, or AIF with the issuer itself or its agent, such as a registrar or a transfer agent, are not considered to be held in custody.

The CSSF's *Frequently Asked Questions* (FAQ) on Luxembourg's AIFM Law and on Commission Delegated Regulation (EU) No 231/2013 ("Level 2") (the FAQ on AIFM) clarifies that financial instruments can be directly registered in the name of the AIF, or the AIFM on behalf of the AIF, with the issuer or an agent of the issuer in the following circumstances:

- ▶ When the law applicable to the issuer explicitly requires those financial instruments to be registered directly in the name of the AIF, or the AIFM on behalf of the AIF, with the issuer or an agent of the issuer
- ▶ When the law applicable to the issuer does not prohibit an AIF to register its investment directly in the name of the AIF, or the AIFM on behalf of the AIF, with the issuer or an agent of the issuer, provided that the AIF or the AIFM and the depositary agree to register the financial instruments in the name of the AIF or the AIFM on behalf of the AIF

- ▶ All financial instruments that can be physically delivered to the depositary

In order to comply with its safekeeping duties with respect to financial instruments held in custody, the depositary must at least ensure that:

- (1) The financial instruments are properly registered in the depositary's books by means of segregated accounts, opened in the name of the UCITS, 2010 Law Part II UCI, the AIF and the respective compartments, where applicable, so that they can be clearly identified at all times, in accordance with the applicable law, as belonging to the UCITS, 2010 Law Part II UCI, the AIF and respective compartments, where applicable.
- (2) Records and segregated accounts are maintained in a way that ensures their accuracy, and in particular record the correspondence with the financial instruments and cash held for UCITS, 2010 Law Part II UCIs, the AIFs and for each compartment, where applicable.
- (3) Reconciliations are conducted on a regular basis between the depositary's internal accounts and records, and those of any third party to whom custody functions may be delegated
- (4) Due care is exercised in relation to the financial instruments held in custody in order to ensure a high standard of investor protection
- (5) All relevant custody risks throughout the custody chain are assessed and monitored and the management company, investment company, or AIFM is informed of any material risk identified
- (6) Adequate organizational arrangements are introduced to minimize the risk of loss or diminution of the financial instruments or of rights in connection with those financial instruments as a result of fraud, poor administration, inadequate registering, or negligence
- (7) The UCITS, 2010 Law Part II UCI, or AIF's ownership right or the ownership right of the management company, investment company, or AIFM acting on behalf of the AIF over the assets is verified

Where a UCITS, 2010 Law Part II UCI, or AIF provides its assets as collateral to a collateral taker, these assets must be kept in custody by the depositary as long as the UCITS, 2010 Law Part II UCI, or AIF retains property title of the financial instruments. In these circumstances, custody can be arranged in one of the following ways:

- ▶ The collateral taker is the depositary of the UCITS, 2010 Law Part II UCI, or AIF or is appointed by the UCITS, 2010 Law Part II UCI, or AIF's depositary as sub-custodian of the collateral
- ▶ The UCITS, 2010 Law Part II UCI, or AIF's depositary appoints a sub-custodian which acts for the account of the collateral taker
- ▶ The assets subject to collateral arrangements remain with the UCITS, 2010 Law Part II UCI, or AIF's depositary and are "earmarked" in favor of the collateral taker

¹⁹⁹ According to the AIFMD, UCITS V, CSSF Circulars 16/644 and 18/697 investments in UCIs (underlying funds) are considered to be held in custody if registered or held in an account directly or indirectly in the name of the depositary. Investments in UCIs may also be directly registered in the name of the UCITS, 2010 Law Part II UCI, or AIF with the issuer or registrar of the UCITS, 2010 Law Part II UCI, or AIF when the law applicable to the issuer does not prohibit such a registration.

For further information about collateral arrangements refer to the ABBL/ALFI *Guidelines on Financial instruments held in custody*, January 2020 version.

A.2. Custody considerations specific to AIF

The AIFMD foresees for AIF (full AIFM regime AIF) additional depositary requirements with respect to multi-layer holding structures. The depositary's safekeeping duties apply on a look-through basis to underlying assets held by financial or legal structures controlled directly or indirectly by the AIF. This requirement does not, however, apply to fund of funds structures or master-feeder structures where the underlying funds have a depositary that keeps in custody the assets of these funds.

Financial instruments owned by the AIF (or by the AIFM on behalf of the AIF) for which the AIF (or the AIFM on behalf of the AIF) has given its consent to reuse by the depositary remain in custody as long as the right of reuse has not been exercised.

A.3. Custody considerations specific to UCITS and 2010 Law Part II UCIs marketed to retail investors

UCITS V defines tighter rules compared to AIFMD concerning the reuse of assets. The assets held in custody by the depositary are allowed to be reused only where:

- (a) The reuse of the assets is executed for the account of the UCITS
- (b) The depositary is carrying out the instructions of the management company on behalf of the UCITS
- (c) The reuse is for the benefit of the UCITS and in the interest of the unitholders
- (d) The transaction is covered by high-quality and liquid collateral received by the UCITS under a title transfer arrangement

It is important to note that as stated under (d) the collateral is received under a title transfer arrangement, not a pledge arrangement.

CSSF Circular 16/644 contains additional requirements for UCITS and depositaries in relation to collateral handling. As such, depositaries must, in-line with the AIFMD rules, be in a position to determine whether collateral provided to or by a third party for the benefit of the UCITS is the property of the UCITS. The assessment by the depositary must take into consideration the legal nature and the legal and regulatory or contractual provisions applicable to the relevant transaction which is at the origin of the collateral. The assessment should, *inter alia*, allow the depositary to determine the nature of the collateral in order to determine the safekeeping obligations in relation to such assets (refer to Section 9.4.2.1.A.1.).

Regarding collateral, the depositary needs to further take into account the ESMA *Guidelines on ETF and other UCITS issues* as implemented in Luxembourg by CSSF Circular 14/592 where a UCITS enters into OTC transactions or when it engages in effective portfolio management techniques. The duties of the depositary include in this respect, *inter alia*, (see also CSSF Circular 08/356):

- ▶ To ensure that the collateral to be received by the UCITS in the context of securities lending transactions is effectively received prior to, or at the same time as, the transfer of the securities
- ▶ To verify that collateral received complies with the legal and regulatory provisions in force considering also the rules of CSSF Circular 14/592

Specific obligations in case of delegation of custody activities to third-party sub-custodians are described in Section 9.7.

B.1. Other assets - UCITS, 2010 Law Part II UCIs and AIF

For other assets, the depositary is required to verify the ownership of the UCITS, 2010 Law Part II UCI, or AIF of such assets and maintain a record of those assets for which it is satisfied that the UCITS, 2010 Law Part II UCI, or AIF holds the ownership of such assets.

The assessment of whether the UCITS, 2010 Law Part II UCI, or AIF holds the ownership must be based on information or documents provided by the management company, investment company or the AIFM and, where available, on external evidence.

In order to comply with its obligations in relation to safekeeping of other assets, the depositary must at least have access without undue delay to all relevant information required to perform its ownership verification and record-keeping duties, including relevant information to be provided to the depositary by third parties, and:

- ▶ Possess sufficient and reliable information for it to be satisfied of the UCITS, 2010 Law Part II UCI, or AIF's ownership right over the assets

- ▶ Maintain a record of those assets for which it is satisfied that the UCITS, 2010 Law Part II UCI, or AIF holds the ownership. In order to comply with this obligation, the depository must:
 - ▶ Register in its record, in the name of the UCITS, 2010 Law Part II UCI, or AIF, such other assets, including their respective notional amounts, for which it is satisfied that the UCITS, 2010 Law Part II UCI, or AIF holds the ownership
 - ▶ Be able to provide at any time a comprehensive and up-to-date inventory of the UCITS, 2010 Law Part II UCI, or AIF's assets, including their respective notional amounts

This implies that the depository has procedures in place so that registered assets cannot be assigned, transferred, exchanged, or delivered without the depository or its delegate having been informed of such transactions and the depository shall have access without undue delay to documentary evidence of each transaction and position from the relevant third party.

The management company, investment company, or AIFM is required to ensure that the relevant third party provides the depository without undue delay with certificates or other documentary evidence every time there is a purchase or sale of other assets, or a corporate action.
- ▶ Be in a position at any time to provide a complete overview of the UCITS, 2010 Law Part II UCI, or AIF related assets, including the others assets and cash
- ▶ Set up and implement an escalation procedure for situations where an anomaly is detected including notification of the management company, investment company, or AIFM and of the competent authorities if the situation cannot be clarified and, as the case may be, corrected

The CSSF's FAQ on AIFM clarifies that the depository can maintain its record based on its own systems or based on records of third parties provided that the depository performs ongoing due diligence on the third party and has access to all information required by the depository in order to comply with its obligations.

The concept of third party in this context also includes other divisions or services of the depository, provided that a functional and hierarchical separation of the performance of the depository functions is ensured.

CSSF Circular 16/644, provides additional clarifications for UCITS regarding the possibility by the depository to rely on other parties in order to comply with its record-keeping responsibilities. E.g., depositaries can rely on records of the fund accounting agent or statements from other third parties under the following conditions:

- ▶ Access to the accounting information of the UCITS is such to permit the depository to know at any moment the detailed assets which are reflected in the books of the UCITS
- ▶ Execution of a due diligence by the depository on the accounting agent or other third party which covers the accounting system and which allows the depository to conclude that accounting transactions are accurately and exhaustively recorded by the accounting agent or other third party, or alternatively, that the accounting system is subject to a ISAE 3402 or US Attestation Standard AT-C section 320

B.2. Other assets - considerations specific to AIF

Most key asset categories of private equity funds or real estate funds represent other assets. In general, these other assets may be held either directly or indirectly through legal structures which raises a number of questions as to the scope depositaries are expected to apply when executing their depository duties in relation to such structures including investments held through them.

The depository's safekeeping duties apply on a look-through basis to underlying assets held by financial and/or legal structures established by the AIF (or by the AIFM acting on behalf of the AIF) for the purpose of investing in the underlying assets and that are controlled directly or indirectly by the AIF (or by the AIFM acting on behalf of the AIF). This requirement does not apply to fund of funds structures and master-feeder structures where the underlying funds have a depository that provides ownership verification and record-keeping functions for the underlying fund's assets.

Given that the depository of an AIF neither physically holds custody of nor has direct access to the AIF's "other assets", it may experience certain challenges in applying a "look-through" principle when performing its ownership verification duties. In such instances, the depository is required to rely on the AIF or the AIFM acting on behalf of the AIF to ensure that the necessary information and documentation is provided to it.

The CSSF FAQ on AIFM clarifies that the definition of a controlled entity is a matter of professional judgment and will depend on the specific structure in question. The AIF or the AIFM should provide the depositary with all the required information to confirm whether the underlying entity is directly or indirectly controlled or not.

Further clarification on the definition and determination of control is provided in the ABBL/ALFI *Depositary Bank Guidelines on Look-Through and Control* published in March 2020.

The depositary is required to assess, on an independent basis and in the interest of the investors, and decide together with the AIF or the AIFM whether or not control exists. In case of disagreement, the depositary should use an appropriate escalation procedure to ensure that the right documentation and information is provided to it.

Exclusive control should be assumed and look-through applied in cases of:

▸ *de jure* control:

The AIF or the AIFM on behalf of the AIF holds:

- The majority of ownership or voting rights, either directly or through a shareholder agreement
- The right to appoint or remove the majority of the members of the management body of the underlying structure
- The contractual right to exercise dominant influence

▸ *de facto* control:

The AIF or the AIFM on behalf of the AIF holds less than 50% of the voting rights but there is no other shareholder in the structure with more voting rights and it can be demonstrated that the AIF or the AIFM on behalf of the AIF exercises a dominant influence, notably on the basis of the investment chart the AIF needs to provide as required by Circular 18/697.

In all other cases with less clear ownership and control scenarios such as for example, cases of joint control via joint agreement and/or co-ownership agreement, the depositary will need to determine whether or not to apply “look-through” in light of the risk-based approach it applies. When applying professional judgement, the depositary may take into consideration the type of underlying assets, how the AIFM conducts its duties, the parties involved in administering or managing the assets of the AIF including other matters such as the onboarding of such assets and the process of ownership monitoring.

The depositary needs to be granted an inspection right in relation to tangible assets even where such assets are held through a chain of controlled entities of an ownership structure.

The ABBL/ALFI *Depositary Bank Guidelines on Look-Through and Control* provide detailed recommendations for depositaries related to cash deposits, ownership verification procedures and application of the look through principle, monitoring procedures and information to be requested from AIFs. Also, the Guidelines include concrete examples of ownership scenarios.

CSSF Circular 18/697 provides in Part III, Section 5.3.3. additional requirements and guidance for depositaries when executing their safekeeping functions with respect to selected asset classes, such as:

- Real estate
- Target funds
- Investments in issuers or non-listed companies
- Intangible rights
- Financial derivative instruments
- Movable property

9.4.2.2. Other safekeeping duties

Specific Luxembourg requirements may apply in addition to the safekeeping requirements applicable to the depositaries of UCI.

If the Luxembourg depositary itself holds the securities of the UCI in custody, then it is required to respect the Luxembourg legal requirements on deposits, including those of the Luxembourg Civil Code (in particular Title XI) and the Law of 1 August 2001 concerning the circulation of securities and other fungible financial instruments, as amended. The Law of 1 August 2001 requires, *inter alia*, that fungible securities and other financial instruments received on deposit or held in an account be booked to an account with the depositary opened in the name of the depositor, separate from its own assets, and off-balance sheet.

In respect of financial collateral of UCITS, additional requirements apply on how collateral and assets acquired upon reinvestment of cash collateral must be safekept (refer to Section 4.2.2.10.(6) and (7)).

In addition, the depositary may also be required to comply with the Luxembourg Law of 5 August 2005 on financial collateral arrangements, which implements Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

CSSF Circulars 16/644 and 18/697 specify that the depositary must be in a position to produce a comprehensive inventory/statement of all the asset positions of a UCITS/AIF. This requirement must be specifically met for the end of each financial year of the UCITS/AIF in view of the audit of the annual accounts.

9.4.3. Day-to-day administration of the assets of the UCI

Day-to-day administration of the assets of the UCI may include, for example, the collection of dividends, interest, and proceeds of matured securities, the exercise of options, and, in general, any other operation concerning the day-to-day administration of the assets of the UCI.

9.4.4. Cash flow monitoring

CSSF Circulars 16/644 and 18/697, UCITS V and AIFMD, as well as the UCITS V and AIFMD delegated acts, are largely aligned with respect to cash flow monitoring.

The aligned cash flow monitoring rules implemented under UCITS V, CSSF Circular 16/644 as well as AIFMD and CSSF Circular 18/697 are as follows:

For UCITS, 2010 Law Part II UCIs and full AIFM regime AIFs, the depositary must ensure that cash flows are properly monitored and in particular ensure that all payments made by or on behalf of investors upon the subscription of units or shares of a UCITS, 2010 Law Part II UCI, or AIF have been received and that all cash has been booked in cash accounts opened in the name of the respective UCITS, 2010 Law Part II UCI, or AIF, or in the name of the management company, investment company, or AIFM acting on behalf of the UCITS, 2010 Law Part II UCI, or AIF, or in the name of the depositary acting on behalf of such UCITS, 2010 Law Part II UCI, or AIF.

The management company, investment company, or AIFM is required to ensure that the depositary is provided, upon commencement of its duties and on an ongoing basis, with all information it needs to comply with its cash flow monitoring obligations. In order to have access to all information regarding the UCITS, 2010 Law Part II UCI, and AIF's cash accounts and cash flows, the depositary must at least be:

- ▶ Informed, upon its appointment, of all existing cash accounts opened in the name of the UCITS, 2010 Law Part II UCI, or AIF
- ▶ Informed at the opening of any new cash account by the UCITS, 2010 Law Part II UCI, or AIF
- ▶ Provided with all information related to the cash accounts opened at the third party entity, directly by those third parties

The depositary is required to perform the following cash flow monitoring duties:

- ▶ Ensure that all cash of the UCITS, 2010 Law Part II UCI, or AIF is booked in accounts opened with a central bank, an authorized EU credit institution, or a bank authorized in a third country, or another entity of the same nature, in the relevant market where cash accounts are required, provided that such entity is subject to effective prudential regulation and supervision that has the same effect as European Union law and is effectively enforced. Where the cash accounts are opened in the name of the depositary acting on behalf of the UCITS, 2010 Law Part II UCI, or AIF, no cash of the entity at which the cash accounts are opened, and none of the depositary's own cash, can be booked on such accounts
- ▶ Implement effective and proper procedures to reconcile all cash flow movements and perform such reconciliations on a daily basis or, in case of infrequent cash movements, when such cash flow movements occur
- ▶ Implement appropriate procedures to identify at the close of each business day significant cash flows and in particular those that could be inconsistent with the UCITS, 2010 Law Part II UCI, or AIF's operations
- ▶ Review periodically the adequacy of those procedures, including a full review of the reconciliation process at least once a year, and ensure that the cash accounts opened in the name of the UCITS, 2010 Law Part II UCI, or AIF, in the name of the management company, investment company, or AIFM acting on behalf of the UCITS, 2010 Law Part II UCI, or AIF, or in the name of the depositary acting on behalf of the UCITS, 2010 Law Part II UCI, or AIF, are included in the reconciliation process

- ▶ Monitor on an on-going basis the outcomes of the reconciliations and actions taken as a result of any discrepancies identified by the reconciliation procedures and notify the management company, investment company, or AIFM if an irregularity has not been corrected without undue delay and also the competent authorities if the situation cannot be clarified and/or corrected
- ▶ Check the consistency of its own records of cash positions with those of the management company, investment company, or AIFM

With respect to subscriptions, the management company, investment company, or AIFM must ensure that the depositary is provided with information about payments made by or on behalf of investors upon the subscription of shares or units of a UCITS, 2010 Law Part II UCI, or AIF at the close of each business day when the management company, investment company, or AIFM, the UCITS, 2010 Law Part II UCI, or AIF or a party acting on behalf of it, such as a transfer agent, receives such payments or an order from the investor. The management company, investment company, or AIFM must ensure that the depositary receives all other relevant information it needs to ensure that the payments are then booked in cash accounts of the UCITS, 2010 Law Part II UCI, or AIF.

For AIF, the following additional clarifications are provided:

The CSSF's FAQ on AIFM clarifies that the depositary may rely on material tasks executed by a third party with respect to cash flow monitoring for the execution of its own obligations or may use information received with respect to cash flow reconciliations performed by a third party, provided that the depositary obtains all information it needs to comply with its own cash monitoring obligations and has performed adequate due diligence of the reconciliation processes performed by the third party. The concept of third party in this context also includes other divisions or services of the entity appointed as depositary of an AIF, provided that a functional and hierarchical separation of the performance of the depositary functions is ensured.

While the safekeeping duties related to financial instruments and other assets are subject to a look-through obligation with respect to ownership verification for assets held by an ownership structure that is directly or indirectly controlled by the AIFM, the CSSF's FAQ on AIFM clarifies that the Level 2 Regulation requires effective and proper monitoring of cash accounts to be executed solely at the level of the AIFs.

The depositary may want to expand the monitoring of cash flows related to investments/disinvestments at the level of the ownership structures (e.g., SPV) to identify relevant cash balances within the AIF, to monitor the ownership structure and the investment activity of the AIF (at the level of the ownership structure), which is not under the direct control of the depositary bank.

Further clarification on the cash flow monitoring provisions and guidance on controls is provided in the *ABBL/ALFI Guidelines and Recommendations for Depositaries - Oversight Duties and Cash Monitoring* for AIFs & UCITS.

9.4.5. Oversight duties

9.4.5.1. General requirements

The depositary is required to perform defined oversight duties. Among others, they aim to verify whether the UCI is managed in accordance with the provisions of its constitutional documents, its prospectus or issuing document.

In carrying out its oversight duties, the depositary is not required to re-perform the tasks itself, but rather to ensure that they are correctly executed.

General rules to be followed by the depositary have been defined under UCITS V and AIFMD and related delegated acts as described below.

These general oversight rules for UCITS, 2010 Law Part II UCIs and AIF are as follows:

- ▶ Risk assessment: the depositary must at the time of its appointment assess the risks associated with the nature, scale, and complexity of the UCITS, 2010 Law Part II UCI, or AIF's strategy and the management company, investment company, or AIFM's organization in order to devise oversight procedures that are appropriate to the UCITS, 2010 Law Part II UCI, or AIF and the assets in which it invests and that are then implemented and applied. Such procedures must be regularly updated. Depositaries should pay specific attention to certain types of UCIs, namely real estate, private equity, as well as infrastructure UCIs, known for the complexity of their set-up which often include several layers of SPVs and holding structures.

- ▶ Procedures review: the depository must perform *ex-post* controls and verifications of processes and procedures that are under the responsibility of the management company, investment company, or AIFM, the UCITS, 2010 Law Part II UCI, or AIF or an appointed third party. The depository must in all circumstances ensure that an appropriate verification and reconciliation procedure exists and that it is implemented and applied and frequently reviewed. The management company, investment company, or AIFM must ensure that all instructions related to the UCITS, 2010 Law Part II UCI, or AIF's assets and operations are sent to the depository, so that the depository is able to perform its own verification or reconciliation procedure
- ▶ Escalation procedure: the depository must establish a clear and comprehensive escalation procedure to deal with situations where potential irregularities are detected in the course of its oversight duties, the details of which should be made available, upon request, to the competent authorities of the management company, investment company, or AIFM
- ▶ Access to information: the management company, investment company, or AIFM must provide the depository, upon commencement of its duties and on an on-going basis, with all relevant information it needs to perform the oversight duties including information to be provided to the depository by third parties. The management company, investment company, or AIFM must, in particular, ensure that the depository can access the books and perform on-site visits on the premises of the management company, investment company, or AIFM and any service provider appointed by the UCITS, 2010 Law Part II UCI, and AIF or the management company, investment company, or AIFM, such as administrators or external valuers, and/or review reports and statements of recognized external certifications by qualified independent auditors or other experts to ensure the adequacy and relevance of the procedures in place.

Further clarification on the oversight duties and guidance on controls is provided in the *ABBL/ ALFI Guidelines and Recommendations for Depositories – Oversight Duties and Cash Monitoring for AIFs & UCITS*. The text provides a list of proposed oversight activities and controls in relation to subscriptions and redemptions, the valuation of shares/units, carrying out the UCI's instructions, the timely settlement of transactions, and the UCI's income distribution.

9.4.5.2. Subscriptions and redemptions

The oversight duties regarding subscriptions and redemptions apply to all UCITS, 2010 Law Part II UCIs and all full AIFM regime AIF.

The depository is required to ensure that the sale, issue, repurchase, and cancellation of shares or units of the UCITS, 2010 Law Part II UCI, or AIF are carried out in accordance with the law and the constitutional document.

More detailed requirements are:

- ▶ The depository must ensure that the UCITS, 2010 Law Part II UCI, or AIF, the management company, investment company, or AIFM or the designated entity has established, implemented, and applied an appropriate and consistent procedure to:
 - ▶ Reconcile the subscription orders with the subscription proceeds and the number of shares or units issued with the subscription proceeds received by the UCITS, 2010 Law Part II UCI, or AIF
 - ▶ Reconcile the redemption orders with the redemptions paid and the number of shares or units cancelled with the redemptions paid by the UCITS, 2010 Law Part II UCI, or AIF
 - ▶ Verify on a regular basis that the reconciliation procedure is appropriate
- ▶ In particular, the depository must regularly check the consistency between the total number of shares or units in the UCITS, 2010 Law Part II UCI, or AIF's accounts and the total number of outstanding shares or units that appear in the UCITS, 2010 Law Part II UCI, or AIF's register
- ▶ A depository must ensure and regularly check that the procedures regarding the sale, issue, repurchase, redemption, and cancellation of shares or units of the UCITS, 2010 Law Part II UCI, or AIF comply with the applicable national law and with the UCITS, 2010 Law Part II UCI, or AIF rules or instruments of incorporation and verify that these procedures are effectively implemented
- ▶ The frequency of the depository's checks must be consistent with the frequency of subscriptions and redemptions

Subscriptions and redemptions are covered in Section 8.7.

9.4.5.3. Valuation of shares or units

The oversight duties regarding the valuation of shares or units apply to all UCITS, 2010 Law Part II UCIs, and all full AIFM regime AIF.

The depositary is required to ensure that the value of the shares or units is calculated in accordance with the law and the constitutional document.

More specifically, the depositary must:

- Verify on an on-going basis that appropriate and consistent procedures are established and applied for the valuation of the assets of the UCITS, 2010 Law Part II UCI, or AIF in compliance with the relevant UCI law, the AIFM Law, UCITS V Directive or AIFM Directive and related implementing measures and with the UCITS, 2010 Law Part II UCI, or AIF constitutional document
- Ensure that the valuation policies and procedures are effectively implemented, for example, by the performance of sample checks or by comparing the consistency of the change in the NAV calculation over time with that of a benchmark
- Ensure that the valuation policies and procedures are periodically reviewed
- The depositary's procedures must be conducted at a frequency that is consistent with the UCITS, 2010 Law Part II UCI, or AIF's valuation policy as defined in the UCI Law or AIFM Law or UCITS V Directive or AIFM Directive and related implementing measures
- Where a depositary considers that the calculation of the value of the shares or units of the UCITS, 2010 Law Part II UCI, or AIF has not been performed in compliance with applicable law or the UCITS, 2010 Law Part II UCI, or AIF rules or with the relevant UCI law and AIFM Law valuation requirements, it must notify the management company, investment company, or AIFM and/or the UCITS, 2010 Law Part II UCI, or AIF and ensure that timely remedial action is taken in the best interest of the investors in the UCITS, 2010 Law Part II UCI, or AIF
- Where an external valuer has been appointed, the depositary must check that the external valuer's appointment is in accordance with the AIFM Law or AIFM Directive and its implementing measures

Valuation requirements are covered in Chapter 7.

9.4.5.4. Carrying out of the manager's instructions

The oversight duties regarding the carrying out of the manager's instructions apply to all UCITS, 2010 Law Part II UCIs and all full AIFM regime AIFs.

The depositary is required to carry out the instructions of the management company, investment company, or AIFM, unless they conflict with the constitutional document.

More detailed requirements of the depositary include the obligation to implement:

- Appropriate procedures to verify that the UCITS, 2010 Law Part II UCI, or AIF and management company, investment company, or AIFM comply with applicable laws and regulations and with the UCITS, 2010 Law Part II UCI, or AIF's constitutional document. In particular, the depositary must monitor the UCITS, UCI or AIF's compliance with investment restrictions and leverage limits laid down in the UCITS, 2010 Law Part II UCI, or AIF's offering documents. Those procedures should be proportionate to the nature, scale, and complexity of the UCITS, 2010 Law Part II UCI, or AIF
- An escalation procedure for situations where the UCITS, 2010 Law Part II UCI, or AIF has breached one of the aforementioned limits or restrictions

9.4.5.5. Timely settlement of transactions

The oversight duties regarding the timely settlement of transactions apply to all UCITS, 2010 Law Part II UCIs, and all full AIFM regime AIFs.

More detailed requirements include the following:

- The depositary must set up a procedure to detect any situation where a consideration related to the operations involving the assets of the UCITS, 2010 Law Part II UCI, or AIF is not remitted to the UCITS, 2010 Law Part II UCI, or AIF within the usual time limits, notify the management company, investment company, or AIFM, and, when the situation has not been remedied, request the restitution of the financial instruments from the counterparty, when possible
- Where transactions do not take place on a regulated market, the usual time limits must be assessed with regard to the conditions attached to the transactions (OTC derivative contracts or investments in real estate assets or in privately held companies for AIF)

The Delegated Regulation 2018/1229 (RTS on settlement discipline) was expected to come into force as from 1 February 2021. On 28 July 2020, the European Securities and Markets Authority announced the preparation of a new RTS, subject to the non-objection of the European Parliament and of the Council, to further postpone CSDR settlement discipline until 1 February 2022.

The CSDR settlement discipline regime will apply primarily to investment firms and will impact all parties in the settlement chain involved in transactions in European securities, affecting both the receiving and delivering parties in a failing transaction.

Measures to prevent settlement fails include:

- Flows of contractual written allocations and confirmations between the investment firm and its client
- Functionalities and tools to assist matching and settlement

Measures to address settlement fails include:

- Cash penalties for late matching and failed settlement
- Mandatory buy-in and cash compensation; in the event of a settlement fail, a buyer of securities has the right to source the securities from another counterparty, cancel the original transaction and settle between the two original counterparties any additional costs incurred by the new transaction

9.4.5.6. Distribution of the UCI's income

The oversight duties regarding the distribution of income apply to all UCITS, 2010 Law Part II UCIs and all full AIFM regime AIFs.

More detailed requirements for depositaries include the following:

- Ensure that the net income calculation, once declared by the management company, investment company, or AIFM, is applied in accordance with the UCITS, 2010 Law Part II UCI, or AIF constitutional document and applicable national law
- Ensure that appropriate measures are taken where the UCITS, 2010 Law Part II UCI, or AIF's auditors have expressed reservations on the annual financial statements. The UCITS, 2010 Law Part II UCI, or AIF must provide the depositary with all information on the reservations expressed on the financial statements
- Check the completeness and accuracy of dividend payments, once they are declared by the management company, investment company, or AIFM, and, where relevant, of the carried interest for AIF

Where a depositary of a UCITS, 2010 Law Part II UCI, or AIF considers that the income calculation has not been performed in compliance with applicable law or with the UCITS, 2010 Law Part II UCI, or AIF rules or instruments of incorporation, it must notify the management company, investment company, or AIFM and/or the UCITS, 2010 Law Part II UCI, or AIF and ensure that timely remedial action has been taken in the best interest of the UCITS, UCI's or AIF's investors.

9.4.6. Other specific duties in relation to UCITS

9.4.6.1. Luxembourg UCITS managed cross-border

In the case of Luxembourg UCITS that are managed by a management company in another EU Member State (i.e., the management company passport regime - refer to Section 6.3.4.), the depositary and management company must sign a written agreement regulating the flow of information deemed necessary to allow it to perform its depositary functions (refer to Section 6.3.5.1.).

9.4.6.2. Master-feeder UCITS

In the case of master-feeder UCITS (refer to Section 2.3.4.1.), if the master and feeder UCITS have different depositaries, those depositaries must enter into an information-sharing agreement in order to ensure the fulfillment of the duties of both depositaries. The agreement must cover, *inter alia*:

- The documents and information that are to be routinely shared between both depositaries
- The manner and timing of the transmission of information by the depositary of the master UCITS to the depositary of the feeder UCITS

- ▶ The coordination of the involvement of both depositaries, to the extent appropriate in view of their respective duties under national law, in relation to operational matters, including:
 - ▶ The procedure for calculating the NAV of each UCITS, including any measures appropriate to protect against the activities of market timing
 - ▶ The processing of the feeder UCITS' subscription and redemption orders for shares or units in the master UCITS and the settlement of such transactions, including any arrangement to transfer assets in kind
- ▶ The coordination of accounting year-end procedures
- ▶ Information to be provided by the depositary of the master UCITS to the depositary of the feeder UCITS on breaches by the master UCITS of the law and the constitutional document
- ▶ The procedure for handling ad hoc requests for assistance from one depositary to the other
- ▶ Identification of particular contingent events in relation to which the depositaries need to notify to each other on an ad hoc basis and the manner and timing of notification

The depositary of the master UCITS is required to immediately inform the competent authorities of the master UCITS home Member State, the feeder UCITS, or, where applicable, the management company and the depositary of the feeder UCITS about any irregularities that it detects with regard to the master UCITS and that are deemed to have a negative impact on the feeder UCITS. Such irregularities include:

- ▶ Errors in the NAV calculation of the master UCITS
- ▶ Errors in transactions or settlement of feeder UCITS' subscription or redemption orders for shares or units in the master UCITS
- ▶ Errors in the payment or capitalization of income arising from the master UCITS or in the calculation of any related withholding tax
- ▶ Breaches of the investment objectives, policy, or strategy of the master UCITS, as described in its constitutional document, prospectus, or Key Investor Information (KII)
- ▶ Breaches of investment and borrowing limits set out in national law or in the management regulations, instruments of incorporation, prospectus, or KII

9.4.6.3. Mergers of UCITS

Where two UCITS merge (see Section 3.7.), the depositaries of the merging and receiving UCITS that are established in Luxembourg are required to verify compliance of certain particulars of the common draft terms of the merger with the requirements of the 2010 Law and the constitutional document of their respective UCITS and to issue a statement to the CSSF confirming that they have performed the verification. The particulars to be verified include the rules applicable to the transfer of assets and the exchange of shares or units.

9.5. Conduct of business and conflicts of interest rules

9.5.1. Conduct of business and conflicts of interest

The depositary is expected to act honestly, fairly, professionally, and independently, solely in the interest of the UCI and its investors.

The Directors of the depositary should be of good repute and sufficiently experienced in relation to the UCI.

The depositary of UCITS, 2010 Law Part II UCIs, and full AIFM regime AIFs is not permitted to carry out activities for the UCITS, 2010 Law Part II UCI, or AIF that may create conflicts of interest between the UCITS, 2010 Law Part II UCI, or AIF, the investors in the AIF, the management company, investment company, or AIFM, and the depositary, unless the depositary has functionally and hierarchically separated the performance of its depositary tasks from its other potentially conflicting tasks and the potential conflicts of interest are properly identified, managed, monitored, and disclosed to the investors of the UCITS, 2010 Law Part II UCI and AIF.

The relationship between the depositary and prime broker is covered in Section 9.8.

The assets of the AIF cannot be reused by the depositary without the prior consent of the AIF (or the AIFM acting on behalf of the AIF) (see also Sections 10.3.4. and 10.4.2.3.). The constraints concerning the reuse of assets as defined under UCITS V go even further as described in Section 9.4.2.1.A3.

Additional governance rules for UCITS, 2010 Law Part II UCIs and AIFs include:

- ▶ No delegation of the principal function of investment management can be made to the depository or to any entity in the custody chain. The delegation to an entity linked to the depository by common control is not prohibited
- ▶ Neither the depository nor an entity in the custody chain can be entrusted with the risk management function. However, certain operational tasks linked to the risk management function can be delegated to a depository or any entity within the custody chain
- ▶ The depository may hold a direct or indirect shareholding in the management company appointing it, under certain conditions
- ▶ No person employed by the depository can act as a Director of a UCITS, 2010 Law Part II UCI and AIF appointing it

UCITS V has defined rules concerning independence requirements between the management company or investment company and the depository.

Common management or supervision: The UCITS V delegated acts require that the board of directors of the management company (one-tier governance) should not comprise any member of the board of directors or any employee of the depository and vice versa. Where the management company has a supervisory body complementary to the board of directors (two-tier governance), only one third of the members of the supervisory body of the management company may be at the same time members of the supervisory body, member of the management body or an employee of the depository and vice versa.

Existence of link or group link: In case a link or group-link exists between the management company or the investment company and the depository of a UCITS, the concerned entities need to ensure that they have conflict of interest policies and procedures in place which:

- ▶ Identify all conflicts of interest from that link, and
- ▶ Take all reasonable steps to avoid those conflicts of interest

Existence of group link: In case a group-link exists between the management company or the investment company and the depository of a UCITS, the concerned entities need to comply with the following requirements:

- ▶ One-tier governance entities should make sure that one third of the members of the board of directors or two persons (whichever is lower) are independent
- ▶ Two-tier governance entities should make sure that one third of the members of the supervisory body or two persons (whichever is lower) are independent

Members of the above mentioned bodies are deemed independent as long as:

- ▶ They are neither members of the management body or the body in charge of the supervisory functions nor employees of any of the other undertakings between which a group link exists
- ▶ They are free of any business, family, or other relationship with the management company or the investment company, the depository and any other undertaking within the group that gives rise to a conflict of interest such as to impair their judgment

In the context of independence requirements, UCITS V further imposes specific requirements concerning the appointment of the depository.

In general, all management or investment companies should select and appoint the depository following a documented decision-making process based on objective and pre-defined criteria.

In case the management company or the investment company and the appointed depository are linked entities (including a group link), an assessment comparing the merits of appointing a linked depository with the merits of appointing an unrelated depository is to be performed. This assessment must at a minimum cover the costs, expertise, financial standing and the quality of services provided by all depositories assessed. A report on this assessment including a description of the extent to which the appointment meets the pre-defined criteria and the extent to which it is made in the sole interest of the UCITS and its investors must be prepared.

The management company or the investment company must demonstrate to the competent authority of the UCITS home Member State that it is satisfied with the appointment of the depository and that the appointment is in the sole interest of the UCITS and its investors. The management company or the investment company must make the report and documentary evidence referred to above available to the competent authority of the UCITS home Member State.

The management company or the investment company must justify to investors of the UCITS, upon request, the choice of the depository.

9.5.2. Organization (internal procedures)

The UCITS V delegated acts, CSSF Circular 16/644 as well as the AIFMD and CSSF Circular 18/697 provide specific requirements concerning internal procedures of the depositary and written procedures or contracts with external parties.

Internal written procedures must be established for accepting new depositary mandates and executing the depositary function and must describe the type of UCI (legal nature and investment strategies) that the depositary may serve. The procedures must foresee controls during the acceptance process which ensure that legal and operational risks are appropriately assessed.

The internal procedures need to clearly define the persons in-charge of the depositary function. The depositary further needs to describe the human and technical resources put in place for the performance of the duties and to describe in detail how the depositary function is exercised for the different types of investment funds with due consideration of the respective investment policies and take into account operational specificities of certain families of funds. Also, the procedures are required to address the due diligence criteria applied by the depositary.

In addition to the internal procedures, the depositary must also establish written procedures with the external persons who have not been appointed by the depositary itself, such as, for example, the administration agent or transfer agent of a UCITS, or contracts with the external persons who have been appointed by the depositary itself, such as, for example, a delegate of the depositary. The objective of the written procedures that may be completed by operating memoranda or service level agreements is to document the operational procedures between the depositary and the third parties.

The depositary acting on behalf of a UCITS, is not permitted to grant loans or act as a guarantor for third parties. A depositary acting on behalf of a UCITS common fund cannot carry out uncovered sales of transferable securities, money market instruments, or other financial instruments.

The depositary of a 2010 Law Part II common fund is not permitted to grant loans to purchasers and unitholders of the common fund with a view to the acquisition or subscription of units.

9.6. Liability

The liability regime applicable to the depositary of UCITS, 2010 Law Part II UCIs, and full AIFM regime AIFs has been largely aligned with the implementation of UCITS V.

The sole, yet significant, difference in the depositary's liability between AIFMD and UCITS V concerns the case of delegation (see Section 9.7.3.). UCITS V foresees, under no circumstances, a discharge of liability. It further requires that the liability of the depositary shall not be excluded or limited by agreement.

CSSF Circular 16/644 does not address the liability of the depositary.

9.6.1. UCITS, 2010 Law Part II UCIs and full AIFM regime AIF

9.6.1.1. Loss of financial instruments held in custody

As a general rule, the depositary is liable to a UCITS, 2010 Law Part II UCI, or AIF or its investors for the loss of financial instruments held in custody by the depositary itself or by a third party to whom custody had been delegated (the sub-custodian²⁰⁰). In case of such loss, the depositary is required to return to the UCITS, 2010 Law Part II UCI, or AIF (or the management company, investment company, or AIFM acting on behalf of the UCITS, 2010 Law Part II UCI, or AIF) a financial instrument of identical type or the corresponding amount, without undue delay.

A loss of a financial instrument held in custody is deemed to have taken place when, in relation to a financial instrument held in custody by the depositary or by a third party to whom the custody of financial instruments held in custody has been delegated, any of the following conditions is met:

- ▶ A stated right of ownership of the UCITS, 2010 Law Part II UCI, or AIF is demonstrated not to be valid because it either ceased to exist or never existed
- ▶ The UCITS, 2010 Law Part II UCI, or AIF has been definitively deprived of its right of ownership over the financial instrument
- ▶ The UCITS, 2010 Law Part II UCI, or AIF is definitively unable to directly or indirectly sell the financial instrument

²⁰⁰ Liability in the case of delegation is covered in Section 9.7.4.

The ascertainment by the management company, investment company, or AIFM of the loss of a financial instrument must follow a documented process readily available to the competent authorities. Once a loss is ascertained, it must be notified immediately to investors in a durable medium.

A financial instrument held in custody is not deemed to be lost where a UCITS, 2010 Law Part II UCI, or AIF is definitively deprived of its right of ownership in respect of a particular instrument, but this instrument is substituted by or converted into another financial instrument or instruments.

In the event of insolvency of the third party to whom the custody of financial instruments held in custody has been delegated, the loss of a financial instrument held in custody must be established by the management company, investment company, or AIFM as soon as one of the abovementioned conditions are met with certainty. There is certainty as to whether any of the conditions is fulfilled at the latest at the end of the insolvency proceedings. The management company, investment company, or AIFM and the depositary must monitor closely the insolvency proceedings to determine whether all or some of the financial instruments entrusted to the third party to whom the custody of financial instruments held in custody has been delegated are effectively lost.

However, the depositary is not liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

The notion of “external event beyond reasonable control” covers all events that are not related to the depositary and its sub-custodians.

Therefore, events that occur within the “chain of custody” would not be deemed “external”, irrespective of whether these events happened at the level of an affiliated sub-custodian or at the level of a sub-custodian that does not belong to the same corporate group as the depositary.

Any natural disasters, acts of state, or government measures (e.g., market closures) would be classified as being “external events beyond reasonable control”.

Liability in the case of delegation is covered in Section 9.7.4.

9.6.1.2. Other losses

The depositary is also liable to the UCITS, 2010 Law Part II UCI, or AIF or its investors for all other losses suffered by them as a result of negligent or intentional failure to properly perform its depositary duties (e.g., oversight duties, cash flow monitoring).

9.6.2. Simplified AIFM registration regime AIF

The depositary is liable in accordance with Luxembourg law to the management company and the share/unitholders for any losses suffered by them as a result of its wrongful failure to perform its obligations or its wrongful improper performance thereof (also in case of delegation of safekeeping tasks).

The liability to share/unitholders is invoked indirectly through the management company. Should the management company fail to act despite a written notice to that effect from a share/unitholder within a period of three months following receipt of such a notice, such share/unitholder may directly invoke the liability of the depositary.

Those who have suffered damages should prove the depositary’s negligence in respect of its duty of supervision and the link between cause and effect.

On the extent of the duty of supervision of the depositary, the depositary may be considered to have performed its duty of supervision when it is satisfied from the outset and during the entire duration of the contract that the third parties with whom the assets of the simplified AIFM registration regime AIF are held in deposit are reputable and competent and have sufficient financial resources.

9.7. Delegation

The UCI depositary is in principle authorized to delegate to a third party certain functions or certain tasks related to its different functions in accordance with the defined rules. As to the core function of the depositary as a general rule, the depositary is permitted to delegate the safekeeping of financial instruments to be held in custody to a third party, however, cannot delegate its general safekeeping duty, oversight duties or cash flow monitoring obligations.

A depositary can appoint and entrust a third party to effectively execute certain safekeeping functions after performing a due diligence on such third party covering, *inter alia*, the good repute, effective prudential regulation and supervision, as well as expertise and effective segregation of assets.

UCITS V and CSSF Circular 16/644 as well as the AIFMD and CSSF Circular 18/697 define procedures and criteria that need to be followed upon appointment of a third party (initial due diligence) and that need to be re-performed on a regular basis, at least annually (ongoing due diligence). The rules summarized below regarding UCITS according to the Circulars, UCITS V, and AIFMD are largely aligned with respect to delegation of safekeeping tasks and due diligence activities to be performed. The existing differences as well as the general delegation principles defined by the Circular with respect to UCITS, e.g., concerning IT outsourcing or intra-group delegation, are highlighted below.

A key matter for consideration in the context of the safekeeping delegation rules relates to asset segregation which further addressed in Section 9.7.3.

9.7.1. General delegation requirements for UCITS, 2010 Law Part II UCIs and AIFs

The depositary is permitted to delegate safekeeping duties to a third party, but not its oversight and cash flow monitoring duties.

The depositary may delegate safekeeping duties to a third party if it can demonstrate that:

- The tasks are delegated for a demonstrable, objective reason and not with the intention of avoiding the AIFMD and UCITS V requirements
- It has exercised all due skill, care, and diligence in the selection, appointment, periodic review, and ongoing monitoring of:
 - The third party to whom it has delegated its tasks
 - The arrangements of the third party in respect of the matters delegated

The depositary is required to implement and apply an appropriate, documented due diligence procedure for the selection and ongoing monitoring of the delegate. The due diligence must be reviewed regularly, at least once a year, and made available upon request to competent authorities.

When selecting and appointing a third party to whom safekeeping functions are delegated, the depositary must exercise all due skill, care, and diligence to ensure that entrusting financial instruments to this third party provides an adequate standard of protection, including at least:

- Assessing the regulatory and legal framework, including country risk, custody risk, and the enforceability of the third party's contracts. The assessment must enable the depositary to determine the potential implication of insolvency of the third party, on the assets and rights of the UCITS, 2010 Law Part II UCI, and AIF. If a depositary becomes aware that the segregation of assets is not sufficient to ensure protection from insolvency because of the law of the country where the third party is located, it must immediately inform the management company, investment company, or AIFM (see also Section 9.7.3.)
- Assessing whether the third party's practice, procedures, and internal controls are adequate to ensure that the financial instruments of the UCITS, 2010 Law Part II UCI, and AIF are subject to a high standard of care and protection
- Assessing whether the third party's financial strength and reputation are consistent with the tasks delegated. That assessment must be based on information provided by the third party as well as other available information
- Ensuring that the third party has the operational and technological capabilities to perform the delegated custody tasks with a satisfactory degree of protection and security

The depositary must exercise all due skill, care, and diligence in the periodic review and ongoing monitoring to ensure that the third party continues to comply with the aforementioned criteria. To this end the depositary must at least:

- Monitor the third party's performance and its compliance with the depositary's standards

- Ensure that the third party exercises a high standard of care, prudence, and diligence in the performance of its custody tasks and in particular that it effectively segregates the financial instruments in line with the requirements (see Section 9.7.3.)
- Review the custody risks associated with the decision to entrust the assets to the third party and without undue delay notify the management company, investment company, or AIFM of any change in those risks. That assessment must be based on information provided by the third party and other available information. During market turmoil or when a risk has been identified, the frequency and the scope of the review must be increased. If the depository becomes aware that the segregation of assets is no longer sufficient to ensure protection from insolvency because of the law of the country where the third party is located, it must immediately inform the management company, investment company, or AIFM.

The depository is required to ensure that, at all times during the performance of the tasks delegated to it, the third party:

- (1) Has the structure and expertise that are adequate and proportionate to the nature and complexity of the assets that have been entrusted to it
- (2) As far as the delegation of safekeeping of financial instruments is concerned, is subject to effective prudential regulation, including minimum capital requirements, and supervision in the jurisdiction concerned and to periodic external audit to ensure that the financial instruments are in its possession
- (3) Segregates the assets of the depository's clients from its own assets and from the assets of the depository so that they can at any time be clearly identified as belonging to clients of the depository (see Section 9.7.3.)
- (4) Does not make use of the assets without prior consent of the AIF (or the AIFM acting on behalf of the AIF) and prior notification of the depository
- (5) Complies with the same general custody obligations and prohibitions applicable to the depository

In case of delegation of safekeeping of financial instruments held in custody, the depository remains subject to requirements on records and segregated accounts, reconciliations, due care, and custody risks (see Points (2) to (5) of Section 9.4.2.1.A1.).

In addition, the depository is required to ensure that the third party delegate complies with these requirements and, in addition, those on adequate organizational arrangements and right of ownership (see Points (2) to (7) of Section 9.4.2.1.A1.).

The depository is required to monitor compliance with the management company, investment company and AIFM requirements in relation to conflicts of interest, as applicable.

The depository is required to devise contingency plans for each market it appoints a third party to perform safekeeping duties. Such a contingency plan must include the identification of an alternative provider, if any.

The depository is required to take measures, including termination of the contract, that are in the best interest of the UCI and its investors where the delegate no longer complies with the requirements.

A third party delegate may in turn sub-delegate these tasks, provided that the same conditions are met.

Management companies, investment companies and AIFM are required to make available to investors, before they invest in the UCI, information on any safekeeping function delegated by the depository, the identification of the delegate, and any conflicts of interest that may arise from such delegation, as well as any material changes thereto (refer to Section 10.3.4.).

An area of intense debate has been the question of the extent to which CSDs are subject to the AIFMD and UCITS V delegation requirements. On 20 July 2017 ESMA published an opinion to the EU Parliament, the Council and Commission (the EU institutions) proposing clarifications of the legislative provisions under the AIFMD and UCITS Directive regarding, *inter alia*, the application of depository delegation rules to CSDs.

ESMA undertook a detailed review of both directives including feedback from the industry and taking into account the CSDR regulatory framework. Based on its review, ESMA recommends certain changes to the AIFMD and UCITS frameworks by introducing a distinction between issuer CSDs (CSD providing the core service of "initial recording of securities in a book-entry system ('notary service')" or central maintenance services) and investor CSDs (CSD that either is a participant in the securities settlement system operated by another CSD or that uses a third party or an intermediary that is a participant in the securities settlement system operated by another CSD in relation to a securities issue).

ESMA suggests that issuer CSDs would not be subject to any depositary delegation rules of the AIFMD and UCITS V because the use of such issuer CSDs is mandatory for the holding of securities in certain jurisdictions. Alternatively, investor CSDs, would be subject to the delegation provisions. In presenting its recommendations, ESMA makes reference to the detailed CSDR regulatory framework applicable to CSDs which meets some of the delegation requirements. For that purpose, ESMA has elaborated an overview which compares the AIFMD/UCITS and CSDR frameworks on asset segregation and depositary delegation requirements and highlights where the CSDR framework and the AIFMD/UCITS provisions present similarities (Annex IV to the ESMA Opinion).

While there are differences in the recitals of UCITS V that diverge from AIFMD (e.g., the AIFMD states that entrusting the custody of assets to the operator of a securities settlement system as designated for the purposes of Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 should not be considered to be a delegation of custody functions, while UCITS V provides that this should be considered a delegation of custody function, unless the CSD operates a securities settlement system and provides initial recording in a book-entry system through initial crediting or is maintaining securities accounts at the top tier level for the securities concerned) it is expected that a coherent view will be applied to both, in line with ESMA's proposals.

There are also divergent interpretations as to the CSD's liability where it is part of the custody chain of a depositary and the application of the AIFMD rules to CSDs. In a public staff working document published on 10 June 2020, the EU Commission highlights that the strict liability regime of depositaries regarding custodial assets justifies that depositaries should be in a position to fulfil their duties and able to undertake due diligence on the CSD, if they are part of the custody chain. Further clarification may be proposed by the EU Commission in the context of the ongoing AIFMD review.

CSSF Circular 16/644 and 18/697 provide additional general rules for UCITS, Part II funds and AIFs with respect to the outsourcing of functions, which include, *inter alia*, the following:

- It is the responsibility of UCITS depositaries to ensure that appropriate risk management policies and procedures are in place addressing the identification and management of risks linked to the delegation and outsourcing of functions
- Every delegation and outsourcing relationship by the depositary must be recorded in contractual documentation between the depositary and the delegate or outsourcing agent
- With respect to the delegation of safekeeping functions, the Circulars make reference to the respective articles of the Law of 2010 and the UCITS V Delegated Regulation defining the applicable rules of such delegations. The Circulars make reference to the requirement that all delegates of a depositary are required to be included in a list which is to be submitted to the CSSF on an annual basis
- Each outsourcing with external parties is subject to the requirements outlined in CSSF Circular 12/552, as amended and in CSSF Circular 16/654, as amended.
- Also, each outsourcing of an essential or important function of a depositary is subject to prior approval by the CSSF. A notification explaining the outsourcing rationale with specific reference to the 2010 Law, the UCITS V Delegated Regulation and CSSF Circular 12/552 as amended may be sufficient, where the outsourcing is contracted either with a Luxembourg credit institution or with specific PSFs

The CSSF's FAQ on UCIs clarifies that in case of data transfer to another service provider, depositaries of UCIs must obtain consent from the Board of Directors of an investment company or management company of a common fund for the services outsourced, the type of information transmitted and the country of establishment of the entities providing the outsourced services.

Boards of Directors should inform and obtain consent from investors to the transfer of their personal and confidential data through:

- (1) a letter with a possibility to object,
- (2) immediate change of the subscription form to seek consent from future investors and,
- (3) a modification of the prospectus.

Before outsourcing the services in scope, a depositary should obtain the commitment of the Board of Directors of the SICAV, or the IFM for common funds that investors have been informed and consented to the transfer of their personal and confidential data.

9.7.2. Delegation considerations specific to AIFs

A. Considerations for assets to be held in custody

The CDR 2018/1618 amending AIFM CDR 231/2013 and CDR 2018/1619 amending UCITS CDR 438/2016 (the “CDRs”) were both published on 30 October 2018 and have introduced a number of important changes to selected delegation requirements involving the delegation of safekeeping of assets to be held in custody. The introduced changes are equally applicable for UCITS and AIFM and are applicable from 1 April 2020 onwards.

The main amendments introduced by the CDRs can be summarized as follows:

- ▶ Reconciliations: Prior to implementation of the CDRs, reconciliations between the depositary and the third party delegates had to be done “on a regular basis”. The CDRs now require reconciliations to be performed “as frequently as necessary”. The CDRs provides further guidance on which factors to consider by depositaries in determining the frequency of the reconciliations.
- ▶ Maintaining books and records: An important amendment is the requirement for depositaries to maintain a record in financial instruments accounts opened in the name of an AIF/UCITS or in the name of the AIFM/management company acting on behalf of the AIF/UCITS showing that the assets kept in custody by a third party belong to a particular AIF/UCITS client. The requirements imply that such accounts reflect the underlying activity in such accounts leading to the balances of assets to be held in custody belonging to the respective AIF/UCITS.
- ▶ Identification of all third party delegates in the custody chain: The depositary must identify all entities which constitute the custody chain and secure access to all relevant information with third parties to verify the quantity of the identified financial instruments kept in custody by the third party. The binding arrangement between the depositary and any third party to whom custody functions are delegated (including prime brokers or collateral agents), should reflect that the financial instruments owned by the AIF/UCITS are held in custody by the third party under a delegation arrangement with the depositary bank.
- ▶ Maintaining omnibus accounts at the level of the delegated third party: A custodian can hold assets of UCITS, AIFs and other clients of the same depositary in one omnibus account, provided that the segregation requirements with respect to its own assets, the own assets of the depositary and the assets of the other clients of the third party are kept in segregated financial instruments accounts.
- ▶ Supervision over the custody chain: The CDRs introduce amendments for depositaries delegating the custody of assets to third party delegates located outside the EU. In such instances, depositaries are required to obtain independent legal advice on the legal framework of the third country insolvency rules. The new requirements for AIFs shift the obligation to the depositary against its delegate, whereas for UCITS the obligation remains with the delegate against its depositary. In addition, the depositary has to upgrade its supervision and due diligence to comply with the enhanced provisions of the CDRs.

A key aspect resulting from the AIFM CDR 2018/1618 and UCITS CDR 2018/1619 relates to the maintenance of records and accounts for custodial assets, where the safekeeping is delegated to third party delegates. The wording of the EU Delegated Regulations 213/2013 for AIFMs and 438/2016 for UCITS was such to leave room for interpretation among practitioners whether such records had to be compiled on the basis of individual transactions or whether they could be “registered” in the books of the depositary on the basis of end-of-day statements provided by the third party delegate. Where a depositary has delegated its custody functions to a third party, both EU Delegated Regulations now clearly refer to the requirement to ensure that the financial instruments are properly registered in accordance with Article 21(8)(a)(ii) of Directive 2011/61/EU, and accordingly, are registered in financial instruments accounts in the depositary’s books and in the name of the AIF or the AIFM acting on behalf of the AIF, “so that they can be clearly identified as belonging to the AIF in accordance with the applicable law at all times”. Therefore, where safekeeping is delegated to third parties, depositaries must ensure that the movements of assets held in custody by a third party delegate are reflected in the depositary’s books and records, and that the depositary’s books and records are distinct from those of the third party delegate, or put otherwise: the delegation of safekeeping to a third party delegate does not dispense depositaries from registering such financial instruments in its own books.

The above represents a significant challenge where AIFs/UCITS involve either prime brokers or collateral agents acting as sub-custodians of AIF/UCITS assets. For these specific circumstances, the ABBL/ALFI Depositary Bank Forum has developed an alternative approach for a depositary to construct the books and records from the end-of-day settled positions information as sourced from the third party delegate itself or another source deemed appropriate, subject to certain conditions. Reference is made to the *ABBL/ALFI Guideline on the implementation of New AIFM/UCITS CDRs on delegated safekeeping* issued in September 2019.

B. Consideration for delegation of safekeeping of other assets for AIFs

The delegation of the custody functions related to assets which are not held in custody is possible, provided that the depositary has executed an appropriate and documented due diligence procedure in relation to the delegate. The purpose of the due diligence is to ensure that the process of ownership verification, the registration of other assets, for which the ownership has been verified, and record-keeping obligations are met by the delegate.

In order to achieve an appropriate level of certainty that an AIF is the owner of an asset not held in custody, the depositary must receive all necessary information for that purpose. The nature of such information is dependent upon the nature of the underlying assets and the approach applied to any such investments. Irrespective of the AIF's investment strategy, the depositary remains responsible to ensure that compliance with the provisions in relation to ownership verifications and record keeping are met.

9.7.3. General segregation obligation for - UCITS, 2010 Law Part II UCIs and AIFs

9.7.3.1. General requirements

The segregation requirements of UCITS, 2010 Law Part II UCIs and AIFs are largely aligned. Some differences exist. The common segregation requirements are described in this section; specific considerations are described in the subsequent sections.

The concept of asset segregation implies that the depositary maintains records and accounts which enable it at any time and without delay to identify the assets of its UCITS, 2010 Law Part II UCI or AIF clients. In order to achieve this objective certain requirements need to be met at the level of depositary itself and at the level of each third party to which safekeeping functions are delegated.

- ▶ At the level of the depositary, accounts and records need to be opened and maintained in the name of each individual UCITS, 2010 Law Part II UCI, AIF and for each compartment, where applicable. This implies that the depositary must be in a position to segregate the assets of each UCITS, 2010 Law Part II UCI or AIF from the assets of its other clients and the assets held for its own account.
- ▶ At the level of the third party to which safekeeping functions are delegated, the concept of asset segregation is assured by means of separate accounts to be opened with such third party for the depositary's client assets (including UCITS, 2010 Law Part II UCIs and AIFs), for its own assets and by ensuring that the third party has implemented procedures which ensure compliance with minimum asset segregation requirements at its level and, where such third party has further sub-delegated safekeeping functions, at the various levels of the custody chain.

More specifically, the depositary must ensure that the third party acts in accordance with the segregation obligations by verifying that the third party:

- ▶ Keeps such records and accounts necessary to enable it at any time and without delay to distinguish the assets of the depositary's clients (including UCITS, 2010 Law Part II UCI or AIF clients) from the depositary's own assets, the assets of the third party's other clients and the assets of the third party's own account

The ABBL/ALFI *Guidelines on the implementation of the new AIFM/UCITS CDRs* on delegated safekeeping have been published on 30 September 2019, and proposed, *inter alia*, a list of acceptable principles underlying the creation and reconciliation of the depositary's records.

Whilst custody books and records are traditionally built from transactions instructed by an independent party from the delegate and settlement agents, the depositary may, as an alternative option and for some specific transaction activities, construct its records from the end-of-day settled positions information, provided that the depositary:

- ▶ Receives and/or accesses via an online platform the necessary information with regard to the underlying activity on the accounts
 - ▶ Has performed a satisfactory due diligence on the processes and associated control environment
 - ▶ Has ensured that an effective reconciliation process exists between the records from the source at the origin of the creation of the depositary's records and those from a relevant party independent from that source
- ▶ Maintains records and accounts in a manner that ensures their accuracy and in particular their correspondence to the assets safekept for the depositary's clients
 - ▶ Conducts, as frequently as necessary, reconciliations between its internal accounts and records and those of the third party to whom it has delegated safekeeping functions. The frequency of reconciliations should be determined on the basis of criteria described in Section 9.7.3.2.

- Introduces adequate organizational arrangements to minimize the risk of loss or diminution of financial instruments or of rights in connection with those financial instruments as a result of misuse of the financial instruments, fraud, poor administration, inadequate record-keeping, or negligence
- Where the third party is a central bank, an authorized EU credit institution, or a bank authorized in a third country that is subject to effective prudential regulation and supervision that has the same effect as European Union law and is effectively enforced, the depository must take the necessary steps to ensure that the UCITS, 2010 Law Part II UCI's or AIF's cash is held in an account or accounts in accordance with the cash flow monitoring requirements applicable to the depository (refer to Section 9.4.4.)

Where a depository has delegated its custody functions to a third party in accordance with the delegation requirements, the monitoring of the third party's compliance with its segregation obligations must ensure that the financial instruments belonging to its clients are protected from any insolvency of that third party.

If, according to the applicable law, including in particular the law relating to property or insolvency, the requirements laid down in the previous paragraph are not sufficient to achieve that objective, the depository is required to assess what additional arrangements are needed to minimize the risk of loss and maintain an adequate standard of protection.

The same requirements apply when the third party delegate further sub-delegates its safekeeping tasks.

9.7.3.2. Developments related to segregation considerations

The topic of asset segregation is subject to continued discussions as different interpretations and models are applied in different jurisdictions and by different players. A key point relates to the account structure to be applied at the level of delegates and sub-delegates.

Important developments were introduced by the publication on 20 July 2017 of an ESMA opinion on asset segregation. In its opinion, ESMA concluded that for the purpose of asset segregation, depositories needed to ensure that without prejudice to any additional EU or national segregation rule and to the extent applicable, delegates open at least three accounts per depository: one account for the delegate's own assets, one account for the own assets of each delegating depository and one account for the assets of the depository's clients, which may include UCITS, AIFs and other clients. Additional accounts will need to be opened for each direct client of the delegate. Accordingly, ESMA did not consider the opening of separate accounts for each asset class (UCITS, AIF, other clients) to be a mandatory requirement of the UCITS V Directive and the AIFMD.

ESMA's opinion was followed on 29 May 2018 by the publication of two draft amendments to the Delegated Regulations No 231/2013 and 2016/648 addressing, *inter alia*, asset segregation. They led to the release on 30 October 2018 by the European Commission of Delegated Regulation (EU) 2018/1618 of 12 July 2018 amending Delegated Regulation (EU) No 231/2013 as regards safe-keeping duties of depositories of AIFs, and of Delegated Regulation (EU) 2018/1619 of 12 July 2018 amending Delegated Regulation (EU) 2016/438 as regards safe-keeping duties of depositories of UCITS which are applicable since 1 April 2020.

These two Delegated Regulations allowed depositories the use of omnibus accounts at the level of their delegates (custodians can hold assets of UCITS, AIFs and other clients of a given depository in the same omnibus account, provided its own assets, the proprietary assets of the depository and the assets belonging to other clients of the third party are held in segregated financial instruments accounts), as long as they do not include any own assets of the depository and of the delegate.

In addition, the use of omnibus accounts is subject to the following:

- 1) Depositories need to ensure that assets are not available for distribution to creditors of a failed delegate
- 2) There are accounting and reconciliation systems in place allowing the depository to accurately verify the existence of UCITS, AIF or client assets in the accounts opened with the delegate.

Whilst custody books and records are traditionally reconciled back to the agents involved in the settlement chain, the depository should be permitted, for the specific transaction activities, to leverage existing reconciliation processes in place and associated reporting made available at the level of the delegate itself and/or any relevant third parties provided that the depository:

- Receives and/or accesses via an online platform the necessary information
- Has performed satisfactory due diligence on the processes and associated control environment
- Implements or oversees an effective reconciliation process between the custody function records and records from the UCI or a third party acting on behalf of the UCI

- 3) Depositories need to ensure that the reconciliation measures described in (2) are conducted as often as necessary and in line with the nature, scope and volume of transactions. The frequency of the reconciliations shall be determined on the basis of:
 - The normal trading activity of the UCITS
 - Any trade occurring outside the normal trading activity
 - Any trade occurring on behalf of any other client whose assets are held by the third party in the same financial instruments account as the assets of the UCITS
- 4) Processes foreseeing the reuse of securities are only allowed if foreseen in the relevant contracts and permitted by relevant legislation
- 5) The relationship between the depository and its delegate is subject to a written contract
- 6) The contract between the depository and the delegate includes sufficient information, access and inspection rights for the depository at the level of the delegate and sub-delegate
- 7) Depositories of AIFs must obtain a legal opinion on the insolvency laws of any third country delegate. This requirement was already applicable to depositories of UCITS. The depositories are required to monitor that their third-country delegates comply with national laws securing the benefits of asset segregation, and keep them informed about any changes to the insolvency laws they are subject to. In addition, the depository will have to upgrade its supervision program (e.g., due diligence reviews) to comply with the enhanced provisions of the new regulation (refer to AIFM-CDR 231/2013; UCITS CDR 438/2016; ABBL/ALFI *Guidelines on the implementation of new AIFM/UCITS CDRs on delegated safekeeping*)

By way of a derogation, the accounts of an investment firm or a PDAOIF acting as an AIF depository at the level of its delegate to either hold cash deposits or to maintain accounts for financial instruments in custody, must be opened in the name of each individual AIF or compartment, if applicable (refer also to Sections 9.3.2.1. and 9.3.2.2.).

9.7.4. Liability in the case of delegation

The UCITS V and AIFMD liability regime are aligned, with one important exception outlined in Section 9.7.4.1., and share the following key elements:

- The depository is liable to the UCITS, 2010 Law Part II UCI, and AIF and to the investors for the loss by the depository or a third party to whom the custody of financial instruments held in custody has been delegated
- In case of loss of a financial instrument held in custody, the depository must return a financial instrument of identical type or the corresponding amount without undue delay
- The depository is not liable if it can prove that the loss of the financial instrument is a result of an external event beyond its reasonable control (e.g., natural disaster, state act)
- The depository is also liable to the UCITS, 2010 Law Part II UCI, and AIF for all other losses suffered by them as a result of the depository's negligent or intentional failure to properly fulfill its obligations pursuant to the UCITS V Directive and AIFMD
- The liability of the depository is not affected by any delegation
- The share/unitholder in the UCITS, 2010 Law Part II UCI, and AIF may invoke the liability of the depository directly, or indirectly through the management company, as applicable, provided that this does not lead to a duplication of redress or to unequal treatment of share/unitholders

9.7.4.1 Liability in the case of delegation - considerations specific to AIF

Unlike for UCITS, the liability for loss of financial instruments of an AIF held in custody can be transferred from the depository to the third party if the delegation complies with the delegation requirements and the following conditions are met:

- There is a written contract between the depository and the AIF (or the AIFM acting on behalf of the AIF) that establishes the objective reason to contract such a discharge of liability

The objective reasons to contract a discharge of liability must be:

- Limited to precise and concrete circumstances characterizing a given activity
- Consistent with the depository's policies and decisions

The objective reasons must be established each time the depository intends to discharge itself of liability. The depository is considered to have objective reasons for contracting the discharge of its liability when the depository can demonstrate that it had no other option but to delegate its custody duties to a third party. This is the case where:

- ▶ The law of a third country requires that certain financial instruments be held in custody by a local entity and local entities exist that satisfy the delegation requirements
- ▶ The AIFM insists on maintaining an investment in a particular jurisdiction despite warnings by the depository as to the increased risk this presents

The CSSF's FAQ on AIFM clarifies that the definition of objective reasons for discharge of liability is a matter of professional judgment, based on the aforementioned criteria, and the facts of the specific case in question. The objective reasons could, for example, be related to:

- ▶ The investment policy and strategy of the AIF
- ▶ The types of counterparties used by the AIFM on behalf of the AIF
- ▶ The sub-custody network used for safekeeping of the financial instruments

- ▶ There is a written contract between the depository and the third party that explicitly provides for the transfer of liability from the depository to the third party and makes it possible for the AIF, the AIFM, or the depository acting on their behalf to make a claim against the third party in respect of the loss of financial instruments
- ▶ The arrangement is disclosed to investors before they invest (see Sections 10.3.4. and 10.4.2.5.)

Further, where the delegation requirements with regard to financial instruments held in custody cannot be met in a certain country (Point (2) of the sixth paragraph of Section 9.7.1.) because there are no such entities, the depository can discharge itself of its liability provided that the following conditions are fulfilled:

- ▶ The constitutional document expressly allows for such discharge
- ▶ The investors in the AIF have been duly informed, prior to their investment, of the discharge and the reasons justifying the discharge
- ▶ The AIF (or AIFM acting on behalf of the AIF) instructed the depository to delegate the custody of such financial instruments
- ▶ There is a written contract between the depository and AIF (or the AIFM acting on behalf the AIF) that expressly allows such a discharge
- ▶ There is a written contract between the depository and the third party that explicitly transfers the liability of the depository to that local entity and makes it possible for the AIF, the AIFM acting on behalf of the AIF, or the depository acting on their behalf to make a claim against that local entity in respect of the loss of financial instruments

9.8. Prime broker

A prime broker is an entity subject to prudential regulation and ongoing supervision that:

- ▶ Offers to professional investors one or more services primarily to finance or execute transactions in financial instruments as counterparty
- ▶ May also provide other services such as clearing and settlement of trades, custodial services, securities lending, customized technology, and operational support facilities²⁰¹

The selection and appointment of the prime broker is generally the responsibility of:

- ▶ The Board of Directors of the UCI, in the case of an investment company
- ▶ The management company or AIFM, in the case of a common fund

For full AIFM regime AIF, where a prime broker is appointed, the depository, if separate from the prime broker, must be informed of the contract with the prime broker. The appointment of the prime broker is covered in Section 6.3.5.2. The prime broker is required to report information to the depository on a daily basis (see Section 9.8.1.). If the depository entrusts the safekeeping of the assets of the AIF to the prime broker, the prime broker must be appointed by the depository as a sub-custodian, and all the requirements applicable to delegation of safekeeping must be met (see Section 9.8.2.). A prime broker may also act as depository, if certain conditions are met (see Section 9.8.3.).

²⁰¹ | AIFM Law definition.

The models possible where an AIF provides its assets as collateral to a collateral taker are outlined in Section 9.4.2.1.A.1.

The contract with the prime broker must cover the terms under which the prime broker may transfer and reuse AIF assets (see Section 6.3.5.2.).

Information that must be disclosed to investors before they invest in AIF is the following:

- The identity of one or more prime broker(s)
- A description of any material arrangements of the AIF with the prime broker(s)
- The way conflicts of interest thereto are handled
- The provisions in the contract with the depositary on the possibility of a transfer of assets
- The provisions in the contract with the depositary on the possibility of reuse of assets
- Information about any transfer of liability to the prime broker

9.8.1. Reporting obligations

Where a prime broker has been appointed, the AIFM is required to ensure that from the date of that appointment, an agreement is in place pursuant to which the prime broker is required to make available to the depositary a statement in a durable medium that contains the following information at the close of each business day:

- The total value of assets held by the prime broker for the AIF, where safekeeping functions are delegated (see also Section 9.8.2.), and the value of each of the following:
 - Cash loans made to the AIF and accrued interest
 - Securities to be redelivered by the AIF under open short positions entered into on behalf of the AIF
 - Current settlement amounts to be paid by the AIF under any futures contracts
 - Short sale cash proceeds held by the prime broker in respect of short positions entered into on behalf of the AIF
 - Cash margins held by the prime broker in respect of open futures contracts entered into on behalf of the AIF. This obligation is in addition to the cash flow monitoring obligations
 - Mark-to-market close-out exposures of any OTC transaction entered into on behalf of the AIF
 - Total secured obligations of the AIF against the prime broker
 - All other assets relating to the AIF
- The value of other assets held as collateral by the prime broker in respect of secured transactions entered into under a prime brokerage agreement
- The value of the assets where the prime broker has exercised a right of use in respect of the AIF's assets
- A list of all the institutions at which the prime broker holds or may hold cash of the AIF in an account opened in the name of the AIF or in the name of the AIFM acting on behalf of the AIF

The statement must be made available to the depositary of the AIF no later than the close of the next business day to which it relates.

The prime broker is also required to make available to the depositary details of any other matters necessary to ensure that the depositary of the AIF has up-to-date and accurate information about the value of assets the safekeeping of which has been delegated.

9.8.2. Delegation to prime brokers

Delegation of custody tasks by the depositary to a prime broker is permitted provided the delegation conditions are met (see Section 9.7.).

9.8.3. Prime broker acting as depositary

A prime broker can also act as a depositary only if:

- It has functionally and hierarchically separated the performance of its depositary functions from its tasks as a prime broker
- The requirements on delegation of custody tasks by the depositary to a third party are met (see Section 9.7.)
- The potential conflicts of interest are properly identified, managed, monitored, and disclosed to the investors of the AIF (see also Section 10.3.4. for more information on AIF disclosure requirements)

9.9. Other reporting and disclosure obligations

In addition to the aforementioned disclosure requirements, UCITS V and AIFMD define some general requirements with regards to disclosure to investors. Both UCITS V and AIFMD require, in addition to the identity of the depositary, a description in the prospectus of any safe-keeping function delegated by the depositary, the identification of the delegate, and any conflicts of interest that may arise from such delegations.

UCITS V goes even further and requires a disclosure of sub-delegates and potential conflicts of interest arising from the sub-delegation. UCITS V states further that up-to-date information regarding the above disclosures needs to be made available to investors on request.

The CSSF has clarified in its Press Release 16/10 of 2 March 2016 that the requirement to include a list of the delegates and sub-delegates of the depositary in the prospectus can be fulfilled by including a reference to a website where the list is available to investors.

CSSF Circular 16/644 and 18/697 requires new depositaries to provide comprehensive information. The information needs to be kept up-to-date and to be delivered to the CSSF on an annual basis at the latest six months after the closure of the financial accounts of the depositary. This information includes, *inter alia*, the following elements (additional elements can be required upon request of the CSSF):

- ▶ Name and title of the person(s) in charge of the depositary bank business
- ▶ Organization chart, especially of the departments that intervene and work on the various functions of a depositary bank
- ▶ Number of employees of the depositary bank business
- ▶ CV detailing background and experience of the person(s) in charge
- ▶ Detailed description of the technical resources, for example, IT infrastructure and systems
- ▶ List of the sub-custodians or information on the website on which such an up-to-date list is available
- ▶ List of the delegates assisting the depositary, including a description of the links with each delegate and the mode of operation with them
- ▶ Description of the links with the transfer agent and the fund administrator, including the elements assuring the segregation of the duties, if they belong to the same legal entity
- ▶ The contract of designation of the depositary accompanied by a matrix indicating where the different elements of the Delegated Regulation are covered
- ▶ List of operational procedures indicating the date of their latest update
- ▶ Description of the type of funds the depositary wishes to include in its service portfolio

10

Fund documentation and reporting

EY supports asset managers, traditional and alternative investment fund houses with fund documentation preparation including prospectuses, KII or KID and other investor information, financial reports (Luxembourg GAAP, IFRS and US GAAP), and other periodic regulatory reporting to the CSSF and foreign supervisory authorities.



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10.1. Introduction

This Chapter covers:

- ▶ The content of the initial disclosures to investors to be included in the:
 - ▶ Prospectus (for 2010 Law UCIs)
 - ▶ Key Investor Information (KII) document applicable:
 - ▶ For UCITS until 31 December 2021
 - ▶ For AIFs, where the KII was made available before 31 December 2017
 - ▶ Key Information Document for Packaged Retail and Insurance based Investment Products (PRIIP KID) applicable:
 - ▶ For AIFs, which cannot use the UCITS derogation of the CSSF (Key Investor Information document prepared by the end of 2017) and are marketed to retail investors (may also include informed investors)
 - ▶ For UCITS from 1 January 2022 (will replace UCITS KII)
 - ▶ Initial disclosures to investors in AIF, as required by the AIFM Law
 - ▶ Offering documents (for SIFs, RAIFs, EuVECAs, EuSEFs and ELTIFs)
- ▶ Periodic investor disclosures and updates
- ▶ Financial reporting: the annual, semi-annual, quarterly and interim reporting requirements and audit requirements
- ▶ General meetings
- ▶ Submission of periodic reports to the Trade and Companies Register
- ▶ Information to be sent to the authorities responsible for the collection of such information, including monthly, quarterly, semi-annual and annual financial information as well as financial reports and prospectuses or offering documents

AIFM reporting to the CSSF is covered in Section 6.5.1.

Marketing of UCIs to investors is covered in Chapter 12.

Additional reporting requirements for UCIs admitted to trading on a securities market of the Luxembourg Stock Exchange (LuxSE) are set out in Section 13.4.2.

In this Chapter, the term “AIF” is used to refer to both AIF managed by authorized AIFM and internally managed AIF that are subject to the AIFM Law (“Full AIFM regime AIF”).

The term “management company” is used to refer to both management companies and AIFM where the AIFM fulfils management company activities.

10.1.1. Investor information for 2010 Law UCIs

A 2010 Law investment company, or a management company for each of the 2010 Law common funds that it manages, is required to publish:

- ▶ A prospectus

The prospectus must include the information necessary for investors to be able to make an informed judgment of the investment proposed to them, and, in particular, of the associated risk. The essential elements of the prospectus must be kept up-to-date.

The prospectus must meet UCI-specific requirements covered in Section 10.3.1. If a closed-ended UCI applies for admission to a securities market, the prospectus will, in addition, be required to meet the Prospectus Regulation²⁰² requirements (see also Chapter 13).

²⁰² Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

- ▶ KII, for UCITS

The KII is designed to provide investors with information on the essential characteristics of the UCITS, so that investors are reasonably able to understand, before they invest, the nature and the risks of the investment product that is being offered to them. The essential elements of the KII must be kept up-to-date.

- ▶ An annual report for each financial year:
 - ▶ For UCITS: within four months of the end of the period to which it relates
 - ▶ For 2010 Law Part II UCIs: within six months of the end of the period to which it relates or four months when the UCI is admitted to trading on a regulated market (see Section 13.4.1.)
- ▶ A semi-annual report covering the first six months of the financial year:
 - ▶ For UCITS: within two months of the end of the period to which it relates
 - ▶ For 2010 Law Part II UCIs: within three months of the end of the period to which it relates
- ▶ Subscription and redemption price (see Sections 8.6. and 8.7.)

The prospectus and the latest published annual and semi-annual reports must be provided to investors on request and free of charge. For UCITS, the KII must be provided to investors free of charge; in general, the KII must be provided to investors before they invest (see Section 12.2.). The prospectus and, for UCITS, KII may be provided to investors in a durable medium or by means of a website. A paper copy of the prospectus, the latest published annual and semi-annual reports, and, for UCITS, the KII must be delivered to the investors on request and free of charge.

For UCITS, an up-to-date version of the KII must be made available on the website of the investment company or management company.

Updated KIIs must be made available within 35 business days from 31 December each year, to investors and to the CSSF via e-filing of the documents.

The annual and semi-annual reports must be available to investors in the manner specified in the prospectus and, for UCITS, in the KII.

All marketing communications to investors (e.g., factsheets) must meet certain requirements. The marketing of UCITS, including provision of fund information to investors, is covered in Chapter 12.

Updates to existing UCIs may entail amendments to the prospectus and, for UCITS, the KII; the procedure to be followed is outlined in Section 3.4.

The management company or investment company that has not appointed a management company is also required to disclose information on the exercise of voting rights and may be required to disclose information in relation to conflicts of interest (see Sections 10.4. and 5.1.3.B. for further information on disclosures).

10.1.2. Investor information for SIFs

A SIF investment company and a management company for each of the SIF common funds that it manages must establish:

- ▶ An offering document

The offering document must include the information necessary for investors to be able to make an informed judgment of the investment proposed to them and, in particular, of the associated risks.

- ▶ An annual report for each financial year, which must be available to investors within six months of the end of the period to which it relates or four months when the SIF is admitted to trading on a regulated market (see Section 13.4.1.)

The offering document and the latest annual report must be provided to investors on request, free of charge.

10.1.3. Investor information for RAIFs

A RAIF, and the management company for each of the RAIF common funds it manages, must establish:

- ▶ An offering document
- ▶ An annual report for each financial year, which must be available to investors within six months of the end of the period to which it relates or four months when the RAIF is admitted to trading on a regulated market (see Section 13.4.1.)

If a prospectus has been prepared to meet the requirements of the Law of 16 July 2019 which transposes the Prospectus Regulation²⁰³, there is no obligation to establish an offering document.

10.1.4. Investor information for full AIFM regime AIF

Full AIFM regime AIF are required to meet AIFM investor information requirements on:

- Information that must be provided to investors before they invest. This information must be disclosed in the prospectus or the offering document or as supplementary information
- Periodic and regular disclosures to investors, for example on leverage and liquidity
- Annual report

10.1.5. Investor information for ELTIFs

ELTIFs are required to publish:

- A prospectus containing all information required to be disclosed by closed-ended UCIs in accordance with the Prospectus Regulation²⁰⁴ and Commission Delegated Regulation (EU) 2019/980²⁰⁵
- An annual report

10.1.6. Financial reporting standards

Most UCIs prepare their financial statements under Luxembourg generally accepted accounting principles (Lux GAAP). However, UCIs created as investment companies may prepare their financial statements under IFRS as long as this is disclosed in the prospectus or offering document. UCIs created as common funds should seek pre-approval, on a case-by-case basis, from the CSSF, to prepare their financial statements under IFRS.

Approval should be sought from the CSSF, for UCIs under its supervision, or the Minister of Justice, for RAIIFs, for the use of other generally accepted accounting principles (GAAP). Where a Luxembourg AIF is managed by a non-Luxembourg AIFM, it may be possible to prepare the financial statements of the Luxembourg AIF under another GAAP (including US GAAP) if permitted by the AIFM's supervisor.

In any case, the accounting principles to be applied should be disclosed in the prospectus or similar offering document of the UCI.

10.2. Constitutional documents

10.2.1. Management regulations of a common fund

The management company is required to draw up the management regulations for a common fund. The provisions of the management regulations are deemed to be accepted by unitholders who acquire units of the common fund.

The management regulations of a common fund are subject to Luxembourg Law and must contain provisions at least on the following:

- The name and duration of the common fund, the name of the management company and of the depositary
- The investment policy, elaborated in line with the specific objectives and criteria of the UCI
- The distribution policy
- The remuneration and expenses that the management company is entitled to charge to the common fund and the method of calculation of that remuneration
- The provisions as to publications
- The date of the closing of the accounts of the common fund

²⁰³ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

²⁰⁴ Idem.

²⁰⁵ Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004.

- Subscriptions and redemptions:
 - The procedure for the issue of units
 - In the case of a 2010 Law common fund, the procedure for the repurchase of units and the conditions under which repurchases are carried out and may be suspended
 - In the case of a SIF or RAIF common fund, the procedure for the redemption of units, where relevant
- The procedures for amendment of the management regulations
- The cases where, without prejudice to legal grounds, the common fund shall be dissolved
- In the case of a RAIF common fund, the rules applicable to the valuation and the calculation of the net asset value per unit

Where applicable, the management regulations of a common fund must expressly provide that the common fund may be comprised of multiple compartments, each compartment corresponding to a distinct part of the assets and liabilities of the common fund, and the applicable operational rules (see Section 2.3.2.).

The management regulations must be lodged with the trade and companies register and their publication in the *Recueil électronique des sociétés et associations* will be made by way of a notice advising of the deposit of the document.

All publications regarding Luxembourg companies and associations appear in electronic format (.pdf) in the electronic gazette RESA (*Recueil Electronique des Sociétés et Associations*) hosted on the RCS website.

10.2.2. Articles of incorporation of an investment company

The articles of incorporation of an investment company, and any amendment to them, must be recorded in a special notarial deed drawn up in French, German or English. Where the notarial deed is drawn up in English, translation into one of the official languages is not required. The articles of incorporation of an investment company generally contain provisions on the following:

- The name, registered office, duration, and object/purpose of the investment company
- The share capital and characteristics of shares
- The governing body and management of the investment company and its administration
- Expenses to be borne by the investment company
- The financial year
- General meetings of the investment company
- The distribution policy
- Valuation policy for the underlying assets
- Subscriptions and redemptions: the issue and repurchase of shares including, *inter alia*, time limits for issue and repurchase payments, the frequency of calculation of the issue and repurchase price, and the conditions under which the issues and repurchases are carried out and the conditions under which the issues and repurchases may be suspended
- The procedure to amend the articles of incorporation
- In case of a multiple compartment investment company, the possibility to liquidate or merge compartments
- The cases where, without prejudice to legal grounds, the investment company shall be liquidated

Where applicable, the articles of incorporation of an investment company must expressly provide that the investment company may be comprised of multiple compartments, each compartment corresponding to a distinct part of the assets and liabilities of the investment company, and the applicable operational rules (see Section 2.3.2.).

Where other deeds recorded in notarial form are drawn up in English, such as notarial deeds drawing-up reports of shareholders' meetings of an investment company or recording a merger project regarding an investment company, translation into one of the official languages is not required.

The rules or instruments of incorporation of an ELTIF should specifically disclose :

- A specific date for the end of the life of the ELTIF and may provide for the right to extend temporarily the life of the ELTIF and the conditions for exercising such a right
- The procedures for the redemption of shares or units and the disposal of assets, and state clearly that redemptions to investors will commence on the day following the date of the end of the life of the ELTIF. Should the ELTIF provide the possibility to redeem before the end of its life, the rules or instruments of incorporation must state this fact along with the conditions required to be met for such redemptions to be possible, being:
 - Redemptions are not granted before the date the ELTIF invests at least 70% of its capital in eligible investment assets

- ▶ The manager is able to demonstrate that an appropriate liquidity management system and effective procedures for monitoring the liquidity risk of the ELTIF are in place
- ▶ The manager sets out a defined redemption policy which clearly indicates when investors may request redemptions
- ▶ The redemption policy ensures that the overall amount of redemptions within any given period is limited to a percentage of UCITS' eligible assets invested in
- ▶ The redemption policy ensures that investors are treated fairly and redemptions are granted on a pro rata basis if the total amounts of redemption requests exceed the limit in the previous bullet point
- ▶ The distribution policy the ELTIF will apply during its life

The rules or instruments of incorporation of an ELTIF marketed to retail investors should provide that all investors benefit from equal treatment and no preferential treatment or economic benefits are granted to individual, or groups of, investors.

10.3. Initial disclosures to investors

10.3.1. Prospectus of 2010 Law UCIs

The principal contents of the prospectus are set out in Schedule A of Annex I to the 2010 Law, as supplemented by the Law of 10 May 2016, and in Chapter L of IML Circular 91/75 as amended. The prospectus, and any amendments thereto, must be approved by the CSSF before the prospectus is used (see Chapter 3). The essential elements of the prospectus must be kept up-to-date.

Commission Regulation (EU) No 583/2010 outlines the conditions applying when providing a prospectus to investors in a "durable medium" other than paper or by means of a website.

The prospectus in general must be clear and easily understandable and must include the information necessary for investors to be able to make an informed judgment of the investment proposed to them, and, in particular of the risks attached thereto.

The information required may be summarized as follows:

A. Information concerning the UCI and its management company, if applicable

	Common fund	Investment company	Management company
Name	X	X	X
Legal form		X	X
Registered and head office (if different)		X	X
Date of establishment/incorporation	X	X	X
Other UCIs managed by management company			X
For umbrella funds, the name of the compartments ²⁰⁶	X	X	
Place where constitutional document may be obtained (see Section 10.2.)	X	X	
Brief description of tax system including details of whether deductions from the income and capital gains paid by the shareholders or unitholders are made at source	X	X	
Accounting and distribution dates	X	X	
Name of auditor	X	X	
Names and positions of management and their outside activities		X	X
Capital		X	X
Details of types and characteristics of shares or units (for each compartment, if applicable)	X	X	
Stock exchanges on which shares or units are listed (for each compartment, if applicable)	X	X	

²⁰⁶ Unlaunched compartments and compartments awaiting reactivation for more than 18 months must be removed from the prospectus (see Section 3.11.).

	Common fund	Investment company	Management company
Procedures and conditions for issuing shares or units (for each compartment, if applicable)	X	X	
Procedures and conditions for repurchasing and switching of shares or units (for each compartment, if applicable)	X	X	
Circumstances for suspending subscriptions and redemptions	X	X	
Rules for determining and applying income	X	X	
Description of the investment objectives (for each compartment, if applicable), including its financial objectives (e.g., capital growth or income), investment policy (e.g., specialization in geographical or industrial sectors), any limitations on that investment policy, and an indication of any techniques and instruments or borrowing powers that may be used in the management of the UCI, or each compartment of a multiple compartment UCI ²⁰⁷	X	X	
Description of the risks (for each compartment, if applicable) ²⁰⁸	X	X	
Rules for valuing assets	X	X	
Frequency of the NAV calculation (for each compartment, if applicable) ²⁰⁹	X	X	
Determination of subscription and redemption price (method and frequency of calculation, charges, places, and frequency of publication) (for each compartment, if applicable)	X	X	
Information on remuneration paid by the UCI to the management company, depositary or third parties (for each compartment, if applicable) ²¹⁰	X	X	

B. Information concerning the depositary

The Law of 10 May 2016 implementing UCITS V slightly enhanced the information to be provided on the depositary:

- ▶ Identity of the depositary of the UCI, the description of its duties and the conflicts of interests that might arise
- ▶ A description of any safekeeping functions delegated by the depositary, the list of the delegates and sub-delegates and the conflicts of interests that might arise from such delegation
- ▶ A declaration indicating that updated information on the above sections will be made available to investors upon request

C. Information concerning investment advisers (for each compartment, if applicable)

- ▶ Name
- ▶ Material provisions of the contract, excluding remuneration
- ▶ Other significant activities

D. Investor redemption arrangements and investor information

Information concerning arrangements for making payments to shareholders or unitholders and repurchasing shares or units and making available information on the UCI; such information is to be given in Luxembourg and other countries where the prospectus is to be circulated.

E. Other information (to be provided for all compartments in the case of multiple compartment UCIs)

- ▶ Historical performance of the UCI (where applicable): such information may be either included in or attached to the prospectus and should be updated on an annual basis
- ▶ Profile of the typical investor

F. Fees and expenses

Possible expenses or fees, other than charges relating to the subscription or redemption of shares or units, distinguishing between those to be paid directly by the shareholder or unitholder and those to be borne by the UCI.

²⁰⁷ See Section 10.3.1.O.

²⁰⁸ Required in practice.

²⁰⁹ Idem.

²¹⁰ Where a "substantial proportion" of net assets of a UCITS is invested in other UCIs that are linked to the investing UCITS, the prospectus must disclose the maximum level of management fees that may be charged both to the UCITS itself and to the other UCIs in which it intends to invest (see Section 4.2.2.8.1.III.(3)).

As per the CSSF's *Frequently Asked Questions concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment*:

- ▶ Where a service fee is directly paid out of the assets of the UCITS to the investment manager(s), and possibly to any investment advisor(s) contractually linked to the UCITS, the method of calculation or the rate of the fee to each recipient must be disclosed in the prospectus
- ▶ The investment manager's fee and/or the investment advisor's fee should only pay for investment management and investment advice respectively. As a general rule, the investment advisor's fee is expected to be at a lower level than the investment manager's fee
- ▶ When other expenses or fees for activities beyond the direct scope of investment management or advice are payable out of the assets of the UCITS to the investment manager(s) or investment advisor(s), such expenses or fees must be disclosed separately from the investment manager's and investment advisor's fee respectively, in a way that clearly informs investors about the nature of such expenses or fees
- ▶ In cases where the option of an "all-in" fee is proposed, which implies that only one compensation amount is paid out of the assets of the UCITS to a recipient (typically the management company) who will remunerate the other service providers to the UCITS, the prospectus must clearly state the scope and nature of such "all-in" fee. Each contractual recipient of this all-in fee should be specified
- ▶ In case of a performance fee, both the performance fee model and the investment manager as the recipient of the performance fee must be disclosed in the prospectus. Should a sharing arrangement be in place for the performance fee with any investment advisor(s) contractually linked to the UCITS, the prospectus must disclose this arrangement

On 3 April 2020, ESMA issued its *Guidelines on performance fees in UCITS and certain types of AIFs* which include a certain number of disclosure requirements:

- ▶ Investors should be adequately informed about the performance fees and their impact on return
- ▶ All ex-ante documents (prospectus, KII, marketing documents) should clearly set out all information necessary to understand the performance fee model and the computation methodology, including the main elements and parameters, the payment date. Concrete computation examples should be included in the prospectus
- ▶ Where a performance fee model uses a different but consistent benchmark, the explanation of the choice of benchmark should be included in the prospectus
- ▶ Where a performance fee is payable in times of overall negative performance, a prominent warning must be included in the KII
- ▶ Where applicable, the KII and the prospectus should display the name of the benchmark index and disclose past performance of the UCI against the benchmark index
- ▶ The annual and semi-annual reports and any other ex-post information should indicate for each relevant share class the amount of performance fees and the percentage of the share class NAV they represent

The CSSF must notify ESMA of its intention to comply or not within two months of the date of publication of the official translations of the guidelines into all EU official languages, which is expected to take place in Q4 2020 at the earliest. At the end of this period, and should the CSSF confirm Luxembourg's compliance with the guidelines, they will become immediately applicable in Luxembourg for all UCIs in scope introducing a performance fee after the date of application. Managers of UCIs with a performance fee existing before the date of application will be required to comply with the guidelines by the beginning of the financial year following six months from the date of application.

G. Date

The prospectus must be dated and may only be used as long as the information in it is accurate.

H. Delegation of management company functions

The prospectus of a UCITS must list the functions delegated by the management company, including name of the delegate, legal form and material provisions of the contract.

I. Risk management disclosures for UCITS (see also Section 7.2.6.B.)

The UCITS should disclose in its prospectus the method used to calculate the global exposure (i.e., commitment approach, relative VaR or absolute VaR).

UCITS using VaR approaches should disclose in the prospectus the expected level of leverage and the possibility of higher leverage levels. CSSF Circular 11/512, as amended, provides further clarification on the assessment and disclosure of the expected level of leverage.

CSSF *Communiqué* 12/29 clarifies that, as regards the publication of leverage in the prospectus, the CSSF considers that newly created UCITS (including UCITS compartments) must, from the date of launch, base the disclosure of leverage in the prospectus on the sum of notionals approach. This information may be complemented with the leverage determined based on the commitment approach (provided that the underlying calculation method is clearly and precisely indicated for every mentioned figure) or with other additional explanations.

Where FDIs are used and benefit only specific share or unit classes (e.g., hedging, leverage), it is good practice to disclose global risk exposure (market risk) and leverage at share or unit class level, although there are no specific requirements on disclosures at share or unit class level.

When using the relative VaR approach, information on the reference portfolio should be disclosed in the prospectus. CSSF Circular 11/512, as amended, provides further clarification on the content of the information to be disclosed.

For structured, passively managed UCITS where the commitment approach is used for the calculation of global exposure, the prospectus should:

- ▶ Contain full disclosure regarding the investment policy, underlying exposure, and payoff formulae in clear language that can be easily understood by the retail investor
- ▶ Include a prominent risk warning informing investors who redeem their investment prior to maturity that they do not benefit from the predefined payoff and may suffer significant losses

J. Prospectus of a feeder UCITS

In addition to the information required by Schedule A of Annex I of the 2010 Law, the prospectus of a feeder UCITS must contain the following:

- ▶ A declaration that the feeder UCITS is a feeder of a particular master UCITS and as such permanently invests 85% or more of its assets in shares or units of that master UCITS
- ▶ The investment objectives and policies of both the master and the feeder UCITS
- ▶ A brief description of the master UCITS, its organization, its investment objective and policy, including the risk profile, and an indication on how the prospectus of the master UCITS may be obtained
- ▶ Details of where to obtain the prospectus of the master UCITS
- ▶ A summary of the agreement (or internal conduct of business rules) between master and feeder UCITS
- ▶ Details of how the shareholders or unitholders may obtain further information on the master UCITS and on the agreement entered into between the master and feeder UCITS
- ▶ A description of all remuneration and reimbursement of costs payable by the feeder UCITS by virtue of its investment in units of the master UCITS, as well as the aggregate charges of the feeder UCITS and the master UCITS
- ▶ The tax implications of the chosen structure

K. Investor rights

The CSSF's Newsletter of November 2011 introduced the requirement to include a paragraph on investor rights in the prospectuses of 2010 Law UCIs.

The paragraph draws attention to the fact that investors will only be able to fully exercise their investor rights directly against the UCI (including the right to participate in general shareholders' meetings in the case of investment companies) if the investor is registered in the shareholders' or unitholders' register. It also advises investors to take advice on their rights.

The text of the paragraph must follow the model provided by CSSF Newsletter No. 130 of November 2011.

L. Remuneration

The Law of 10 May 2016 implementing UCITS V amended the 2010 Law and requires the prospectus of a UCITS to include either:

- ▶ The details of the up-to-date remuneration policy, including, but not limited to, a description of how remuneration and benefits are calculated, the identities of persons responsible for awarding the remuneration and benefits including the composition of the remuneration committee; or
- ▶ A summary of the remuneration policy and a statement to the effect that the details of the up-to-date remuneration policy, including, but not limited to, a description of how remuneration and benefits are calculated, the identity of persons responsible for awarding the remuneration and benefits, including the composition of the remuneration committee where such committee exists, are available by means of a website, including a reference to that website, and that a paper copy will be made available free of charge upon request

M. Share classes

Following ESMA's *opinion on share classes of UCITS of 30 January 2017, and the CSSF's Frequently Asked Questions concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment*, to ensure transparency, the prospectus should:

- ▶ Provide the details of the types and main characteristics of the share classes such as, *inter alia*, fee structure, dividend policy, investor type, currency or currency risk hedging. However, it does not have to provide an exhaustive list of all individual share classes together with all their individual characteristics. Additional information on share classes issued (such as e.g., list of all the share classes offered to investors or effectively launched classes) should be available to investors either on request and free of charge, or through a reference in the prospectus to an internet website, where such information can be found
- ▶ The information related to share classes with contagion risk can be addressed by means of a website publication if the prospectus includes a link to the relevant website of the Management Company/UCITS

N. Benchmarks

When an index is used to measure the UCI's performance with the purpose of tracking the return of such index, or of defining the asset allocation of a portfolio, or of computing the performance fees, a 2010 Law UCI falls under the scope of the Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the "Benchmark Regulation").

As per the Benchmark Regulation²¹¹, a prospectus issued under the Prospectus Regulation²¹² or the UCITS Directive²¹³ should include clear and prominent information stating whether the benchmark is provided by an administrator included in the register referred to in Article 36 of the Benchmark Regulation.

In its *Questions and Answers on the Benchmarks Regulation*, ESMA considers that prospectuses should include reference to ESMA's register of administrators and benchmarks ("the register") as follows:

In relation to prospectuses approved on or after 1 January 2018:

- ▶ Where the register already includes the relevant administrator by the time a prospectus under the Prospectus Regulation²¹⁴ or the UCITS Directive²¹⁵ is published, ESMA considers that the prospectus should include a reference to the fact that the administrator is listed in the register
- ▶ Where the register does not include the relevant administrator by the time a prospectus is published, ESMA considers that the prospectus should include a statement to that effect

Additionally:

- ▶ Prospectuses published under the UCITS Directive²¹⁶ should be updated once the relevant administrator is included in the register, the next time prospectus updates are made
- ▶ Prospectuses approved under the Prospectus Regulation²¹⁷ are not required under the Benchmark Regulation²¹⁸ to be systematically updated by means of a supplement once the relevant administrator is included in the register

In relation to prospectuses approved prior to 1 January 2018:

- ▶ For prospectuses approved under the UCITS Directive²¹⁹, if by 1 January 2019 the relevant administrator was not included in the register, ESMA considers that these prospectuses should be updated to include a statement to that effect
- ▶ Prospectuses approved under the Prospectus Regulation²²⁰ are not required under the Benchmark Regulation²²¹ to be systematically updated by means of a supplement once the relevant administrator is included in the register

²¹¹ Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

²¹² Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

²¹³ Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

²¹⁴ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

²¹⁵ Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

²¹⁶ *Idem*.

²¹⁷ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

²¹⁸ Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

²¹⁹ Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

²²⁰ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

²²¹ Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

O. Additional prospectus disclosures

The prospectus of a UCITS must indicate the categories of assets in which the UCITS is authorized to invest (see Section 4.2.2.3.) and prominently indicate its policy in relation to financial derivative instruments (FDIs). UCITS that use FDIs for purposes other than hedging should include in their prospectus a description of the risks (including, if appropriate, an indication of the leverage and market risk).

Where the UCITS is authorized to invest up to 100% of its net assets in at least six different transferable securities issued or guaranteed by an EU Member State, its local authorities, a non-Member State of the EU or public international bodies of which one or more EU Member States are members (see Section 4.2.2.8.1.II.(2)), this must be explicitly stated in the prospectus.

When a UCITS invests principally in any category of assets other than transferable securities and money market instruments or replicates a stock or debt securities index, the prospectus must include a prominent statement drawing attention to its investment policy. When the NAV of a UCITS is likely to have a high volatility due to its portfolio composition or the portfolio management techniques that may be used, the prospectus must include a prominent statement drawing attention to this characteristic of the UCITS.

Where a UCI intends to use techniques and instruments relating to transferable securities and money market instruments (see Section 4.2.2.6.), it must clearly indicate in its prospectus:

- ▶ That it intends to enter into such techniques and use such instruments
- ▶ The types of transaction considered and purpose thereof
- ▶ The conditions and limits of such transactions
- ▶ The conditions and limits of cash collateral reinvestment if the UCI intends to reinvest the collateral
- ▶ A description of the risks inherent in such transactions

Depending on the risk of investment in, specificities and magnitude of certain types of assets within a portfolio, the CSSF may request disclosures to be made in the UCI's prospectus. For example:

- ▶ If a UCITS invests more than 20% of its net assets in Mortgage Backed Securities (MBS) or Asset Backed Securities (ABS), the prospectus must provide explicit information on such investments, in particular the risks associated with investing in such securities

ESMA's *Guidelines on ETFs and other UCITS issues*, as amended, require disclosure of the following information in the prospectus:

- ▶ Efficient Portfolio Management (EPM) techniques:
 - ▶ Techniques and instruments to be employed, the risks involved including counterparty risk, potential conflicts of interest, and the impact on the performance of the UCITS
 - ▶ A policy relating to the treatment of direct and indirect operational costs and fees arising from EPM, the identity of entities to which such costs and fees are paid, and any relationship with the management company or depositary
- ▶ Financial Derivative Instruments (FDIs):
 - ▶ UCITS entering into total return swaps (TRS) or similar derivative instruments: the underlying strategy and composition of the investment portfolio or index, information on counterparties, their risk of default and the potential effect on investor returns, the extent to which the counterparties assume any discretion over the UCITS' portfolio or over the underlying of the FDIs and whether the approval of the counterparty is required in relation to any UCITS investment portfolio transaction, and, where relevant, identification of the counterparty as investment manager
- ▶ Management of collateral:
 - ▶ UCITS' collateral policy covering permitted types of collateral, level of collateral required, haircut policy, and, in the case of cash collateral, reinvestment policy
 - ▶ Clear information to investors of the collateral policy
 - ▶ UCITS that intend to be fully collateralized in securities issued or guaranteed by a Member State should disclose this fact in the prospectus
- ▶ UCITS ETFs:
 - ▶ Use of the "UCITS ETF" identifier in the name and prospectus; this English identifier should be used independently of the language of the document; the identifiers "UCITS ETF", "ETF" or "exchange-traded fund" cannot be used by other UCITS
 - ▶ The policy on portfolio transparency and where information on the portfolio can be obtained, including the indicative net asset value (iNAV)
 - ▶ How the iNAV is calculated and the frequency of calculation

- ▶ For an actively-managed UCITS ETF:
 - ▶ That it is actively managed
 - ▶ Strategy to meet the stated investment policy, including any intention to outperform an index
- ▶ Treatment of secondary market investors: inclusion of a warning in the prospectus and marketing communications to the effect that shares or units purchased on the secondary market, if applicable, are generally not redeemable from the ETF, as well as the procedure and costs for direct redemptions in exceptional circumstances
- ▶ Index-tracking UCITS:
 - ▶ Description of the index, including information on its underlying components (or a website link to such information), how the index will be tracked and implications in terms of exposure to the underlying index and counterparty risk, anticipated tracking error (in normal market conditions), and factors impacting the ability of the UCITS to track the performance of the index
 - ▶ Index-tracking leveraged UCITS: leverage policy, associated costs and risks, impact on returns, impact of any reverse leverage (short exposure), and a description of how the performance may differ significantly from the multiple of the index over the medium to long term
- ▶ Financial indices:
 - ▶ When a UCITS intends to make use of the increased diversification limits for financial indices referred to in Article 53 of the UCITS Directive²²² (see Section 4.2.2.7.7.), this should be disclosed clearly in the prospectus, together with a description of the exceptional market conditions that justify this investment
 - ▶ Rebalancing frequency and its effects on the costs within the strategy

For structured UCITS where the commitment approach is used for the calculation of global exposure, additional disclosures are required (see Section 10.3.1.1.).

Regulation EU 2015/2365 on *transparency of securities financing transactions and of reuse* requires that a UCITS prospectus specifies the securities financing transactions (SFTs) and total return swaps which UCITS management companies, or self-managed UCITS, are authorized to use, and include a clear statement that those transactions and instruments are used.

The prospectus must include the following data:

- ▶ General description of the SFTs and total return swaps used by the UCITS and the rationale for use
- ▶ Overall data to be reported for each type of SFTs and total return swaps:
 - ▶ Types of assets that can be subject to them
 - ▶ Maximum proportion of assets under management that can be subject to them
 - ▶ Expected proportion of assets under management that will be subject to each of them
- ▶ Criteria used to select counterparties (including legal status, country of origin, minimum credit rating)
- ▶ Acceptable collateral: description of acceptable collateral with regard to asset types, issuer, maturity, liquidity as well as the collateral diversification and correlation policies
- ▶ Collateral valuation: description of the collateral valuation methodology used and its rationale, and whether daily mark-to-market and daily variation margins are used
- ▶ Risk management: description of the risks linked to SFTs and total return swaps as well as risks linked to collateral management, such as operational, liquidity, counterparty, custody and legal risks and, where applicable, the risks arising from its reuse
- ▶ Specification of how assets subject to SFTs and total return swaps and collateral received are safe-kept (e.g., with the UCITS custodian)
- ▶ Specification of any restrictions (regulatory or self-imposed) on the reuse of collateral
- ▶ Policy on sharing or return generated by SFTs and total return swaps: description of the proportions of the revenue generated by SFTs and total return swaps that is returned to the UCITS, and of the costs and fees assigned to the manager or third parties (e.g., the agent lender). The prospectus should also indicate if these are related parties to the manager

CSSF Circular 14/591 clarifies that the minimum notification period to notify investors of a significant change to the UCI they are invested in should be one month. During this one-month period before the entry into force of the significant change, investors have the right to request, without any repurchase or redemption charge, the repurchase or redemption of their shares/units. In addition to the possibility to redeem shares/units free of charge, the UCI may also (but is not obliged to) offer the option to investors to convert their shares/units into shares/units in another UCI (or, in case the change affects only one compartment, into shares/units of another compartment of the same UCI) without any conversion charges.

²²² Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

The CSSF may nevertheless agree, through a duly supported request for derogation made in advance, to not impose such a notification period with the ability for investors to redeem or convert their holdings free of charge (for example, in cases where all the investors in the relevant UCI agree with the contemplated change). Similarly, the CSSF may agree to only impose a notification period to duly inform the investors of the relevant change before it becomes effective, but without the ability for investors to redeem or convert their holdings free of charge. It should be noted that where the UCI is registered for cross-border distribution, the regulators in the host countries may impose a notification period exceeding one month.

Following ESMA's *opinion on share classes* of UCITS of 30 January 2017, information about existing share or unit classes should be provided via the UCITS prospectus as part of the details of the types and main characteristics of the shares or units. See also Section 2.3.3.

Prospectuses of closed-ended UCIs whose shares/units are listed on the Bourse de Luxembourg are required to comply with the requirements of the Prospectus Regulation²²³. CSSF Circular 16/636 implemented ESMA's Guidelines on Alternative Performance Measures. These Guidelines aim at promoting the usefulness and transparency of Alternative Performance Measures (APMs) disclosed by issuers or the person responsible for the prospectus prepared in accordance with the Prospectus Regulation²²⁴.

10.3.1.1. Hedge funds

As laid down in CSSF Circular 02/80, the prospectus of a 2010 Law Part II UCI pursuing alternative investment strategies, akin to those pursued by hedge funds must contain a description of the investment strategy and the inherent risks and make reference to the fact that:

- Potential losses from short selling differ from those where securities are acquired for cash
- The leverage effect creates an opportunity for increased yield, but at the same time increases volatility and the risk of capital loss. Borrowings involve an interest cost that may exceed income or gains
- Low liquidity may mean investors' redemption requests cannot be met

The prospectus must indicate that investing in the UCI in question entails a higher than average risk and is only suitable for investors prepared to lose the total value of their investment.

Where applicable, the prospectus must contain a description of the dealing strategy as regards futures and options, making reference to their volatility.

10.3.1.2. Venture capital UCIs

As laid down in Chapter I.I of IML Circular 91/75, the prospectus of a 2010 Law Part II UCI making venture capital investments should contain a detailed description of investment risk inherent to the policy of the UCI and of the type of conflict of interest that could arise between the interests of the Directors of the portfolio management and advisory bodies and the interests of the UCI.

The prospectus must contain a statement indicating that an investment in such a UCI represents an above average risk, is only suitable for persons who can afford to take such a risk, and that investors are advised to invest only a part of their savings in such long-term investments.

Where investors have the right to present their shares or units for redemption, the UCI may provide for certain restrictions to this right. Any such restrictions should be stated in the prospectus.

If the remuneration of the portfolio management and advisory bodies is higher than that usually applicable to UCIs, the prospectus should state whether the additional remuneration is also payable on assets not invested in venture capital.

10.3.1.3. Futures contracts and/or options UCIs

As laid down in Chapter I.II of IML Circular 91/75, the prospectus of a 2010 Law Part II UCI investing in futures contracts and options should contain a detailed description of the trading strategy with regard to futures contracts and options, as well as the inherent investment risk and the high risk of loss.

The prospectus should include a statement indicating that the UCI is only suitable for persons who can afford to take such a risk.

If the remuneration of the portfolio management and advisory bodies is higher than that usually applicable to UCIs, the prospectus should state whether the additional remuneration is also payable on assets not invested in futures contracts and options.

²²³ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

²²⁴ *Idem*.

10.3.1.4. Real estate UCIs

As laid down in Chapter I.III of Circular IML 91/75, the prospectus of a 2010 Law Part II UCI investing in real estate should include a description of the inherent risks.

It should also provide details of the type of commissions, expenses, and charges to be borne by the UCI, together with the method of calculation and accounting treatment.

If the remuneration of the portfolio management and advisory bodies is higher than that usually applicable to UCIs, the prospectus must state whether the additional remuneration is also payable on assets not invested in real estate.

10.3.2. Key Investor Information (KII) document of UCITS

Key Investor Information (KII) documents²²⁵ must be drawn up for every share or unit classes of every compartments of a UCITS. The KII must include appropriate information about the essential characteristics of the UCITS concerned. It must be provided to investors so that they are reasonably able to understand the nature and the risks of the investment product that is being offered to them and, consequently, to take investment decisions on an informed basis.

10.3.2.1. Content and layout of the KII

The KII must be presented and laid out in a way that is easy to read. KII must contain fair, clear, and understandable information about the UCITS. It must be brief and non-technical. It must be consistent with the relevant parts of the prospectus. It should be drawn up in a common format, allowing for comparison, and be presented in a way that is likely to be understood by retail investors.

The form, presentation, and content of the sections of the KII has been laid down in *Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards Key Investor Information and conditions to be met when providing Key Investor Information or the prospectus in a durable medium other than paper or by means of a website* and the 2010 Law. The KII must include:

- ▶ Title
- ▶ The required explanatory statement, *inter alia*, advising the client to read it in order to make an informed decision about whether to invest
- ▶ Name (of compartment or share or unit class followed by name of UCITS) and identifier of the share or unit class (commonly the ISIN of the share or unit class) and the reference that the CSSF is the competent authority for the supervision of the UCITS pursuant to the 2010 Law
- ▶ Name of the management company and group, if relevant
- ▶ A description of objectives and investment policy covering, *inter alia*:
 - ▶ Main categories of eligible financial instruments
 - ▶ Targets of the UCITS in relation to industrial, geographical or other market sectors, or specific asset classes
 - ▶ Whether the UCITS allows for discretionary choice with regard to particular investments
 - ▶ Reference to a benchmark, if relevant

ESMA²²⁶ clarified in its *Questions and Answers on the Application of the UCITS Directive*, that a UCITS must clearly indicate in the objectives and investment policy section of the KII whether it has an index tracking objective or alternatively allows for discretionary choices. ESMA recommends using the terms “passive” or “passively managed” in addition to “index-tracking”, and “active” or “actively managed” to assist investor understanding.

ESMA's *Questions and Answers* also provide clarifications of the meaning of the terms “whether this approach includes or implies a reference to a benchmark” and “the degree of freedom from the benchmark”, from article 7(1)(d) of the Regulation.

- ▶ Possibility to redeem shares or units on demand and dealing frequency
- ▶ Whether dividend income is distributed or reinvested
- ▶ Risk and reward profile, including guidance on the associated risks; this will take the form of:
 - ▶ A synthetic risk and reward indicator (SRRI) following ESMA's *guidelines on the methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document*, published in July 2010.

²²⁵ Also referred to as KIIDs.

²²⁶ The Committee of European Securities Regulators (CESR) became the ESMA on 1 January 2011.

The SRRRI aims to provide potential investors with an indication of the overall risk and reward profile of a UCITS. The SRRRI corresponds to an integer number designed to rank the UCITS, according to its increasing level of volatility, on a scale from 1 to 7. The methodology is tailored to cover the particular features of the different types of UCITS. It must be based on the estimated volatility using weekly past returns of the UCITS or, if not otherwise possible, using monthly returns. The returns relevant for the computation of volatility must be gathered from a sample period covering the last five years of the life of the UCITS and, in case of distribution of income, must be measured taking into account the relevant earnings or dividend payoffs.

There are specific rules on application of the methodology to absolute return UCITS, total return UCITS, life cycle UCITS, and structured UCITS. In the case of structured UCITS, the SRRRI should be calculated on the basis of the annualized volatility corresponding to the 99% Value at Risk (VaR) at maturity.

- ▶ A narrative explanation of the main limitations of the SRRRI .
- ▶ A narrative presentation of the material risks that are not fully captured by the methodology of the SRRRI.
- ▶ Charges: following the standard presentation format, including narrative explanations. Ongoing charges should be calculated according to ESMA's²²⁷ *guidelines on the methodology for calculation of the ongoing charges figure in the Key Investor Information Document*, published in July 2010
- ▶ Past performance for the last 10 years; for any years for which data is not available, the year must be shown as blank; for UCITS that do not yet have past performance data for a complete calendar year, a statement must be provided explaining that there is insufficient data to provide a useful indication of past performance

ESMA²²⁸ clarified in its *Questions and Answers on the Application of the UCITS Directive*, that where a UCITS refers to an index in its investment objectives and policy as a benchmark and will measure performance against that index, but does not intend to track the index, the performance of the benchmark index must be shown in the past performance section of the KII.

The requirement to disclose a bar showing the performance of the benchmark index equally applies to total return/absolute return UCITS if the investment objectives and policy clearly mention that the UCITS will aim to outperform an index.

UCITS management companies should ensure that the KII is updated to include this latest ESMA clarification as soon as practicable and that performance disclosed in the KII regarding a benchmark index is consistent with performance disclosure in other investor communications including:

- ▶ Across offering documents and marketing material, including the prospectus
- ▶ Across distribution channels
- ▶ Across investor types
- ▶ Practical information including:
 - ▶ Name of depositary
 - ▶ Where and how to obtain further information about the UCITS, including where and how to obtain, free of charge, the prospectus and annual and semi-annual reports
 - ▶ Where and how to obtain other practical information, including latest prices of shares or units
 - ▶ A statement regarding the tax impact on the investor
 - ▶ A statement regarding the liability of the investment company or management company in relation to the KII
 - ▶ Authorization details
 - ▶ Date of publication
- ▶ Statement to the effect that the details of the up-to-date remuneration policy, including, but not limited to, a description of how remuneration and benefits are calculated, the identity of the persons responsible for awarding the remuneration and benefits including the composition of the remuneration committee, where such a committee exists, are available by means of a website and that a paper copy will be made available free of charge upon request.

The KII document must not exceed two pages of A4-sized paper when printed, or three pages in the case of structured UCITS.

Specific provisions of *Commission Regulation (EU) No 583/2010* cover compartments, share or unit classes, funds of funds, feeder UCITS, and structured UCITS.

²²⁷ The Committee of European Securities Regulators (CESR) became the ESMA on 1 January 2011.

²²⁸ Idem.

In December 2010, ESMA issued various guidelines on KII including:

- ESMA's²²⁹ *template for the Key Investor Information document* showing the type of contents and layout of a KII for a standard UCITS
- ESMA's *guide to clear language and layout for the Key Investor Information document (KII)*, which is intended as a statement of good practice. It covers:
 - Using plain language: what is meant by plain language and how to deal with barriers to clear language
 - Designing a clear KII: covering, *inter alia*, font, layout, and colors
 - Specific guidance on key sections of the KII
- Guidelines on the *Selection and presentation of performance scenarios in the Key Investor Information document (KII) for structured UCITS*. For structured UCITS, the objective and investment policy section of the KII must include an explanation of how the formula works or how the pay-off is calculated, accompanied by an illustration showing at least three scenarios of the UCITS potential performance. The guidelines indicate that the scenarios to illustrate how the pay-off works under the different market conditions should include an unfavorable outcome, a favorable outcome, and a medium outcome, and specific features of the formula. They also provide examples of scenario selection and presentation

The Association of the Luxembourg Fund Industry (ALFI) has issued a *Key Investor Information Document Q&A*. The Q&A, which represents the view of the ALFI working group on KII, covers questions relating to Commission Regulation (EU) No 583/2010, ESMA's guidelines, and using the KII in distribution networks.

The Q&A has been updated a number of times and covers:

- The form and presentation of the KII including:
 - The title of the document, order of contents, and headings of sections
 - Language, length, and presentation
- The content of sections of the KII addressing:
 - The objectives and investment policy
 - The risk and reward profile
 - Charges
 - Past performance
 - Practical information and cross references
 - The review and revision of the KII
- Particular UCITS structures including:
 - Investment compartments
 - Share or unit classes
- Issues in relation to "durable medium"
- ESMA's *guidelines on the methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document*
- ESMA's *guidelines on the methodology for the calculation of the ongoing charges figure in the Key Investor Information Document*
- Using KII in distribution networks

In May 2012, the CSSF issued a *Key Investor Information Document - Frequently Asked Questions* document (the CSSF KII FAQ), updated in July 2012, covering, *inter alia*:

- Minimum regulatory documents to be taken into consideration for drafting a KII
- Procedure to file the final version of a KII with the CSSF
- In the context of a request for authorization of a UCITS or compartment thereof:
 - Procedure when submitting a draft of the KII to the CSSF
 - Requirement to submit a draft of the KII of at least the share or unit class deemed to be the most relevant per compartment
- Responsibility for the content of the KII
- Formal CSSF approval (or visa stamping) - none is provided for KII
- Requirements to be met before issuing a share or unit class (including filing the KII with the CSSF)
- Impact of temporary suspension of subscriptions and redemptions on requirement to keep KII up-to-date
- Provision of translations of the KII to the CSSF
- Requirements to be met in relation to the publication of KII on a website

²²⁹ | The Committee of European Securities Regulators (CESR) became the ESMA on 1 January 2011.

In March 2015, ESMA published an updated Q&A-Key Investor Information Document for UCITS (2015/ESMA/631); covering, *inter alia*:

- Preparation of KII by UCITS that are no longer marketed to the public or by UCITS in liquidation
- Communication of KII to investors
- Treatment of UCITS with share or unit classes
- Past performance
- Clear language
- Identification of the UCITS

ESMA's *Guidelines on ETFs and other UCITS issues*, as amended, require disclosure of the following information in the KII:

- UCITS ETF:
 - Use of the "UCITS ETF" identifier in the name and KII; this English identifier should be used independently of the language of the document; the identifiers "UCITS ETF", "ETF" or "exchange-traded fund" cannot be used by other UCITS
 - The policy on portfolio transparency and where information on the portfolio can be obtained, including the indicative net asset value (iNAV)
 - Actively-managed UCITS ETF:
 - That it is actively managed
 - Strategy to meet the stated investment policy, including any intention to outperform an index
- Index-tracking UCITS:
 - How the index will be tracked and implications in terms of exposure to the underlying index and counterparty risk, in summary form
 - Index-tracking leveraged UCITS: leverage policy, associated costs and risks, impact on returns, impact of any reverse leverage (short exposure), and description of how the performance may differ significantly from the multiple of the index over the medium to long term, in summary form

On 26 November 2014 Regulation (EU) 1286/2014 on key information documents for packaged retail and insurance-based investment product (PRIIPs) was adopted and entered into force from 1 January 2018, following its amendment on 14 December 2016 by Regulation (EU) 2016/2340. On 8 March 2017, the European Commission adopted the Delegated Regulation (EU) 2017/653 supplementing the PRIIPs regulation and laying down regulatory technical standards specifying the content and underlying methodology of the Key Information Document (KID) that will have to be provided to retail consumers when they buy certain investment products.

The CSSF clarified in its *Frequently Asked Questions concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment*, that manufacturers of Luxembourg UCITS need to have in place a PRIIPs KID as of 1 January 2022. Until such date Luxembourg UCITS will be exempt from the obligations of the PRIIPs Regulation in conformity with article 32(1) of such Regulation.

On 3 April 2020, ESMA issued its *Guidelines on performance fees in UCITS and certain types of AIFs* which include a certain number of disclosure requirements in the KII, *inter alia*:

- Investors should be adequately informed about the performance fees and their impact on return
- All ex-ante documents (prospectus, KII, marketing documents) should clearly set out all information necessary to understand the performance fee model and the computation methodology, including the main elements and parameters, the payment date.
- Where a performance fee is payable in times of overall negative performance, a prominent warning must be included in the KII
- Where applicable, the KII and the prospectus should display the name of the benchmark,

For more information on ESMA Guidelines, see Section 10.3.1.F.

10.3.2.2. Production of the KII

KIIs must be drawn up for every UCITS. In the case of umbrella UCITS, a separate KII must be produced for each compartment. In the case of multiple share or unit classes, a separate KII must be produced for each share or unit class, except where a share or unit class can be selected to represent other share or unit classes and certain conditions are met. In the case of master-feeder structures, a separate KII must be produced for each feeder UCITS.

Where a UCITS consists of more than one class of shares or units, the ALFI working group on KII considers that there may be three options:

- ▶ Single share or unit class KIIs: separate KIIs are prepared for each class of shares or units
- ▶ A representative share or unit class KII: in case of multiple share or unit classes, one share or unit class may be selected to represent one or more other classes of the UCITS
- ▶ A multiple share or unit class KII: information on multiple share or unit classes is provided on a single KII

KIIs must be submitted to the CSSF in English, French, German or Luxembourgish.

Where the UCITS is distributed in other Member States, KIIs must be translated into the official language or one of the languages of the UCITS host Member State or into a language approved by the competent authorities of that Member State (see Section 12.3.6.).

10.3.2.3. Update of the KII

The investment company or, in the case of common funds, the management company must ensure that the KII is up-to-date. The KII must be updated annually and reviewed prior to or following any changes regarded as material to the information contained in the KII:

- ▶ *Ex-ante* material changes: the KII must be reviewed prior to any change to the prospectus, constitutional document or any other material change. In general, before a material change is implemented by the investment company or, in the case of common funds, the management company, a draft update to the authorization file, including draft updated KIIs, are communicated to the CSSF (see Section 3.4.)
- ▶ SRRR: the KII must be updated when either of the following occurs:
 - ▶ Changes to the risk and reward section of the KII are the result of a decision by the management company or self-managed UCITS regarding the investment policy or strategy of the UCITS
 - ▶ The relevant volatility of the UCITS has fallen outside the bucket corresponding to its previous risk category on each weekly or monthly data reference point over the preceding four months
- ▶ Other *ex-post* material changes: it is up to the Board of Directors of the investment company, or, in the case of common funds, the management company to define a frequency for identification of material changes. Thresholds and procedures need to be implemented to identify material changes in the composition of the charges and material changes to the ongoing charges
- ▶ Annual updates: the KII must be updated annually. Updated KIIs must be made available and distributed no later than 35 business days after 31 December

As a matter of good practice, management companies and UCITS may also choose to review the KII before entering into any initiative that is likely to result in a significant number of new investors acquiring shares or units in the UCITS.

10.3.2.4. Distribution and publication of KII

New and updated KIIs need to be communicated to:

- ▶ The CSSF (see Sections 3.2., 3.3., and 10.9.)
- ▶ Each host Member State competent authority where the UCITS is registered for public distribution (the "written notice" - see Section 12.3.4.)

The KII must be used without alterations or supplements, except translation, in all Member States where the UCITS is notified to be marketed to the public.

Communication of the KII to investors and distributors is covered in Section 12.2.1.

An up-to-date version of the KII must be made available on the website of the investment company or management company.

According to the CSSF KII FAQ, the UCITS may rely on a third party website, which is not the website of the UCITS or its management company, to make available its KIIs, only when the third party website allows unconditional access that fulfills the following principles:

- The internet address of the location where the KII must be made available is disclosed in the prospectus and KII
- Access to the KII must be available to the general public (with no registration needed) and free of charge
- Public access to the KII must not be restricted in time
- Public access to the KII must be straightforward and dedicated to the UCITS
- When a UCITS publishes its KIIs and other data and information on the internet, all information must be contained within one single website

10.3.2.5. Record keeping

UCITS or their management companies are required to keep a record of certain information including, *inter alia*:

- The choice of a representative share or unit class
- Calculations (e.g., SRRI, simulated data for past performance, charges)

In practice, UCITS or their management companies may choose to keep records of much more of the KII process, from underlying data to KII distribution.

10.3.2.6. Responsibility for KII

The KII constitutes pre-contractual information. The KII must be drawn up and made available by the investment company or, in the case of common funds, the management company in accordance with the EU regulatory requirements concerning format, content, and publication. The Board of Directors of the investment company or management company is accountable for the content of KIIs. The investment company or management company may be held liable solely on the basis of any statement contained in the KII (including any translation thereof) that is misleading, inaccurate or inconsistent with the relevant parts of the prospectus.

10.3.3. PRIIP Key Information Document (PRIIP KID)

10.3.3.1. Content and layout of the KID

The form, presentation, and content of the sections of the KID has been laid down in Commission Regulation (EU) No 1286/2014 of 26 November 2014 on *key information documents for packaged retail and insurance-based investment product (PRIIPs)* following its amendment on 14 December 2016 by Regulation (EU) 2016/2340. The Regulation is supplemented by the Delegated Regulation (EU) 2017/653 of 8 March 2017 laying down regulatory technical standards with regards to the presentation, content, review and revision of KIDs.

The KID must be presented and laid out in a way that is easy to read. KID must be fair, clear, and not misleading. It must be brief and non-technical. It must be consistent with the relevant parts of the offer documents and with the terms and conditions of the PRIIP. It should be written in a concise manner and of maximum three sides of A4-sized paper, allowing for comparison and focus on key information that retail investors need and be presented in a way that is likely to be understood by retail investors.

The information contained in the document should be capable of being relied on by a retail investor when making an investment decision, even in the months and years following the initial preparation of the key information document, for those PRIIPs that remain available to retail investor. Standards should therefore be laid down to ensure timely and appropriate review and revision of key information document, so that those documents remain accurate, fair and clear.

The KID must at least include :

- Title
- Sections containing the following information:
 - A. Description of the purpose of the key information document with the required explanatory statement, *inter alia*, advising the client to read it in order to make an informed decision about whether to invest

- B. "General Information" section containing:
- ▶ Name of the PRIIP assigned by the PRIIP manufacturer and, where applicable, the PRIIP's identifier (e.g., International Number Securities Identification Number (ISIN) of the fund/share class)
 - ▶ Identity and contact details of the PRIIP manufacturer, such as manufacturer specific website and telephone number, providing retail investors with information on how to get in contact with the PRIIP manufacturer
 - ▶ Name of the competent authority responsible for the supervision of the PRIIP manufacturer
 - ▶ The date of the document (the date of the production or, if the document has been recently revised, the date of the revision)
 - ▶ A comprehension alert for complex PRIIPs
- C. "What is this product" section describing the nature and main features of the PRIIP including, *inter alia*:
- ▶ Type of the PRIIP (description of legal form)
 - ▶ Its objectives (markets, including where applicable specific environmental and social objectives targeted) and means for achieving them and, in particular, whether they are achieved with direct or indirect investments including underlying instruments
 - ▶ Description of the type of intended retail investor to whom the PRIIP is intended to be marketed. The MiFID II target market definition can be used as a reference to describe the various target market dimensions such as the recommended holding period/investment horizon or the ability to bear losses.
- D. "What are the risks and what could I get in return" section relating to the risk-reward profile of the PRIIP, consisting of all technical aspects for the methodology and the presentation of the summary risk indicator, as set out in Annex III and the methodology and format for the presentation of performance scenarios, as set out in Annex IV and V of the Regulation comprising, *inter alia*:
- ▶ The level of risk of the PRIIP in the form of a risk class by using a summary risk indicator having a numerical scale from 1 to 7

1	2	3	4	5	6	7
Lower risk					Higher risk	

- ▶ A narrative explanation of that indicator, the main limitations of the indicator and a standard and free-text narrative presentation of the material risks that are not fully captured by the summary risk indicator. The narrative should include an indication of the possible maximum loss, information that the investment may be lost if it is not protected or where the PRIIP manufacturer is unable to pay out, that necessary additional investment payments to the initial investment may be required, and that the total loss may significantly exceed the total initial investment.
 - ▶ Appropriate performance scenarios, as set out in Annex V of the Regulation. These scenarios are built, in most cases, on historical data and are aimed at projecting future performance of the PRIIP. The performance scenarios are as follow:
 - ▶ Unfavorable scenario
 - ▶ Moderate scenario
 - ▶ Favorable scenario
 - ▶ Stress scenario
 - ▶ The four performance scenarios under the Regulation need to show a range of possible returns. Depending on the recommended holding period of the PRIIP, performance should be displayed at:
 - ▶ The end of the first year
 - ▶ The end of the recommended holding period
 - ▶ If applicable, after half of the recommended holding period rounded upwards
 - ▶ The performance should be shown in monetary units (including the relevant currency). In addition, performance should be presented in percentage terms, as the average annual rate of return on the investment
 - ▶ Standard narratives to describe the product/fund performance scenario presentation
- E. "What happens if (the name of the PRIIP manufacturer) is unable to pay out?" section containing information about whether the related loss is covered by an investor compensation or guarantee scheme and if so, which scheme it is, the name of the guarantor and which risks are covered and not covered by the scheme

- F. “What are the costs?” section describing the costs associated with an investment in the PRIIP, comprising both direct and indirect costs to be borne by the retail investor, including one-off and recurring costs, presented by means of summary indicators of these costs and, to ensure comparability, total aggregate costs expressed in monetary and percentage terms, to show the compound effects of the total costs on the investment
- Costs over time are presented as an impact on return (Reduction in Yield) per year in percentage terms. The Reduction in Yield shows what impact the total costs paid will have on the investment return. The cost should be shown as a cumulative cost of the PRIIP. The figure should assume an investment of EUR 10,000 at:
 - The end of the first year
 - The end of the recommended holding period
 - If applicable, after half of the recommended holding period rounded upwards
 - A breakdown of the costs should be disclosed. The composition of costs should include the impact of costs in percentage terms each year, of the different types of costs on the investment return. In addition, the meaning of the different cost categories should be provided as follows:
 - One-off costs such as entry or exit costs borne by the retail investor, not deducted from the assets of the UCI, such as upfront subscription fees
 - Recurring costs
 - Portfolio transaction costs – the impact of the costs of buying and selling
 - Other recurring costs – the impact of the costs incurred in operations, *inter alia*, management company fees, depositary fees, professional fees
 - Incidental costs
 - Performance fees – the impact of the performance fee
 - Carried interest – the impact of carried interest
- G. “How long should I hold it and can I take money out early?” section describing:
- Where applicable, whether there is a cooling off period or cancellation period for the PRIIP
 - An indication of the recommended and, where applicable, required minimum holding period
 - The ability and conditions for any divestments before maturity or any other specified date other than the recommended holding period, including all applicable fees and penalties. Information about potential consequences of cashing in before the end of the term of the recommended holding period such as the loss of capital protection or additional contingent fees
- H. “How can I complain?” section containing all the information about how and to whom a retail investor can make a complaint about the product, the conduct of the PRIIP manufacturer, or a person advising on, or selling, the product. A link to the relevant website for such complaints and an up-to-date postal address and email address to which such complaints may be submitted should also be included
- I. “Other relevant information” section describing any additional information documents that may be provided to the retail investor at the pre-contractual and/or post-contractual stage

As of October 2019, ESMA released a Joint Consultation Paper²³⁰ setting out proposed amendments to PRIIPs RTS²³¹ and requesting an industry perspective to allow an appropriate application of the PRIIP KID by UCITS and relevant non-UCITS funds, subject to the end of the temporary exemption of such UCIs from the requirements of the PRIIPs Regulation.

In light of the above, the ESAs²³² consulted with NCAs²³³ in June 2020 on a new proposal with a view to change how the risk and performance indicators are currently calculated and/or displayed. As of 20 July 2020, the ESAs informed the European Commission that they were not in a position to formally submit the RTS to the European Commission. The primary considerations for this were the upcoming comprehensive review of the PRIIPS regulation and reservations raised on the proposal to present past investment performance in a separate publication from the KID.

10.3.3.2. Production of and responsibility for the KID

Since 1 January 2018, existing AIFs, which utilised the CSSF’s UCITS derogation (see Section 12.5.2.1.1.) currently ending in December 2019, and all new AIFs sold to retail investors (may also include informed investors) need to have a PRIIP KID as a pre-contractual document. As a result, investment companies need to identify which entity is the PRIIP manufacturer and hence must assume the responsibility for preparing, providing and publishing the KID for retail investors.

²³⁰ Joint Consultation Paper concerning amendments to the PRIIPs KID (JC 2019 63).

²³¹ Regulatory Technical Standards, i.e., Level II of PRIIPs Regulation.

²³² European Supervisory Authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority).

²³³ National Competent Authorities.

As the PRIIP manufacturer (investment company/management company) is held accountable for the content and accuracy of the KID, it may be held liable for a violation of the PRIIP Regulation where a retail investor suffers damage merely on the basis of any statement contained in the KID:

- That is misleading or inaccurate (also applying to translations of the content)
- That is inconsistent with the relevant parts of the prospectus
- That is not compliant with the prescribed format and content requirements of the KID

Each KID should be produced and updated by the PRIIP manufacturer.

The PRIIP KID needs to be provided as a pre-contractual document and therefore must be prepared and be available well in advance of any sale to a retail investor or to an intermediary distributing the PRIIP to retail investors.

10.3.3.3. Update of the KID

PRIIP manufacturers must establish and maintain adequate processes throughout the life of the PRIIP where it remains available to retail investors to identify without undue delay any circumstances which might result in a change that affects or is likely to affect the accuracy, fairness or clarity of the information contained in the KID.

PRIIP manufacturers must review the information contained in the key information document every time there is a change that significantly affects or is likely to significantly affect the information contained in the KID and, at least, every 12 months following the date of the initial publication of the KID.

The review must verify whether the information contained in the KID remains accurate, fair, clear, and non-misleading. In particular, it must verify the following:

- a) Whether the information contained in the key information document is compliant with the general form and content requirements under the Regulation and Delegated regulation
- b) Whether the PRIIP's market risk or credit risk measures have changed, where such a change has the combined effect that necessitates the PRIIP's move to a different class of the summary risk indicator from that attributed in the key information document subject to review
- c) Whether the mean return for the PRIIP's moderate performance scenario, expressed as an annualized percentage return, has changed by more than five percentage points.

10.3.3.4. Record keeping for KID

PRIIP manufacturers or their management companies are required to keep a record of certain information including, *inter alia*, each published PRIIP KID for a period of 10 years.

In practice, PRIIP manufacturers or their management companies may choose to keep records of much more of the PRIIPs process, such as underlying data used and calculations.

10.3.4. AIF

The following information must be disclosed to investors before they invest in an AIF:

- A description of the investment strategy and objectives of the AIF
- Information on where any master AIF is established and where the underlying funds are established if the AIF is a fund of funds
- A description of the types of assets in which the AIF may invest
- The techniques it may employ and all associated risks (see Section 7.3.)
- Any applicable investment restrictions
- Leverage (see also Section 7.3.6.A.):
 - The circumstances in which the AIF may use leverage
 - The types and sources of leverage permitted and the associated risks
 - Any restrictions to the use of leverage and any collateral and asset re-use arrangements
 - Information on the maximum level of leverage that the AIFM may employ on behalf of the AIF

Where FDIs are used and benefit only specific share or unit classes (e.g., hedging, leverage), it is good practice to disclose leverage at share or unit class level, although there are no specific requirements on disclosures at share or unit class level.

- A description of the procedures by which the AIF may change its investment strategy or investment policy, or both

- ▶ A description of the main legal implications of the contractual relationship entered into for the purpose of investment, including information on jurisdiction, on the applicable law, and on the existence or not of any legal instruments providing for the recognition and enforcement of judgments in the territory where the AIF is established
- ▶ The identity of the AIFM, the AIF's depositary, auditor and any other service providers and a description of their duties, and the investors' rights
- ▶ A description of how the AIFM is complying with the professional liability cover requirements (see Section 6.2.3.2.D.)
- ▶ A description of any delegated management function (see Section 6.3.3.) and of any safe-keeping function delegated by the depositary (see Section 9.7.), the identification of the delegate and any conflicts of interest that may arise from such delegations (see also Section 9.8.)
- ▶ Information about any arrangement made by the depositary to contractually discharge itself of liability (see Section 9.7.4. and 10.4.2.5.)
- ▶ A description of the AIF's valuation procedure and of the pricing methodology for valuing assets, including the methods used in valuing hard-to-value assets (see Section 7.6.2.)
- ▶ A description of the AIF's liquidity risk management, including the redemption rights both in normal and in exceptional circumstances, and the existing redemption arrangements with investors (see Section 7.3.6.C.)
- ▶ A description of all fees, charges, and expenses and of the maximum amounts thereof that are directly or indirectly borne by investors (see Section 11.2.)
- ▶ A description of how the AIFM ensures a fair treatment of investors and, whenever an investor obtains preferential treatment or the right to obtain preferential treatment, a description of that preferential treatment, the type of investors who obtain such preferential treatment, and, where relevant, their legal or economic links with the AIF or AIFM (see Section 6.4.2.)
- ▶ The latest annual report (see Section 10.5.2.)
- ▶ The procedure and conditions for the issue and sale of shares or units (see Section 8.7.)
- ▶ The latest net asset value of the AIF or the latest market price of the share or unit of the AIF
- ▶ Where available, the historical performance of the AIF
- ▶ Prime broker (see Section 6.3.5.2.):
 - ▶ Identity of the prime broker
 - ▶ A description of any material arrangements of the AIF with its prime brokers and the way the conflicts of interest in relation thereto are managed
 - ▶ The provision in the contract with the depositary on the possibility of transfer and re-use of AIF assets
 - ▶ Information about any transfer of liability to the prime broker that may exist
- ▶ A description of how and when the periodic disclosures on liquidity and the regular disclosures on leverage will be provided to investors (see Section 10.4.2.)

Where the AIF is required to publish a prospectus and not all of the aforementioned information is included in the prospectus, the additional information needs to be disclosed separately or as additional information in the prospectus.

Prospectuses of closed-ended AIFs whose shares/units are listed on the Bourse de Luxembourg are required to comply with the requirements of the Prospectus Regulation²³⁴. CSSF Circular 16/636 implemented ESMA's *Guidelines on Alternative Performance Measures*. These Guidelines aim at promoting the usefulness and transparency of Alternative Performance Measures (APMs) disclosed by issuers or the person responsible for the prospectus prepared in accordance with the Prospectus Regulation²³⁵.

Investors must also be informed of any material changes to the information provided to them. Any material changes to the information disclosed to investors before they invest and not already present in the financial statements must be disclosed in the report on the activities for the financial year (see Section 10.5.2.).

Regulation (EU) 2015/2365 on *transparency of securities financing transactions and of reuse* (SFTR) requires that disclosures by AIFMs, or internally managed AIFs, to investors specify the securities financing transactions (SFTs) and total return swaps which AIFMs, or internally managed AIFs, are authorized to use, and include a clear statement that those transactions and instruments are used.

The disclosures to investors must include the following data:

- ▶ General description of the SFTs and total return swaps used by the AIF and the rationale for use

²³⁴ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market

²³⁵ Idem.

- ▶ Overall data to be reported for each type of SFTs and total return swaps:
 - ▶ Types of assets that can be subject to them
 - ▶ Maximum proportion of assets under management that can be subject to them
 - ▶ Expected proportion of assets under management that will be subject to each of them
- ▶ Criteria used to select counterparties (including legal status, country of origin, minimum credit rating)
- ▶ Acceptable collateral: description of acceptable collateral with regard to asset types, issuer, maturity, liquidity as well as the collateral diversification and correlation policies
- ▶ Collateral valuation: description of the collateral valuation methodology used and its rationale, and whether daily mark-to-market and daily variation margins are used
- ▶ Risk management: description of the risks linked to SFTs and total return swaps as well as risks linked to collateral management, such as operational, liquidity, counterparty, custody and legal risks and, where applicable, the risks arising from its reuse
- ▶ Specification of how assets subject to SFTs and total return swaps and collateral received are safe-kept (e.g., with the AIF custodian)
- ▶ Specification of any restrictions (regulatory or self-imposed) on the reuse of collateral
- ▶ Policy on sharing or return generated by SFTs and total return swaps: description of the proportions of the revenue generated by SFTs and total return swaps that is returned to the AIF, and of the costs and fees assigned to the manager or third parties (e.g., the agent lender). The disclosures should also indicate if these are related parties to the manager.

On 3 April 2020, ESMA issued its *Guidelines on performance fees in UCITS and certain types of AIFs* which include a certain number of disclosure requirements in the KII, *inter alia*:

- ▶ Investors should be adequately informed about the performance fees and their impact on return
- ▶ All ex-ante documents (prospectus, KII, marketing documents) should clearly set out all information necessary to understand the performance fee model and the computation methodology, including the main elements and parameters, the payment date.
- ▶ Where a performance fee is payable in times of overall negative performance, a prominent warning must be included in the KII
- ▶ Where applicable, the KII and the prospectus should display the name of the benchmark

For more information on ESMA Guidelines, see Section 10.3.1.F.

An AIF falls under the scope of the Regulation (EU) 2016/1011 on *indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the "Benchmark Regulation")* when an index is used to measure its performance with the purpose of tracking the return of such index or of defining the asset allocation of a portfolio or of computing the performance fees.

As per the Benchmark Regulation²³⁶, a prospectus issued under the Prospectus Regulation²³⁷ or the UCITS Directive²³⁸ should include clear and prominent information stating whether the benchmark is provided by an administrator included in the register referred to in Article 36 of the Benchmark Regulation.

In its Questions and Answers on the Benchmarks Regulation, ESMA considers that prospectuses should include reference to ESMA register of administrators and benchmarks ("the register") as described in Section 10.3.1.N.

10.3.5. Offering document of SIFs

A SIF, or its management company, must establish an offering document. The offering document may be labeled as a private placement memorandum, offering memorandum, issuing document or prospectus, as the case may be. The document must include the information necessary for investors to be able to make an informed judgment of the investment proposed to them and, in particular, of the associated risks.

Generally, the offering document of a SIF contains most of the information required for 2010 Law UCIs (see Section 10.3.1.).

The offering document of a SIF should also provide details on how the principle of risk diversification will be implemented, including quantifiable investment limits.

²³⁶ Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds

²³⁷ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market

²³⁸ Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

The offering document should also list the delegated functions.

The essential elements of the offering document must be up-to-date when new shares or units are issued to new investors.

10.3.6. Offering documents of RAIFs

The offering document of a RAIF must include information necessary for investors to be able to make an informed judgment of the investment proposed to them, and in particular, of the risks attached thereto.

It must also contain a clearly visible statement on its cover page stating that the RAIF is not subject to supervision by a Luxembourg supervisory authority.

The essential elements of the offering document must be up-to-date when new shares or units are issued to new investors.

Information to be provided to investors of a RAIF is consistent with the requirements of the AIFM Law.

10.3.7. EuVECA and EuSEF

The managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) are, for each qualifying European fund they manage, required to provide investors before they invest with information in a clear and understandable manner, including:

- ▶ The identity of the manager and any other service providers and a description of their duties
- ▶ The amount of own funds of the manager and a detailed statement as to why the manager considers that amount to be sufficient for maintaining the adequate human and technical resources
- ▶ A description of the investment strategy and objectives of the qualifying European fund, including a description of the types of the qualifying portfolio undertakings, other qualifying European funds and non-qualifying investments in which the qualifying European fund intends to invest, the techniques it may employ, and any applicable investment restrictions
- ▶ In the case of EuSEFs:
 - (i) The positive social impact being targeted by the investment policy of the EuSEF, including where relevant, projections of such outcomes and information on past performance in this area
 - (ii) The methodologies to be used to measure social impacts
 - (iii) A description of the assets other than qualifying portfolio undertakings and the process and criteria that are used for selecting these assets (other than cash or cash equivalents)
- ▶ A description of the risk profile of the qualifying European fund and any risks associated with the assets in which the fund may invest or investment techniques that may be employed
- ▶ A description of the qualifying European fund's valuation procedure and pricing methodology for the valuation of assets
- ▶ A description of how the remuneration of the manager is calculated
- ▶ A description of all relevant costs and the maximum amounts thereof
- ▶ Where available, the historical performance
- ▶ The business support services and the other support activities the manager is providing or arranging in order to facilitate the development, growth or, in some other respect, the ongoing operations of the qualifying portfolio undertakings, or explanation of the fact that such services or activities are not provided
- ▶ A description of the procedures by which the qualifying European fund may change its investment strategy or investment policy, or both

The EuVECA and EuSEF regimes are introduced in Section 2.4.4.3.

10.3.8. ELTIF

The prospectus of an ELTIF should include all information necessary to enable investors to make an informed assessment regarding the investment proposed to them, and in particular, the risks attached thereto.

The prospectus should contain at least the following:

- ▶ A statement setting out how the ELTIF's investment objectives and strategy for achieving the objectives qualify the fund as long-term in nature

- ▶ Information to be disclosed by closed-end UCIs in accordance with the Prospectus Regulation²³⁹ and Regulation (EC) 809/2004
- ▶ Information to be disclosed to investors required by Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers as supplemented by the Delegated Regulation (EU) No.694/2014 of the European Commission
- ▶ A prominent indication of the categories of assets in which the ELTIF is allowed to invest
- ▶ A prominent indication of the jurisdictions in which the ELTIF is allowed to invest
- ▶ Information about the illiquid nature of the ELTIF, in particular clearly:
 - ▶ Informing investors about the long-term nature of the ELTIF's investments
 - ▶ Informing investors about the end of the life of the ELTIF as well as the option to extend the life, where provided for and conditions relating thereto
 - ▶ Stating whether the ELTIF is intended to be marketed to retail investors
 - ▶ Explaining the rights of investors to redeem
 - ▶ Stating the frequency and timing of distributions of proceeds, if any
 - ▶ Advising investors that only a small overall proportion of their overall investment portfolio should be invested in an ELTIF
 - ▶ Describing the hedging policy, including an indication that financial derivative instruments may only be used for hedging and the possible impact on the risk profile of the ELTIF as a result thereof
 - ▶ Informing investors about the risks related to investing in real assets, including infrastructure
 - ▶ Informing investors regularly, at least once a year, of the jurisdictions in which the ELTIF has invested
- ▶ The level of costs borne directly or indirectly by the investors, grouped using the headings of (i) costs of set up, (ii) costs related to the acquisition of assets, (iii) management and performance related fees, (iv) distribution costs and (v) other costs including administrative, regulatory, depositary, custodial, professional services and audit costs
- ▶ An overall ratio of the costs to the capital of the ELTIF
- ▶ Any other information requested by the competent authorities

10.4. Periodic investor disclosures and updates

The management company or investment company that has not appointed a management company may be required to periodically disclose information, including in relation to conflicts of interest, on the exercise of voting rights, and, in the case of AIF, on liquidity, leverage, and remuneration.

10.4.1. UCITS

10.4.1.1. Conflicts of interest

Self-managed UCITS investment companies and UCITS management companies must inform investors about the situations where organization or administrative arrangements made by the management company or the investment company to manage conflicts of interest have not been sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the UCITS it manages or its shareholders or unitholders will be prevented. Such information must be transmitted in a durable medium (see also Section 6.4.1.).

10.4.1.2. Voting rights

A summary of the strategies for determining when and how voting rights attached to instruments held in the managed portfolios will be exercised to the exclusive benefit of the UCITS it manages has to be made available to investors, in particular by way of a website. Details of the actions taken on the basis of those strategies have to be made available to investors upon request (see also Section 5.1.3.B.).

10.4.1.3. Share classes

The CSSF's *Frequently Asked Questions concerning the Luxembourg Law of 17 December 2010* relating to undertakings for collective investment, stipulates that a notice to existing investors about the update of the prospectus is required if the update of the prospectus includes changes to the rights/interests of the investors.

²³⁹ Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

10.4.2. AIF

10.4.2.1. Conflicts of interest

Where organizational arrangements made by the AIFM and internally managed AIF in relation to conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to investors' interests will be prevented, the AIFM and internally managed AIF must disclose information on the conflicts of interest to the investors. This disclosure must be provided in a durable medium or by means of a website, to investors before undertaking business on their behalf (see also Section 6.4.1. for SIFs, Section 2.4.2.3. and for ELTIFs see Section 2.4.5.).

10.4.2.2. Liquidity risk

AIFMs and internally managed AIFs are required to periodically disclose to investors:

- The percentage of the AIF's assets that are subject to special arrangements due to their illiquid nature, providing an overview of such special arrangements in place, including whether they relate to side pockets, gates or other similar arrangements, the valuation methodology applied to assets that are subject to such arrangements, and how management and performance fees apply to these assets
- The current risk profile of the AIF including:
 - (i) Measures to assess the sensitivity of the AIF's portfolio to the most relevant risks to which the AIF is or could be exposed
 - (ii) If risk limits set by the AIFM and internally managed AIF have been or are likely to be exceeded and where these risk limits have been exceeded, a description of the circumstances and the remedial measures taken
- The risk management systems employed by the AIFM outlining the main features of the risk management systems to manage the risks to which each AIF it manages is or may be exposed. In the case of a change, the disclosure shall include the information relating to the change and its anticipated impact on the AIF and its investors

This information must be provided as part of the AIF's periodic reporting to investors or at the same time as the prospectus or offering document and, as a minimum, at the same time as the annual report is made available.

AIFMs and internally managed AIFs are also required to:

- Notify investors of any material changes to liquidity management systems and procedures
- Immediately notify investors where they activate gates, side pockets or similar special arrangements or where they decide to suspend redemptions
- Provide an overview of any changes to liquidity arrangements, including special arrangements

See also Section 7.3.6.

10.4.2.3. Leverage

The following information must be disclosed to investors on a regular basis:

- The original and revised maximum level of leverage that the AIFM, on behalf of the AIF, or the internally managed AIF may employ, calculated according to the gross method and the commitment method
- The nature of the rights granted for the re-use of collateral
- The nature of any guarantees granted under the leveraging arrangement
- Details of any changes in service providers relating to one of the previous bullet points
- The total amount of leverage employed by that AIF

The information must be disclosed as part of the AIF's periodic reporting to investors, or at the same time as the prospectus or offering document and, at a minimum, at the same time as the annual report is made available.

Where FDIs are used and benefit only specific share or unit classes (e.g., hedging, leverage), it is good practice to disclose leverage at share or unit class level, although there are no specific requirements on disclosures at share or unit class level.

See also Section 7.3.6.

10.4.2.4. Voting rights

A summary description of the effective strategies for determining when and how any voting rights held in the AIF portfolios it manages will be exercised and details of the actions taken on the basis of those strategies must be made available to the investors on their request. See also Section 5.1.3.B.

10.4.2.5. Depositary liability

The AIFM or internally managed AIF must inform investors of any changes with respect to depositary liability without delay (see Section 9.6.).

10.4.3. Remuneration disclosures

A management company, self-managed UCITS or internally managed AIF should disclose relevant information on the remuneration policy and any updates in case of policy changes in a clear and easily understandable way to relevant stakeholders. Such disclosure may take the form of an independent remuneration policy statement, a periodic disclosure in annual financial statements or any other form.

The information disclosed should include:

- The decision-making process used for determining the remuneration policy
- Linkage between pay and performance
- The criteria used for performance measurement and the risk adjustment
- Performance criteria on which the entitlement to shares, options or variable components of remuneration is based
- The main parameters and rationale for any annual bonus scheme and any other non-cash benefits

Remuneration requirements are covered in Section 6.4.3.

UCITS annual report remuneration disclosures by UCITS management companies are covered in Section 10.5.1. and AIF annual report remuneration disclosures by AIFM are covered in Section 10.5.2.

10.4.4. SIFs

10.4.4.1. Conflicts of interest

Where the organizational and administrative arrangements made by a SIF to manage conflicts of interest are not sufficient to guarantee, with reasonable confidence, that risks of damage to the interests of the SIF or its investors will be prevented, the SIF is required to inform the investors of such conflicts of interest and explain the measures adopted by the SIF in relation to those conflicts of interest (see Section 2.4.2.3.). The information must be provided in a durable medium.

10.4.5. ELTIF

An ELTIF is required to include in its periodical reports, the market value of its listed units or shares along with the net asset value per unit or share.

Any material change to the value of an asset is also required to be disclosed in the periodical reports.

10.4.6 Money Market Funds

On 30 June 2017, the final text of Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on *money market funds* (MMF) was published in the Official Journal of the European Union. The regulation applies to all funds and compartments that qualify as money market funds as per the definition set out in article 1 of the regulation.

An MMF must indicate clearly which type of MMF it is in accordance with Article 3(1) of the regulation and whether it is a short-term or a standard MMF in any external document, report, statement, advertisement, letter or any other written evidence issued by it or by the manager of the MMF, addressed to or intended for distribution to prospective investors, unitholders, or shareholders.

The manager of an MMF must, at least weekly, make all of the following information available to the MMF's investors:

- (a) The maturity breakdown of the portfolio of the MMF
- (b) The credit profile of the MMF
- (c) The Weighted Average Maturity (WAM) and Weighted Average Life (WAL) of the MMF

- (d) Details of the 10 largest holdings of the MMF, including the name, country, maturity and asset type, and the counterparty in the case of repurchase and reverse repurchase agreements
- (e) The total value of the assets of the MMF
- (f) The net yield of the MMF

The CSSF's *Frequently Asked Questions concerning Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds* clarify that :

- ▶ (a) to (f) above may be provided by means of a website indicated in the MMF's offering document
- ▶ The MMF or its manager may decide at its discretion the timing of the weekly disclosures
- ▶ The MMF or its manager should provide information relating to the internal credit quality assessment. This information may be complemented by external ratings provided by a registered and certified credit rating agency

Any document of an MMF used for marketing purposes shall clearly include all of the following statements:

- (a) That the MMF is not a guaranteed investment
- (b) That an investment in MMFs is different from an investment in deposits, with particular reference to the risk that the principal invested in an MMF is capable of fluctuation
- (c) That the MMF does not rely on external support for guaranteeing the liquidity of the MMF or stabilizing the NAV per unit or share
- (d) That the risk of loss of the principal is to be borne by the investor

No communication by the MMF or by the manager of an MMF to investors or potential investors shall in any way suggest that an investment in the units or shares of the MMF is guaranteed.

Investors in an MMF shall be clearly informed of the method or methods used by the MMF to value the assets of the MMF and calculate the NAV.

Public debt constant net asset value (CNAV) MMFs and low volatility net asset value (LVNAV) MMFs should explain clearly to investors and potential investors any use of the amortized cost method or of rounding or both.

10.5. Financial reporting

This section covers the financial reporting requirements for UCIs. The reporting requirements apply as follows:

- ▶ UCITS: the 2010 Law requirements
- ▶ 2010 Law Part II UCIs subject to full AIFM regime: the 2010 Law requirements and the AIF requirements
- ▶ 2010 Law Part II UCIs subject to simplified AIFM registration regime: the 2010 Law requirements
- ▶ SIFs subject to full AIFM regime: the SIF requirements and the AIF requirements
- ▶ SIFs subject to simplified AIFM registration regime: the SIF requirements
- ▶ ELTIFs
- ▶ RAIFs: the RAIF requirements and the AIF requirements

It also covers multiple compartment UCIs and audit requirements.

The CSSF expects that the financial statements of a UCI will be drawn up from:

- ▶ For an investment company - the date of incorporation
- ▶ For a common fund (FCP) - the date of constitution (which is not necessarily the date of launch of the UCI).

10.5.1. Annual report of 2010 Law UCIs

An annual report including the audited financial statements (often referred to as the short form report) is to be published:

- ▶ For UCITS: within four months of the end of the period to which it relates
- ▶ For 2010 Law Part II UCIs: within six months of the end of the period to which it relates or four months when the UCI is admitted to trading on a regulated market (see Section 13.4.1.).

The annual report must be communicated to the CSSF (see Section 10.9.). The annual report must also be available 8 days prior to the annual general meeting of shareholders, where applicable.

The annual report must include information specified in Schedule B of Annex I to the 2010 Law as well as any significant information which will enable investors to make an informed judgement on the development of the activities and the results of the UCI.

Schedule B of Annex I to the 2010 Law includes:

- I. Statement of assets and liabilities:
 - ▶ Transferable securities
 - ▶ Bank balances
 - ▶ Other assets
 - ▶ Total assets
 - ▶ Liabilities
 - ▶ Net asset value (NAV)
- II. Number of shares or units in circulation
- III. NAV per share or unit
- IV. Portfolio, distinguishing between:
 - a) Transferable securities and money market instruments (MMIs) admitted to official stock exchange listing
 - b) Transferable securities and MMIs dealt in on another regulated market
 - c) Recently issued transferable securities and MMIs
 - d) Other transferable securities and MMIs (see Section 4.2.2.3.)

The portfolio should be analyzed in accordance with the most appropriate criteria in light of the investment policy of the UCI (e.g., in accordance with economic, geographical or currency criteria) as a percentage of net assets; for each of the above investments, the proportion it represents of the total net assets of the UCI should be stated.

Statement of changes in the composition of the portfolio during the reference period.

The CSSF may permit that this statement be omitted from the annual report, provided that it is made available free of charge to shareholders or unitholders and that this is clearly stated in the annual report.

- V. Statement of the developments (generally known as the “statement(s) of operations and changes in net assets”) concerning the assets of the UCI during the reference period including the following:
 - ▶ Income from investments
 - ▶ Other income
 - ▶ Management charges
 - ▶ Depository’s charges
 - ▶ Other charges and taxes
 - ▶ Net income
 - ▶ Distributions and income reinvested
 - ▶ Increases or decreases of the capital account
 - ▶ Appreciation or depreciation of investments
 - ▶ Any other changes affecting the assets and liabilities of the UCI
 - ▶ Transaction costs

Transaction costs must be disclosed on a compartment basis.

Transaction costs are all costs incurred by a UCI in connection with investment transactions, including those charged by the depository for the execution of the UCI’s transactions

Transaction costs may be disclosed either under a specific heading “transaction costs” in the statement of operations or in the notes to the financial statements.

- VI. A comparative table covering the last three financial years and including, for each financial year, at the end of the financial year:
 - ▶ The total NAV
 - ▶ The NAV per share or unit
- VII. Details of FDI transactions and techniques and instruments employed, by category of transaction, carried out by the UCI during the reference period, and of the resulting amount of commitments (i.e., transactions within the meaning of Article 42 of the 2010 Law).

A statement of changes in the number of shares or units outstanding is also normally included. It is not required to disclose the individual and total cost of the investments. Comparative figures are also not, in practice, disclosed.

The Law of 10 May 2016 implementing UCITS V supplemented the 2010 Law annual report disclosure requirements to include:

- ▶ The total amount of remuneration for the financial year, split into fixed and variable remuneration paid by the management company and by the investment company to its staff, and the number of beneficiaries, and where relevant, any amount paid directly by the UCITS itself, including any performance fee
- ▶ The aggregate amount of remuneration broken down by categories of employees or other members of staff of the management company whose actions have a material impact on the risk profile of the UCITS
- ▶ A description of how the remuneration and benefits have been calculated
- ▶ The outcome of the reviews of the remuneration policy, including any irregularities that have occurred
- ▶ Material changes to the remuneration policy

ESMA's *Questions and Answers on the Application of the UCITS Directive*, indicate that the remuneration-related disclosure requirements under Article 69(3)(a) of the UCITS Directive²⁴⁰ also apply to the staff of the delegate of a management company to whom investment management functions (including risk management) have been delegated.

Management companies can ensure compliance in one of the following two ways:

- (i) Where the delegate is subject to regulatory requirements on remuneration disclosure for its staff to whom investment management (including risk management) activities have been delegated that are equally as effective as those under Article 69(3)(a) of the UCITS Directive²⁴¹, the management company should use the information disclosed by the delegate for the purposes of fulfilling its obligations under Article 69(3)(a) of the UCITS Directive²⁴²
- (ii) In other cases, appropriate contractual arrangements should be put in place with the delegate allowing the management company to receive (and disclose in the annual report for the relevant UCITS that it manages) at least information on the total amount of remuneration for the financial year, split into fixed and variable remuneration, paid by the management company, the investment company and, where relevant the UCITS itself to the identified staff of the delegate - and number of beneficiaries, and, where relevant, performance fee - which is linked to the delegated portfolio. This means that the disclosure should be done on a prorated basis for the part of the UCITS' assets which are managed by the identified staff within the delegate

In both situations set out above, the disclosure may be provided on an aggregate basis i.e., by means of a total amount for all the delegates of the management company in relation to the relevant UCITS.

Where a UCITS invests a substantial proportion of its assets in other UCITS and/or other UCIs that are linked to the investing UCITS (see Section 4.2.2.8.1.III.(3)), the 2010 Law requires disclosure of the maximum proportion of management fees charged both to the UCITS itself and to the UCITS and/or other UCIs in which it invests.

CSSF Circulars 14/592 and 13/559 implementing ESMA's *Guidelines on ETFs and other UCITS issues* require disclosure of the following information in the annual report of the UCITS:

- ▶ Efficient Portfolio Management (EPM) techniques:
 - (i) The exposure gained through EPM techniques
 - (ii) The identity of the counterparties to these EPM techniques
 - (iii) The type and amount of collateral received to reduce counterparty exposure
 - (iv) The revenues arising from EPM techniques for the entire reporting period together with the direct and indirect operational costs and fees incurred
- ▶ FDIs: UCITS entering into total return swaps (TRS) or similar derivative instruments:
 - (i) The underlying exposure obtained through FDIs
 - (ii) The identity of the counterparties to these FDI transactions
 - (iii) The type and amount of collateral received to reduce counterparty exposure
- ▶ Index-tracking UCITS: size of the tracking error at the end of the period under review, explanation of any divergence between the anticipated and realized tracking error for the relevant period and an explanation of the annual tracking difference between the performance of the UCITS and the performance of the index tracked

²⁴⁰ Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

²⁴¹ Idem.

²⁴² Idem.

According to CSSF Circular 08/356, where the UCI employs certain techniques and instruments relating to transferable securities and MMIs (see Section 4.2.2.6.), the annual report of the UCI must disclose the:

- Global valuation of securities lent at the year-end date
- Total amount of open transactions related to securities purchased with a repurchase option at the year-end date
- Total amount of open transactions related to securities sold with a repurchase option at the year-end date
- Total amount of open reverse repurchase agreements at the year-end date
- Total amount of open repurchase agreements at the year-end date

If cash collateral received has been reinvested, reinvestments must be specified, with their values given, in an appendix to the annual report of the UCI.

ESMA's *Revision of the provisions on diversification of collateral in ESMA's Guidelines on ETFs and other UCITS issues* requires that the UCITS' annual report should contain details of the following in the context of OTC FDI transactions and EPM techniques (see also Sections 4.2.2.8. and 4.2.2.10.):

- Where collateral received from an issuer has exceeded 20% of the NAV of the UCITS, the identity of that issuer
- Whether the UCITS has been fully collateralized in securities issued or guaranteed by a Member State

Section I of Chapter H of IML Circular 91/75 requires that the financial statements of a UCITS identify the securities that are the subject of an option and individually indicate the writing of call options on securities that are not held in the portfolio. The financial statements should also breakdown, by category of options, the aggregate of the exercise (strike) prices of options outstanding as at the year-end date.

Regulation (EU) 2015/2365 of the European Parliament and of the Council, of 25 November 2015, on the *transparency of securities financing transactions and of reuse* (the SFT Regulation) requires the following disclosures to be made in the semi-annual and annual reports of UCITS:

Global data

- The amount of securities and commodities on loan as proportion of total lendable assets defined as excluding cash and cash equivalents
- The amount of assets engaged in each type of SFTs and total return swaps expressed as an absolute amount (in the base currency of the UCITS) and as a proportion of the UCITS' assets under management

Concentration data

- Ten largest collateral issuers across all SFTs and total return swaps (breakdown of volumes of the collateral securities and commodities received per issuer's name)
- Top 10 counterparties of each type of SFTs and total return swaps separately (name of counterparty and gross volume of outstanding transactions)

Aggregate transaction data for each type of SFT and total return swap separately to be broken down according to the below categories

- Type and quality of collateral
- Maturity tenor of the collateral broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open maturity
- Currency of the collateral
- Maturity tenor of the SFTs and total return swaps broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open transactions
- Country in which the counterparties are established
- Settlement and clearing (e.g., tri-party, central counterparty, bilateral)

Data on reuse of collateral

- Share of collateral received that is reused, compared to the maximum amount specified in the prospectus
- Cash collateral reinvestment returns to the UCITS*

Safekeeping of collateral received by the UCITS as part of SFTs and total return swaps

- Number and names of custodians and the amount of collateral assets safe-kept by each of the custodians

Safekeeping of collateral granted by the UCITS as part of SFTs and total return swaps

- The proportion of collateral held in segregated accounts or in pooled accounts, or in any other accounts

Data on return on cost for each type of SFTs and total return swaps

- ▶ Broken down between the UCITS, the manager of the UCITS and third parties (e.g., agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFT and total return swaps*

ESMA's *Questions and Answers on the Application of the UCITS Directive*, provides clarification on data to be reported under the SFT Regulation in the semi-annual and annual reports of UCITS. ESMA clarified that all items except those marked with an * above should be reported on a snapshot basis. Items marked with an * should be disclosed on an aggregate basis.

In the case of a UCITS master/feeder structure, in addition to the information provided for in Schedule B of Annex I to the 2010 Law, the annual report of the feeder UCITS must include a statement on the aggregate charges of the feeder UCITS and the master UCITS. The annual and semi-annual reports of the feeder UCITS must also indicate how the annual and the semi-annual reports of the master UCITS can be obtained.

In practice, the financial statements of a feeder UCITS should include the following:

- ▶ The position held by the feeder UCITS in the master UCITS, shown in the statement of investments of the feeder UCITS. The value of the master UCITS should be based on its NAV as of the year-end of the feeder UCITS
- ▶ Indication of where the annual report and semi-annual report of the master UCITS can be obtained. The language in which the annual report and semi-annual report of the master UCITS must be prepared must be a language commonly used in Luxembourg (English, French or German)
- ▶ A note covering the following information:
 - (i) General description of the master and feeder structure
 - (ii) The investment objective and policy of the master UCITS
 - (iii) The feeder UCITS percentage ownership share of the master UCITS at the year-end date of the feeder UCITS
- ▶ Aggregate charges disclosed in both of the following ways:
 - (i) Monetary terms (expressed in the fund currency of the feeder UCITS) by applying a look through approach
 - (ii) By adding total charges expressed as a percentage of the average NAV of the master UCITS and feeder UCITS

If aggregate charges cannot be disclosed in monetary terms, as a transitional measure, the aggregate charges of the master UCITS and feeder UCITS may only be disclosed by adding total charges expressed as a percentage of their average NAVs.

Both aggregate charges disclosures must be given in the annual report. This information may be presented in the notes to the financial statements of the feeder UCITS or in a section providing other information.

The charges-related information regarding the master UCITS should be presented, in principle, for the same accounting period of the feeder UCITS. However, if this information cannot be obtained without undue costs, the information may be provided for the last audited period of the master UCITS, where all of the following conditions are met:

- ▶ Aggregate charges of the feeder UCITS and master UCITS are expressed in monetary terms and as a percentage of the average NAVs
- ▶ These main charges applicable for the master UCITS have not changed significantly since its last year-end (i.e., no change in the fee rates applicable to, for example, portfolio management, administration, depositary, distribution)
- ▶ There were no significant subscriptions/redemptions at the level of the master UCITS that could have a significant impact on the total of charges expressed in monetary terms and as a percentage of the average NAV due to dilution of fixed charges (charges not linked to the NAV such as audit fees and legal fees)
- ▶ It is clearly mentioned in the annual report that total charges of the master UCITS do not cover the entire financial period of the feeder UCITS

CSSF Circular 11/512 as amended and ESMA's *Guidelines on risk measurement and the calculation of Global Exposure and Counterparty Risk for UCITS* require disclosure of the following information in the annual report of UCITS (see also Section 7.2.6.B.):

- ▶ The method used to calculate global exposure, making a distinction between the commitment approach, the relative VaR or the absolute VaR approach
- ▶ Information on the reference portfolio for UCITS using the relative VaR approach. CSSF Circular 11/512 as amended provides further clarification on the content of the information to be disclosed

- ▶ The utilization of the VaR limit of the UCITS, where applicable. The information provided should at least include the lowest, the highest, and the average utilization of the VaR limit calculated during the financial year; this is further clarified in CSSF Circular 11/512 as amended
- ▶ The VaR model and parameters used for calculation (confidence interval, holding period, length of data history), where applicable
- ▶ The level of leverage employed during the relevant period for UCITS using VaR approaches. CSSF Circular 11/512 as amended provides further clarification on the disclosure of the expected level of leverage

CSSF *Communiqué* 12/29 clarifies that, as regards the publication of leverage in the annual report, the CSSF considers that the leverage information to be included in the annual report must be based on the sum of notionals approach.

This information may be complemented with the leverage determined based on the commitment approach (provided that the underlying calculation method is clearly and precisely indicated for every mentioned figure) or with other additional information.

The annual report must be available to investors in the manner specified in the prospectus as well as in the KII. A paper copy of the annual report must, in any case, be delivered to investors on request and free of charge. An abridged annual report (comprising a report on activities, independent auditor's report, statements of net assets, operations and changes in net assets) may also be prepared. Only the full annual report is required to be filed with the CSSF.

For UCIs marketing their shares or units in foreign countries, specific additional reporting requirements may have to be included in the annual report. Additional reporting requirements vary from one country to another (e.g., number of shares or units issued and redeemed, Total Expense Ratio (TER), performance of share or unit classes, portfolio turnover) and may in some cases have to be audited.

The annual report of a Luxembourg UCI admitted to trading on the *Bourse de Luxembourg* must be made public within four months of each financial year-end and comprise financial statements, the related audit report, a management report and a corporate governance statement.

UCIs admitted to the Euro MTF must make available to the public financial statements prepared in accordance with the UCI's national legislation, related audit report thereon, and management report (see also Section 13.4.1.).

Other disclosures to be made include:

- ▶ Period end exchange rates
- ▶ If mergers have occurred during the period (between compartments, with compartments of other entities), the merger share/unit exchange ratios should be disclosed
- ▶ Cross-investments (investing and investee compartments, amount invested, expressed as an absolute value and as a percentage of the NAV of the investing compartment)

On 3 April 2020, ESMA issued its *Guidelines on performance fees in UCITS and certain types of AIFs* which include a certain number of disclosure requirements, notably:

- ▶ The annual and semi-annual reports and any other *ex-post* information should indicate for each relevant share class the amount of performance fees and the percentage of the share class NAV they represent

For more information on ESMA Guidelines, see Section 10.3.1.F.

10.5.1.1. Venture capital UCIs

In addition to the requirements described previously, the annual and semi-annual reports of venture capital UCIs must contain information on the development of the companies in which the UCI has invested and disclose separately the profit or loss on investments sold.

Specific instances where potential conflicts of interest could arise between the interests of a Director of the portfolio management or advisory bodies and the interests of the UCI must be indicated in the financial statements.

10.5.1.2. Futures contracts and/or options UCIs

In addition to the requirements described previously, the annual and semi-annual reports of futures contracts and/or options UCIs must disclose the profit or loss for each category of closed contract.

Commissions paid to brokers and fees paid to the portfolio management and advisory bodies must be quantified in the financial statements.

10.5.1.3. Real estate UCIs

In addition to the requirements described previously, the independent auditor of a real estate UCI and its affiliated real estate companies, which are 50% or more funded by the UCI, must be the same.

The accounts of the UCI and its affiliated companies, which should in principle be drawn up at the same date, must be consolidated semi-annually, disclosing the accounting principles applied for the consolidation.

Minority unlisted shareholdings in real estate must be either partially consolidated at the year-end or valued based on the probable realizable value. The value of minority listed shareholdings in real estate companies should be based on the stock exchange value or market value.

The portfolio of properties in the annual and semi-annual reports must show, for each class of properties, the cost, insured value, and valuation. Properties must be shown at their valuation in the financial statements.

10.5.2. Annual report of AIF

AIF are required to produce an annual report that must be made available to investors within six months of the end of the financial year or within four months when the AIF is admitted to trading on a regulated market (see Section 13.4.1.). The annual report must be made available to the competent authorities of the home Member State of the AIFM and, where applicable, the home Member State of the AIF.

The annual report of the AIF must at least contain a balance sheet or a statement of assets and liabilities, an income and expenditure account for the financial year, a report on the activities of the financial year, and any material changes in the disclosures to investors (see Section 10.3.3.) during the year, including the following elements and underlying line items:

- I. Balance sheet or statement of assets and liabilities:
 - Investments
 - Cash and cash equivalents
 - Receivables
 - Total assets
 - Payables
 - Borrowings
 - Other liabilities
 - Total liabilities
 - Net assets
- II. Income and expenditure account:
 - Investment income (dividend income, interest income, and rental income)
 - Realized gains on investments
 - Total income
 - Investment advisory or management fees
 - Other expenses
 - Total expenses
 - Net income or expenditure
 - Unrealized gains on investments
 - Other income
 - Realized loss on investments
 - Unrealized loss on investments

The annual report of the AIF must also:

- Disclose the total amount of remuneration paid by the AIFM to its staff for the financial year, split into fixed and variable remuneration, number of beneficiaries, and, where relevant, carried interest paid by the AIF
- Disclose the aggregate amount of remuneration broken down by senior management and members of staff of the AIFM whose actions have a material impact on the risk profile of the AIF
- State which of the following the total remuneration disclosure relates to:
 - (i) The total remuneration of the entire staff of the AIFM
 - (ii) The total remuneration of those staff of the AIFM who in part or in full are involved in the activities of the AIF
 - (iii) The proportion of the total remuneration of the staff of the AIFM attributable to the AIF
- Indicate the number of beneficiaries
- Include an allocation or breakdown in relation to each AIF, where the information is disclosed at the level of the AIFM

- ▶ Provide information on the financial and non-financial criteria of the remuneration policies and practices for relevant categories of staff to enable investors to assess the incentives created, including the information necessary to provide an understanding of the risk profile of the AIF and the measures it adopts to avoid or manage conflicts of interest

ESMA's *Questions and Answers on the Application of the AIFMD* indicates that the remuneration-related disclosure requirements under Article 22(2)(e) of the AIFMD also apply to the staff of the delegate of an AIFM to whom portfolio management or risk management activities have been delegated. AIFMs can ensure compliance in one of the following two ways:

- (i) Where the delegate is subject to regulatory requirements on remuneration disclosure for its staff to whom portfolio management or risk management activities have been delegated that are equally as effective as those under Article 22(2)(e) of the AIFMD, the AIFM should use the information disclosed by the delegate for the purposes of fulfilling its obligations under Article 22(e) of the AIFMD and Article 107 of the AIFMD Level 2 Regulation; or
- (ii) In other cases, appropriate contractual arrangements should be put in place with the delegate allowing the AIFM to receive (and disclose in the annual report for the relevant AIF(s) that it manages) at least information on the total amount of remuneration for the financial year, split into fixed and variable remuneration, paid by the AIF and/or the AIFM to the identified staff of the delegate - and number of beneficiaries, and, where relevant, carried interest - which is linked to the delegated portfolio. This means that the disclosure should be done on a prorated basis for the part of the AIF's assets which are managed by the identified staff within the delegate.

In both situations set out above, the disclosure may be provided on an aggregate basis i.e., by means of a total amount for all the delegates of the AIFM in relation to the relevant AIF.

- ▶ The information prescribed by Article 22(2)(e) and (f) of the AIFMD (quantitative information on remuneration) should be included in the annual report and cannot be disclosed in the annual report by the way of a link to a document where the relevant information is available

Periodic remuneration disclosures are covered in Section 10.4.3.

When an AIF acquires, individually or jointly, control over a non-listed company, the AIFM is required, *inter alia*, to either:

- ▶ Make the information in the annual report of the non-listed company available to the investors of each such AIF at the latest when the annual report of the non-listed company is made available
- ▶ Include in the annual report of each such AIF information relating to the relevant non-listed company

The requirements on acquisitions of major holdings and control over non-listed companies, including the minimum amount of information to be disclosed in the annual report of the non-listed company or of the AIF are covered in Section 4.6.

Regulation (EU) 2015/2365 of the European Parliament and of the Council, of 25 November 2015, on the transparency of securities financing transactions and of reuse (the SFT Regulation) requires the following disclosures to be made in the annual reports of AIFs:

Global data

- ▶ The amount of securities and commodities on loan as proportion of total lendable assets defined as excluding cash and cash equivalents
- ▶ The amount of assets engaged in each type of SFTs and total return swaps expressed as an absolute amount (in the base currency of the AIF) and as a proportion of the AIF's assets under management

Concentration data

- ▶ Ten largest collateral issuers across all SFTs and total return swaps (breakdown of volumes of the collateral securities and commodities received per issuer's name)
- ▶ Top 10 counterparties of each type of SFTs and total return swaps separately (name of counterparty and gross volume of outstanding transactions)

Aggregate transaction data for each type of SFT and total return swap separately to be broken down according to the below categories

- ▶ Type and quality of collateral
- ▶ Maturity tenor of the collateral broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open maturity
- ▶ Currency of the collateral
- ▶ Maturity tenor of the SFTs and total return swaps broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open transactions

- Country in which the counterparties are established
- Settlement and clearing (e.g., tri-party, central counterparty, bilateral)

Data on reuse of collateral

- Share of collateral received that is reused, compared to the maximum amount specified in the disclosures to investors
- Cash collateral reinvestment returns to the AIF*

Safekeeping of collateral received by the AIF as part of SFTs and total return swaps

- Number and names of custodians and the amount of collateral assets safe-kept by each of the custodians

Safekeeping of collateral granted by the AIF as part of SFTs and total return swaps

- The proportion of collateral held in segregated accounts or in pooled accounts, or in any other accounts

Data on return on cost for each type of SFTs and total return swaps

- Broken down between the AIF, the manager of the AIF and third parties (e.g., agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFT and total return swap*

ESMA's *Questions and Answers on the Application of the AIFMD* provides clarification on data to be reported under the SFT Regulation in the annual reports of AIFs. ESMA clarified that all items except those marked with an * above should be reported on a snapshot basis. Items marked with an * should be disclosed on an aggregate basis.

A 2010 Law Part II UCI must also include the information specified in Schedule B of Annex 1 to the 2010 Law (see Section 10.5.1.). A SIF must also include the information specified in the Annex to the SIF Law (see Section 10.5.3.). A RAIF must also include the information specified in the Annex to the RAIF Law (see Section 10.5.6.).

Where the AIF is required to make public an annual report in accordance with the Transparency Directive²⁴³, only additional information must be provided to investors on request. This information must be provided either separately or as an additional part of the annual report. In the latter case, the annual report must be made public no later than four months following the end of the financial year to which it refers.

The layout, nomenclature, and terminology of line items must be consistent with the accounting standards applicable to or the rules adopted by the AIF and must comply with legislation applicable where the AIF is established. Such line items may be amended or extended to ensure compliance with the above.

The report on the activities to be included in the annual report of the AIF must contain at least an overview of investment activities, an overview of the AIF's portfolio at year-end or period-end, AIF performance over the year or period, a description of the principal risks and investment or economic uncertainties that the AIF might face, and any material changes to the information disclosed to investors.

The information in the report on the activities of the AIF shall form part of the directors or investment managers' report.

Any changes in the disclosures to investors (see Section 10.3.3.) are deemed material if there is a substantial likelihood that a reasonable investor, becoming aware of such information, would reconsider its investment in the AIF, *inter alia*, because such information could impact an investor's ability to exercise its rights in relation to its investment or otherwise prejudice the interests of one or more investors in the AIF.

On 3 April 2020, ESMA issued its *Guidelines on performance fees in UCITS and certain types of AIFs* which include a certain number of disclosure requirements, notably:

- The annual and semi-annual reports and any other *ex-post* information should indicate for each relevant share class the amount of performance fees and the percentage of the share class NAV they represent

For more information on ESMA Guidelines, see Section 10.3.1.F.

10.5.3. Annual report of SIFs

SIFs are required to produce an annual report that must be made available to investors within six months of the end of the financial year or within four months for closed-ended funds admitted to trading on the Luxembourg Stock Exchange's (LuxSE) regulated market (see Section 13.4.1.). The annual report of a SIF must also be communicated to the CSSF (see Section 10.9.).

²⁴³ Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (the Transparency Directive - see also Chapter 13).

SIFs that are managed by authorized AIFM as well as internally managed SIFs subject to AIFM Law (see Chapter 6) are subject to AIF reporting requirements (see Section 10.5.2.); they are not subject to the following SIF Law-specific reporting requirements.

The annual report must include a report on the SIF's activities, a statement of assets and liabilities, a detailed income and expenditure account, and the information specified in the Annex to the SIF Law, which is set out below.

- I. Statement of assets and liabilities:
 - Investments
 - Bank balances
 - Other assets
 - Total assets
 - Liabilities
 - NAV
- II. Number of shares or units in circulation
- III. NAV per share or unit
- IV. Quantitative and/or qualitative information on the investment portfolio enabling investors to make an informed judgment on the development of the activities and the results of the SIF
- V. Statement of the developments (generally known as the "statement(s) of operations and changes in net assets") concerning the assets of the SIF during the reference period including the following:
 - Income from investments
 - Other income
 - Management charges
 - Depositary's charges
 - Other charges and taxes
 - Net income
 - Distributions and income reinvested
 - Increase or decrease of capital accounts
 - Appreciation or depreciation of investments
 - Any other changes affecting the assets and liabilities of the SIF
- VI. A comparative table covering the last three financial years and including, for each financial year, at the end of the financial year:
 - The total NAV
 - The NAV per share or unit

A statement of changes in the number of shares or units outstanding is also normally included. It is not required to disclose the cost of the investments. Comparative figures are also not in practice disclosed.

It is not necessary to disclose details of the portfolio, though sufficient quantitative and/or qualitative information for investors to make an informed judgment on the development of the activities and the results of the SIF should be provided.

SIFs and their subsidiaries are exempt from the obligation under Luxembourg legal and regulatory requirements of consolidating the companies owned for investment purposes.

The annual report of a closed-ended SIF admitted to trading on an EU regulated market must include a management report and a responsibility statement (see Section 13.4.1.).

10.5.4. Annual report of EuVECA and EuSEF

The managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) are, for each qualifying European fund they manage, required to make its audited annual report available to the competent authority no later than six months after the end of the financial year and to make it available to investors on request. The report must describe the composition of the portfolio of the qualifying European fund and the activities for the year. Therefore the annual report of a EuSEF must at least include:

- Details of the overall social outcomes achieved by the investment policy and the method used to measure these outcomes
- A statement of any divestments related to qualifying portfolio undertakings
- A description of whether divestments in relation to the other assets of the EuSEF that are not invested into qualifying portfolio undertakings occurred on the basis of processes and criteria that are used for selecting such assets and that were disclosed to investors
- A summary of the activities the EuSEF has undertaken in relation to the qualifying portfolio undertakings in terms of business support services and other support activities
- Information on the nature and purpose of the investments other than qualifying portfolio undertakings

The EuVECA and EuSEF regimes are introduced in Section 2.4.4.3.

10.5.5. Annual report of ELTIF

The annual report of an ELTIF should specifically contain the following:

- A cash flow statement
- Information on any participation in instruments involving European Union budgetary funds
- Information on the value of the individual qualifying portfolio undertakings (see Section 2.4.4.) and the value of other assets in which the ELTIF has invested, including the value of financial derivative instruments used
- Information on the jurisdictions in which the assets of the ELTIF are located

10.5.6. Annual report of RAIFs

The annual report must include the information specified in the Annex to the RAIF Law, which is set out below.

- I. Statement of assets and liabilities:
 - Investments
 - Bank balances
 - Other assets
 - Total assets
 - Liabilities
 - Net asset value
- II. Number of shares or units in circulation
- III. NAV per share or unit
- IV. Quantitative and/or qualitative information on the investment portfolio enabling investors to make an informed judgment on the development of the activities and the results of the RAIF
- V. Statement of the developments (generally known as the statement(s) of operations and changes in net assets) concerning the assets of the RAIF during the reference period including the following:
 - Income from investments
 - Other income
 - Management charges
 - Depositary's charges
 - Other charges and taxes
 - Net income
 - Distributions and income reinvested
 - Increase or decrease of capital accounts
 - Appreciation or depreciation of investments
 - Any other changes affecting the assets and liabilities of the RAIF
- VI. A comparative table covering the last three financial years and including, for each financial year, at the end of the financial year:
 - The total net asset value
 - The net asset value per share or unit

The above requirements from the Annex to the RAIF Law are not applicable to RAIFs which provide in their constitutive documents that their exclusive object is the investment of their funds in assets representing risk capital. Investment in risk capital means the direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange.

As per the Q&A CNC 19/018 of the Commission des *Normes Comptables*, the RAIFs investing in risk capital have the choice to present their annual accounts either following the standard chart of accounts as defined in the Grand-Ducal Regulation of 12 September 2019 or following the format defined in the Appendix to the RAIF Law entitled *Information to be included in the annual report of reserved alternative investment funds other than those subject to Article 48* ('RAIF Law Appendix'). RAIFs and their subsidiaries are exempt from the obligation to consolidate the companies owned for investment purposes.

In addition to being submitted to the Trade Register (see Section 10.7.), annual reports of RAIFs must be sent to the CSSF by the AIFM via email to the following address: aifm@cssf.lu.

10.5.6.1 Annual report of RAIFs with multiple sub-funds

According to Article 49(1) of the RAIF Law, RAIFs may also be constituted with multiple compartments, each sub-fund corresponding to a distinct part of the assets and liabilities of the RAIF.

The RAIF Law does not require the presentation of individual financial statements for each compartment. However, the annual report must include "any significant information enabling investors to make an informed judgement on the development of the activities and of the results of the RAIF".

Consequently, although detailed individual financial statements for each compartment are not explicitly required in the statutory accounts of RAIFs, a sufficient level of information for each compartment in accordance with the RAIF Law Appendix, should be included in the annual report of the umbrella RAIF.

Generally, such information relating to each compartment is presented in a note to the financial statements. A multi-column presentation covering each compartment of the statement of net assets and statement of changes in net assets is not appropriate given the auditor's report only refers to the combined overall reported results of the RAIF.

A separate report may be also established for each or several of the compartments provided it contains, in addition to the information on the compartment(s) concerned, the combined results of all compartments.

10.5.6.2 Specific report for RAIFs investing in risk capital

As per the RAIF Law, for a RAIF whose exclusive object is the investment of its funds in assets representing risk capital (direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange), the independent auditor of such RAIF must issue for each financial year a report certifying that, during the past financial year, the RAIF has complied with the policy of investing in risk capital. This report must be transmitted to the Direct Tax Administration ("*Administration des Contributions Directes*").

10.5.7. Semi-annual report of UCIs

For a 2010 Law UCI, an unaudited semi-annual report is to be published (and communicated to the CSSF - see Section 10.1.1.):

- ▶ For UCITS: within two months of the end of the period to which it relates
- ▶ For Part II UCIs: within three months of the end of the period to which it relates
- ▶ The semi-annual report must disclose at least the information specified in Sections 10.5.1. I - IV. A statement of income and expenditure is not obligatory

See also Sections 10.5.1.1. to 10.5.1.3. for specific additional disclosure requirements for specific types of 2010 Law Part II UCIs.

CSSF Circulars 14/592 and 13/559 implementing ESMA's *Guidelines on ETFs and other UCITS issues* require disclosure of the size of the tracking error in the semi-annual report of index-tracking UCITS.

There is no requirement to produce a semi-annual report for SIFs, except for closed-ended SIFs admitted to trading on a regulated market or other trading venue, such as the *Bourse de Luxembourg* or Euro MTF (see also Section 13.4.1.).

The semi-annual report of UCITS also needs to include the disclosures required by the SFT Regulation, as described in Sections 10.5.1. and 10.5.2.

On 3 April 2020, ESMA issued its *Guidelines on performance fees in UCITS and certain types of AIFs* which include a certain number of disclosure requirements, notably:

- ▶ The annual and semi-annual reports and any other *ex-post* information should indicate for each relevant share class the amount of performance fees and the percentage of the share class NAV they represent

For more information on ESMA Guidelines, see Section 10.3.1.F.

10.5.8. Interim management statement of UCIs

An interim management statement must be published for closed-ended UCIs admitted to trading on an EU regulated market, such as the *Bourse de Luxembourg* (see Section 13.4.1.).

10.5.9. Multiple compartment UCIs

In the case of multiple compartment UCIs, all the annual and semi-annual information outlined in Sections 10.5.1. to 10.5.9., where applicable, is required for each compartment. Each compartment may be denominated in different currencies. Combined figures of the financial statements are required to be shown in the currency of the UCI. The notes to the financial statements and semi-annual financial statements (if any) should include the exchange rates between the currency of the combined figures and the currencies of the various compartments.

In addition to the full report, multiple compartment UCIs may provide for the publication of separate financial reports for each of their compartments. Such reports must include either the independent auditor's report or a separate audit report for each compartment.

10.5.10. Audit

10.5.10.1. General rules

The audit requirements and auditors' responsibilities are covered in Article 154 of the 2010 Law, Article 55 of the SIF Law, Article 20 of the AIFM Law, Article 43 of the RAIF Law, and CSSF Circulars 02/77 (on NAV calculation errors and compensation of losses arising from non-compliance with applicable investment restrictions) and 02/81 (on the long form report). Auditors are bound by the obligation of professional secrecy.

The financial statements included in the annual report must be audited by a Luxembourg independent auditor (*réviseur d'entreprises agréé*), that is approved by the CSSF in accordance with the amended Law of 23 July 2016 on the audit profession and that is also suitably qualified in terms of relevant experience. The audit is conducted in accordance with International Standards on Auditing (ISAs) issued by the International Federation of Accountants (IFAC), as adopted for Luxembourg by the CSSF. The audit report is to be reproduced in full in each annual report.

Except for RAIFs which are not directly under the supervision of the CSSF, the independent auditor must report promptly to the CSSF where information provided to investors or the CSSF does not truly describe the financial situation and any fact or decision, which he has become aware of during the audit of a UCI, that is liable to:

- Constitute a substantial breach of the Law or regulations
- Affect the continuous functioning of the UCI
- Lead to a refusal to certify the accounts or to the expression of qualifications thereon

The CSSF may determine rules regarding the scope of the audit and the independent auditor's report and may request auditors to carry out special audits.

In accordance with article 52(5)b) of the amended Law of 23 July 2016 on the audit profession, in Luxembourg UCITS and AIFs are exempt from the requirement to establish an audit committee.

UCIs must immediately send to the CSSF, without being specifically requested to do so, the certificates, reports, and written commentaries (in particular the "management letter") issued by the independent auditor, as indicated in Chapter P of IML Circular 91/75 as amended.

The independent auditor must also intervene and has certain reporting requirements in the case of NAV calculation errors and compensation of losses arising from non-compliance with applicable investment restrictions (see Sections 8.8.2.3.4. and 8.8.3.).

The 2010 Law requires that if a master UCITS and a feeder UCITS have different auditors, the auditors should enter into information-sharing agreements in order to ensure the fulfillment of their duties (see also Section 2.3.4.1.).

In kind subscriptions and, in some cases, in kind redemptions (see Sections 8.7. and 3.9.3.), fund mergers (see Section 3.7.), and liquidations (see Section 3.10.) may also require reporting by the independent auditor.

For 2010 Law UCIs and SIFs, the independent auditor will express an opinion covering the financial statements of the UCI and each of its compartments. For RAIFs, however, in line with the RAIF Law, the independent auditor will only express an opinion on the financial statements of the RAIF -not on its compartments.

10.5.10.2. Long form report on the activity of 2010 Law UCIs

CSSF Circular 02/81 on long form reports, which was published on 6 December 2002 and contains external audit guidelines, introduced the requirement for the independent auditor to submit a long form report on the activity of the 2010 Law UCI to the Board of Directors of the UCI or its management company, and to the CSSF for each 2010 Law UCI. No long form report is required for SIFs.

The long form report, issued for the exclusive use of the Board of Directors of the UCI or its management company and the CSSF, covers defined areas such as an evaluation of key internal control procedures existing at the central administration and depositary, anti-money laundering and counter terrorist financing (AML/CFT) provisions, valuation methods, and description of the risk management system.

The table of contents of the long form report on the activity of the UCI is as follows:

1. Organization of the UCI
 - 1.1. Central administration
 - 1.1.1. Reliance by the UCI's independent auditor on a report issued by the independent auditor of the central administration
 - 1.1.1.1. Procedures and controls
 - 1.1.1.2. Information technology
 - 1.2. Depositary
 - 1.2.1. Reliance by the UCI's independent auditor on a report issued by the independent auditor of the depositary
 - 1.2.1.1. Procedures and controls
 - 1.2.1.2. Results of reconciliations
 - 1.3. Relationship with the management company/conducting officers
 - 1.4. Relationships with other intermediaries
2. Review of the transactions of the UCI
 - 2.1. Anti-money laundering and counter terrorist financing procedures (see Section 8.7.4.4.7.I.)
 - 2.2. Valuation methods
 - 2.3. Risk management systems
 - 2.4. Specific tests, including NAV errors and instances of active non-compliance with investment limits
 - 2.5. Statements of net assets and of changes in net assets, also including "window dressing"²⁴⁴, portfolio turnover²⁴⁵, performance fees, soft commissions²⁴⁶ or similar arrangements and rebates²⁴⁷, retrocessions²⁴⁸, and expenses
 - 2.6. NAV publication
 - 2.7. Results of reconciliations
 - 2.8. Late trading and market timing
3. Internet
4. Investor complaints
5. Follow-up of issues raised in the previous report on the activity of the UCI or the management letter
6. Overall conclusion

In the case of a change of service provider (central administration, depositary, management company or manager) during the period under review, the long form report needs to make reference only to the new service providers in the relevant sections.

UCIs which were put into liquidation or merged by absorption should obtain clarification from the CSSF as regards to the period to be covered by the last long form report.

The independent auditor is required to issue a management letter covering the period between the last accounting period end date and the date of liquidation or merger.

10.5.10.3. Additional provisions regarding late trading and market timing

CSSF Circular 04/146 includes provisions on the role of the independent auditor regarding late trading and market timing (see Section 8.7.5.), which are additional to those of CSSF Circular 02/81.

²⁴⁴ Purchases and sales of securities in order to improve the appearance of the portfolio and/or its conformity with the Law and the prospectus before presenting it to shareholders or unitholders.

²⁴⁵ Generally using the method described below:

$$\text{Turnover} = [(\text{Total 1} - \text{Total 2}) / \text{M}] * 100$$

With:

Total 1 = Total of securities transactions during the relevant period = X + Y, where X = purchases of securities and Y = sales of securities

Total 2 = Total of transactions in shares or units of the UCI during the relevant period = S + T, where

S = subscriptions of shares or units of the UCI and T = redemptions of shares or units of the UCI.

M = average assets of the UCI.

²⁴⁶ Arrangements by which the investment adviser or UCI manager obtains products or services from a broker in exchange for the orders the broker has received from the investment adviser or UCI manager.

²⁴⁷ Arrangements between the broker and the manager of the UCI and/or its linked entities by which the broker reduces, refunds or renounces part of the brokerage fees due by the UCI manager and/or its linked entities (e.g., on the basis of the transaction volume) to the benefit of a party other than the UCI (for example the manager).

²⁴⁸ Retrocessions or rebates received by the manager of the UCI or any party related to the manager of the UCI from managers of investee funds.

The independent auditor of the UCI checks the procedures and controls put in place by the UCI so as to protect itself from late trading practices and describes these in its long form report. For UCIs that, due to their structure, are likely to be subject to market timing practices, the independent auditor checks the measures and/or controls put in place by the UCI to protect itself by the best possible means against such practices and describes such measures and/or controls in its long form report.

If the independent auditor of the UCI, during the performance of its duties, becomes aware of a case of late trading or market timing, it must indicate this in the long form report.

In case of indemnification of investors harmed by late trading or market timing practices during the accounting year, the independent auditor must give, in the long form report, an opinion as to whether investors have been adequately indemnified.

10.5.10.4. Additional provisions regarding CSSF regulations 12-02

CSSF Regulation No. 12-02 includes provisions on the role of the independent auditor regarding compliance with the legal and regulatory requirements and AML/CFT which are additional to those of CSSF Circular 02/81. In this respect the long-form report should include the following information:

- The description of the AML/CFT policy
- The assessment of the analysis of money laundering and terrorist financing risks
- The declaration on the realization of a regular audit of the AML/CFT policy by the internal audit department and the AML/CFT compliance officer
- The verification of the training and awareness-raising measures for employees as regards money laundering and terrorist financing
- The historical statistics concerning the detected suspicious transactions
- The control of the application of the provisions of Regulation (EC) 1781/2006

10.6. General meetings

An investment company, or the management company of a common fund, must generally hold at least one general meeting of shareholders each year within six months of the financial year end²⁴⁹.

The convocation to the annual general meeting must indicate how to obtain the annual accounts, the independent auditor's report, the management report, and the observations of the supervisory board (if applicable) and state that the investor may request that these documents be sent to him.

The annual accounts, including the report of the independent auditor, must be available at the investment company's registered office 8 days before the annual general meeting.

The annual general meeting hears the reports of the directors or of the management board, as well as the independent auditor, before adopting the annual accounts.

The annual general meeting then votes specifically as to whether discharge is given to the directors or members of the management board. Such discharge is only valid, *inter alia*, if the annual accounts contain no omission or false information concealing the true situation of the company.

10.7. Submission to the Trade Register

The annual report of an investment company has to be registered at the Trade and Companies Register (*Registre de Commerce et des Sociétés*, Luxembourg - RCS) in one of the official languages (being French, German and Luxembourgish) or English during the month of its approval by the general meeting of shareholders.

The RCS number of the investment company or the common fund should be disclosed on the cover of the annual report.

²⁴⁹ An investment company, or management company, formed as a private limited liability company (S.à r.l.) must hold at least one annual general meeting of shareholders if there are more than 25 shareholders. If there are less than 25 shareholders, there is no obligation to hold general meetings.

The presentation and the form of the documents to be published must meet certain technical standards defined in the amended ministerial regulation of 27 May 2016 (*Règlement ministériel*), including requirements such as:

- PDF/A format
- The header must disclose, among others, the denomination, the legal form, the registered number, and the registered address

The Law of 27 May 2016 has specific implications for common funds (fonds commun de placement - FCP):

- Common funds must be registered with the Trade and Companies Register
- The management company must file with the Trade and Companies Register the common fund's management regulation within the common fund's own file under Section K
- Other documents subject to deposit with the Trade and Companies Register:
 - The facts leading to the liquidation of the common fund
 - The injunction to put the common fund into liquidation addressed by the CSSF to the management company

A progressive scale of late filing fees relating to the filing of company annual accounts not performed within the time prescribed by law applies.

The late filing fees are described in Appendix J of the Grand Ducal Regulation dated 27 May 2016.

10.8. Financial information reporting to authorities

10.8.1. UCIs

Monthly and annual financial information must be provided in an electronic format to:

- The CSSF for statistical and supervisory purposes
- The Luxembourg Central Bank (BCL)

The contents of the monthly, semi-annual and annual financial information to be reported to the CSSF are set out:

- For 2010 Law UCIs, in Circular 97/136, as amended, and Circular 15/627
- For SIFs, in Circular 07/310, as amended, and Circular 15/627. The information must be prepared separately for each compartment. Consolidated information is not required

The CSSF issued *Frequently Asked Questions concerning U1.1 Reporting* on 3 June 2016 clarifying certain requirements of Circular 15/627.

Report	Reporting deadline (from end of period)
2010 law UCIs:	
▸ Monthly information (Table U 1.1)	10 days
▸ Annual information (Table O 4.1 and O 4.2)	4 months ²⁵⁰
SIFs:	
▸ Monthly information (Table U 1.1)	10 days
▸ Annual information (Tables O 4.1 and O 4.2)	6 months

Monthly information (Table U 1.1) includes details of:

- I. General information on the report and the sender
- II. General information on the UCI
- III. Financial information on the UCI in the base currency of the UCI
- IV. General information on the unit/share class
- V. Financial information on the unit/share class for the reference month
- VI. Information on investment income and expenses for the reference month in the base currency of the UCI

UCIs that offer a formal guarantee to their investors (guaranteed funds) are also required to complete an additional table of monthly financial information (Table O 1.2).

²⁵⁰ The AIFM Law extends the annual reporting deadline for Part II UCIs to 6 months, but, at the time of writing, no amendment had been made to change the annual reporting deadline.

The reference date for monthly reporting is, in principle, the last day of each month. For UCIs that calculate a weekly NAV, the reference date may be the last NAV calculation day. For UCIs that calculate their NAV on a monthly basis, the reference date is the NAV calculation date closest to the last day of the month. For 2010 Law Part II UCIs that calculate their NAV on a less frequent basis, the reporting should be based on end of month accounting data. For SIFs that calculate their NAV on a less frequent basis, the reporting can be based on the last available NAV; the final NAV per share or unit must be provided to the CSSF when it becomes available.

Annual information to be reported (Table O 4.1) includes detailed breakdowns of:

- I. Net assets
 - Total assets
 - Total liabilities
 - Net assets at the end of the year
- II. Operations
 - Total income
 - Total charges
 - Net investment income
 - Profit or loss on operations
- III. Changes in net assets
 - Net assets at the beginning of the year
 - Net assets at the end of the year
- IV. Changes in the investment portfolio
 - Total purchases of transferable securities and other investments
 - Total sales of transferable securities and other investments
- V. Breakdown of the securities portfolio and of liquid assets other than cash at bank
- VI. Countries in which the UCI is marketed

Forward transactions and options data to be reported (Table O 4.2) includes detailed breakdowns of:

- I. Commitments at the year-end arising in respect of transactions entered into for purposes other than hedging
- II. Premiums received and paid in respect of options contracts in the course of the financial year

The reference date for annual reporting is the year end closing date.

The main circulars covering BCL reporting are BCL Circular 2014/237, CSSF Circular 14/508 on the statistical data collection for money market funds and investment funds, and BCL Circular 2018/241 on the new statistical data collection for non-regulated alternative investment funds. The reporting templates, detailed instructions, circulars and circular letters, and reporting calendars are available on the BCL website.

The BCL reporting requirements distinguish between money market funds²⁵¹ and non-monetary investment funds, which are categorized as follows:

- Equity UCIs
- Bond UCIs
- Real estate UCIs
- Mixed UCIs
- Other UCIs
- Alternative UCIs (hedge funds)
- Non-regulated alternative investment funds

Report	Reporting deadline (from month end in working days)
Monthly statistical report:	
▸ Money market funds (MMFs): S 1.3. "Monthly statistical balance sheet for MMFs"	10
▸ Non-monetary investment funds and non-regulated alternative investment funds: S 1.6. "Information on valuation effects on the balance sheet of non-MMF investment funds"	20
Quarterly statistical report: S 2.13. "Quarterly statistical balance sheet of non-MMF investment funds"	
Monthly security by security reporting:	
▸ MMFs	10
▸ Investment funds	20

The BCL may grant non-regulated alternative investment funds a derogation from the monthly and quarterly reporting obligations if the total assets (of all compartments) remain below EUR 500 million.

²⁵¹ The criteria to be met by MMFs for the purpose of reporting are the same as those to be met for the purpose of utilization of the "money market fund" label under Regulation (EU) No 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds (see Section 2.6.1.). The CSSF establishes a list of MMFs, or compartments of MMFs, that are reported on the list of monetary financial institutions; the BCL transmits this list to the European Central Bank (ECB).

The information to be included in the Monthly statistical balance sheet for MMFs is the same as the information to be included in the Quarterly statistical balance sheet of UCIs. Breakdowns must be provided for the following categories of assets and liabilities:

- ▶ Assets:
 - ▶ Claims
 - ▶ Securities other than shares
 - ▶ Quoted shares
 - ▶ Unquoted shares
 - ▶ Participating interests: quoted shares
 - ▶ Participating interests: unquoted shares
 - ▶ Fixed assets
 - ▶ Accrued interest
 - ▶ Other assets
 - ▶ Financial derivatives
- Total assets
- ▶ Liabilities:
 - ▶ Overnight borrowings
 - ▶ Borrowings with agreed maturity
 - ▶ Borrowings redeemable at notice
 - ▶ Repurchase agreements
 - ▶ Short sale of securities
 - ▶ Shares or units issued
 - ▶ Accrued interest
 - ▶ Debt securities issued
 - ▶ Other liabilities
 - ▶ Financial derivatives
- Total liabilities

The data must be provided according to:

- ▶ Country of counterparty
- ▶ Currency
- ▶ Economic sector of the counterparty
- ▶ Initial maturity

Information on valuation effects on the balance sheet of investment funds includes information on fixed assets and financial derivatives, which must be provided if the amount reported for an item exceeds 5% in terms of total assets.

Monthly security by security reporting must be provided for certain categories of assets and liabilities and includes information on:

- ▶ The balance sheet line
- ▶ The identification code of the security
- ▶ The identification of the issuer
- ▶ The type of holding of securities
- ▶ The quantity of securities
- ▶ Supplementary information for securities not identified by an ISIN code

In practice, monthly, quarterly, semi-annual, and annual financial information is transmitted to the CSSF and the BCL via e-file (see Section 10.9.1.).

In addition, management entities are required to submit to the CSSF on an annual basis a written report of the management on the state of the internal controls (see Section 6.3.2.1.). UCITS management companies are required to transmit their updated risk management process (RMP) to the CSSF (see Section 7.2.8.) on at least an annual basis.

Regulation (EU) 2015/2365 *on transparency of securities financing transactions and of reuse* requires a UCITS management company on behalf of a UCITS, a self-managed UCITS, an AIFM on behalf of an AIF, and an internally managed AIF, to report to a registered or recognized trade repository details of any securities financing transaction, on a T+1 basis. Securities financing transactions include repurchase transactions, securities or commodities lending and borrowing, buy-sell back transactions and margin lending transactions.

10.8.2 Specific reporting for MMFs

On 30 June 2017, the final text of Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on *money market funds* (MMF) was published in the Official Journal of the European Union. The regulation applies to funds and compartments that qualify as money market funds as per the definition set out in article 1 of the Regulation.

According to the Regulation, for MMF whose assets under management do not exceed EUR 100,000,000, the manager of the MMF must report to the competent authority of the MMF on at least an annual basis.

For MMFs whose assets under management exceed EUR 100,000,000, the manager of the MMF must report information to the competent authority of the MMF on at least a quarterly basis.

The manager of an MMF must also, upon request, provide the information to the competent authority of the manager of an MMF, if different from the competent authority of the MMF.

The information reported must comprise the following points:

- (a) The type and characteristics of the MMF
- (b) Portfolio indicators such as the total value of assets, NAV, WAM, WAL, maturity breakdown, liquidity and yield
- (c) The results of stress tests and, where applicable, the proposed action plan
- (d) Information on the assets held in the portfolio of the MMF, including:
 - (i) The characteristics of each asset, such as name, country, issuer category, risk or maturity, and the outcome of the internal credit quality assessment procedure
 - (ii) The type of asset, including details of the counterparty in the case of derivatives, repurchase agreements or reverse repurchase agreements
- (e) Information on the liabilities of the MMF, including:
 - (i) The country where the investor is established
 - (ii) The investor category
 - (iii) Subscription and redemption activity

If necessary and duly justified, competent authorities may solicit additional information.

In addition to the information referred to in the preceding paragraph, for each LVNAV MMF that it manages, the manager of an MMF must report the following:

- (a) Every event in which the price of an asset valued by using the amortized cost method deviates from the price of that asset calculated using mark-to-market or mark-to-model by more than 10 basis points
- (b) Every event in which the constant NAV per unit or share calculated using the amortized cost method deviates from the NAV per unit or share calculated using mark-to-market or mark-to-model or both by more than 20 basis points
- (c) Every event where the imposed thresholds regarding weekly maturing assets and net daily redemptions on a single working day are breached and details of the course of action decided by the Board of Directors or equivalent of the MMF in these situations

On 17 April 2018, the European Commission published Commission Implementing Regulation (EU) 2018/708 *laying down implementing standards with regard to the template to be used by managers of money market funds when reporting to competent authorities as stipulated by Article 37 of Regulation (EU) 2017/1131 of the European Parliament and of the Council (the MMF Regulation)*. This implementing Regulation was based on ESMA's *Final Report on technical advice, draft implementing technical standards and guidelines under the MMF Regulation*, issued on 13 November 2017.

On 19 July 2019 ESMA published its *Final Report on Guidelines on the reporting to competent authorities under Article 37 of the MMF Regulation*.

These guidelines complement the information included in the draft technical standards so that managers of MMFs have all the necessary information to fill in the reporting template they will need to send to the competent authorities of their MMFs.

CSSF Circular 20/736 implemented these guidelines into Luxembourg regulation applicable to MMFs under the supervision of the CSSF and to the Luxembourg managers of MMFs and CSSF Circular 20/734 clarifies technical details that managers of MMFs need to take into account in order to fulfil their reporting obligations.

On 31 March 2020, ESMA indicated that the reporting instructions will be updated and that the first reports by the managers of MMF under the MMF Regulation should be submitted in September 2020, when both the Q1 and Q2 reporting will be due. The original date for submissions was April 2020.

On 4 June 2020, ESMA updated the reporting instructions to be used for reporting under the MMF Regulation.

CSSF issued the MMFR Handbook describing the reporting principles to be used by the MMF managers in order to report activity to the CSSF as the National Competent Authority (NCA) for Luxembourg.

On 19 July 2019 ESMA published its *Final Report on Guidelines on stress test scenarios under the MMF Regulation* establishing common reference parameters of the stress test scenarios MMFs or managers of MMFs should include in their stress scenarios.

CSSF Circular 20/735 implemented those guidelines into Luxembourg regulation applicable to the MMFs under the supervision of the CSSF and to the Luxembourg managers of MMFs.

10.8.3. AIF

Reporting by AIFM and internally managed AIF is covered in Section 6.5.1.B.

10.9. Electronic transmissions to the CSSF and publication

10.9.1. Documents to transmit electronically and to publish

CSSF Circular 03/97 of 28 February 2003 clarifies the procedure for the publication of KII, prospectuses, and annual and semi-annual reports under the 2010 Law. It requires that the KII, prospectuses as well as the annual and semi-annual reports of 2010 Law UCIs be published in the database of the financial center.

CSSF Circular 19/708 of 28 January 2019 covers the electronic transmission of:

- Prospectuses and annual and semi-annual reports of 2010 Law UCIs
- Offering documents, prospectuses and annual reports of SIFs
- UCI management letters and long form reports

to the CSSF, in their final form, via an electronic communication channel.

The electronic filing of these documents is to be completed using a secured system that is accepted by the CSSF.

In practice, prospectuses, offering documents, KII, annual and semi-annual reports, management letters, long form reports, and financial information (see Section 10.8.) are transmitted to the CSSF via the e-file system (see Section 6.5.2.).

10.9.2. Transmission deadlines

A 2010 Law UCI's prospectus and a SIF's offering document or prospectus must be transmitted once it has been approved by the CSSF, or if later than the approval by the CSSF, when the marketing of the UCI begins, or when the activities of the SIF begin.

Annual and semi-annual reports must be transmitted within the deadline for the publication of the reports in the case of 2010 Law UCIs and the deadline for making the report available to investors in the case of SIFs. UCIs do not need to transmit these reports to the CSSF in paper form.

10.9.3. Format of transmission

All files must be transmitted to the CSSF in PDF-text format as detailed in CSSF Circular 19/708.

11

Expenses and taxation: structuring and reporting

EY services include:

- ▶ Review of performance fee models and methodologies
- ▶ Benchmarking of fee structures
- ▶ Advice in relation to:
 - ▶ Tax structuring and restructuring of funds
 - ▶ Tax structuring and restructuring of corporate asset management structures
 - ▶ Transfer pricing for all dealings between related parties
 - ▶ Taxation of assets of funds
 - ▶ Taxation of fund investors
 - ▶ Fund fees
- ▶ FATCA and Common Reporting Standard compliance
- ▶ European tax reporting
- ▶ Fund tax services
- ▶ Mandatory disclosure rules/DAC 6 compliance



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11.1. Introduction

This Chapter covers:

- The formation and operating expenses incurred by Luxembourg UCIs
- The taxation of Luxembourg UCIs, the assets of Luxembourg UCIs, investors in Luxembourg UCIs, fees paid by Luxembourg UCIs, and the tax implications of restructuring UCIs
- The VAT regime applicable to services provided to such Luxembourg UCIs and their service providers

11.2. Expenses

This section covers the types of formation expenses and annual operating expenses of Luxembourg UCIs. Disclosure of fees and expenses is covered in Chapter 10.

11.2.1. Formation expenses

Formation expenses include costs incurred to establish a UCI and to enable it to do business, excluding initial capital requirements (see Section 2.5.). A newly established compartment of a UCI may also incur formation expenses. For master-feeder UCI structures, formation expenses may be incurred at the master fund and feeder fund level(s).

Formation expenses are borne by the UCI, unless its management company or general partner agrees to absorb these expenses in full or to absorb a portion of the formation expenses in excess of an amount stated in the UCI's prospectus or offering document. Under Luxembourg generally accepted accounting principles, formation expenses may be amortized over a period not exceeding five years.

Formation expenses for a Luxembourg UCI may include the following:

- Notary fees
- Legal fees
- Advisory fees relating to initial structuring
- CSSF initial authorization fee:
 - Single compartment UCI EUR 4,000
 - Multiple compartment UCI EUR 8,000
 - Self-managed UCITS and internally managed UCIs (single or multiple compartment)²⁵² EUR 15,000
- Printing of prospectus/offering document

Grand-Ducal Regulation of 21 December 2017, as amended, introduced a single lump sum fee of EUR 500 for each authorization request for a new compartment within an existing multiple compartment structure. A single lump sum fee of EUR 1,000 is also payable for each authorization request of an AIF compartment set up as an ELTIF.

Formation expenses of a Luxembourg management entity are covered in Section 6.5.3.2.

11.2.2. Operating expenses

Luxembourg UCIs incur various expenses in the conduct of their operations.

The management company, AIFM, or general partner will normally be paid a fee by the UCI for its services, when applicable.

The management company, AIFM, or general partner may, subject to the fee arrangements in place, be responsible for paying any appointed delegates, out of the fees it receives from the UCI. Alternatively, the UCI may pay the delegates directly out of its assets.

²⁵² See Section 2.3.

The most significant expense incurred by a Luxembourg UCI is the fee paid for portfolio management or investment management services. The portfolio management/investment management fee is generally a fixed percentage typically ranging from 0.05% to 2% of net assets. Minimum amounts and reduced fee rates for certain asset levels may be applied. In addition, a performance fee, usually ranging from 5% to 20%, may also be applied. This may incorporate a high watermark, trigger limits and claw back provisions.

On 3 April 2020, ESMA released its *Guidelines on performance fees in UCITS and certain types of AIFs*. The guidelines are more prescriptive than the principle-based 2016 IOSCO good practices applied by most national competent authorities, notably in terms of consistency between the performance fee model used and the UCI's investment objective, where a UCI is managed by reference to a benchmark index, or as regards to the minimum performance reference period.

All UCITS are in scope of the guidelines. The guidelines will also apply to open-ended AIFs marketed to retail investors. However, EuVECAs or other types of venture capital AIFs, EuSEFs, private equity and real estate AIFs remain out of scope.

ESMA's report comprises five guidelines:

1. The calculation of a performance fee should be verifiable and the method should include at least:
 - A performance reference indicator, i.e., an index, a high-water mark ("HWM"), a hurdle rate or a combination
 - The crystallization frequency and the crystallization date
 - The performance reference period
 - The performance fee rate
 - The calculation methodology
 - The computation frequency which should match with the NAV calculation frequency

Performance fees should be proportionate to the UCI's performance. Artificial increases arising from new subscriptions should not be taken into account when calculating UCI performance.

Managers should be able to demonstrate that managers' and investor's interests are aligned.

It is permissible to calculate performance fees on a single investor basis.

2. The performance fee model implemented must be, and remain, consistent with the UCI's investment objectives, strategy and policy.
 - The manager should implement and maintain a periodic review process to ensure that the performance fee model is consistent with the UCI's investment objectives, strategy and policy
 - As a general principle, a UCI which is managed by reference to a benchmark, or where the UCI's portfolio does not deviate materially from a benchmark index portfolio, should use the same benchmark in the performance fee model
 - Where the UCI is managed by reference to a benchmark, but the UCI's holdings are not based upon the holdings of the benchmark index, the benchmark used for the calculation of the performance should be consistent with the benchmark used for the portfolio composition, according to a non-exhaustive list of consistency indicators:
 - Expected return
 - Investment universe
 - Beta exposure to an underlying asset class
 - Geographical exposure
 - Sector exposure
 - Income distribution of the UCI
 - Liquidity measures (e.g., daily trading volumes, bid-ask spreads, etc)
 - Duration
 - Credit rating category
 - Volatility and/or historical volatility
 - Performance should be calculated net of all costs but may be calculated without deducting the performance fee as long as this would be in the investor's best interest
 - If the reference indicator changes during the performance reference period, the performance should be calculated by linking the benchmark index that was previously in force until the date of the change and the new reference indicator used afterwards

3. Crystallization frequency

- ▶ It should allow for the alignment of the manager's and the investors' interests
- ▶ It should not be more than once a year, except for the high water-mark model or high-on-high model where these cannot be reset during the whole life of the UCI, and fulcrum fee model and other models which provide a symmetrical fee structure
- ▶ It should be the same for all share classes of a UCI with a performance fee
- ▶ Performance fee should crystallize in due proportion in case of closure/merger of UCIs or upon investor's redemption. However, where both merging and receiving UCIs are managed by the same manager, crystallization should be presumed to be contrary to investors' best interests, unless justified otherwise by the manager
- ▶ Generally, it should coincide with the end of the financial year of the UCI

4. Loss recovery

- ▶ Any loss or underperformance previously incurred during the performance reference period should be recovered before a performance fee becomes payable
- ▶ A performance fee may be payable in the case where the UCI outperformed the benchmark but had negative performance
- ▶ The performance reference period should be, as far as possible, consistent with the recommended investor holding period. Where the performance reference period is shorter than the whole life of the UCI, it should be set equal to at least five years (on a rolling basis for UCIs using a HWM)

5. Disclosures

- ▶ Investors should be adequately informed about the performance fees and their impact on return
- ▶ All *ex-ante* documents (prospectus, KIID, marketing documents) should clearly set out all information necessary to understand the performance fee model and the computation methodology, including the main elements and parameters and the payment date. Concrete computation examples should be included in the prospectus
- ▶ Where a performance fee model uses a different but consistent benchmark, the explanation of the choice of benchmark should be included in the prospectus
- ▶ Where a performance fee is payable in times of negative performance a prominent warning must be included in the KIID
- ▶ Where applicable the KIID and the prospectus should display the name of the benchmark index and disclose past performance against it
- ▶ The annual and semi-annual reports and any other *ex-post* information should indicate for each relevant share class the amount of performance fees and the percentage of the share class NAV they represent

The CSSF must notify ESMA of its intention to comply or not within two months of the date of publication of the official translations of the guidelines into all EU official languages. At the end of this period, the guidelines may become immediately applicable in Luxembourg for all in scope UCIs introducing a performance fee after the application date. Managers of UCIs with a performance fee existing before the application date should comply by the beginning of the financial year following six months from the application date.

On 10 March 2020, the CSSF updated its *Frequently Asked Questions concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment* with respect to disclosure of performance fees, the investment manager's fee and the investment advisor's fee, to investors of a UCITS. In this document the CSSF clarified the following:

- ▶ Both the fee model and the investment manager as the recipient of a performance fee must be disclosed in the prospectus. In cases where there is a sharing arrangement of the performance fee with any investment advisor(s) contractually linked to the UCITS, the prospectus must inform investors of this arrangement
- ▶ Where a service fee is directly paid out of the assets of the UCITS to the investment manager(s), and to any investment advisor(s) contractually linked to the UCITS, the method of calculation or the rate of the fee to each recipient must be disclosed in the prospectus
- ▶ The investment manager's fee and/or the investment advisor's fee must only pay for investment management and investment advice, respectively. In general, the investment advisor's fee is expected to be lower than that of the investment manager

- ▶ When other expenses or fees for activities beyond the direct scope of investment management or advice are payable out of the assets of the UCITS to the investment manager(s) or investment advisor(s), such expenses or fees must be disclosed separately from investment manager's fee and investment advisor's fee respectively, in a manner that clearly informs investors about the nature of such expenses or fees
- ▶ Where the "all-in" fee is proposed, which implies that only one compensation amount is paid out of the assets of the UCITS to a recipient (commonly the management company) who will afterwards pay the other service providers to the UCITS, the prospectus must clearly state the scope and nature of such "all-in" fee. Ideally, each contractual recipient of this all-in fee should be specified

Another significant expense incurred by a Luxembourg UCI is the fee paid for administration (including, *inter alia*, fund accounting and transfer agency – see also Chapter 8). The administration fee is also often based on a specified percentage of net assets, or average net assets, of the UCI. The administration agreement may also provide for minimum fees and/or reduced fee rates on net assets in excess of specified levels of assets under administration.

Other operating expenses incurred by a Luxembourg UCI include:

- ▶ Directors fees, insurance, conducting persons fees (if applicable), and management company fees (if applicable)
- ▶ Depositary fees, transaction fees, and brokerage fees
- ▶ Domiciliation fees
- ▶ Preparation of financial reports (annual and semi-annual reports, where relevant)
- ▶ Annual and semi-annual report printing costs
- ▶ Net asset value (NAV) or price publication expenses
- ▶ Independent valuation costs
- ▶ Annual registration duty (if applicable)
- ▶ CSSF annual fee:
 - ▶ Single compartment UCI EUR 4,000
 - ▶ Multiple compartment UCI:
 - ▶ 1 to 5 compartments EUR 8,000
 - ▶ 6 to 20 compartments EUR 15,000
 - ▶ 21 to 50 compartments EUR 24,000
 - ▶ More than 50 compartments EUR 35,000

Grand-Ducal Regulation of 21 December 2017, as amended, introduced a single lump sum fee of EUR 4,000 for each conversion request of a single compartment UCI into a multiple compartment UCI. In addition, any change of legal status of an existing UCI or its conversion into another legal form (for example an FCP into an investment company) is considered as a new examination and will incur CSSF initial authorization fees as set out in Section 11.2.1.

An annual lump sum of EUR 3,000 is also payable by each UCI in non-judicial liquidation. This lump sum is due for each financial year in which the non-judicial liquidation has not been completed, except for the financial year in which the UCI has been deregistered from the official list.

- ▶ Legal fees
- ▶ Audit fees
- ▶ Stock exchange maintenance fee (if applicable):
 - ▶ 1st quotation line EUR 1,875
 - ▶ 2nd quotation line EUR 1,250
 - ▶ 3rd quotation line EUR 875
 - ▶ 4th and subsequent quotation lines, per line EUR 500
- ▶ Cross-border registration application, authorization, and maintenance fees
- ▶ Cross-border tax compliance fees
- ▶ Distribution costs including:
 - ▶ Initial registration costs
 - ▶ Ongoing registration costs
 - ▶ Local representatives costs
 - ▶ Local paying agent and other facilities costs
- ▶ Annual subscription tax for UCIs (see Section 11.3.2.2.)
- ▶ Investor communication costs
- ▶ Marketing costs

Luxembourg UCIs may cap their fees and/or expenses. This may be achieved by:

- Waive of fees, or a portion of certain expenses/fees
- Reimbursement by portfolio manager or other party of certain expenses/fees, or a portion of the expenses/fees or assume certain expenses, or a portion of the expenses

Best practice is to disclose in the annual report the impact of any waiver/reimbursement on the performance of the UCI's shares/units.

Operating expenses may be paid either directly by the UCI, or by the management company or general partner (when the UCI is not self-managed). When they are paid by the management company or general partner, the UCI is typically charged a fixed service fee covering certain operating expenses incurred on behalf of the UCI.

Ongoing expenses of a Luxembourg management entity are covered in Section 6.5.3.2.

On 4 June 2020, ESMA published a *supervisory briefing on the supervision of costs in UCITS and AIFs*. The briefing is expected to be considered by National Competent Authorities ("NCAs").

ESMA has developed criteria to support NCAs in:

- (i) Assessing the notion of "undue costs" and supervising the pricing process of the management company

The notion of undue costs should be primarily assessed against what should be considered as being in the best interest of the UCI or its share/unitholders.

NCAs are expected to require management companies to develop and review periodically a structured pricing process.

NCAs should supervise that the payment of any fee is aimed at remunerating a service provided to the UCI/its investors and does not impair compliance with the management company's duty to act in the best interests of the share/unitholders.

- (ii) Supervising the obligation to prevent undue costs being charged to investors

NCAs are expected to review management companies' pricing processes as part of their supervisory activity to ensure that undue costs are not charged to investors.

NCAs are expected to scrutinize:

1. Whether the costs are necessary for the fund to operate in line with its investment objective (e.g., portfolio management fees, transaction and settlement fees) or strictly functional to the ordinary activity or to fulfil regulatory requirements (audit fees, taxes, NCA levies)
2. Whether the costs are proportionate to market standards and the type of service provided, notably in the context of potential conflicts of interest where payments are made to third parties, intragroup delegates or depositaries
3. Whether the fees are proportionate to the complexity of assets, strategies and activities performed
4. Whether the fees are sustainable in light of the expected net return of the fund
5. Whether the costs ensure investors' equal treatment, except for AIFs not distributed to retail investors disclosing a preferential treatment, where such treatment is allowed under the applicable legislation
6. Whether there is no duplication of costs and costs are properly identified and accounted for
7. Whether a cap on fees, if any, is applied and disclosed to investors
8. Whether the performance fee model and its disclosure is compliant, where applicable, with the *ESMA Guidelines on performance fees in UCITS and certain types of AIFs*
9. Whether all costs disclosures to investor comply with applicable EU and national rule
10. Whether the pricing process and all charged costs are based on reliable and documented data and verifiable at a single portfolio level

ESMA expects the outcome of any supervisory action to include an assessment of the possibility of investor compensation, fee reduction, review of disclosure documents and/or communication of good and poor practices by NCAs to the market.

11.3. Taxation

11.3.1. Introduction

This section covers the taxation of:

- Luxembourg UCIs
- The assets of Luxembourg UCIs
- Investors in Luxembourg UCIs
- Fees paid by Luxembourg UCIs

This section also covers taxation impacts of selected restructuring scenarios.

11.3.2. Taxation of Luxembourg UCIs

Luxembourg UCIs constituted under the 2010 Law, the SIF Law or the RAIF Law (other than under article 48 of the RAIF Law) are tax exempt in Luxembourg with the exception of the registration duty and annual subscription tax. There is no stamp duty in Luxembourg on share issues or transfers. Most of the UCIs have to register for Luxembourg VAT purposes in order to self-assess the VAT due in Luxembourg on services received from foreign suppliers (unless an exemption is applicable).

Taxation of management companies and AIFM is covered in Section 6.5.3.4.

11.3.2.1. Registration duty

UCIs incorporated as investment companies are subject to a registration duty of EUR 75 on incorporation and in case of:

- Modification of the articles of incorporation
- Transfer of the effective place of management or registered office to Luxembourg

This registration duty is fixed; it does not vary with the number of compartments.

UCIs constituted as common funds are not subject to this registration duty.

11.3.2.2. Annual subscription tax

The Law of 23 July 2016 on the electronic filing of tax returns for *taxe d'abonnement* introduced an obligation for all UCIs to electronically file tax returns from 1 January 2018.

11.3.2.2.1. General tax rate

2010 Law UCIs are generally subject to an annual subscription tax of 0.05%; for SIFs and RAIFs²⁵³, the rate is 0.01%. This tax is calculated and payable quarterly, based on the total NAV of the UCI on the last day of every calendar quarter.

On incorporation of the UCI, this tax is calculated in proportion to the duration, in days, between the date of incorporation and the end of the following quarter. For each additional compartment incorporated thereafter, the tax base remains the total NAV on the last day of each quarter.

On the dissolution of the UCI, the subscription tax is calculated in proportion to the number of days between the beginning of the last quarter and the dissolution (the appointment of a liquidator). Where a compartment is liquidated but the UCI is not dissolved, there is no subscription tax due for the quarter during which the compartment was liquidated.

11.3.2.2.2. Reduced tax rate

For 2010 Law UCIs, a reduced tax rate is applicable in the following cases:

A. UCIs investing in money market instruments and deposits

The rate is reduced to 0.01% for UCIs and UCI compartments whose exclusive policy is the investment in money market instruments or deposits with credit institutions.

²⁵³ Other than RAIFs investing exclusively in risk capital, which choose to be subject to a regime similar to that of SICARs, per Article 48 of the RAIF Law of 23 July 2016.

As clarified in the Grand-Ducal Regulation of 14 April 2003, such money market instruments are deemed to include any notes and instruments representing claims, whether or not they may be characterized as securities, including bonds, certificates of deposit, treasury bills, and any other similar instruments, provided that at the time of their acquisition their residual maturity does not exceed twelve months, taking account of any related hedging financial instruments. In addition, floating rate notes with a residual maturity exceeding twelve months are permitted provided the interest rate is adjusted to market conditions at least annually. In certain cases, a UCI whose portfolio has an average remaining maturity not exceeding twelve months may also qualify for the reduced rate.

It should be noted that the definition of “money market instruments” for the purpose of subscription tax is different to the criteria for the purpose of UCITS (see Section 4.2.2.7.5.). See also Section 2.6.1.

B. Institutional investor compartments or share classes

The reduced rate of annual subscription tax of 0.01% also applies to individual compartments of multiple compartment UCIs subject to the 2010 Law, as well as to individual share classes of a UCI or of a compartment of a multiple compartment UCI, if the shares of these compartments or classes of these shares are restricted to one or several institutional investors.

11.3.2.2.3. Exemption

A subscription tax exemption is applicable in the following cases:

A. Investment in other Luxembourg UCIs

In order to avoid double taxation, the value of assets represented by investments in other Luxembourg UCIs (2010 Law UCIs, SIFs and RAIFs) that have already been subject to subscription tax is exempt.

B. Institutional cash UCIs

UCIs (2010 Law UCIs, SIFs and RAIFs), compartments of multiple compartment UCIs, and share classes are exempt from the subscription tax provided all the following conditions are met:

- ▶ The shares are reserved for institutional investors
- ▶ The exclusive policy is the investment in money market instruments or deposits with credit institutions
- ▶ The weighted residual portfolio maturity does not exceed 90 days (floating rate notes with a maturity exceeding 90 days but whose interest rate is adjusted at least every 90 days are also permitted)
- ▶ The UCI benefits from the highest possible ranking by a recognized ranking agency

C. Pension Fund Pooling Vehicles (PFPVs)

Luxembourg Pension Fund Pooling Vehicles (PFPVs) (whether 2010 Law UCIs, SIFs or RAIFs) are exempt from subscription tax.

D. Microfinance UCIs

2010 Law UCIs, SIFs, and RAIFs, or compartments thereof, whose main objective is investment in microfinance institutions are exempt from subscription tax.

The Grand-Ducal Regulation of 14 July 2010 clarified that UCIs, as well as compartments of umbrella UCIs whose investment policy is to invest at least 50% of their assets in one or several microfinance institutions or that benefit from the microfinance label issued by the Luxembourg Fund Labeling Agency (*LuxFLAG*) are exempt from subscription tax. Microfinance institutions are defined as those that invest at least half of their assets in microfinance investments or microfinance UCIs. Microfinance includes all financial operations other than consumer loans, the objective of which is to support poor populations excluded from the traditional financial system by financing small revenue generating activities, and whose value does not exceed EUR 5,000.

E. Exchange Traded Funds or Products

2010 Law UCIs, or compartments thereof, whose securities are listed or regularly traded on at least one stock exchange or another regulated market and whose exclusive objective is to replicate the performance of one or more indices are exempt from subscription tax.

11.3.2.3. Tax on dissolution

Mergers, demergers, and dissolutions of a Luxembourg UCI generally do not give rise to Luxembourg tax at the level of the Luxembourg UCI.

The transformation of a SICAV into a common fund and vice versa has no impact for Luxembourg tax purposes at the level of the Luxembourg UCI.

11.3.3. Taxation of the assets of Luxembourg UCIs

This section provides an overview of the taxation of assets of Luxembourg UCIs.

11.3.3.1. Withholding tax on income

Luxembourg UCIs may be subject to withholding taxes (WHT) on dividends and interest and to tax on capital gains in the country of source of the income from their investments.

Only certain double tax treaties (DTTs) signed by Luxembourg are applicable to Luxembourg UCIs. Treaties with the following 56 countries should be applicable to investment companies (according to publicly available information):

Andorra	Finland ²⁵⁴	Laos	Romania	The Seychelles
Armenia	Georgia	Liechtenstein	San Marino	Trinidad and Tobago
Austria	Germany	Macedonia	Saudi Arabia	Tunisia
Azerbaijan	Guernsey	Malaysia	Serbia	Turkey
Bahrain	Hong Kong	Malta	Singapore	United Arab Emirates
Barbados	Indonesia	Moldova	Slovakia ²⁵⁴	Uruguay
Brunei	Ireland	Monaco	Slovenia	Uzbekistan
China	Isle of Man	Morocco	Spain ²⁵⁷	Vietnam
Croatia	Israel	Panama	Sri Lanka	
Czech Republic	Jersey	Poland	Tadjikistan	
Denmark	Kazakhstan ²⁵⁴	Portugal ²⁵⁶	Taiwan	
Estonia	Korea ²⁵⁵	Qatar	Thailand ²⁵⁴	

For investment companies set up under the SIF Law, treaties with these countries should in principle also apply (except for the treaty with Spain); they are also expected to apply to investment companies set up under the RAIF Law.

The applicability of such DTTs, however, is not always clear. In principle, common funds will not benefit (with certain exceptions) unless the unitholders themselves are able to claim the reduced rate under the DTT, which, in practice, may be very difficult. Furthermore, investment companies may be able to benefit from DTTs with certain other countries that do not specifically mention their applicability to such funds. These include²⁵⁸:

- Bulgaria
- Greece
- Italy

Please refer to the separate Appendix “Withholding Tax Rates Applicable to Luxembourg UCIs” for detailed information on the withholding tax rates applicable to the different types of income received by Luxembourg UCIs.

11.3.3.1.1. Reclaim opportunity for withholding tax

Investment funds may have the possibility to obtain refunds of dividend withholding taxes (typically, where the withholding tax was considered to be discriminatory by the European Court of Justice (e.g., Aberdeen C-303/07, Santander C-338/11)).

Investment funds may therefore consider filing protective claims in a range of European jurisdictions in order to safeguard their potential refund claims.

²⁵⁴ Luxembourg UCIs' eligibility for the benefits of the treaty with Finland, Kazakhstan, Slovakia and Thailand, is based on the Luxembourg tax authorities' interpretation of the treaty; this may, however, conceivably be contested by the treaty partner.

²⁵⁵ On 16 January 2020, the Korean Supreme Court ruled that Luxembourg SICAVs and SICAFs were entitled to benefit from the Double Tax Treaty between Luxembourg and the Republic of Korea. The court ruled that SICAVs and SICAFs are Luxembourg tax residents and beneficial owners of the Korean source income earned and are not holding companies for the purposes of article 28 of the treaty based on which the Korean Ministry of Strategy and Finance had, in May 2011, issued an authoritative tax barring them from treaty benefits.

²⁵⁶ In August 2012, the Portuguese tax authorities published a technical note regarding the entitlement of Luxembourg domiciled investment companies with variable capital (SICAVs) to benefit from the Double Tax Treaty between Luxembourg and Portugal. The note clarifies that Treaty benefits should apply, provided the SICAV meets the residency requirements of the Treaty. However, it does not clarify whether Treaty benefits will be extended to entities other than SICAVs. Historically, Treaty benefits were not generally extended to Luxembourg SICAVs, due to interpretations of an article of the Treaty.

²⁵⁷ Only applicable to UCITS (Part I of the 2010 Law).

²⁵⁸ See Circular L.G. A n°61 dated 8 December 2017 on Certificates of Residence for Luxembourg UCIs. With respect to Korea, see footnote above.

Opportunities to file protective claims exist, for example, in a range of European jurisdictions including:

- ▶ Austria
- ▶ Belgium
- ▶ Denmark
- ▶ Finland
- ▶ France
- ▶ Germany
- ▶ Italy
- ▶ Norway
- ▶ Poland
- ▶ Spain
- ▶ Sweden
- ▶ The Netherlands

11.3.3.2. Financial transaction tax

Financial transaction tax (FTT) regimes may apply to certain transactions in financial instruments held by Luxembourg UCIs in case these transactions fall within the scope of domestic FTT regimes e.g., in France or in Italy.

In September 2011, the European Commission published its proposals for the introduction of an EU Financial Transaction Tax (FTT). In February 2013, the European Commission submitted the revised *Proposal for a Council Directive implementing enhanced cooperation²⁵⁹ in the area of Financial Transaction Tax*.

The key objectives of the FTT include:

- ▶ Harmonizing legislation concerning indirect taxation on financial transactions
- ▶ Ensuring that financial institutions make a fair and substantial contribution to covering the costs of the recent crisis and creating a level playing field with other sectors from a taxation point of view
- ▶ Creating appropriate disincentives for transactions that do not enhance the efficiency of financial markets or of the real economy, thereby complementing regulatory measures to avoid future crises

Under the proposed directive, financial transactions carried out by “financial institutions” would be subject to FTT when there is an established link to the FTT-zone. The FTT-zone would consist of Member States participating in the FTT under the enhanced cooperation procedure.

“Financial institutions” would include credit institutions, investment firms, insurance and reinsurance undertakings, UCITS, pension funds, alternative investment funds (AIF), securitization vehicles, regulated markets, and other organized trading venues or platforms.

The “residence” principle and the “issuance” principle would apply to determine whether there is a link to the FTT-zone.

In December 2015, the Finance Ministers of 10 participating Member States (Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain) issued a joint statement reaffirming their aim to create a harmonized taxation regime for financial transactions and to introduce an EU FTT and agreeing certain, but not all, features of such an EU FTT.

In March 2016, Estonia, which had previously intended to participate in the FTT, completed the formalities to leave the enhanced co-operation on FTT.

During the first half of 2016, within the relevant EU Working Party on Tax Questions which performs preparatory work for the EU Council, the debate continued, without unanimous agreement, on selected issues already raised: application of the issuance and residence principles and the territorial scope for the FTT, the possible exemption of market making activities and the scope of transactions in derivatives to be subject to the FTT.

In early 2017, the EU Commissioner responsible for FTT indicated that a draft legislative text would be forthcoming later in 2017. However no draft has been published yet and the finance ministers of the 10 prospective participating Member States suspended negotiations in September 2017 to examine the impact on FTT of the UK’s departure from the EU, planned at the time for March 2019. For the time being, discussions are still going on.

In October 2019, a meeting of the Finance Ministers of the prospective Participating Member States was held, which asked the German Finance Minister to circulate a new version of the proposed FTT directive on the basis of the discussions to date; this new version was circulated in December 2019.

On 29 January 2020, the European Commission adopted its 2020 Work Program, which sets out the actions the Commission will take in 2020 and includes pending legislative initiatives that should receive priority attention in 2020, including enhanced cooperation in the area of a Financial Transaction Tax.

Further discussions and developments are expected in 2020.

²⁵⁹ The enhanced cooperation procedure allows a group of Member States to cooperate within an EU framework without all Member States participating. At least nine Member States must address a formal request to the European Commission, describing the scope and the objectives of the cooperation, and should sign this request. The enhanced cooperation allows any other Member State to join at a later stage upon request.

11.3.3.3. Taxation of holding structures

In addition to taxation at the level of the underlying assets of Luxembourg UCIs, intermediate holding structures may also be subject to taxation.

This section provides a general overview on the Luxembourg holding regimes. The most common is the SOPARFI; the securitization vehicle is also used in certain cases.

The taxation of international holding structures is beyond the scope of this *Technical Guide*.

A. SOPARFIs

Luxembourg SOPARFIs are briefly introduced in Section 2.7.1.

SOPARFIs are fully taxable Luxembourg companies, subject to corporate income tax, municipal business tax, net worth tax and potentially VAT. The taxable worldwide income is subject to corporate income tax (plus employment fund surcharge) and municipal business tax. The aggregate tax rate is currently 24.94% in Luxembourg City. Furthermore, SOPARFIs are subject to annual net worth tax at a tax rate of 0.5% on the adjusted net asset value (the unitary value) up to and including EUR 500 million plus 0.05% for taxable amounts exceeding EUR 500 million at the beginning of the year. Upon request, the NWT could be reduced (up to the amount of the prior year CIT due) by creating a special reserve equal to five times the amount of NWT to be reduced. Such reserve needs to be kept in the annual accounts for five years. Since 1 January 2016, SOPARFIs that are subject to Luxembourg corporate income tax and whose financial assets, transferable securities, bank deposits and receivables owed by affiliated companies amount to more than 90% of total assets and exceed EUR 350,000 are subject to a flat annual minimum net worth tax amounting, from 1 January 2017, to EUR 4,815. SOPARFIs that do not meet the above conditions are subject to a variable annual minimum net worth tax, which ranges from EUR 535 to EUR 32,100, depending on the balance sheet total at the financial year end.

Assets that generate income (or are likely to generate income) that is not taxable in Luxembourg, including income for which the taxation right belongs to another country based on a DTT concluded with Luxembourg (e.g., immovable property, or assets allocated to a permanent establishment) should be excluded from the balance sheet total for the purpose of determining the said minimum tax. This allows, *inter alia*, Luxembourg real estate vehicles directly holding foreign real estate property not to be highly impacted.

Minimum corporate income tax was abolished with effect from 1 January 2016.

Withholding tax (WHT) may be levied on dividends distributed and, in certain specific cases, interest paid by a SOPARFI. Furthermore, provided certain conditions are met:

- ▶ Dividends paid by and capital gains realized from direct subsidiaries of a SOPARFI may be exempt from corporate income tax and municipal business tax (i.e., the participation exemption regime may apply)
- ▶ Interest expenses may be tax deductible if the arm's length principle is respected and they are not linked to the financing of a tax exempt asset; interest deductibility, since 2019, is nevertheless subject to the interest limitation rules and, where relevant, the anti-hybrid rules, of the Law of 21 December 2018 implementing the EU Anti-Tax Avoidance Directive (the "ATAD Law" - see box below) and the rules of the Law of December 2019 implementing amendments to ATAD (the "ATAD 2 Law")
- ▶ Qualifying subsidiaries of the SOPARFI may be exempt from net worth tax

Dividends paid by SOPARFIs may be exempt from 15% WHT on the gross amount of the dividend under domestic law or double tax treaty (DTT) provisions. SOPARFIs have access to more than 80 DTTs and benefit from the provisions of European Union (EU) Directives. Measures to prevent treaty abuse and improve dispute resolution have been introduced through the MLI (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS), with effect, for Luxembourg, from January and February 2020.

The Anti-Tax Avoidance Directive (ATAD) Law and ATAD 2 Law

The Law of 21 December 2018 implementing the European Union (“EU”) Anti-Tax Avoidance Directive (2016/1164) (“ATAD Law”) has introduced several anti-tax avoidance provisions applicable to tax years starting on or after 1 January 2019. The ATAD Law has clarified the scope of the Luxembourg general anti-avoidance rule (“GAAR”) in line with the GAAR included in the ATAD itself. As reworded, the GAAR provides that tax law cannot be circumvented by an abuse of forms or institutions of law; the latter occurs if a legal path is used, at least one of whose principal objectives is to obtain a circumvention or reduction of taxation that defeats the object or purpose of the tax law and is not authentic, i.e., is not put in place for valid commercial reasons which reflect economic reality.

The ATAD Law also introduces anti-hybrid mismatch rules whereby Luxembourg will deny the deduction of an expense related to a hybrid arrangement to the extent the latter would otherwise result in a deduction both in Luxembourg and in another EU Member State (double deduction) or in a deduction (in Luxembourg) without inclusion in another EU Member State involved in the arrangement. The scope of these rules is further expanded through the ATAD 2 Law implementing the EU Anti-Tax Avoidance Directive (2017/952) providing for minimum standards for hybrid mismatches involving third countries (ATAD 2). ATAD 2 expands the hybrid instruments and hybrid entity mismatches between EU Member States foreseen by ATAD to hybrid mismatches involving third countries. In addition, the scope is expanded to certain types of hybrid mismatches that were not covered by ATAD, to cover hybrid permanent establishment (PE) mismatches, hybrid transfers, imported mismatches, reverse hybrid mismatches and dual resident mismatches. The ATAD 2 Law’s provisions apply to financial years starting on or after 1 January 2020, except for the provisions on reverse hybrid entities, that will apply as from tax year 2022.

The ATAD Law limits the deductibility of “exceeding borrowing costs” to the higher of EUR 3 million or 30% of the taxpayer’s taxable earnings before interest, tax, depreciation and amortization (taxable EBITDA); exceeding borrowing costs may be carried forward with no limit in time and unused interest capacity may be carried forward for 5 years. Interest on loans concluded before 17 June 2016 and not subsequently modified is grandfathered; an equity escape rule is available to members of a group consolidated for financial accounting purposes; stand-alone entities and financial undertakings specified by the ATAD Law (essentially credit institutions, regulated investment firms, insurance and reinsurance undertakings, UCITS management companies and AIFMs, UCITS, AIFs managed by an AIFM, and certain pension institutions) are not subject to interest limitation.

Finally, the ATAD Law introduced Controlled Foreign Company (“CFC”) rules whereby the income of a CFC (as defined by the ATAD Law) not distributed directly to the Luxembourg controlling entity, which results from arrangements put in place for the essential purpose of obtaining a tax advantage and which are “non-genuine arrangements”, is included in the Luxembourg entity’s taxable income to the extent it arises from assets and risks in relation to which the Luxembourg entity carries out significant people functions.

B. Securitization Vehicles

Luxembourg securitization vehicles are briefly introduced in Section 2.7.2.

Luxembourg securitization vehicles have access to beneficial taxation regimes, which can be briefly summarized as follows:

- ▶ Securitization companies:
 - ▶ Are fully taxable companies subject to corporate income tax and municipal business tax; however, commitments (interest or dividend) to investors and creditors qualify as tax deductible business expenses even if they have not been actually paid out in a given year.
 - ▶ Are subject to the interest limitation rule which limits the annual deductibility of taxpayers’ exceeding borrowing costs, defined as the excess of borrowing costs (as defined) over interest income and other economically equivalent taxable revenues, to the higher of 30% of the taxable EBITDA (taxable profits before net interest, tax, write-downs, depreciation and amortization) or EUR 3 million (safe harbor rule).
 - ▶ Since 1 January 2016, are subject to minimum net worth tax (i.e., EUR 4,815 per fiscal year from 2017)
 - ▶ Have access to existing DTTs on a case-by-case basis
 - ▶ Are subject to VAT and usually benefit from a VAT exemption for their management
- ▶ Securitization funds are tax transparent entities that are exempt from any direct taxation in Luxembourg, including the annual subscription tax
- ▶ Management services provided to securitization vehicles are VAT exempt in practice
- ▶ Repatriation of proceeds to investors are free from Luxembourg WHT

11.3.3.4. Transfer pricing considerations

Transfer pricing is the determination of the compensation to be applied on dealings between related parties, where a “natural” negotiation process and market behavior would not apply. These compensations impact the assessable basis of the relevant entity and are thus an area of focus for the tax authorities.

The Luxembourg transfer pricing legislation is included in Article 56 and Article 56bis of the Income Tax Law. Article 56 introduces the arm’s length principle in the domestic legislation, while Article 56bis provides details on the application of the arm’s length principle, in particular with regard to the comparability analysis.

Transfer pricing impacts all dealings between related parties, which include:

- Management company remuneration
- Management fees allocation
- Delegation of functions/retrocessions
- General Partner remuneration
- Financing transactions
- Service flows and cost allocation
- Restructurings (e.g., transfer of functions, sale of portfolio, etc)

Taxpayers need to be in a position to support the impact of these related party transactions on their tax returns. As it relies on the functions performed, assets used, and risks borne, transfer pricing documentation is not only of interest for the tax authorities but is also of interest for the regulators.

11.3.3.5. Other taxes impacting the assets of Luxembourg UCIs

There are many other types of taxes that may impact the assets of Luxembourg UCIs. For example, investments in real estate may be subject to transfer taxes or registration duties. Other taxes are beyond the scope of this Technical Guide.

11.3.4. Taxation of investors in Luxembourg UCIs

11.3.4.1. Withholding tax on dividends paid by Luxembourg UCIs

There are no withholding taxes (WHT) on dividends paid by Luxembourg UCIs (2010 Law UCIs, SIFs and RAIFs). Note that payments of the type that were subject to withholding tax under the Luxembourg Law implementing the EU Savings Directive until 31 December 2014, were subject to automatic exchange of information under the same law, as amended, from 1 January 2015 to 31 December 2015 and, in the case of payments on or after 1 January 2016, are subject, instead, to automatic exchange of information under the CRS Law (see 11.3.4.4.3).

11.3.4.2. Foreign UCI investors and foreign feeders

Non-resident UCI investors (individuals and corporations) are exempt from taxation in Luxembourg on capital gains realized upon sale of their shares in a Luxembourg corporate UCI (even in cases where they held a substantial shareholding of more than 10%). This facilitates the creation of master-feeder structures with a Luxembourg investment company as the master fund.

11.3.4.3. Luxembourg resident investors in UCIs

Upon distribution of dividends by the UCI or redemption of the shares or units of the UCI, the Luxembourg individual or corporate investor has to declare his income from the UCI in his annual tax return. Capital gains arising from the sale of UCI shares or units, other than speculative gains (i.e., sale of the shares or units of the UCI within six months after acquisition), are exempt from taxation in the hands of Luxembourg resident individual investors. In case the individual investor holds more than 10% of the capital of an investment company (SICAV or SICAF)²⁶⁰, any gain realized on sale of the shares is subject to individual taxation in Luxembourg.

Dividends and capital gains realized upon redemption of shares or units in a Luxembourg UCI are generally subject to corporate taxation at the level of a Luxembourg corporate investor (regardless of the holding period and the percentage held).

²⁶⁰ The 10% threshold is determined on an umbrella fund basis.

11.3.4.4. Enhanced international cooperation

11.3.4.4.1. European Union Member States

The Law of 29 March 2013 transposing part of the Directive 2011/16/EU *on administrative cooperation in the field of taxation* (often referred to as "DAC 1") entered into force with retroactive effect from 1 January 2013.

The Law of 29 March 2013 lays down the rules and procedures under which Luxembourg will cooperate with other EU Member States on the exchange of tax related information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Member States. The Law complements Luxembourg's legislation enabling the exchange of information provided for by double taxation treaties (DTTs). In recent years, Luxembourg has signed new DTTs and amended existing DTTs with other countries that comply with the OECD standards on the exchange of information upon request between tax authorities.

The Law applies to all taxes except value added tax (VAT), customs duties and excise duties covered by other EU legislation on administrative cooperation between EU countries. It does not apply to social security contributions.

The Law implements almost all provisions of the Directive, *inter alia*:

- Inclusion of information held by a bank or other type of financial institution in the scope of exchange of information on request regarding taxable periods from 1 January 2011
- Introduction of deadlines for the exchange of information
- Introduction of other forms of administrative cooperation

In March 2014, a Law was adopted by the Luxembourg Parliament implementing automatic exchange of information in accordance with Article 8 of the Directive 2011/16/EU on administrative cooperation in the field of taxation.

The Law introduced the automatic and mandatory exchange of information for specific categories of income. Luxembourg tax authorities communicate information on employment income (falling within the scope of Luxembourg withholding tax on wages), pension income, and Directors' fees paid from 2014 onwards.

The tax authorities also released new forms to be used for the declaration of withholding tax on directors' fees.

On 9 December 2014, Council Directive 2014/107/EU amending Directive 2011/16/EU *as regards mandatory automatic exchange of information in the field of taxation* (often referred to as "DAC 2") was adopted. It required that all EU Member States apply automatic exchange of information between Member States starting 1 January 2016 (except Austria, which had to start by 2017) in accordance with the OECD's Common Reporting Standard (CRS) (see Section 11.3.4.4.3.). DAC 2 was implemented in Luxembourg by the Law of 18 December 2015 on the automatic exchange of financial account information in tax matters (the "CRS Law").

The scope of the Directive 2011/16/EU *on administrative cooperation in the field of taxation* has gradually been extended by the addition of further types of automatic exchange of tax-related information, through amending Directives known as DAC 3 on automatic exchange of information concerning tax rulings and advance pricing agreements, DAC 4 on country-by-country reporting of certain financial information by multinational groups, DAC 5 ensuring that tax authorities have access to information collected for anti-money laundering purposes and DAC 6 on automatic exchange of information on reportable cross-border arrangements (also known as Mandatory Disclosure Rules - MDR - see Section 11.3.4.4.4.).

11.3.4.4.2. FATCA

The Foreign Account Tax Compliance Act (FATCA) provisions are United States legislation that applies mainly to non-US entities that FATCA defines as Foreign Financial Institutions (FFIs) and aims to prevent tax evasion by US persons through the use of accounts outside the US or of foreign investment vehicles.

The FATCA provisions were ultimately incorporated into the Hiring Incentives to Restore Employment Act (HIRE Act), which was enacted in March 2010. Regulations were issued in January 2013 and were amended and completed by a further package of Regulations in February 2014 and January 2017. The FATCA provisions were essentially applicable from 1 July 2014.

The implementation of FATCA is ensured mainly by Intergovernmental Agreements (IGAs) signed by the United States with many countries, including Luxembourg²⁶¹.

In March 2014, Luxembourg signed a Model 1 IGA providing that Reporting Luxembourg FFIs will report information annually on certain account holders to the Luxembourg tax authorities, which in turn will provide such information to the US under an automatic exchange of information. The Luxembourg-USA IGA was amended by an exchange of notes signed 31 March 2015 and 1 April 2015 and approved by the Law of 24 July 2015 (the "FATCA Law").

By the end of May 2020, the United States had IGAs in force with 95 countries, IGAs signed with a further 9 countries, and substantial agreement had been reached with 9 other countries.

Under FATCA, FFIs are *de facto* required to become information-gathering and tax collection agents on behalf of the IRS. FFIs, as defined by FATCA, cover a broad range of financial institutions, including banks, life insurance companies, investment funds, pension funds, mutual funds, private equity funds, broker dealers, and management companies.

FFIs' "on-boarding" processes²⁶² for "new account holders" (including investors in investment funds) had to be FATCA-compliant by 1 July 2014 and a data and (in some cases) documentation review process with respect to "pre-existing accounts" had to be performed and completed by specified dates, the latest being 30 June 2016. Luxembourg reporting FFIs are required to register with the IRS and to obtain a Global Intermediary Identification Number (GIIN).

FFIs that are Investment Entities (e.g., investment funds) must report the following information annually:

- ▶ The identity and account balances of US Specified Persons that were, at any time during the year reported, account holders or the Controlling Persons of a Passive Non-Financial Foreign Entity (Passive NFFE) that was an account holder, the aggregate income and redemption proceeds paid to such US accounts during the year reported, and, with respect to 2015 and 2016, payments to non-participating FFIs.
- ▶ Luxembourg Reporting FFIs are also required to provide a "nil report" to the Luxembourg tax authorities if they have no accounts to report.

Certain FFIs may face a lighter burden of compliance if they fulfill conditions to be "deemed-compliant" FFIs, also referred to as "Non-Reporting FIs" under the IGA.

Failure by a FFI to comply with FATCA will result in a 30% WHT being applied by US withholding agents and by other FFIs on "withholdable payments"²⁶³ to such a "non-participating FFI", including dividends and interest paid by US issuers (in some cases, starting 1 July 2014), as well as potentially in the future gross proceeds of the sale of US securities.

The FATCA Law also provides for penalties to be charged by the Luxembourg tax authorities, up to EUR 250,000 if a Luxembourg FI fails to comply with the required due diligence procedures or fails to implement reporting mechanisms and 0.5% of amounts due to be reported by the FI (and minimum EUR 1,500) in case of failure to report or incomplete or incorrect reporting.

Finally, in fulfilling its obligations under the FATCA Law, a Luxembourg FI has duties to fulfill pursuant to Luxembourg's Data Protection Law and the EU Global Data Protection Regulation (GDPR) (see further details under in Section 11.3.4.4.3. OECD Common Reporting Standard (CRS)).

²⁶¹ The US Department of the Treasury publishes a list of partner jurisdictions and signed IGAs.

²⁶² This refers essentially to the procedures to be applied upon opening of a new "account" or upon issuance of new shares or units of a UCI to an investor. The UCI (or other FFI) must identify the investor (or other "account holder"), categorize it correctly for FATCA purposes, and obtain the appropriate documentation for FATCA purposes. With respect to pre-existing accounts of individuals, the presence of certain "US indicia" needs to be checked and, if present, triggers further documentation requirements or reporting of such individuals as Specified US Persons. In the case of entities, the categorization is relatively complex and, for some, control of the entity, through ownership or by other means, needs to be identified and, in some cases, reported.

²⁶³ "Withholdable payment" includes not only payments of income and gains from US sources (including but not limited to dividends and interest, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income) but also gross proceeds from the disposition of securities that can produce US sourced dividends or interest. Payments relating to certain grand-fathered obligations are excluded.

11.3.4.4.3. OECD Common Reporting Standard (CRS)

In line with FATCA developments, in February 2014, the OECD released a new standard for the automatic exchange of information between tax authorities, also known as the Common Reporting Standard (CRS). Further details were published in July 2014.

The CRS, like FATCA IGAs, broadly defines Financial Institutions (FIs), thereby including among others banks, insurance companies, investment funds, pension funds, mutual funds, private equity funds, broker dealers, and management companies, unless they present a low risk of being used for evading tax and, subject to detailed conditions, are excluded from reporting obligations. The CRS requires that FIs in CRS-participating countries should:

- ▶ Apply “account holder” identification and documentation procedures, including indicia searches, to identify the country of tax residence of account holders (including investors in investment funds)
- ▶ Annually report individuals resident (or deemed to be resident) in CRS-participating countries (including controlling persons of “passive” non-financial entities) and entities resident in CRS-participating countries other than FIs, the value of their assets or account and the aggregate of certain payments they receive, to the FI’s tax authority, who will in turn forward this information to the tax authority of the country (or countries) of residence or deemed residence

In May 2013, Luxembourg signed the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which provides a legal basis for the automatic exchange of tax information between signatory countries who so agree. By passing the Law of 26 May 2014, the Luxembourg Parliament approved the Convention.

By December 2019, 108 countries (including Luxembourg) had signed the Multilateral Competent Authority Agreement (MCAA) under which they participate in applying the OECD’s common reporting standard. 53 countries, including Luxembourg, signed as “early adopters” of the OECD’s common reporting standard, adhering to the following phasing in of the CRS rules:

- ▶ 1 January 2016: New account opening procedures to record tax residence had to be in place for new accounts that are or were opened on or after this date
- ▶ 31 December 2016: Due diligence procedures for identifying high-value, pre-existing individual accounts had to be completed
- ▶ 30 September 2017: The first exchange of information between tax authorities was completed by this date, in relation to new accounts and pre-existing accounts identified as reportable for 2016
- ▶ 31 December 2017: Due diligence procedure for identifying low-value, pre-existing individual accounts had to be completed
- ▶ 30 September 2018: exchange of information between tax authorities took place by this date in relation to accounts identified as reportable for 2017

48 other signatories of the MCAA committed to apply the CRS from 1 January 2017. For them, each of the above milestones is one year later than for the early adopters. One signatory committed to apply the CRS from 2018, five from 2019 and one from 2020.

Directive 2014/107/EU of 9 December 2014 (often referred to as “DAC 2”) also requires that all EU Member States apply the CRS between Member States starting 1 January 2016 (except Austria, which had to do so by 2017). In Luxembourg, the Directive and the CRS were implemented by the Law of 18 December 2015 on the automatic exchange of financial account information in tax matters (the “CRS Law”).

Both the FATCA Law and the CRS Law provide for penalties to be charged by the Luxembourg tax authorities, up to EUR 250,000 if a Luxembourg FI fails to comply with the required due diligence procedures or fails to implement reporting mechanisms and 0.5% of amounts due to be reported by the FI (and minimum EUR 1,500) in case of failure to report or incomplete or incorrect reporting. A Bill laid before Parliament in February 2020 would, if enacted as expected, introduce as of 1 January 2021 a further fine of EUR 10,000 if a Luxembourg Reporting FI fails to submit an annual FATCA or CRS report on time (including in case of failure to submit a nil report). These penalties apply separately (and may therefore be cumulated) for FATCA and for CRS.

Finally, in fulfilling its obligations under the FATCA Law and under the CRS Law, a Luxembourg UCI is acting as a data controller as defined by the Luxembourg data protection law of 2 August 2002 (as amended from time to time) (the “Data Protection Law”) and, from 25 May 2018, by the EU GDPR, and, in accordance with the Data Protection Law, the GDPR, the FATCA Law and the CRS Law, it has a duty to notify investors and investors’ controlling persons (where applicable):

- That personal information will be collected and processed for the purposes of the FATCA Law and the CRS Law by the UCI, or by the UCI’s investment manager, central administration agent, depository bank, global distributor, management company or their delegates on its behalf and will, where required by the FATCA Law and/or the CRS Law, be reported to the Luxembourg tax authorities and by the Luxembourg tax authorities to the US Internal Revenue Service and/or to the tax authorities of other countries that are or will be participating in the CRS
- Which data will be reported
- That replying to requests for information or documentation required by the FATCA Law or by the CRS Law is compulsory and the consequences that may result from the absence of the required response
- And that each person whose personal data is so collected and processed or disclosed to the Luxembourg tax authorities has a right of access to such data and a right to have incorrect or incomplete data rectified

11.3.4.4.4 Mandatory Disclosure Rules/DAC 6

The Council of the European Union (EU) has adopted Directive 2018/822 (“DAC 6”) aimed at boosting transparency to tackle what it sees as aggressive cross-border tax planning. The Directive, which entered into force on 25 June 2018, requires “intermediaries” to report transactions and arrangements that are considered by the EU to be potentially aggressive. If there are no intermediaries which can report, the obligation will shift to the taxpayers. Following the reporting of the arrangements, the information about the arrangements will be automatically exchanged between Member States.

The main objectives of the EU DAC 6 MDR are to:

- Provide tax administrations with comprehensive and relevant information about potentially aggressive arrangements to enable authorities to react promptly against harmful tax practices, i.e., closing loopholes with new legislation or undertaking tax audits.
- Place an obligation on those who are involved in designing, marketing, organizing or managing the implementation of reportable cross-border transactions or a series of such transactions, as well as those who provide assistance or advice.
- Act as a deterrent against marketing and implementation of these types arrangements.

To be reportable, an arrangement needs to meet the definition of being cross-border (involving one or more EU Member States, or, involving one EU Member State and a third-party country) and must meet one or more of the conditions that are defined through hallmarks.

The deadline for Member States to adopt and publish new rules to comply with the Directive was 31 December 2019, a deadline that was not met by all Member States. On 21 March 2020, the Luxembourg Parliament approved the law implementing the DAC6. Luxembourg implemented the DAC 6 Directive by enacting the law of 25 March 2020. The final Luxembourg Mandatory Disclosure Rules (MDR) legislation is broadly aligned to the requirements of the Directive.

The final legislation does not extend the list of hallmarks beyond those listed in DAC 6.

Lawyers, certified accountants and independent auditors are exempt from reporting under the Law but they are still required to notify other intermediaries of their obligation to report or, in the absence of an intermediary that has a reporting obligation, to notify relevant taxpayers or their obligation to report.

The UK, under terms of the EU withdrawal agreement, is required to implement the rules during the then agreed transition period (ending in December 2020).

Cross-border reportable arrangements, where the first step of implementation is taken from the date of entry into force of the Directive (25 June 2018), were originally supposed to be reported by 31 August 2020. Further to the pandemic, the Council of the European Union adopted amendments to the DAC6 Directive allowing EU member states an option to defer for up to six months the time limits for the filing and exchange of information on cross-border arrangements. This option was chosen by Luxembourg and adopted on 24 July 2020 - so that:

- Reporting of historic arrangements (25 June 2018 - 30 June 2020) to the tax authorities will be due by 28 February 2021
- The 30-day period for reporting arrangements after 1 July 2020 will only start on 1 January 2021 (in effect there will be a one-off catch-up period of all arrangements between 1 July 2020 and 31 December 2020 in January 2021)
- The first exchange from the tax authorities to the EU will be due by 30 April 2021.

Note: not all EU member states have opted for the deferral, notably Finland and Germany. Deferral conditions should be verified at the level of each EU member state.

11.3.5. Taxation of fees paid by Luxembourg UCIs

11.3.5.1. Directors' fees

A withholding tax (WHT) of 20% is levied on the gross amount of the fees (equivalent to 25% of the net amount of the fees) at the time of payment. It applies to Directors' fees paid to companies and to individuals and is creditable against the recipient company's/individual's Luxembourg tax.

The WHT will be final for non-resident Directors provided that this is their only Luxembourg sourced professional income and provided this income does not exceed EUR 100,000 gross per year.

Starting with the income of the year 2014, the Luxembourg tax authorities automatically communicate with the tax authorities of the country of residence of the beneficiary (to the extent the beneficiary resides in another EU Member State) information regarding Luxembourg Directors' fees.

A specific return (WHT return on Directors' fees) is to be filed by the entity paying the Directors' fees within eight days of the payment. The WHT must be paid to the relevant tax authority within the same period (within eight days of the fee payment). A register of the WHTs must be kept up-to-date, recording the name and address of the beneficiary, the amount of the tax withheld, and the date the tax was paid.

Directors' fees also fall within the scope of VAT but should benefit from a VAT exemption when in relation to the management of UCIs.

11.3.5.2. Carried interest

The AIFM Law defines "carried interest" as a share in the profits of the AIF accrued to the AIFM as compensation for the management of the AIF and excluding any share in the profits of the AIF accrued to the AIFM as a return on any investment by the AIFM into the AIF.

The Law considers that carried interest corresponding to such definition, realized by certain physical persons that are employees of the AIF or their management company is to be regarded as "speculative income" under Luxembourg's Income Tax Law, giving rise to a taxation at standard tax rates (maximum tax rate being 45.78%) and being subject to dependence insurance contribution levied at a rate of 1.4%. A beneficial tax rate was available under certain circumstances, whereby the applicable tax rate would be 25% of the average tax rate applicable to the taxpayer's adjusted income – i.e., a maximum of 11.44%. In addition, dependence insurance (1.4%) would also be due.

To benefit from the tax regime, physical persons must not have been Luxembourg tax residents, or subject to tax in Luxembourg on their professional income, during the five years before the year of implementation of the AIFM Law. The physical persons must, furthermore, establish their tax domicile in Luxembourg during the year of implementation of the AIFM Law or during the following five years. The favorable tax treatment will no longer be applicable to individuals establishing their residence in Luxembourg after 31 December 2018. Developments around a new regime are expected. However, it is not yet known when it will be enforced.

Provided that the carried interest is considered as compensation for the management of the AIF, the remuneration falls within the scope of VAT but should benefit from the VAT exemption scheduled for the management of UCIs.

11.3.6. Taxation impacts of selected restructuring scenarios

Tax considerations need to be examined carefully prior to proceeding with any particular restructuring project, be they mergers of UCIs (see also Section 3.7.), conversions of ordinary UCITS into feeder UCITS (see also Section 3.6.3.), creation of master-feeder structures (see also Section 2.3.4.1. and 11.3.4.2.), feeder UCITS changing master UCITS (see also Section 3.6.3.), cross-border restructuring of the fund management activities (see Sections 6.3.4. and 6.5.3.7.), or recourse to third-party service providers (see also Section 6.3.3.).

The following table presents an overview of the potential tax implications of selected UCI restructuring scenarios to be examined:

Potential tax implications of selected UCI restructuring scenarios on the UCI, on investors, and on the management companies

	UCI mergers	Converting from UCI to feeder UCI (or vice versa) <i>(If portfolio sales required to constitute new portfolio, or portfolio transfer to master UCI)</i>	Creating a new feeder UCI	Changing master UCI <i>(Due to portfolio sales or transfer by existing master UCI, if required)</i>	
Potential tax impact of restructuring to be ascertained:					
In the country of:	The merging UCI(s)	The UCI to be converted		The current master UCI	The feeder UCI
▸ Income tax on capital gains realized by the UCI	X	X		X	X
▸ WHT to be applied by the UCI or an agent on a deemed distribution or deemed interest payment	X			X	X
▸ Impact on UCI's FATCA and CRS status	X	X		X	X
▸ Impact on UCI's FATCA and CRS reporting	X	X		X	X
In the country of:	The receiving UCI	The converted UCI	The feeder UCI	The future master UCI	The feeder UCI
▸ Capital duty on capital increase	X		X	X	
▸ Impact of the change of composition of the UCI's portfolio on taxable income deemed to accrue to the investor, computed by the UCI	X	X	X	X	X
▸ Impact on UCI's FATCA and CRS status	X	X	X	X	X
▸ Impact on UCI's future FATCA and CRS reporting	X	X	X	X	X
In the country of the issuer of securities held by:	The merging UCI (s)	The UCI to be converted		The current master UCI	The feeder UCI
▸ WHT upon transfer (e.g., on accrued interest)	X	X		X	
▸ Capital gains tax upon transfer	X	X		X	X
▸ Stamp duty	X	X		X	X
In the country of residence of the investor in:	The merging UCI(s)	The UCI to be converted	The current UCI/ future master UCI	The feeder UCI	The feeder UCI
▸ Taxation of capital gains realized on the shares or units of such UCI	X	X	X		
▸ Taxation of income deemed to have been realized by the investor	X	X	X	X	X
▸ Impact of the change of composition of the UCI's portfolio on taxable income deemed to accrue to the investor in the post-restructuring UCI	X	X	X	X	X
▸ Reconciliation of information received by tax authorities through CRS or FATCA with actual taxability	X	X			X

Potential tax implications of selected UCI restructuring scenarios on the UCI, on investors, and on the management companies

	UCI mergers	Converting from UCI to feeder UCI (or vice versa)	Creating a new feeder UCI	Changing master UCI	
In the country of residence of the management company (if any) of:	The merging UCI(s)	The UCI being converted		The current master UCI	The feeder UCI
▶ If the pre-restructuring UCI has no legal personality and is not a taxpayer, whether the management company is subject to income tax on capital gains realized upon transfer of the pre-restructuring UCI's assets	X	X		X	X
▶ Income tax on an indemnity if the management company is indemnified for the termination of the management contract	X	X		X	
Post restructuring tax impact:					
Impact of location of UCI on VAT costs	X		X	X	X
Direct tax costs due to differences between the direct tax regimes (including WHT on distributions) applicable to the following UCIs in their own country(ies)	The receiving UCI vs. the merging UCI(s)	The combination of feeder UCI and master UCI vs. single UCI	The combination of feeder UCI and master UCI vs. single UCI	The future master UCI vs. the current master UCI	The feeder UCI holding the future vs. the current master UCI
Different taxes in the country of the issuer of securities when held by:	The receiving UCI vs. the merging UCI(s)	The master UCI vs. the UCI being converted		The future master UCI vs. the current master UCI	
▶ WHT upon sale (e.g., on accrued interest)	X	X		X	
▶ Capital gains tax upon sale	X	X		X	
▶ Stamp duty	X	X		X	
▶ WHT on dividend distributions/ interest payments	X	X		X	
Different taxes in the country of residence of the investor holding shares or units of:	The receiving UCI vs. the merging UCI(s)	The converted UCI vs. the UCI to be converted	The feeder UCI vs. the current UCI/ future master UCI	The future master UCI vs. the current master UCI (indirectly)	
▶ Taxation of capital gain realized on the shares or units of the post-restructuring UCI	X		X		
▶ Taxation of income deemed to have been realized by the investor	X	X		X	
▶ Difference in ease or difficulty of reconciliation of information received by authorities through CRS or FATCA and determination of taxable income	X	X	X	X	

11.3.7. Taxation of foreign UCIs managed in Luxembourg

The 2010 Law and the AIFM Law have introduced provisions into Luxembourg tax law whereby UCIs established under foreign law whose place of effective management or central administration is in Luxembourg are exempt from corporate income tax, municipal business tax, and net worth tax.

Assets and profits of the management company resident in Luxembourg remain, however, fully subject to corporate taxation in Luxembourg (see Section 6.5.3.)

11.4. Value added tax (VAT)

11.4.1. Introduction

This section outlines the taxable status of Luxembourg UCIs and their service providers (in particular management companies, AIFM, and advisory companies) and the VAT regime applicable to services provided to such Luxembourg UCIs and their service providers.

In order to determine the VAT treatment, and therefore the VAT rate or exemption applicable, the following questions need to be answered:

- Are the supplier and the purchaser of services considered as VATable persons?
- In which country is the service deemed to take place?
- If the place of supply is in Luxembourg, what is the applicable VAT regime?

11.4.2. Status of UCIs and management companies

11.4.2.1. Common funds and their management companies

As a common fund has no legal personality, it is disregarded for VAT purposes and is thus not a VATable entity, while its management company is deemed to be a VATable person. Consequently, services provided to a common fund are deemed to be provided to its management company.

Where a common fund is managed by a management company established in a different Member State, the lack of harmonization within the EU in respect of the independent taxable status of common funds could, from a VAT perspective, lead to any of the following situations in case of services provided to the common fund:

- Double taxation
- Taxation in the home Member State of the common fund
- Taxation in the home Member State of the management company
- No taxation

Based on the current interpretation of the Luxembourg VAT Authorities, a common fund is disregarded for VAT purposes and the services are deemed to be rendered to the management company.²⁶⁴

Consequently, from a Luxembourg VAT perspective, services provided by a third party to a common fund established in a Member State other than Luxembourg and that has a Luxembourg management company should continue to be deemed to be provided to its management company established in Luxembourg.

11.4.2.2. Investment companies

Unlike common funds, investment companies have a legal personality. Following a decision of the Court of Justice of the European Union (CJEU)²⁶⁵, SICAVs are to be considered as taxable persons for VAT purposes. In view of this, VAT Circular No. 723 of 29 December 2006 confirmed that investment vehicles (such as SICAVs and SICAFs) whose management is VAT exempt by virtue of Article 44(1)(d) of the Luxembourg VAT Law²⁶⁶ have the status of "taxable persons" for VAT purposes.

11.4.2.3. Other investment vehicles

Other investment vehicles also benefit from the exemption from VAT for their management. This is the case for SIFs, SICARs, pension funds set up under the law of 13 July 2005 and that are subject to the supervision of the CSSF, pension funds set up under the law dated 7 December 2015 and subject to the supervision of the *Commissariat aux Assurances* as well as in-house collective life insurance investment funds for which the subscribers bear the financial risk and that are subject to the supervision of the *Commissariat aux Assurances*.

²⁶⁴ This interpretation is notably supported by some other EU Member States.

²⁶⁵ In the BBL case (C-8/03, 21/10/2004), the Court of Justice of the European Union (CJEU) highlighted the fact that the activities performed by investment funds investing in transferable securities surpass the scope of the simple acquisition and sale of securities and consist of the exploitation of an asset for the purpose of obtaining income on a continuous basis. Therefore, the activities carried out by SICAVs qualify as economic activities from a VAT perspective. Hence, SICAVs are to be considered as taxable persons for VAT purposes.

²⁶⁶ Law of 12 February 1979 concerning value added tax, as amended.

The exemption from VAT scheduled by article 44, §1, d) is also applicable to similar undertakings established in other EU Member States and subject to the supervision of a similar regulatory body to the CSSF or the *Commissariat aux Assurances*.

Finally, securitisation vehicles set up under the law of 22 March 2004 and similar vehicles performing a securitisation activity as defined by the ECB Regulation no 24/2009 and Alternative Investment Funds as defined by the Law of 12 July 2013 also benefit from the VAT exemption for their management.

11.4.2.4. Management companies and AIFM

In Luxembourg, management companies, general partners, and AIFM are considered to perform an economic activity and consequently are regarded as VATable persons.

11.4.2.5. Fund mergers

The merger of Luxembourg funds should be considered as a transfer of going concern outside the scope of VAT, provided certain conditions are met.

In case of cross-border mergers, the place of taxation is in principle the country of the absorbing UCI (except in case of real estate assets) with possible exemption depending on the type of services or goods transferred.

11.4.2.6. Conversion of a UCI into a feeder fund and master-feeder structures

No Luxembourg VAT consequences arise from the sole conversion of a Luxembourg UCI into a feeder UCI. Moreover, the transfer of the portfolio of assets of a Luxembourg feeder UCI to a master UCI in Luxembourg or in another country should fall outside the scope of the Luxembourg VAT (with exceptions, such as for real estate assets).

11.4.3. VAT group

Luxembourg implemented the VAT group into its legislation in 2018. The main purposes of its implementation was to replace the use of “Independent Group of Persons” in the financial sector, to mitigate VAT costs on intra-company transactions and VAT leakage when VAT group members have a limited or no input VAT deduction right.

There are various criteria to be met to be able to be part of a VAT group: financial, economic and organizational. Moreover, the implementation of a VAT group triggers various obligations but also administrative simplifications.

An in-depth analysis of the pros and cons is essential before any implementation of a VAT group.

11.4.4. Place of supply

11.4.4.1. General rule

In order to determine the VAT regime applicable to a service, it is necessary to establish the country in which the service is deemed to be rendered.

For services rendered by Luxembourg suppliers to a Luxembourg purchaser, the service is deemed to be rendered in Luxembourg.

Example: An advisory service provided by a Luxembourg bank to a Luxembourg UCI is deemed to have been rendered in Luxembourg.

For services rendered by foreign suppliers to a Luxembourg taxable purchaser, the place of service is, as a general rule, considered to be the place where the recipient is established, i.e., Luxembourg.

The general rule to determine the place of supply of a service is as follows:

- For services rendered to a VATable person²⁶⁷, the place of supply is where that person has established its business or the place where a fixed establishment is located (if those services are provided to that fixed establishment)
- For services rendered to a non-VATable person, the place of supply is where the supplier has established its business or the place where a fixed establishment is located (if the services are supplied from that fixed establishment – see Section 11.4.4.2.). For non-taxable persons outside the EU, the place of supply is where that person is established, has his permanent address, or usually resides

As the management company established in Luxembourg is considered to be a VATable person, services rendered to it by foreign suppliers generally fall within the scope of Luxembourg VAT.

Example: An advisory service provided by a foreign company to a Luxembourg management company is deemed to take place in Luxembourg. The Luxembourg management company is liable to pay VAT relating to this supply of services (reverse charge mechanism), unless an exemption applies.

As investment companies are considered as taxable persons, the place of supply of services provided by a foreign supplier to such Luxembourg entities is deemed to fall within the scope of Luxembourg VAT.

Example: An advisory service provided by a foreign company to a SICAV is, from a Luxembourg point of view, deemed to take place in the country of establishment of the SICAV (i.e., in Luxembourg).

11.4.4.2. Fixed establishment in the field of supply of services

As mentioned in the previous section, the place of supply of services rendered to a VATable person is where that person has established his business or the place where its fixed establishment is located (if those services are provided to that fixed establishment).

A fixed establishment according to Council Implementing Regulation (EU) No 282/2011 of 15 March 2011²⁶⁸ is any establishment, other than the place of establishment of a business that is characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to provide the services or receive and use the services supplied to it for its own needs.

When receiving a service, having a VAT identification number is not in itself sufficient to consider that a taxable person has a fixed establishment.

11.4.5. Nature of service and applicable VAT rate

11.4.5.1. General rule

Once the place of supply has been established, it is important to determine the applicable VAT rate, unless an exemption applies.

The standard VAT rate is 17% in Luxembourg while intermediate, reduced, and super reduced rates of 14%, 8%, and 3% are also applicable on various items and services.

Example: Lawyers' and tax advisors' services rendered to Luxembourg UCIs are, in principle, subject to the standard VAT rate.

²⁶⁷ The concept of "taxable persons" for the purpose of applying the rules concerning the place of supply of services also includes, for all services rendered to them:

- A taxable person who also carries out activities or transactions that are not considered to be taxable supplies of goods or services from a VAT standpoint
- A non-taxable legal person who is identified for VAT purposes

²⁶⁸ Article 11, §1 and §2 of Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC in the common system of value added tax.

11.4.5.2. Domiciliary services

Domiciliary services provided to UCIs are considered to be part of the management services, which are, in principle, exempt from VAT under the Luxembourg VAT Law.

11.4.5.3. Management services

Management services provided directly to UCIs and AIF (including RAIFFs) are exempt from VAT in accordance with Article 44(1)(d) of the Luxembourg VAT Law.

The Luxembourg legislation does not expressly define the notion of management of UCIs.

Investment management services as well as UCI and AIF administration services fall within the VAT exemption provision²⁶⁹. In addition to portfolio management, the following administrative functions also fall within the VAT exemption (non-exhaustive list), as confirmed by the Luxembourg VAT administration in its VAT Circular No 723:

- ▶ Legal²⁷⁰ and fund management accounting services
- ▶ Customer inquiries
- ▶ Valuation of portfolio and pricing of the shares or units (including tax returns)
- ▶ Regulatory compliance monitoring
- ▶ Maintenance of shareholder or unitholder register
- ▶ Distribution of income
- ▶ Unit issues and redemptions
- ▶ Contract settlements (including certificate dispatch)
- ▶ Record keeping

Further to the release of VAT Circular No 723 by the Luxembourg VAT administration, the VAT treatment of depositary services, the aim of which is to ensure that the management is performed in compliance with the law, has been confirmed. While most of the services rendered by depositaries are exempt, the control and supervisory activities, as defined in Articles 7(1) and (3), and 14(1) and (3) of the UCITS Directive, are henceforth taxable at an intermediate VAT rate of 14%.

Subsequently, the Court of Justice of the EU confirmed that the exemption also applies to portfolio management and investment recommendations to funds that invest in real estate²⁷¹.

11.4.5.4. Outsourced services

The application of the exemption of Article 44(1)(d) of the Luxembourg VAT Law has been extended to outsourced services when certain conditions are met.

In this respect, outsourced services fall under the exemption provided the principal limits its activity to strictly re-charging the services received from the sub-contractor to the UCIs and that, in the case of administrative and management services of the UCI, these services form a distinct whole, fulfilling in effect the specific and essential functions of the exempt management services. Consequently, mere material or technical supplies, for instance, are not VAT exempt²⁷².

Furthermore, the Court of Justice of the European Union confirmed that advisory services provided by a third party to the management company of a UCI should be considered as VAT exempt²⁷³ provided they are intrinsically connected to the activity of the UCI.

²⁶⁹ The Luxembourg Bankers' Association (Association des Banques et Banquiers, Luxembourg – ABBL) together with the VAT Administration had laid down a non-exhaustive list of the services falling under the scope of the exemption. However, more recently, the CJEU, in the Abbey National case (C169/04, 4/5/2006), confirmed that portfolio management services as well as UCI administration services fall within the VAT exemption provision. The CJEU, as well as the Luxembourg VAT administration in its VAT Circular No 723, referred to Annex II of the UCITS Directive providing a non-exhaustive list of services falling within the VAT exemption.

²⁷⁰ To the extent that legal services are provided by the entity performing the administration.

²⁷¹ In the case *Fiscale Eenheid X NV* (C-595/13), the CJEU confirmed that the exemption scheduled by the VAT Directive for the management of investment vehicles also apply to funds which invest in real estate. The management of those special investment funds which invest in real estate is consequently covered by the article 44 (1) (d) of the Luxembourg VAT Law. The CJEU found that the definition of the term "management" cannot include property management and facilities management and is therefore limited to investment recommendations and portfolio management only.

²⁷² This is in accordance with the CJEU decision in the *Abbey National* case and has been implemented by the Luxembourg VAT administration in Circular No 723 and 723 bis.

²⁷³ *GfBk Gesellschaft für Börsenkommunikation mbH* (C-275/11, 7 March 2013).

11.4.5.5. Risk management functions

VAT Circular No 723ter of November 2013 confirms that risk management services performed by managers of UCIs should be considered as a management service and, therefore, within the scope of the provisions relating to the VAT exemption scheduled by the Luxembourg VAT Law.

When the risk management activities are outsourced to a third party, the VAT exemption remains applicable provided the subcontracted services, viewed broadly, form a distinct whole and are specific to and essential for the activity of the UCI.

11.4.6. Summary tables

The summary tables hereafter have been prepared based on the Luxembourg legislation and doctrine, as well as the CJEU case law. It is important to note that the interpretation of the legislation could be different in countries other than Luxembourg, notably concerning the VAT status of UCIs and their management companies, which might have an impact on the localization of the supply of services.

11.4.6.1. Services provided to a Luxembourg investment company

Supplier	Service	Place of supply	VAT treatment
Luxembourg company	Management services	Luxembourg	Exempt
EU company (except Luxembourg)	Management services	Luxembourg	Exempt
US law firm	Legal advice	Luxembourg	17% VAT (reverse charge mechanism)
Luxembourg central administration	Administration services	Luxembourg	Exempt
Luxembourg depository	Control and supervisory services	Luxembourg	14% VAT
Luxembourg auditor/lawyer/tax advisor	Audit/legal advice/tax advice	Luxembourg	17% VAT
EU lawyer (except Luxembourg)	Legal advice	Luxembourg	17% VAT (reverse charge mechanism)

11.4.6.2. Services provided to a Luxembourg common fund managed by a Luxembourg management company

Supplier	Service	Place of supply	VAT treatment
Luxembourg company	Management services	Luxembourg	Outside the scope of VAT
EU company (except Luxembourg)	Management services	Luxembourg	Exempt
US law firm	Legal advice	Luxembourg	17% VAT (reverse charge mechanism)
Luxembourg central administration	Administration services	Luxembourg	Exempt
Luxembourg depository	Control and supervisory services	Luxembourg	14% VAT
Luxembourg auditor/lawyer/tax advisor	Audit/legal advice/tax advice	Luxembourg	17% VAT
EU lawyer (except Luxembourg)	Legal advice	Luxembourg	17% VAT (reverse charge mechanism)

11.4.6.3. Services provided to a common fund established outside Luxembourg managed by a Luxembourg management company (common fund managed cross-border from Luxembourg)²⁷⁴

Supplier	Service	Place of supply	VAT treatment
Luxembourg company	Management services	Luxembourg	Outside the scope of VAT
EU company (except Luxembourg)	Management services	Luxembourg	Outside the scope of VAT
US Law firm	Legal advice	Luxembourg	17% VAT (reverse charge mechanism)
Luxembourg central administration	Administration services	Luxembourg	Exempt
Luxembourg depository	Control and supervisory services	Luxembourg	14% VAT
Luxembourg auditor/lawyer/tax advisor	Audit/legal advice/tax advice	Luxembourg	17% VAT
EU lawyer (except Luxembourg)	Legal advice	Luxembourg	17% VAT (reverse charge mechanism)

²⁷⁴ In the table, only the taxation in Luxembourg is considered. This does not preclude taxation in the country of the common fund, potentially resulting in a situation of double taxation.

12

Marketing

EY fund distribution and marketing including impact on distribution models services:

- ▶ Regulatory intelligence
- ▶ Fund registration
- ▶ Defining distribution strategy including review of distribution models and agreements
- ▶ Distributor due diligence and compliance reviews



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12.1. Introduction

This Chapter covers the requirements applicable to the marketing of UCITS and other UCIs:

- ▶ Information provided to investors before they invest
- ▶ Marketing Luxembourg UCITS in other EU/European Economic Area (EEA) Member States²⁷⁵
- ▶ Marketing foreign UCITS in Luxembourg
- ▶ Marketing of full AIFM regime AIF in the EU/EEA, also covering third country AIFM and AIF
- ▶ Marketing of AIF with a passport and NPPR
- ▶ EU/EEA and non EU/EEA AIFM and EU/EEA and non EU/EEA AIF
- ▶ Marketing of simplified AIFM registration regime AIF
- ▶ Marketing of AIF in Luxembourg
- ▶ Marketing regulations applicable in Luxembourg
- ▶ Marketing intermediaries: distributors, nominees, and other marketing intermediaries

The general requirements on fund documentation and reporting are covered in Chapter 10.

12.1.1. UCITS

Some of the main reasons why financial participants create UCITS are linked to marketing and distribution:

- ▶ UCITS can be marketed to all types of investors in most key distribution markets
- ▶ UCITS are relatively easy to distribute, compared with other UCIs
- ▶ Investors recognize and demand “UCITS brand” products

UCITS can be distributed to all types of EU/EEA investors, such as retail, professional and other eligible counterparties. Many international investors are also attracted to UCITS, for example, to benefit from well-recognized EU regulation and investment diversification.

The Luxembourg UCITS is the leading investment fund product for cross-border fund distribution in the EU and internationally throughout the World. A continuously increasing number of Luxembourg UCITS are registered for sale in EU/EEA Member States and outside the EU/EEA, particularly in Asia, the Middle East, and Latin America.

The UCITS Directive provides for a harmonized “European passport” for UCITS - meaning that a UCITS authorized in one Member State (the “home Member State”) may be marketed in any other Member State (the “host Member State”) following notification to the host Member State competent authority.

The provisions on the notification procedure for marketing UCITS are covered by the 2010 Law. The practical and technical procedures that UCITS must follow for cross-border marketing - i.e., the notification procedures to be followed by a Luxembourg UCITS intending to market its shares or units in another EU/EEA Member State and by a UCITS of another EU/EEA Member State wishing to market its shares or units in Luxembourg - are clarified in CSSF Circular 11/509 and in CSSF Regulation 10-05, as amended.

ESMA's *Questions and Answers on the Application of the UCITS Directive*, clarifies that a UCITS management company wishing to pursue cross-border activities by way of the UCITS management company passport can notify cross-border activities without having to identify a specific UCITS. When the management company, at a later point in time, has identified a UCITS that it wants to manage on a cross-border basis, it has to notify the competent authorities in the home Member State of the UCITS in accordance with Article 20 of the UCITS Directive.

Marketing of UCITS outside the EU/EEA is subject to each country's national regime.

12.1.2. AIF

In this chapter, the term:

- ▶ “Full AIFM regime AIF” means AIF managed by authorized AIFM and internally managed AIF that are subject to the AIFM Law
- ▶ “Simplified AIFM registration regime AIF” means AIF whose manager is not subject to the AIFM Law (or the AIFM Directive) and internally managed AIF that are not subject to the AIFM Law

²⁷⁵ The EEA includes European Union (EU) Member States plus Iceland, Liechtenstein, and Norway. The reference to the EEA is clarified in 1.3.1.B.

12.1.2.1. Full AIFM regime AIF

Authorized AIFM benefit from a “passport” permitting them to market EU/EEA AIF they manage to professional investors in the EU/EEA, without being required to comply with national private placement regimes (NPPRs). Authorized internally managed AIF that are subject to the AIFM Law or the AIFM Directive also benefit from the “passport”.

Member States may also permit marketing by AIFM to retail investors in their Member State; however they may apply stricter requirements than those required for professional investors.

A number of Member States have introduced further categories for retail investors (such as “qualifying investor”, “informed investor”, or “semi-professional investor”), which, by their definition, share some, but not all elements of the definition of “professional investor”. ESMA’s *Questions and Answers on the Application of the AIFMD* clarifies that the AIF marketing passport may only be used for marketing to professional investors as defined in Article 4(1)(ag) of AIFMD. Any other cross-border marketing activity to non-professional investors as defined in Member States has to be notified and carried out according to national legislation in the host Member State of the AIF and cannot be carried out by way of the AIF marketing passport.

Marketing of full AIFM regime AIF outside the EU/EEA is subject to each country’s national regime.

12.1.2.2. Simplified AIFM registration regime AIF

Marketing of simplified AIFM registration regime AIF is subject to each country’s national distribution requirements.

The managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) benefit from a specific “passport” permitting them to market the UCIs they manage to professional investors and to non-professional investors who commit to a minimum investment of EUR 100,000 across the EU/EEA.

Marketing of simplified AIFM registration regime AIF outside the EU/EEA is subject to each country’s national regime.

12.1.3. Summary of marketing regimes

The general marketing rules applicable for UCITS and AIF are determined by the respective Directives, while local marketing requirements remain fully at the discretion of the respective EU/EEA Member States or non-EU/EEA countries where the UCITS or the AIF are marketed.

The various charges levied by the CSSF to cover the handling costs of the notification and the registration costs for marketing in Luxembourg are laid down by the Grand-Ducal Regulation of 21 December 2017 as amended.

The following table summarizes the marketing regimes applicable to the marketing of UCITS and open and closed-ended AIF; in addition, in the case of closed-ended AIF, Prospectus Regulation²⁷⁶ requirements may apply:

Summary of marketing of UCIs

Regulatory framework	Description	Investors	Region	Marketing regime
UCITS	Marketing of UCITS	Retail and professional	EU/EEA	EU/EEA “passport”
		Retail or professional	Third countries	Third country regime
Full AIFM regime AIF	Marketing throughout the EU/EEA by or on behalf of:	Professional	EU/EEA	EU/EEA “passport”
			EU/EEA	National retail distribution regimes
		Retail or professional	Third countries	Third country regime
				Third country regime
Authorized EU/EEA AIFM of:	EU/EEA AIF			
	Non-EU/EEA AIF ²⁷⁷			
Authorized non-EU/EEA AIFM ²⁷⁸ of:	EU/EEA AIF			
	Non-EEA AIF			

²⁷⁶ As from July 2019, the Prospectus Directive was replaced by the New Prospectus Regulation (Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC).

²⁷⁷ From 2021 at the earliest.

²⁷⁸ Idem.

Summary of marketing of UCIs

Regulatory framework	Description	Investors	Region	Marketing regime
Simplified AIFM registration regime AIF	Marketing of EU/EEA AIF by registered EU/EEA AIFM (i.e., not authorized AIFM)	Professional	EU/EEA	National private placement regimes (NPPRs)
		Retail	EU/EEA	National retail distribution regimes
		Retail or professional	Third countries	Third country regime
EuVECA and EuSEF	Marketing of qualifying EuVECA and EuSEF by registered managers	Qualified	EU/EEA	EU/EEA "EuVECA/EuSEF passport"
Other AIF	Marketing: <ul style="list-style-type: none"> ▸ Of non-EU/EEA AIF by EU/EEA or non-EU/EEA AIFM²⁷⁹ ▸ Of EU/EEA AIF by non-EU/EEA AIFM²⁸⁰ 	Professional	EU/EEA	NPPRs
		Retail	EU/EEA	National retail distribution regimes
		Retail or professional	Third countries	Third country regime
Any AIF	Professional investors invest, on their own initiative, in any AIF of their choice, irrespective of the domicile of the AIF or the AIFM	Professional	EU/EEA	Reverse solicitation (i.e., no marketing)

In principle, a prospectus meeting the requirements of the New Prospectus Regulation must be published before closed-ended UCIs are offered to the public in the EU. However, the obligation to publish a prospectus does not apply to the offer of securities addressed:

- Solely to qualified investors (professional investors and/or investors who may be treated as professionals on request - see Section 12.5.1.) unless they have requested that they be treated as non-professional clients
- To fewer than 150 natural or legal persons per Member State, other than qualified investors
- To investors who acquire securities for a minimum total amount per investor, or to the offer of securities whose denomination per unit is above a specific amount, or with a limited total consideration. The amounts are laid down in the New Prospectus Regulation and delegated acts adopted pursuant to the New Prospectus Regulation

UCIs other than closed-ended UCIs (i.e., open-ended UCIs) are exempt from the requirement to publish a prospectus meeting the requirements of the New Prospectus Regulation.

A prospectus meeting the requirements of the New Prospectus Regulation is required if a UCI is listed on a regulated market (see Chapters 10 and 13).

ESMA has also published a Q&A on the New Prospectus Regulation.

As part of the EU's Capital Markets Union Action Plan, in June 2019, a new EU Directive²⁸¹ and Regulation²⁸² has been introduced, amending the UCITS and AIFM Directives and harmonizing various aspects of cross-border distribution. The Directive should be adopted into the national legislation within 24 months from its publication in EU's Official Journal, and in practice will be applicable from August 2021.

The Directive and its complementing Regulation lay down additional rules and procedures concerning:

- Alignment of national marketing requirements and regulatory fees
- Harmonization of the process and requirements for the verification of marketing material by national competent authorities
- Enabling ESMA to monitor investment funds in greater details

²⁷⁹ Until 2021 at the earliest.

²⁸⁰ Idem.

²⁸¹ Directive (EU) 2019/1160 of the European Parliament and of the Council amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings.

²⁸² Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014.

12.2. Information provided to investors before they invest

12.2.1. UCITS

In general, the key investor information (KII) document must be provided to investors free of charge before they invest.

An investment company, and a management company for each of the common funds that it manages, that sells UCITS, directly or through another natural or legal person who acts on its behalf and under its full and unconditional responsibility, is required to provide investors with the KII on such UCITS in good time before their subscription for shares or units.

ESMA's *Questions and Answers on the Application of the UCITS Directive* issued in February 2016, in Section II - Key Investor Information Document (KII) for UCITS clarifies that the KII constitutes pre-contractual information and that each additional subscription is considered as a new contract.

All prospective investors, including professional investors, must be provided with a KII.

As a pre-contractual document, the investor must receive the KII for the compartment (or share or unit class, if applicable) that he/she is intending to invest into, including where this investment arises from switching from another compartment within the umbrella.

Where shareholders or unitholders in a UCITS invest through a regular savings plan, a KII is not required in relation to the periodic subscriptions, unless a change is made to the subscription arrangements, for example, increases or decreases in the subscription amount, that would require a new subscription form.

ESMA also underlines that investors always have the right to be provided with the KII on request.

An investment company, and a management company for each of the common funds that it manages, that does not sell UCITS directly or through another natural or legal person who acts on its behalf and under its full and unconditional responsibility to investors, is required upon request, to provide the KII to product manufacturers and intermediaries selling or advising investors on potential investments in such UCITS or in products offering exposure to such UCITS. The intermediaries selling or advising investors on potential investments in UCITS should provide the KII to their clients or potential clients²⁸³.

Certain non-EU countries require that a document comparable to the KII be provided to investors in UCIs before they invest (e.g., Hong Kong and Singapore).

The KII may be provided to investors in a durable medium or by means of a website. *Commission Regulation (EU) No 583/2010* outlines the conditions applying when providing KII to investors in a "durable medium" other than paper or by means of a website. A paper copy must be provided to investors on request and free of charge. An up-to-date version of the KII must be made available on the website of the investment company or management company.

The prospectus and the latest published annual and semi-annual reports must be provided to investors on request and free of charge. The requirements covering the provision of these documents to investors, and their content, are covered in Chapter 10.

Additional investor information requirements applicable to the marketing of Luxembourg UCITS in other EU/EEA Member States, including translation requirements, are outlined in Section 12.3.6.

12.2.2. AIF

Detailed information must be disclosed to investors before they invest in a full AIFM regime AIF (see Section 10.3.4.).

Luxembourg Law does not specifically require that information is automatically provided to investors in simplified AIFM registration regime AIF before they invest.

For 2010 Law Part II UCIs, the prospectus and the latest published annual and semi-annual reports must be provided to investors on request and free of charge.

²⁸³ According to the UCITS Directive, Directive 2009/65/EU, "Member States shall require that intermediaries selling or advising investors on potential investments in UCITS provide key investor information to their clients or potential clients." In Luxembourg, the 2010 Law transposed this requirement.

For SIFs and RAIFs, the offering document and the latest annual report must be provided to investors on request free of charge.

The requirements covering the provision of these documents to investors, and their content, are covered in Chapter 10.

12.2.3. Marketing communications of 2010 Law UCIs

Any marketing communication to investors (e.g., factsheet) must be clearly identifiable as such. It must be fair, clear, and not misleading.

In particular, any marketing communication that comprises an invitation to purchase shares or units of UCIs and that contains specific information about UCIs must not make a statement that contradicts or diminishes the significance of the information contained in the prospectus and, in the case of UCITS, the KII. It must indicate that a prospectus exists and, for UCITS, that the KII is available. It must specify where and in which language such information and documents may be obtained by investors or potential investors or how they may have access to them.

12.3. Marketing Luxembourg UCITS in other EU/EEA Member States

Where a Luxembourg UCITS intends to market its shares or units to investors in another EU/EEA Member State (i.e., in a host Member State), it must submit a notification to its home Member State regulator, the CSSF. This procedure applies in cases of:

- ▶ A UCITS intending to market all or part of its shares or units in the host Member State for the first time
- ▶ An umbrella UCITS intending to market all or part of its shares or units of one or several of its compartments in that host Member State for the first time
- ▶ An umbrella UCITS intending to market all or part of the shares or units of one or several additional compartments (i.e., where the marketing of shares or units of other compartments has already been notified in that host Member State) for the first time

In practice, the provisions on marketing of UCITS cross-border in the EU/EEA are generally considered to apply to the marketing of UCITS by entities based in the host Member State to investors in the host Member State. In other cases, national private placement regime (NPPR), where they continue to exist, or national retail distribution regimes and distance marketing requirements may apply (see also Section 12.6.1.).

Subsequent updates to the information submitted via the notification procedure must be provided directly to the host Member State via a written notice (see Section 12.3.4.).

12.3.1. Key notification procedure components

The Luxembourg UCITS is required to submit to the CSSF a notification file that contains:

- ▶ A notification letter
- ▶ The latest versions of the required documents (see Section 12.3.2.)

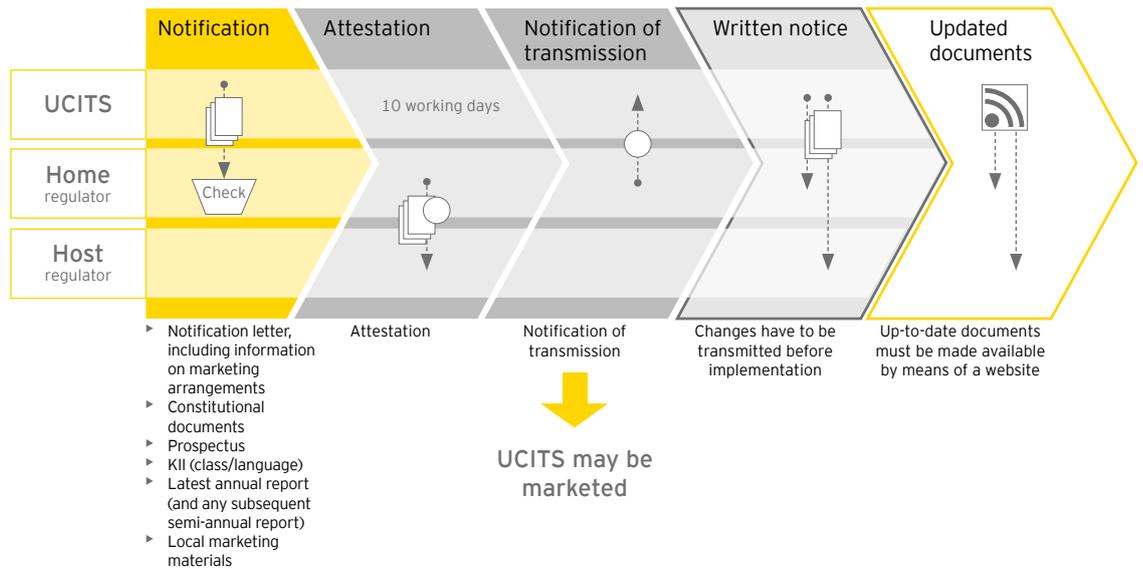
The notification file is to be transmitted electronically to the CSSF (see Section 12.3.3.).

For each host Member State in which the UCITS intends to market its shares or units, a complete notification file needs to be prepared and transmitted to the CSSF.

The CSSF verifies that the documentation provided by the UCITS is complete. It then transmits, within a maximum of 10 working days, the complete documentation to the competent authorities of the host Member State together with an attestation that the UCITS complies with the provisions of the UCITS Directive. The host Member State regulator confirms receipt and completeness of the notification within five working days. In practice, the host regulator's confirmation is not always issued.

This transmission to the competent authorities of the host Member State is notified without delay by the CSSF to the UCITS. The UCITS may access the market of the relevant host Member State as of the date of this notification.

The UCITS notification procedure



12.3.2. Content of the notification file

The notification file must contain:

- ▶ Notification letter. The notification letter includes:
 - ▶ Information on the UCITS, the compartment, and, where relevant, the share or unit classes to be marketed, the management company or self-managed investment company
 - ▶ The arrangements for marketing the UCITS in the host EU/EEA Member State
 - ▶ Details of the facilities that are available in the host Member State for making payments to shareholders or unitholders, repurchasing or redeeming shares or units, and making available the information that UCITS are required to provide
 - ▶ Other information required by laws, regulations, and administrative provisions of the host Member State that are not governed by the UCITS Directive and that are specifically relevant to the arrangements made for the marketing of shares or units of UCITS, such as details of any additional information to be disclosed to shareholders or unitholders or their agents (see also Section 12.3.5.)

The notification letter must follow the template provided for in *Commission Regulation (EU) No 584/2010*. CSSF Circular 11/509 provides further technical requirements to be met.

- ▶ The latest versions of the following documents:
 - ▶ CSSF attestation: the attestation to be attached to the file is the attestation that the CSSF delivered to the UCITS along with the latest visa-stamped prospectus
 - ▶ Constitutional document: the latest consolidated version of the constitutional document must be appended to the file as a single document
 - ▶ Prospectus: the prospectus to be appended to the file has to be the latest prospectus visa-stamped by the CSSF
 - ▶ KIIs
 - ▶ Report(s): the latest audited annual report and any subsequent semi-annual report
 - ▶ Marketing arrangements: this document is optional based on host Member States' requirements and provides additional information on the arrangements made for marketing the shares or units of the UCITS in the case where the structure of the notification letter would not permit the internal methods of marketing to be reproduced exactly
 - ▶ Confirmation of payment: this document should only be appended to the file for marketing applications in host Member States requiring confirmation of the payment of charges to which the UCITS is subject in the host Member State

Requirements for information to be provided to investors, including translation requirements, are covered in Section 12.3.6.

12.3.3. Submission and processing of the notification file

The CSSF requires that the notification file is submitted electronically using one of the following:

- Systems based on channels accepted by the CSSF in accordance with the provisions of CSSF Circular 08/334 on *encryption channels for reporting firms*. This Circular provides detailed technical standards
- Direct filing of the required documents on the CSSF website (subject to specific conditions specified on the CSSF website)

From a technical point of view, all the documents constituting a notification file intended for a given host Member State must be grouped together in a "single package". Further details on the nomenclature and format for electronic transmission are specified in the Annexes to CSSF Circular 11/509.

The CSSF executes a number of verifications on the notification files received to ensure completeness and compliance. The verification rules cover, *inter alia*, compliance with the required nomenclature, document format, ensuring that the documents relate to an existing Luxembourg UCITS or compartments thereof, that they are up-to-date, and, where relevant, consistent with CSSF documents.

In order to be able to execute the verifications effectively, the CSSF must, at all times, be in possession of the latest electronic versions of the constitutional document, prospectus, KII, semi-annual reports and audited annual reports.

Where the formal verification of the file reveals that the file is incomplete or does not comply with the relevant technical requirements, the CSSF informs the UCITS, through the same communication channel the UCITS used for submitting the notification file to the CSSF, of the reason(s) preventing the submission of the file to the competent authorities of the relevant host Member State. It is then the responsibility of the UCITS to submit a new, correct and complete notification file.

If a host Member State competent authority does not, for any reason, accept a notification file submitted by the CSSF, the UCITS is informed of the reason(s) of refusal through the same communication channel it used for submitting the file to the CSSF or directly. It is then the responsibility of the UCITS to submit a new, correct, and complete notification file to the CSSF.

In July 2019, the CSSF published Circular 19/721 regarding "*Dematerialisation of requests to the CSSF*". This Circular prescribes that certain requests to the CSSF should henceforth only be made via the CSSF's online eDesk portal.

The eDesk portal is available at: <https://www.cssf.lu/edesk>

A list of the eDesk request types, as well as additional information and guidelines in the form of a user guide, are published and regularly updated on the homepage of the eDesk portal.

12.3.4. Written notice

Updates to the information submitted via the notification procedure must be provided directly to the host Member State via a written notice. This procedure applies in case of:

- Amendments to the information regarding the arrangements for marketing communicated in the notification letter
- A change regarding the share or unit classes to be marketed
- A change to the documents submitted in the notification file

The UCITS has to address a written notice of the amendments, together with all the amended documents, directly to the competent authority of the host Member State, before implementing the amendment.

It is not necessary to file a copy of this notice with the CSSF. The CSSF remains responsible, however, for the approval of any amendment to the constitutional document or prospectus of the UCITS (see Section 3.4.). Such approval must be obtained prior to sending the written notice to the competent authority of the host Member State.

12.3.5. Host Member State marketing requirements

A UCITS that markets its shares or units in a host Member State is usually required, in accordance with the laws and regulations and administrative provisions in force in the host Member State, to take the necessary measures to ensure that facilities are available in the host Member State for making payments to shareholders or unitholders, repurchasing or redeeming shares or units, and making available the information that UCITS are required to provide to investors in the host Member State.

The UCITS is also required to comply with the laws, regulations, and administrative provisions of the host Member State that are not governed by the UCITS Directive and that are specifically relevant to the arrangements made for the marketing of shares or units of UCITS.

Selected types of host Member State requirements relevant to the marketing of UCITS:

- ▶ Definition of marketing
- ▶ Language requirements
- ▶ Representative and/or paying agent(s) of the UCITS in the host Member State
- ▶ Promotion (i.e., public offering), including advertising materials
- ▶ Investor solicitation (i.e., communication to a targeted clientele)
- ▶ Means of communication (e.g., durable medium (such as paper, CD or DVD), email, website, radio, TV)
- ▶ Entities that are eligible to sell shares or units of UCITS (e.g., management companies, credit institutions, investment firms such as investment advisers and distributors)
- ▶ Conduct of business rules applicable to entities (e.g., credit institutions, investment firms) selling UCITS, and in particular when providing investment services (e.g., investment advice, or the reception and transmission of orders), *inter alia*, implementing the Markets in Financial Instruments Directive (MiFID)²⁸⁴ requirements
- ▶ Rules of conduct applicable to management companies, as well as conduct of business requirements applicable to management companies providing investment services, *inter alia*, implementing MiFID requirements applicable to management companies
- ▶ Distance marketing, *inter alia*, implementing the Distance Marketing Directive²⁸⁵
- ▶ Consumer protection rules
- ▶ Information to be disclosed in the prospectus to investors in the host Member State
- ▶ Information about any investor compensation and/or guarantee scheme(s)
- ▶ Additional information that investors may request to be provided with
- ▶ Information on relevant tax provisions applicable to investors and on any locally applicable tax reporting regime complied with by the UCITS
- ▶ Information to be provided to investors regarding certain changes occurring during the life of the UCITS
- ▶ Publication requirements, e.g., for notices to investors and UCITS prices
- ▶ Remuneration of distributors (e.g., retrocessions)
- ▶ Information on any exemptions from rules or requirements applicable in the UCITS host Member State in relation to marketing arrangements for the UCITS, a specific share or unit class or any category of investors

EU Regulation 1156/2019 on facilitating cross-border distribution of collective investment undertakings, explicitly allows Member States to introduce *ex-ante* verification of marketing communications which UCITS and their managers intended to use directly or indirectly in their dealings with investors. The sole purpose of this process should be verifying compliance with the Regulation and with national provisions concerning marketing requirements. The same rules apply for AIFs, EuVECAs and EuSEFs and their managers targeting retail investors. This *ex-ante* verification, however, should not constitute a prior condition for the marketing and should not be part of the notification procedure.

Where authorities opt to use this tool, they should establish, apply, and publish on their websites, procedures for the prior notification. The internal rules and procedures should ensure transparent and non-discriminatory treatment of all UCIs, regardless of the Member States in which they are authorized.

Member States are required to make information on such provisions easily accessible from a distance and by electronic means - in general on the website of the competent authority.

12.3.6. Investor information requirements

Where a UCITS markets its shares or units in a host Member State, it must provide investors in the host Member State with all the same information and documents that it is required to provide to investors in Luxembourg (see Section 10.1.1. on the documents to be provided).

Such information and documentation must be provided to investors in compliance with the following provisions:

- ▶ The information or documents must be provided to investors in the host Member State in the way prescribed by the laws, regulations or administrative provisions of the host Member State

²⁸⁴ Markets in Financial Instruments Directive (MiFID II), Directive 2014/65/EU, as amended.

²⁸⁵ Directive 2002/65/EC concerning the distance marketing of consumer financial services.

- The KII must be translated into the official language, or one of the languages, of the UCITS host Member State or into a language approved by the competent authority of that Member State
- Information and documents other than the KII may be translated, at the choice of the UCITS, into the official language, or one of the official languages, of the UCITS host Member State, or into a language approved by the competent authority of that Member State or into a language customary in the sphere of international finance
- Translations of information and documents must also be produced under the responsibility of the UCITS and must faithfully reflect the content of the original information

These provisions apply also to all changes to the relevant information and documents.

The frequency of the publication of the subscription or redemption price of shares or units of UCITS is subject to the current laws, regulations, and administrative provisions of Luxembourg (see Section 8.7.).

12.4. Marketing foreign UCITS in Luxembourg

12.4.1. Notification

If a UCITS domiciled in another Member State wishes to market its shares or units in Luxembourg, the CSSF must receive a notification from its home Member State competent authority. The notification must be composed of:

- The documentation required by the UCITS Directive:
 - Notification letter
 - The latest versions of the following documents:
 - Constitutional document
 - Prospectus
 - KII
 - Report(s)
- An attestation that the UCITS fulfills the conditions imposed by the UCITS Directive from the competent authority of the UCITS home Member State

The notification letter must provide the following information:

- The name and address of the paying agent in Luxembourg that may make dividend payments and payments in relation to subscription and redemption of shares or units of the UCITS in Luxembourg
- The place where the investors may present subscription, redemption or conversion requests of shares or units of the UCITS
- The place where Luxembourg investors may obtain the net asset values, issue and redemption prices, the latest prospectus, the latest financial reports, the constitutional document and, if relevant, access to contracts with the UCITS
- The name of the local newspaper where any notice to shareholders or unitholders will be published in Luxembourg

The KII and other documents must be submitted in French, German, English or Luxembourgish. Translations are deemed to be made under the responsibility of the UCITS and must truly reflect the original information.

Upon confirmation to the UCITS of the transmission to the CSSF by the competent authority of the home Member State, the UCITS can access the Luxembourg market.

While evidence of fee payment needs to be provided with the application file, an invoice will be mailed by the CSSF to the applicant after receipt of the notification file. The various charges levied by the CSSF to cover the handling costs of the notification and the registration costs of a UCITS for marketing its shares or units in Luxembourg are laid down by the Grand-Ducal Regulation of 21 December 2017 as amended.

12.4.2. Written notice

Updates to the information submitted via the notification procedure must be provided directly to the CSSF via a written notice (as described in Section 12.3.4.) submitted via the *e-file* system (see Section 6.5.2.) or via e-mail to the address NOTIF-OPCETRUPD@cssf.lu.

12.4.3. Luxembourg marketing requirements

A UCITS established in another Member State that markets its shares or units in Luxembourg must appoint a credit institution to ensure that facilities are available in Luxembourg for making payments to shareholders or unitholders and redeeming units.

Section 12.8. provides information on the marketing regulations in Luxembourg.

12.4.4. Investor information requirements

The UCITS is required to take the necessary measures to ensure that the documents and information that must be provided to investors in its home EU/EEA Member State are made available to investors, either in French, German, English or Luxembourgish. This also applies to any changes to the documents and information.

The frequency of the publication of the subscription or redemption price of the shares or units of the UCITS is subject to the current laws, regulations, and administrative provisions in the UCITS home Member State.

Where a UCITS that is domiciled in an EEA country other than an EU Member State markets its shares or units in Luxembourg, the provisions described above are also applicable within the limits provided for in the EEA Agreement.

12.4.5. Cessation of marketing

The CSSF has to be informed about any cessation of marketing of shares or units of the UCITS.

A number of Member States have specific requirements in relation to the cessation of the marketing of the shares or units of a UCITS or a compartment thereof.

12.5. Marketing of AIF with a passport and NPPR

12.5.1. Summary

Marketing covers any direct or indirect offering or placement, at the initiative of the AIFM or on behalf of the AIFM, of shares or units in an AIF it manages to or with investors domiciled in the EU/EEA.

In this section, we use the term AIFM to refer to authorized AIFM and authorized internally managed AIF.

The main principles of the marketing provisions of the AIFM Directive regime can be summarized as follows:

- Authorized EU/EEA AIFM benefit from a “marketing” passport permitting them to market EU/EEA AIF to professional investors in their home Member State and in other Member States (“host” Member States)
- For EU/EEA AIFM managing and marketing non-EU/EEA AIF and non-EU/EEA AIFM marketing EU/EEA and non-EU/EEA AIF, two regimes will coexist for marketing:
 - Continuation of national private placement regimes (NPPRs), which will be phased out in the future
 - A passport regime, which may be phased in from 2021 at the earliest
- Non-EU/EEA AIFM intending to market AIF they manage in the EU/EEA with a passport must obtain prior authorization from their “Member State of reference”
- All marketing with a passport of EU/EEA and non-EU/EEA AIF to professional investors by EU/EEA and non-EU/EEA AIFM in their home Member State (or “Member State of reference”) or another Member State is subject to a notification procedure
- An authorized AIFM managing a feeder AIF benefits from a “passport” to market its feeder AIF only if the master AIF is managed by an authorized AIFM
- Member States may permit marketing of EU/EEA or non-EU/EEA AIF by AIFM to retail investors in the Member State. They may also apply stricter requirements
- EU/EEA professional investors may invest, on their own initiative, in any AIF of their choice, irrespective of the domicile of the AIF or AIFM (also referred to as “reverse solicitation”)

Professional investors include:

- ▶ Entities that are required to be authorized or regulated to operate in the financial markets:
 - ▶ Regulated financial institutions and insurance companies
 - ▶ UCIs, pension funds, and their management companies
 - ▶ Commodity and commodity derivatives dealers
 - ▶ Locals²⁸⁶
 - ▶ Other institutional investors
- ▶ Large undertakings that meet at least two of the following criteria:
 - ▶ Balance sheet total: EUR 20m
 - ▶ Net turnover: EUR 40m
 - ▶ Own funds: EUR 2m
- ▶ National and regional governments, etc.
- ▶ Other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitization of assets or other financing transactions
- ▶ Investors that may be treated as professional clients within the meaning of Annex II to the MiFID Directive:
 - ▶ The client must as a minimum meet two of the following criteria:
 - ▶ The client must have carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters
 - ▶ The size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, must exceed EUR 500,000
 - ▶ The client must work or have worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged
 - ▶ Before deciding to accept any request for waiver, the investment firm must take all reasonable steps to ensure that the client requesting to be treated as a professional client meets the aforementioned requirements
 - ▶ The client must state in writing to the investment firm that they wish to be treated as a professional client, either generally or in respect of a particular investment service or transaction, or type of transaction or product
 - ▶ The investment firm must give them a clear written warning of the protection and investor compensation rights they may lose
 - ▶ The client must state in writing, in a separate document from the contract, that they are aware of the consequences of losing such protections

Retail investors are investors that are not professional investors.

The extension of the "passport" regimes to non-EU/EEA AIF and non-EU/EEA AIFM is dependent on ESMA issuing a positive opinion on the functioning of the passport for EU/EEA AIFM marketing EU/EEA AIF and the European Commission adopting the required delegated act in light of ESMA's advice. ESMA's first opinion was issued in July 2015 and advised that only three third countries - Jersey, Guernsey and Switzerland - be allowed to distribute alternative funds across the European Union. Further advice from ESMA was received in July 2016 in which ESMA provided advice relating to a further 9 countries: Australia, Bermuda, Canada, Cayman Islands, Hong Kong, Isle of Man, Japan, Singapore and the United States. The phasing out of the NPPRs is dependent on ESMA issuing a second opinion on the functioning of marketing by EU/EEA AIFM of non-EU/EEA AIF in the EU/EEA and on the managing and marketing by non-EU/EEA AIFM of AIF in the EU/EEA (both under the passport and under NPPRs) and the termination of the existence of national regimes, and the European Commission adopting a second delegated act. Initially, ESMA's second opinion was expected three years after the adoption of the first delegated act, implying that the NPPRs could be phased out by 2018 at the earliest. However, the BREXIT referendum in the United Kingdom relating to the country's withdrawal from the European Union resulted in an unclear situation which has been delaying, and may further delay, the issuance of the opinion.

²⁸⁶ Firms dealing for their own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets.

The regime for marketing of EU/EEA and non-EU/EEA domiciled AIF by or on behalf of EU/EEA AIFM to EU/EEA and non-EU/EEA investors is summarized in the following table:

Marketing regimes applicable to authorized EU/EEA AIFM

Domicile		Any EU/EEA marketing?	Is AIFM Directive applicable?	AIFM marketing regimes	Requirements applicable to AIFM and AIF	Requirements applicable to third country domiciles
AIFM	AIF					
EU/EEA	EU/EEA	Yes	Yes	Passport (from 2013)	Full AIFM Directive	None
EU/EEA	EU/EEA	No	Yes	None	Full AIFM Directive	None
EU/EEA	Non-EU/EEA	Yes	Yes	NPPR (2013 until at least 2021)	Full AIFM Directive except provisions on depositary, but entity needs to be appointed to execute depositary functions	Cooperation arrangements AML requirements
				Passport (potentially from 2021 onward)	Full AIFM Directive	Cooperation arrangements AML requirements Tax agreements
EU/EEA	Non-EU/EEA	No	Yes	None	Full AIFM Directive except provisions on depositary and annual report	Cooperation arrangements

The AIFM Directive applies to non-EU/EEA AIFM only to the extent that they manage EU/EEA AIF or market AIF (EU/EEA or non-EU/EEA) to EU/EEA investors. The regime for marketing EU/EEA and non-EU/EEA domiciled AIF by or on behalf of non-EU/EEA AIFM to EU/EEA and non-EU/EEA investors is summarized in the following table:

Marketing regimes applicable to non-EU/EEA AIFM

Domicile		Any EU/EEA marketing?	Is AIFM Directive applicable?	AIFM marketing regimes	Requirements applicable to AIFM and AIF	Requirements applicable to third country domiciles
AIFM	AIF					
Non-EU/EEA	EU/EEA	Yes	Yes	NPPR (2013 until expected 2021 ²⁸⁷)	Provisions on transparency and major holdings and control provisions (if applicable)	Cooperation arrangements AML requirements
				Passport (potentially from 2021 onward)	Full AIFM Directive, including "Member State of reference" authorization EU/EEA legal representative	Cooperation arrangements AML requirements Tax agreements
Non-EU/EEA	EU/EEA	No	Yes	None	Full AIFM Directive, including "Member State of reference" authorization EU/EEA legal representative	Cooperation arrangements AML requirements Tax agreements
Non-EU/EEA	Non-EU/EEA	Yes	Yes	NPPR (2013 until at least 2021)	Provisions on transparency and major holdings and control provisions (if applicable)	Cooperation arrangements AML requirements
				Passport (potentially from 2021 onward)	Full AIFM Directive, including "Member State of reference" authorization EU/EEA legal representative	Cooperation arrangements AML requirements Tax agreements
Non-EU/EEA	Non-EU/EEA	No	No	None	None	None

In addition to the AIFM Directive requirements, the SIF Law and the RAIF Law restrict distribution of the shares or units of SIF and RAIF to "well-informed investors", be they in or outside Luxembourg (see Sections 2.4.2. and 2.4.3.). Procedures must be implemented to ensure that this requirement is respected.

Cross-border management of AIF by AIFM is covered in Section 6.3.4.

²⁸⁷ Because EU/EEA AIF is managed by non-EU/EEA AIFM.

12.5.2. EU/EEA AIFM

12.5.2.1. Marketing of EU/EEA AIF

12.5.2.1.1. Passport regime

Authorized EU/EEA AIFM are entitled to market their EU/EEA AIF to professional investors in any EU/EEA Member State - they benefit from a "passport."

Where the EU/EEA AIF is a feeder AIF, however, there are two possible scenarios:

- ▶ The master AIF is an EU/EEA AIF managed by an authorized EU/EEA AIFM: in this case, the feeder benefits from a passport
- ▶ The master AIF is not an EU/EEA AIF managed by an authorized EU/EEA AIFM: in this case, the provisions applicable to the marketing of non-EU/EEA AIF by EU/EEA AIFM apply (see Section 12.5.2.2.2.)

Member States may permit the marketing of AIF to retail investors in the Member State. The requirements of the AIFM Directive must be met, and, in addition, Member States may impose on the AIFM or the AIF requirements stricter than those applicable to marketing to professional investors. These requirements must not be stricter for EU/EEA AIF marketed cross-border than for AIF marketed domestically (see also Section 12.5.4.).

When an EU/EEA AIFM intends to market its EU/EEA AIF in an EU/EEA Member State (its home Member State or a host Member State), it must submit a notification to its home Member State for each AIF. The notification must include:

- ▶ A notification letter identifying the AIF that the AIFM intends to market and information on where it is established
- ▶ The AIF constitutional document
- ▶ The identity of the depositary for each AIF
- ▶ A description of, or information on, the AIF available to investors, as well as information that must be provided to them before they invest
- ▶ Information on the master AIF, if the AIF is a feeder
- ▶ The identification of the Member State(s) in which it intends to market the AIF
- ▶ Measures to prevent the AIF from being marketed to retail investors (if relevant)
- ▶ Information on arrangements made for marketing the AIF in the home or host Member State and, where relevant, information on the arrangements established to prevent units or shares of the AIF from being marketed to retail investors, including in the case where the AIFM relies on activities of independent entities to provide investment services in respect of the AIF

The CSSF's *Frequently Asked Questions concerning the Luxembourg Law of 12 July 2013 on alternative investment fund managers as well as the Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage transparency and supervision* (CSSF's FAQ on AIFM) covers the impact of the Packaged retail and insurance-based investment products (PRIIPs) Regulation on AIFs. It clarifies that manufacturers of Luxembourg AIFs, the shares/units of which are being advised on, offered or sold to retail investors, needed to have in place a PRIIPs KID as of 1 January 2018, unless they benefit from the exemption provided under article 32(2) of the PRIIPs Regulation. However, such AIFs may have issued a UCITS KII before 1 January 2018 in order to be exempted from the obligations of the PRIIPs Regulation until 31 December 2021, provided that the following conditions are complied with:

- ▶ The UCITS KII should comply with the provisions of the 2010 Law as well as with the provisions of Commission Regulation (EU) n° 583/2010 on key investor information
- ▶ The UCITS KII should have been issued for each retail share/unit class of the compartments of the relevant Luxembourg AIF before 1 January 2018
- ▶ The offering document of the Luxembourg AIF in question should be amended in order to reflect the distribution of a UCITS KII to all retail investors contemplating an investment in the AIF. The offering document should also mention that the UCITS KII will be published on the website of the Registered or Authorized AIFM of the Luxembourg AIF and that it will be available, upon request, in paper form

The PRIIPs Regulation does not apply to manufacturers of and persons advising on or selling Luxembourg AIFs the shares/units of which are solely being advised on, offered or sold to professional investors.

A PRIIPs KID does not need to be provided to retail investors outside the EU/EEA unless the applicable rules and regulations of the third country in which the marketing takes place provide otherwise.

A PRIIPs KID does not need to be drawn up and provided to existing retail investors of a Luxembourg AIF the shares/units of which are not being advised on, offered or sold to any new retail investors.

A PRIIPs KID needs to be drawn up and provided to existing retail investors of a Luxembourg AIF who wish to make an additional investment after 1 January 2018, unless they benefit from the exemption provided under article 32(2) of the PRIIPs Regulation or if the existing retail investors invest through a regular savings plan (unless a change is made to the subscription arrangements and a new subscription form is required).

When no exemption to a PRIIPs KID production is applicable, the person(s) advising on, or selling Luxembourg AIFs the shares/units of which are being advised on, offered or sold to retail investors must provide such investors with the PRIIPs KID in adequate time before those investors are bound by any contract or offer relating to the subscription of shares/units in that AIF, in accordance with Article 13(1) of the PRIIPs Regulation, unless the conditions of Article 13(3) or 13(4) of the PRIIPs Regulation apply.

The PRIIPs KID must be made available to retail investors free of charge:

- ▶ In paper form; or
- ▶ By using a durable medium other than paper, subject to the conditions of Article 14(4) of the PRIIPs Regulation; or
- ▶ By means of a website subject to the conditions of Article 14(5) of the PRIIPs Regulation.

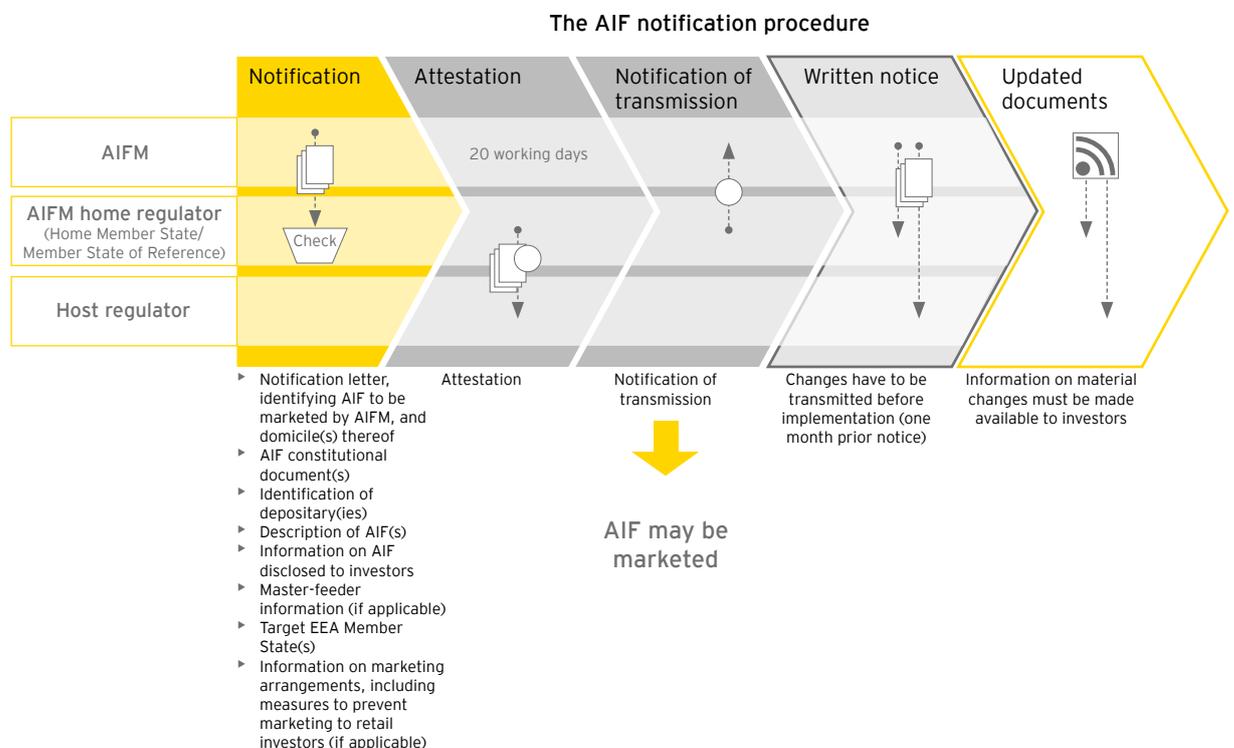
In accordance with article 5(1) of the PRIIPs Regulation, a PRIIP manufacturer must always publish the PRIIPs KID on its website.

Where a Luxembourg AIF advises on, offers or sells its shares/units to retail investors, the PRIIPs KID should be written in the official languages, or in one of the official languages, used in the part of the Member State where the AIF is advised on, offered or sold or in a language accepted by the competent authorities of that Member State.

The final version of a PRIIPs KID will not be visa-stamped by the CSSF; however, the CSSF may request the final PRIIPs KID.

Additional compartments and/or share/unit classes launched after 1 January 2018 of Luxembourg AIFs that have issued a UCITS KII also benefit from the exemption provided by article 32(2) of the PRIIPs Regulation.

Luxembourg AIFs that have issued a UCITS KII need to file a draft and final version of such document with the CSSF.



Provided that the provisions of the AIFM Directive are met, in case of marketing in the AIFM's home Member State, the competent authority is required to inform the AIFM within 20 working days that it may start marketing the AIF. In case of cross-border marketing, the competent authority of the AIFM's home Member State is required to transmit the complete documentation to the competent authority of the host Member State, together with an attestation that the AIFM is authorized to manage AIF with that particular investment strategy within 20 working days. Upon transmission, it is required to notify the AIFM of the transmission. The AIFM may start marketing the AIF in the host Member State from the date of notification of transmission.

Arrangements made for marketing the AIF and measures to prevent the AIF from being marketed to retail investors in the host Member State (if prohibited) are subject to the laws and supervision of the host Member State.

The CSSF's FAQ on AIFM, clarifies that authorized Luxembourg AIFM are required to notify all material changes to the information included in the initial notification file at least one month before implementing the change as regards any changes planned by the AIFM, or immediately after any unplanned change has occurred.

ESMA's *Questions and Answers on the Application of the AIFMD*, clarifies that the creation of a share/unit class of an AIF marketed in a host Member State by way of the AIFMD marketing passport, which is to be marketed cross-border within an already notified compartment, does not constitute a material change of the notification.

On 12 July 2019, the EU introduced a new Regulation²⁸⁸ and a Directive²⁸⁹ amending the UCITS and AIFM Directives and harmonizing various aspects of cross-border distribution. The Directive harmonizes the rules regarding pre-marketing of EEA AIFs, and will in practice become applicable from August 2021.

The harmonized rules would allow managers to target investors by testing their appetite for upcoming investment opportunities or strategies through the same pre-marketing process across all EU/EEA jurisdictions.

For pre-marketing to be recognized as such under this Directive, it should:

- ▶ Be addressed to a professional investor
- ▶ Concern an investment idea or investment strategy an AIF which is not yet established, or an AIF which is established, but not yet notified for marketing in the respective country

During pre-marketing, it is not allowed:

- ▶ For investors to subscribe to the units or shares of the AIF pre-marketed
- ▶ Subscription forms or similar documents whether in draft or final form to be distributed to potential investors

Any subscription by professional investors, within 18 months of the EU AIFM beginning pre-marketing, to units or shares of an AIF referred to in the information provided in the context of pre-marketing, or of an AIF established as a result of the pre-marketing should be considered to be the result of marketing and should be subject to the applicable marketing passporting requirements.

Within two weeks after the commencement of pre-marketing notification the regulator in the host Member State should be notified via the CSSF.

This notification should include, *inter alia*, the name of the targeted Member State(s), the periods of time in which the pre-marketing took place, a brief description of the pre-marketing including information on the investment strategies and, where relevant, a list of AIFs and compartments of AIFs which were the subject of the pre-marketing.

²⁸⁸ Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014.

²⁸⁹ Directive (EU) 2019/1160 of the European Parliament and of the Council amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings.

12.5.2.1.2. National private placement regimes (NPPRs)

Simplified AIFM registration regime AIF are not required to comply with the full requirements of the AIFM Directive. Such AIFM have at least the following options:

- ▶ Continue to market their AIF under NPPRs, where permitted
- ▶ “Opt in” - i.e., voluntarily comply with the requirements of the AIFM Directive - and benefit from the marketing passport²⁹⁰
- ▶ Benefit from another passport²⁹¹

12.5.2.2. Marketing of non-EU/EEA AIF

12.5.2.2.1. Passport regime

Once the passport has been phased in (see Section 12.5.1.), authorized EU/EEA AIFM may market, with a passport:

- ▶ Non-EU/EEA AIF they manage (potentially from 2021 at the earliest)
- ▶ EU/EEA feeder AIF they manage that do not have EU/EEA master AIF managed by an authorized EU/EEA AIFM (from 2021 at the earliest)

The EU/EEA AIFM must comply with all of the relevant requirements of the AIFM Directive, and the following additional conditions must be fulfilled:

- ▶ There must be appropriate cooperation arrangements between the EU/EEA AIFM home Member State competent authority and the supervisory authority of the non-EU/EEA AIF third country, at least for efficient exchange of information
- ▶ The non-EU/EEA AIF country must not be listed as a non-cooperative country and territory (NCCT) by the Financial Action Task Force (FATF)²⁹²
- ▶ The non-EU/EEA AIF country must have signed an Organisation for Economic Co-operation and Development (OECD) Article 26 Model compliant tax convention²⁹³ with the AIFM home Member State and any other Member State in which the non-EEA AIF is intended to be marketed

ESMA has approved cooperation arrangements between EU/EEA competent authorities with responsibility for the supervision of AIF and their global counterparts in third countries and territories. ESMA negotiated the agreements on behalf of all EU Member State competent authorities as well as the authorities from Iceland, Liechtenstein, and Norway and the supervisory authorities of the third countries.

The CSSF has signed Memoranda of Understanding (MoU) with the supervisory authorities of the third countries, based on ESMA's approved cooperation agreement templates.

As negotiations about the market access of the United Kingdom to the EU are still ongoing, the future framework governing the marketing of UCIs domiciled in the United Kingdom or UCIs managed by managers domiciled in the United Kingdom is not in place.

When the EU/EEA AIFM intends to market its non-EU/EEA AIF in an EU/EEA Member State, it must submit a notification to its home Member State for each non-EU/EEA AIF, similar to that required for each EU/EEA AIF.

12.5.2.2.2. National private placement regimes (NPPRs)

EU/EEA Member States may permit EU/EEA AIFM to market non-EU/EEA AIF they manage, or EU/EEA feeder AIF that do not have EU/EEA master AIF managed by an authorized EU/EEA AIFM, without a passport, provided that:

- ▶ The AIFM complies with all the relevant requirements of the AIFM Directive except the full requirements of the AIFM Directive on depositaries. An entity must, however, be appointed to carry out depositary functions

²⁹⁰ See Section 2.4.4.1.

²⁹¹ See Section 12.6.3. on the marketing of European venture capital funds (EuVECA) and European social entrepreneurship funds (EuSEF).

²⁹² An intergovernmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

²⁹³ Article 26 of the OECD Model Tax Convention creates an obligation to exchange information that is foreseeably relevant to the correct application of a tax convention as well as for purposes of the administration and enforcement of domestic tax laws of the contracting states.

- There are appropriate cooperation arrangements to ensure efficient exchange of information for systemic risk oversight between the EU/EEA AIFM home Member State competent authority and the non-EU/EEA AIF third country supervisory authority
- The non-EU/EEA AIF country is not listed as an NCCT by FATF

Member States may impose stricter requirements on marketing to investors in their territory.

12.5.3. Non-EU/EEA AIFM

12.5.3.1. Marketing AIF with a passport

Once the passport has been phased in (in 2021 at the earliest), non-EU/EEA AIFM that have obtained authorization from their “Member State of reference” (see Section 6.3.4.3.) may market the EU/EEA and non-EU/EEA AIF they manage with a passport.

The following requirements apply to non-EU/EEA AIFM marketing AIF with a passport:

- EU/EEA AIF: where an authorized non-EU/EEA AIFM intends to market its EU/EEA AIF in an EU/EEA Member State (its Member State of reference or another Member State) with a passport, it must submit a notification to its Member State of reference for each EU/EEA AIF. The procedure is similar to that applicable to EU/EEA AIFM intending to market EU/EEA AIF
- Non-EU/EEA AIF: the regime is similar to that for EU/EEA AIF and, in addition:
 - There must be appropriate cooperation arrangements between the non-EU/EEA AIFM’s Member State of reference competent authority and the supervisory authority of the non-EU/EEA AIF third country, at least for efficient exchange of information (see also Section 12.5.2.2.1.)
 - The non-EU/EEA AIF country must not be listed as an NCCT by FATF
 - The non-EU/EEA AIF country must have signed an OECD Article 26 Model compliant tax convention with the non-EU/EEA AIFM’s Member State of reference and any other Member State in which the non-EU/EEA AIF is intended to be marketed

12.5.3.2. National private placement regimes (NPPRs)

EU/EEA Member States may permit non-EU/EEA AIFM to market the EU/EEA or non-EU/EEA AIF they manage without a passport, provided that:

- The non-EU/EEA AIFM complies with the relevant requirements on the annual report of AIF (see Section 10.5.2.), disclosure to investors in AIF (see Sections 10.3.4. and 10.4.2.), and reporting to competent authorities by AIFM (see Section 6.5.2.)²⁹⁴, as well as, where relevant, the provisions on acquisition of control (see Section 4.6.) in respect of each AIF it markets
- There are appropriate cooperation arrangements to ensure efficient exchange of information for systemic risk oversight between:
 - EU/EEA AIF: the competent authorities of the Member States where the AIF are marketed, the EU/EEA AIF home Member State competent authorities, and the non-EU/EEA AIFM third country supervisory authority
 - Non-EU/EEA AIF: the competent authorities of the Member States where the AIF are marketed and:
 - The non-EU/EEA AIFM third country supervisory authority
 - The non-EU/EEA AIF third country supervisory authority
- Neither the non-EU/EEA AIFM country of establishment nor, where relevant, the non-EU/EEA AIF country must be listed as an NCCT by FATF

Member States may impose stricter requirements on marketing to investors in their territory.

12.5.4. Distribution to the public

A Member State may permit the marketing of AIF to retail investors in the Member State (see Section 12.5.2.1.1.).

A number of EU/EEA and third countries have national retail distribution regimes permitting distribution of AIF to the public provided specific requirements are met, such as:

- Registration with the national regulator or prior authorization for distribution from the relevant authorities
- Regulation of the distributor

²⁹⁴ In this case, the reporting must be provided to the competent authorities of the Member States where the AIF are marketed.

- AIF meeting certain criteria:
 - Regulation - meeting specific regulatory requirements
 - Domicile of the AIF - some jurisdictions permit the distribution of AIF from specific domiciles, the most recognized one being Luxembourg
 - Type of funds (e.g., certain funds of funds)
- Risk management or diversification
- Investment policy or strategy
- Stock exchange listing (see Chapter 13)

Other examples of types of requirements are outlined in Section 12.3.5.

12.6. Marketing of simplified AIFM registration regime AIF

Marketing of simplified AIFM registration regime AIF is subject to each country's national distribution requirements. Some countries may permit private placement or even, in some circumstances, distribution to the public.

In addition, the SIF Law and the RAIF Law restrict distribution of the shares or units of SIF and RAIF to "well-informed investors", be they in or outside Luxembourg (see Sections 2.4.2. and 2.4.3.). Procedures must be implemented to ensure that this requirement is respected.

12.6.1. National private placement regimes (NPPRs)

In some key distribution markets for AIF, national distribution rules permit private placement. NPPRs permit market participants to buy and sell financial instruments, including the shares or units of AIF, to each other without having to comply with rules that would usually apply when the same instruments are offered to retail investors.

Typically, NPPRs may provide exemptions from national public distribution regimes for distribution of funds meeting certain criteria (e.g., certain funds of funds) to:

- A limited number of investors
- A specific investor type, such as asset managers, professional or qualified investors, or high net worth individuals (HNWIs)
- Investors subscribing a minimum amount

These NPPR participants rely on private contract law to resolve any disputes that arise. The regulatory safeguards for retail investor protection are waived in "private placement". Often, the marketing takes place through an intermediary or placing agent.

12.6.2. Distribution to the public

A number of countries permit distribution of other non-AIFM Directive-compliant Luxembourg UCIs to the public (see Section 12.5.4.).

12.6.3. Marketing EuVECA and EuSEF

The managers of qualifying European Venture Capital Funds (EuVECA) and of qualifying European Social Entrepreneurship Funds (EuSEF) benefit from a "passport" permitting them to market the shares or units of their qualifying European funds to suitably qualified investors throughout the EU/EEA from July 2013.

Eligible investors are professional clients, investors who have requested to be treated as professional clients²⁹⁵, and other investors who meet both of the following criteria:

- The investor commits to investing a minimum of EUR 100,000
- The investor states in writing, in a document separate from the contract to be concluded for the commitment to invest, that they are aware of the risks associated with the envisaged commitment or investment

²⁹⁵ As defined in Section I of Annex II to the Markets in Financial Instruments (MiFID II) Directive (Directive 2014/65/EU as amended).

The managers of qualifying European funds wishing to use the EuVECA and EuSEF designations to market their qualifying European funds are required to inform the competent authority of their home Member State, providing the following information:

- ▶ The identity of the persons who effectively conduct the business of managing the qualifying European funds
- ▶ The identity of the qualifying European funds whose shares or units shall be marketed and their investment strategies
- ▶ Information on the arrangements made for complying with the requirements of the Regulation
- ▶ A list of Member States where the manager of the qualifying European funds intends to market each qualifying European fund
- ▶ A list of Member States where the manager of the qualifying European funds has established or intends to establish qualifying European funds

When the competent authority of the home Member State of the manager registers the manager, the registration provides the manager with a passport allowing it to market its qualifying European funds under the designation EuVECA and EuSEF throughout the EU/EEA.

The manager must also inform its home Member State authority if it intends to market:

- ▶ A new qualifying European fund
- ▶ An existing qualifying European fund in another Member State

Immediately after registration, or a change thereto, the competent authority of the manager's home Member State is required to notify the Member States where the manager intends to market its qualifying European funds. ESMA will maintain a central database of qualifying European fund managers, the qualifying European funds they market, and the countries in which they are marketed.

The EuVECA and EuSEF regimes are introduced in Section 2.4.4.3.

As part of the EU's Capital Markets Union Action Plan, in June 2019, a new EU Directive²⁹⁶ and Regulation²⁹⁷ were introduced, amending the UCITS and AIFM Directives with the aim of harmonizing various aspects of cross-border distribution of UCITS, AIFs, EuVECAs, EuSEFs and ELTIFs. The Directive should be adopted into the national legislation within 24 months from its publication in EU's Official Journal, and in practice will be applicable from August 2021.

The Directive and its complementing Regulation lay down additional rules and procedures concerning:

- ▶ Alignment of national marketing requirements and regulatory fees
- ▶ Harmonization of the process and requirements for the verification of marketing material by national competent authorities
- ▶ Enabling ESMA to monitor investment funds in greater details

12.6.4. Marketing ELTIF

The manager of a European long-term investment fund (ELTIF) will be able to market the units or shares of the ELTIF to professional and retail investors in its home Member State upon notification in accordance with Article 31 of AIFMD, and in other Member States upon notification in accordance with Article 3 of AIFMD.

The manager of an ELTIF must, with respect to each ELTIF it manages, specify to competent authorities whether or not it intends to market the ELTIF to retail investors.

ELTIF may be marketed to retail investors on the condition that such investors are provided with appropriate investment advice from the manager or the distributor. In addition, if ELTIF are marketed to retail investors, special requirements must be met and procedures put in place:

- ▶ The manager must be authorized to provide management of portfolio of investments and investment advice services as referred to in the AIFM Directive and has performed the suitability test referred to below
- ▶ The manager must put in place facilities available for making subscriptions, payments to unit/shareholders, repurchasing or redeeming units or shares and making available the information which the ELTIF and the manager of the ELTIF are required to provide

²⁹⁶ Directive (EU) 2019/1160 of the European Parliament and of the Council amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings.

²⁹⁷ Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014

The regulatory standards, to specify the types and characteristics of the facilities referred to above, have been developed by ESMA and have been incorporated in the Commission Delegated Regulation (EU) 2018/480 of 4 December 2017, published in March 2018.

The CSSF has signed Memoranda of Understanding (MoU) with the supervisory authorities of third countries, based on ESMA's approved cooperation agreement templates.

- ▶ The manager must establish and apply a specific internal process for the ELTIF before it is marketed or distributed to retail investors. As part of this process, the manager must assess whether the ELTIF is suitable for marketing to retail investors, taking in account at least the life of the ELTIF and the intended investment strategy of the ELTIF
- ▶ The manager must make available to any distributor all appropriate information on an ELTIF that is marketed to retail investors, including all information regarding its life and investment strategy, as well as the internal assessment process and the jurisdictions in which the ELTIF will be allowed to invest
- ▶ The manager must obtain information regarding the retail investor's:
 - ▶ Knowledge and experience in the investment field relevant to the ELTIF
 - ▶ Financial situation, including that investor's ability to bear losses
 - ▶ Investment objectives, including the investor's time horizon

Based on the above information, the manager will recommend the ELTIF only if it is suitable to each retail investor (the "suitability test"):

- ▶ Where the life of an ELTIF exceeds ten years, the manager or the distributor must issue a clear written alert that the ELTIF may not be suitable for retail investors that are unable to sustain such a long-term and illiquid commitment.
- ▶ Where the financial instrument portfolio of a potential retail investor does not exceed EUR 500,000, the manager or distributor of the ELTIF, after having performed the suitability test and having provided appropriate investment advice, must ensure, on the basis of the information submitted, that the potential investor does not invest an aggregate amount exceeding 10% of that investor's financial instrument portfolio in ELTIFs and that the initial minimum amount invested in one or more ELTIF is EUR 10,000
- ▶ The legal form of an ELTIF marketed to retail investors must not lead to any further liability for the retail investor or require any additional commitments on behalf of such an investor, apart from the original capital commitment
- ▶ Retail investors must be able to, during the subscription period and at least two weeks after the date of their subscription to units or shares of the ELTIF, cancel their subscription and have their money returned without penalty
- ▶ The manager of the ELTIF must establish appropriate procedures and arrangements to deal with retail investor complaints which allow retail investors to file complaints in the official language or one of the official languages of their Member State
- ▶ A key investor information document must be prepared

12.7. Marketing of AIF in Luxembourg

12.7.1. Luxembourg AIF

Luxembourg AIF that are authorized by and subject to the supervision of the CSSF are automatically authorized for marketing in the territory of Luxembourg, subject to any specific restrictions laid down in the applicable law or the fund documentation.

The marketing of Luxembourg AIF that are not subject to supervision of the CSSF is limited to professional and other eligible investors.

12.7.2. Non-Luxembourg AIF

Authorized AIFM established in Luxembourg, in another Member State, or in a third country once the passport has been phased in (see Section 12.5.1.) are permitted to market units or shares of the full AIFM regime AIF they manage to retail and professional investors in Luxembourg, irrespective of whether such AIF are marketed on a cross-border basis or not, or whether they are EU/EEA or non-EU/EEA AIF.

The marketing of AIF that are not subject to authorization and supervision of the CSSF to professional investors by full AIFM regime AIFM is subject to the requirement to submit a notification through the home Member State competent authority of the AIFM (see Section 12.5.).

The general requirements applicable to the marketing of AIF in Luxembourg by EU/EEA AIFM are covered in Section 12.5.2. and the marketing of AIF by non-EU/EEA AIFM is covered in Section 12.5.3.

Non-EU/EEA AIFM wishing to market without a passport the AIF they manage to professional investors in Luxembourg must complete an information form and submit it to the CSSF. The information form requires general information on the AIFM and on the AIF in relation to which marketing in Luxembourg is notified.

ESMA's *Questions and Answers on the Application of the AIFMD* clarifies that when an AIFM wants to manage AIFs domiciled in another Member State by way of the AIF management passport (Article 33 of AIFMD), in the program of operations, where specific AIFs cannot be identified at the time of the notification, the AIFs to be managed may be identified by their investment strategy. In that regard, ESMA sees merit in relying on the investment strategies contained in the reporting template for identification purposes (Annex IV of Commission Delegated Regulation (EU) No 231/2013). Where an AIFM has only been authorized to manage certain types of AIFs, it could also refer to the scope of its authorization to identify the funds to be managed.

Where the AIFM is able to identify specific AIFs, such AIFs should be identified in the program of operations by their name and national identifier (if available). Information on those funds should also include their investment strategies.

All changes to the program of operations have to be notified by the AIFM to the competent authorities in its home Member State. This includes changes to the program of operations in cases where the AIFM intends to manage further AIFs (if specified by name) or types of AIFs (if specified by investment strategy) not previously listed in the program of operations.

The detailed rules for the marketing of foreign AIF to retail investors in Luxembourg is laid down in the CSSF Regulation 15-03, issued on 2 December 2015.

The following provisions are applicable to the marketing in Luxembourg of open-ended, non-Luxembourg AIF to retail investors:

- ▶ The AIF must be subject in their home State to regulation providing investors guarantees of protection at least equivalent to those provided by Luxembourg laws governing AIF authorized to be marketed to retail investors in Luxembourg. These AIF must also be subject in their home State to permanent supervision considered by the CSSF to be equivalent to that provided in Luxembourg laws governing AIF authorized to be marketed to retail investors in Luxembourg. Cooperation between the CSSF and the supervisory authority of the AIF must also be ensured
- ▶ The AIF must be subject to supervision considered by the CSSF to be equivalent to that laid down in the 2010 Law. This condition is deemed fulfilled by AIF subject to Part II of the 2010 Law
- ▶ The AIF must be managed by a single manager
- ▶ The AIF must appoint a credit institution to ensure that facilities are available in Luxembourg for making payments to unitholders and repurchasing or redeeming units
- ▶ The AIF must take the necessary measures to ensure that the information that it is obliged to provide is made available to unitholders in Luxembourg

An authorization request must be filed with the CSSF, which should include the following documents and information:

- ▶ A certificate by the relevant supervisory authority of the home Member State of the AIF certifying that the AIF is authorized and subject to a permanent supervision in its home State
- ▶ The *addendum* to the prospectus of the AIF which includes specific information for the marketing in Luxembourg and which shall include all information useful to investors in Luxembourg to invest with full knowledge of the facts, such as:
 - ▶ Appropriate information on the risks inherent to the investment policy of the AIF
 - ▶ Information on the fees and expenses that may be charged to investors
 - ▶ The name, address and duties of the paying agent in Luxembourg
 - ▶ The place where the latest prospectus, its constitutional documents and the latest financial reports are made available
 - ▶ Details on how the foreign AIF's net asset value is published
 - ▶ The name of the Luxembourg newspaper in which the investor notices are published
- ▶ The latest annual report of the foreign AIF

- ▶ The curriculum vitae of the conducting persons (dirigeants) of the foreign AIF
- ▶ The draft agreement to be entered into between the Luxembourg paying agent and the foreign AIF
- ▶ If the foreign AIF is a feeder AIF, information on the master AIF including information on where the master AIF is established, the master AIF's constitutional documents and the prospectus of the master AIF

On the basis of the aforementioned requirements, the CSSF will decide whether or not the AIF can be marketed in Luxembourg.

When the AIF decides to no longer market its units or shares to retail investors in Luxembourg it must inform the CSSF.

On 15 January 2019, the CSSF and the Securities and Futures Commission of Hong Kong (SFC) signed a Memorandum of Understanding (MoU) concerning Mutual Recognition of Covered Funds (and Covered Management Companies).

The MoU provides a framework for mutual recognition of Luxembourg funds and Hong Kong domiciled AIFs to be offered, marketed and distributed to retail investors in Luxembourg and to the public in Hong Kong. The conditions and the process is detailed in the CSSF document "*CSSF streamlining requirements and process for mutual recognition of Hong Kong funds*" and in the SFC Circular "*Mutual Recognition of Funds between Luxembourg and Hong Kong*".

12.8. Marketing regulations applicable in Luxembourg

The provisions governing marketing in Luxembourg that a UCI also needs to comply with are as follows:

- ▶ Law of 23 December 2016 on sales and selling on pavement and on misleading and comparative advertising
- ▶ Law of 2 April 2014 amending the Consumer Code in particular and repealing the amended law of 16 July 1987 on canvassing, street vending, displaying goods and seeking orders
- ▶ Law of 8 April 2011 (Consumer Code), as amended, which, *inter alia*, includes provisions concerning the distance marketing of consumer financial services implementing Directive 2002/65/EC

Additional Luxembourg regulations impacting the marketing of UCIs include:

- ▶ Conduct of business rules applicable to Luxembourg credit institutions and investment firms selling UCIs and providing investment services (e.g., investment advice or the reception and transmission of orders) under the 1993 Law²⁹⁸ (implementing MiFID requirements)
- ▶ Rules of conduct applicable to management companies and AIFM (see Section 6.3.3.), as well as conduct of business requirements applicable to management companies and AIFM providing investment services (see Section 6.2.1.E.)

Entities marketing UCITS to investors in Luxembourg through their Luxembourg branches or on a cross-border basis are subject to their home Member State rules of conduct, implementing MiFID and UCITS Directive requirements, respectively.

12.9. Marketing intermediaries

The marketing and execution of subscriptions and redemptions of shares or units is often supported by Luxembourg or foreign intermediaries of different types. The appointment of intermediaries as financial agents and representatives for placing orders in shares or units of UCIs in no way restricts the ability of investors to deal directly with the UCI.

Luxembourg or foreign intermediaries may participate in subscription and redemption operations provided that certain conditions are met. These intermediaries include, but are not limited to:

- ▶ Distributors
- ▶ Nominees
- ▶ Market makers

²⁹⁸ The Law of 5 April 1993 on the financial sector, as amended.

In April 2017 ALFI issued guidelines outlining *Principles of the oversight of financial intermediaries in distribution of funds - covering the full life-cycle of initial and ongoing due diligence reviews*. The purpose of these guidelines is to provide parties charged with the responsibility for oversight of financial intermediaries (“FI”) in the distribution chain with a set of high-level common principles for their consideration. ALFI believes that this will create efficiencies for the Luxembourg fund industry.

The scope of the document covers the key areas of FI oversight: risk assessment of the distribution model, initial due diligence, ongoing due diligence/monitoring, governance of the FI and reporting.

In the UK, EEA firms and EEA domiciliated investment funds which are carrying out a regulated activity in the UK through the EU passport, and which have applied for the “Temporary Permission Regime” prior to 30 January 2020, are permitted to continue to operate within the scope of their current permissions for a limited period of time (1 February 2020 - 31 January 2023).

Notwithstanding the fact that the nature of Post-Brexit relationships between the UK and the EU is still unknown, and regulatory clarity regarding capital and financial market issues between the UK and Europe will be established as part of new trade deal that will be negotiated only at the end of the “Transition Period”, investment fund activity in the UK remains currently primarily regulated by the Financial Services and Market Act 2000 (FSMA) and the rules of the Financial Conduct Authority (FCA). The key frameworks of the FCA, which regulate investment fund activity are the handbooks of the “Collective Investment Scheme Information Guide” and “Investment Funds sourcebook”.

12.9.1. Distributors

Distributors are intermediaries that perform one or both of the following activities:

- Actively market the shares or units
- Receive subscription and redemption orders as appointed agents of the UCI

The following conditions are applicable to distributors:

- (1) For the purposes of processing the subscription and redemption orders, distributors must immediately forward the necessary data to the UCI management company or administrator (see, however, Section 12.9.1.(4))
- (2) For orders concerning registered shares or units, distributors will provide the UCI management company or administrator with the registration data necessary to accomplish the related tasks on an individual basis
- (3) The requirement of Section 12.9.1.(2) does not apply in the case of orders concerning bearer shares or units. In such cases, distributors act as subscribers in relation to the UCI management company or administrator in Luxembourg. They may therefore aggregate individual subscription or redemption orders and transmit them in the form of a combined order to the UCI management company or administrator in Luxembourg
- (4) It is not necessary for distributors to forward to the UCI management company or administrator the documentation relating to subscription and redemption orders from investors. However, the UCI management company or administrator must be allowed access to such documentation in case of need
- (5) Payments and receipts in respect of subscription and redemption orders may be aggregated by distributors in order to deal with the UCI management company or administrator on a net basis

12.9.2. Nominees

Nominees act as intermediaries between investors and the UCI of their choice.

The use of nominees is only authorized if the following conditions are met:

- (1) The relationship between the UCI, the nominee, management company or administrator, and the investors is determined by contract
- (2) The management company, investment company, or the UCI's sponsor, initiator or promoter is required to ensure that the nominee can adequately guarantee to execute properly its obligations towards investors
- (3) The role of the nominee is adequately described in the prospectus
- (4) Investors have the right to directly invest in the UCI without using a nominee and this right is expressly stated in the prospectus
- (5) Agreements between the nominee and the investors include a termination clause giving the investor the right to claim title to the shares or units subscribed through the nominee

The conditions of Section 12.9.2.(4) and Section 12.9.2.(5) are not applicable where the use of a nominee is either compulsory or indispensable.

The CSSF has introduced a template paragraph in relation to investor rights to be inserted in the prospectus covering, *inter alia*, cases where the UCI uses a nominee (see Section 10.3.1.K.).

12.9.3. Market makers

Market makers are intermediaries participating on their own account and at their own risk in subscription and redemption transactions of UCI shares or units.

The use of market makers is only authorized if the following conditions are met:

- (1) The relationship between the UCI, management company or administrator, and the market maker is determined by contract
- (2) The role of the market maker is adequately described in the prospectus
- (3) Market makers may not act as counterparties to subscription and redemption transactions without specific approval of the investors
- (4) Market makers may not price subscription and redemption orders addressed to them on less favorable terms than would be applied by the UCI directly
- (5) Market makers must regularly notify the UCI, management company or administrator of orders executed by them that relate to registered shares or units to ensure that the register of shareholders or unitholders is updated and that registered certificates or confirmations of investment may be sent out from Luxembourg

12.10. Special marketing information for distributors and insurers

ESMA clarified in its Questions and Answers on *MiFID II and MiFIR investor protection and intermediaries topics* that asset managers need to provide PRIIPs transaction costs to their distributors. If transaction cost information along with other MiFID II relevant information is not sent to distributors, distributors will not be able to market the relevant UCIs.

A European Working Group has defined a standard template to exchange this MiFID II relevant information between asset managers and distributors/distribution platforms. This standard is called European MiFID II Template (EMT) and covers the following MiFID II relevant information per share class:

- Target market definition according to the following categories
 - Type of clients to whom the product is targeted
 - Knowledge and experience
 - Financial situation with a focus on the ability to bear losses
 - Risk tolerance and compatibility of the risk/reward profile of the product with the target market
 - Client objectives & needs
- Distribution strategy
- Costs & charges ex ante (incl. PRIIPs transaction costs)
- Costs & charges ex post (incl. PRIIPs transaction costs)

As of 1 January 2020, under the coordination of FinDatEx (Financial Data Exchange), the EMT was revised and has been made available as EMT V3.0. The migration from version 1.0 to 3.0 should be completed by 10 December 2020.

Along with the above-mentioned information, EMT V3.0 will introduce additional information requests, e.g., specification on whether the product is developed with the aim of being compatible with clients having ESG preferences, and a specific breakdown for borrowing costs in both *ex-post* and *ex-ante* costs & charges sections.

The PRIIPs regulation requires that insurers need to collect information on funds, in case these are an investment option to the retail investor investing into this insurance product. A European Working Group has defined a standard template to exchange this PRIIPs relevant information between asset managers and distributors/distribution platforms to help them fulfil their PRIIPs regulatory obligations. This standard is called European PRIIPs Template (EPT) and covers the following PRIIPs relevant information per share class:

- ▶ General portfolio information
- ▶ Risk assessment
- ▶ Performance scenario (without entry cost with exit cost)
- ▶ Costs
- ▶ Narratives
- ▶ Specific UCITS data for insurers opting for Art 14.2 for MOP
- ▶ Specific data for German CAT IV PRIIPs
 - ▶ Characteristics of the fund/portfolio
 - ▶ Additional information for capital preservation funds/portfolio
 - ▶ Specific data for Structured Products - RIY Costs

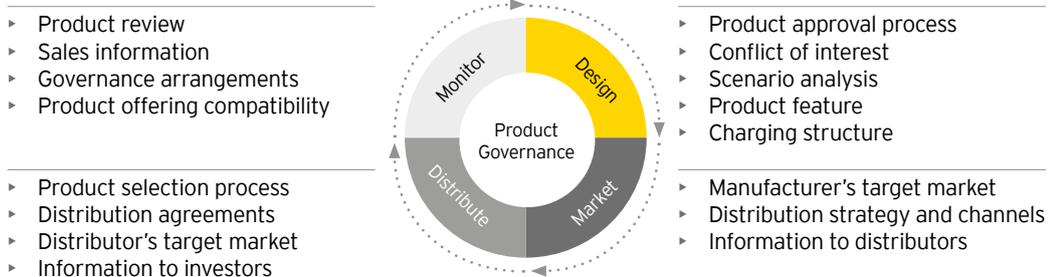
For MiFID II and PRIIPs the target market needs to be clearly defined in these reports. In particular, the type of retail investor to whom the product is intended to be sold to, their ability to bear losses and their investment horizon preferences are taken into consideration when defining the target market. On top of this, the asset managers need to be reviewed periodically post-sale to ensure consistency with the needs, characteristics and objectives of the identified target market.

Target market en product governance

The identification of a target market should be based on both quantitative and qualitative information

Type of client to whom the product is targeted	Knowledge and experience	Financial situation with a focus on the ability to bear losses	Risk tolerance and compatibility of the risk/reward profile of the product with the target market	Clients' objectives and needs
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Governance arrangements to be implemented throughout the product's life-cycle

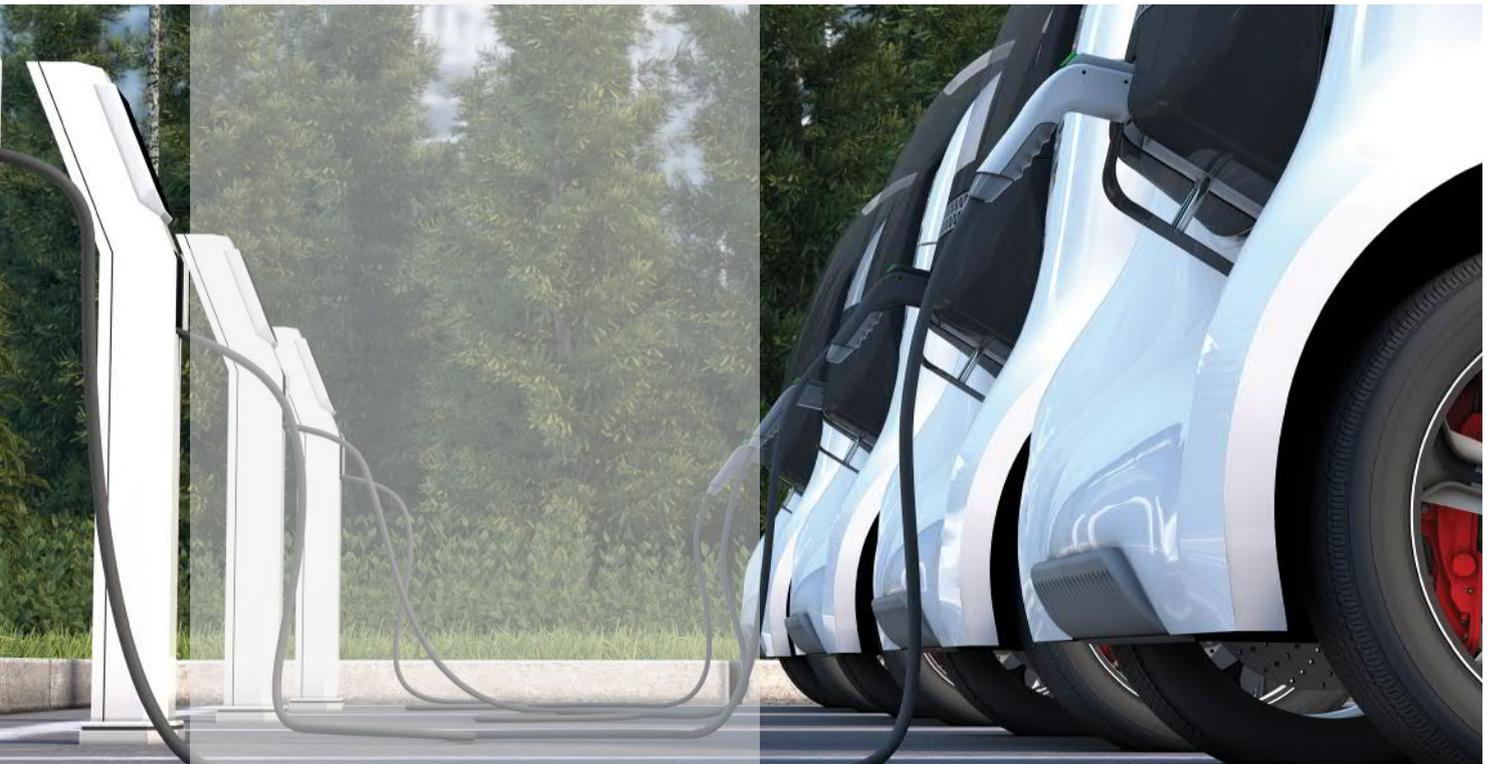


13

Stock exchange listing

EY listing services:

- ▶ Feasibility analysis and determination of listing process and requirements
- ▶ Support with preparation and submission of listing application
- ▶ Support with selection of listing service providers
- ▶ Support with changes to fund listing



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13.1. Introduction

In certain limited cases, investors, in particular institutional investors, may only be permitted to purchase securities (generally shares or units) issued by UCIs that are listed on a recognized or regulated stock exchange. As a result, a stock exchange listing may often be important to accessing certain distribution channels.

This Chapter outlines a summary of some of the key conditions for listing the securities of UCIs either on the regulated market, the *Bourse de Luxembourg* of the Luxembourg Stock Exchange (LuxSE), on the “multilateral trading facility” (Euro MTF) operated by the LuxSE, or on the Luxembourg Stock Exchange Securities Official List (LuxSE SOL), available to issuers and investors since December 2017.

13.2. Luxembourg Stock Exchange (LuxSE)

The LuxSE operates a “regulated market²⁹⁹” - designated as the “*Bourse de Luxembourg*” (BdL), a “multilateral trading facility³⁰⁰” - the “Euro MTF” and the “Securities Official List” (SOL), a dedicated section of the LuxSE’s official list. Securities may not be simultaneously admitted to more than one of these markets.

The BdL, the regulated market, offers issuers a European passport. Issuers on the regulated market must comply with the requirements of the Prospectus Directive³⁰¹ and the Transparency Directive³⁰², or benefit from an exemption. The CSSF is responsible for approving prospectuses under the Prospectus Directive. The LuxSE will normally approve the prospectuses drawn up in connection with admission to trading on the regulated market of securities outside the scope of the Prospectus Directive.

The Euro MTF, on the other hand, was set up to meet the needs of issuers not requiring a European passport. Issuers on the Euro MTF do not have to meet the requirements of the Prospectus Directive and the Transparency Directive. The LuxSE is in charge of approving prospectuses for admission to the Euro MTF.

With the launch in December 2017 of the LuxSE Securities Official List (SOL), a dedicated section of the LuxSE’s official list the Luxembourg Stock Exchange now allows registration of securities solely on the Official List without admission of these securities to trading on any of the markets operated by the Luxembourg Stock Exchange. This is intended to allow issuers to have their securities appear on a widely recognized official list, without the application of a number of capital markets related EU and national laws that solely focus on securities being admitted to trading.

The stock exchange listing requirements for the BdL and the Euro MTF are set out in the *Rules and Regulations of the Luxembourg Stock Exchange* published by the LuxSE. These were updated in January 2020 and are available on the LuxSE website. This new version incorporates:

- ▶ The Law of 13 January 2019 establishing a Register of Beneficial Owner (the RBO Law), which partly implements the 4th and the 5th EU anti-money laundering directives
- ▶ The Regulation (EU) 2017/1129 of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the Prospectus Regulation) and the Luxembourg law of 16 July 2019 implementing this Prospectus Regulation (the “Prospectus Law”)

In order to comply with the RBO law, the LuxSE has full power and authority:

- ▶ To apply to UCIs all anti-money laundering (AML) and know-your customer (KYC) measures and procedures it deems necessary
- ▶ To carry out verifications in order to identify the issuer and its Beneficial Owner(s) (the B.O.) during the scrutiny process
- ▶ To ask for any additional documents and information in order to identify the issuer, its B.O. and generally in order to fight against money laundering and terrorist financing

²⁹⁹ Within the definition of Article 4(1) 14 of the Markets in Financial Instruments Directive (MiFID), Directive 2004/39/EC, as amended.

³⁰⁰ Idem.

³⁰¹ EU Regulation (EU) 2017/1129.

³⁰² Directive 2004/109/EC, as amended.

The due diligence process includes a KYC form which should be provided with the application form and should contain:

- ▶ The full legal name of the UCI, the name of its B.O., and where applicable, the name of any related or involved politically exposed person(s) as defined in the Directive (EU) 2015/849

An application for admission to the official list without admission to trading is possible subject to the conditions set out in the Rulebook - LuxSE Securities Official List, available on the LuxSE website (www.bourse.lu).

In late 2018, the Luxembourg Stock Exchange introduced two Professional Segments, available on the BdL and the Euro MTF markets.

Issuers targeting professional investors³⁰³ only can now apply to have their financial instruments admitted to trading in the new segments. Admitted securities will not be accessible for retail investors as trading on the Professional Segments is only allowed between professional investors.

Application files must clearly indicate the segment chosen by issuers.

The Luxembourg Stock Exchange launched its Luxembourg Green Exchange (LGX) in 2016 in order to help facilitate the development of sustainable finance.

LGX is a dedicated platform for green, social and sustainable securities and aims to provide issuers, asset managers and investors with an environment for bonds and funds which are green, social, sustainable, or ESG-focused. Entry is restricted to issuers and asset managers that provide full disclosure and fulfil their reporting obligations.

LGX is the world's first dedicated green stock exchange.

13.2.1. Listing UCIs on the Bourse de Luxembourg (BdL)

13.2.1.1. Listing UCITS and other open-ended UCIs

UCITS and other open-ended UCIs wishing to list on the BdL must have their prospectus drawn up in accordance with the relevant product law, approved by the CSSF³⁰⁴ or other EU competent authority. Open-ended UCIs do not fall within the scope of the Prospectus Law. Hence a prospectus approved by the CSSF, or by any other relevant EU supervisory authority may be used for public offering in Luxembourg and/ or admission to trading on the BdL.

13.2.1.2. Listing closed-ended UCIs

Closed-ended UCIs wishing to list on the BdL are required to draw up a prospectus under the relevant section of the Prospectus Law³⁰⁵. The CSSF is responsible for the approval of the prospectus³⁰⁶.

13.2.1.3. Listing requirements of the BdL

UCIs wishing to list their shares/units on the BdL must ensure that the shares/units fulfil the following:

- ▶ Are active and have a Net Asset Value
- ▶ Are eligible for clearing and settlement
- ▶ Are freely transferable

The full listing requirements are outlined in Part I, Chapters 5 and 7 of the Rules and Regulations of the LuxSE. A section dedicated to the listing of investment funds is available on the website of the LuxSE.

³⁰³ Within the meaning of Directive 2014/65/EU (MiFID II).

³⁰⁴ The LuxSE is responsible for approving prospectuses in certain circumstances: admissions of securities not covered by Part II of the Prospectus Law; and foreign open-ended UCIs, not being distributed in Luxembourg. Appendix XII of the LuxSE Rules and Regulations contains information to be included in the prospectus for the admission to trading of shares and units for such UCIs.

³⁰⁵ For an offer to the public in Luxembourg, closed-ended UCIs may not legally be required to publish a prospectus under Part II or III of the Prospectus Law providing the following conditions are met: (i) offers of securities addressed solely to qualified investors (i.e., "professional investors" under MiFID), (ii) offers of securities addressed to fewer than 150 natural or legal persons, other than qualified investors, per Member State; and (iii) offers of securities addressed to investors that acquire securities for a total consideration of at least EUR 100,000 per investor and for each separate offer

³⁰⁶ Idem.

13.2.2. Listing UCIs on the Euro MTF

13.2.2.1. Listing UCITS and other open-ended UCIs

UCITS and other open-ended UCIs wishing to list on the Euro MTF must have their prospectus drawn up in accordance with the relevant product law, approved by the CSSF³⁰⁷ or other EU competent authority. Open-ended UCIs do not fall within the scope of the Prospectus Law. Hence a prospectus approved by the CSSF, or by any other relevant EU supervisory authority may be used for public offering in Luxembourg and/or admission to trading on the Euro MTF.

13.2.2.2. Listing closed-ended UCIs

Closed-ended UCIs wishing to list on the Euro MTF are required to draw up a prospectus under the relevant section of the Prospectus Law³⁰⁸. The CSSF is responsible for the approval of the prospectus³⁰⁹.

13.2.2.3. Listing requirements of the Euro MTF

UCIs wishing to list their shares/units on the Euro MTF must ensure that the shares/units fulfil the following:

- ▶ Are active and have a Net Asset Value
- ▶ Are eligible for clearing and settlement
- ▶ Are freely transferable

The full listing requirements are outlined in Part I, Chapters 6 and 7 of the Rules and Regulations of the LSE.

13.2.3. Listing UCIs on the LuxSE SOL

13.2.3.1. Listing UCIs

UCITS and other open-ended UCIs wishing to list on the LuxSE SOL should provide:

- ▶ An Information Notice, in English, French or German, providing details on, *inter alia*, the shares/units to be listed. However, a prospectus approved by the CSSF, or by any other competent authority, may replace the Information Notice
- ▶ An application form containing a declaration that the issuer will comply with the terms and conditions set out in the SOL Rulebook
- ▶ A written confirmation that the issuer and the securities comply with the applicable legislation and regulations
- ▶ Articles of incorporation and annual reports of the issuer (and of the guarantor, if any)

13.2.3.2. Listing requirements of the LuxSE SOL

Closed-ended UCIs wishing to list their shares/units on the LuxSE SOL must ensure that the shares/units fulfil the following:

- ▶ Are freely negotiable
- ▶ Have been actually issued prior to the admission onto the LuxSE SOL
- ▶ Application for admission must cover all shares/units of the same class already issued
- ▶ No free float conditions apply

The full listing requirements are outlined in *Rulebook - LuxSE Securities Official List*.

³⁰⁷ The LuxSE is responsible for approving prospectuses for closed-ended and foreign open-ended UCIs not being distributed in Luxembourg.

³⁰⁸ For an offer to the public in Luxembourg, closed-ended UCIs may not legally be required to publish a prospectus under Part II or III of the Prospectus Law providing the following conditions are met: (i) offers of securities addressed solely to qualified investors (i.e., "professional investors" under MiFID), (ii) offers of securities addressed to fewer than 150 natural or legal persons, other than qualified investors, per Member State; and (iii) offers of securities addressed to investors that acquire securities for a total consideration of at least EUR 100,000 per investor and for each separate offer

³⁰⁹ Idem.

13.3. Procedures for admission to a securities market of the LuxSE

The decision on the application will normally be taken within a few days and, in any case, a maximum period of 10 working days following receipt of a complete application. The admission date will be decided by the LuxSE, although applicants may request a specific date of admission.

13.3.1. Contents of the application for Bourse de Luxembourg or Euro MTF

To begin the listing process, the following documents should be completed and sent to the BdL at bolide@bourse.lu:

- ▶ A copy of the UCI's prospectus
- ▶ Application form
- ▶ KYC form for the Regulated Market/Euro MTF with additional documents:
 - (i) A proof of existence of the UCI
 - (ii) The full list of the UCI's legal representative
 - (iii) The full list of the UCI's B.O.
 - (iv) An organization chart representing the UCI, the guarantor where applicable, the B.O and any intermediaries
- ▶ Undertaking letter
- ▶ Articles of association or management regulations
- ▶ Existing agreements/conventions
- ▶ Last three years' annual reports

Listing will take place once the prospectus is clear of comments and after receipt of the final version of the prospectus and the first listing price (current NAV per share/unit).

The application file may be submitted in English, French, or German and must include a duly signed application form detailing:

- ▶ Name of legal entity filing the application
- ▶ Object of the application - the securities market (*Bourse de Luxembourg*, Euro MTF, professional segment) for which the admission is sought
- ▶ Information on the UCI for which the application is submitted
- ▶ Details of securities to be listed
- ▶ Name of the legal entities responsible for payment of the approval, listing, and maintenance fees
- ▶ Effective date of admission
- ▶ Declaration from the UCI seeking admission that it commits to comply with the EU and/or Luxembourg laws and regulations for the relevant market. A separate declaration from the UCI may be included with the application file instead of signing the declaration in the application form
- ▶ Auditor information

In practice, the documentation to be included in the application file would generally include the UCI's prospectus or offering document and any related supplements as well as the UCI's articles of association. The LuxSE will ensure that the prospectus or offering document complies with the *Rules and Regulations of the Luxembourg Stock Exchange*. If this is not the case, the LuxSE may request that the prospectus be amended accordingly. The listing procedures may be carried out by a listing agent on behalf of the UCI.

13.3.2. Contents of the application for "Securities Official List" ("LuxSE SOL")

The application for admission onto LuxSE SOL must specifically include the following documents:

- ▶ The Information Notice or any document having a similar purpose and containing at least the same data and information as included in the Information Notice (e.g., a prospectus duly approved by a competent authority)
- ▶ A declaration from the issuer in which it commits to comply with the requirements of the Rulebook
- ▶ The application must also mention, to the best of the issuer's (or applicant's) knowledge, where the securities are also listed and/or, as the case may be, admitted to trading
- ▶ KYC form for the SOL with proof of existence of the UCI. Other documents may be requested

- A written confirmation that:
 - The legal position and structure of the issuer comply with the applicable legislation and regulations relating to both its constitution and its operation under its articles of association
 - The legal position of the securities complies with the relevant applicable legislation and regulations
 - The administration of securities events and the payments of dividends and coupons shall be ensured and shall be made properly and in due time
- The articles of association of the issuer and, where applicable, of the guarantor, as well as their annual reports of the last three financial years, where applicable.

The Information Notice is subject to approval by LuxSE taking into account whether the Information Notice meets the Rulebook requirements or not. The Information Notice will be published on LuxSE's website.

The Information Notice must detail the securities and the issuer and needs to contain at least the following sections:

- Section A - Introduction and Warnings
- Section B - Issuer and any Guarantor
- Section C - Securities
- Section D - Risks
- Section E - Offers

13.3.3. General rules and conditions for admission to the *Bourse de Luxembourg*

To qualify for admission to the *Bourse de Luxembourg* (as the LuxSE's regulated market), the securities must be freely negotiable, which means that they are "capable of being traded in a fair, orderly, and efficient manner and to be negotiated freely".

In addition, the securities must be eligible for settlement in a recognized system by the LuxSE.

The LuxSE will consider the following when evaluating if an open-ended UCI's securities are "freely negotiable":

- The distribution of the securities to the public
- Whether there are appropriate market-making arrangements or whether the management body of the UCI provides appropriate alternative arrangements for investors to redeem the securities
- In the case of exchange-traded funds, whether in addition to market making arrangements appropriate alternative arrangements for investors to redeem units or shares are provided, at least in cases where the value of the units or shares significantly varies from the net asset value
- Whether the value of the securities is made sufficiently transparent to investors by means of the periodic publication of the net asset value (NAV)

With respect to a closed-ended UCI (see Section 2.3.) the LuxSE will consider the following:

- The distribution of the securities to the public
- Whether the value of the securities is made sufficiently transparent to investors either by publication of information on the UCI's investment strategy or by the periodic publication of the NAV

Non-UCITS are not required to comply with the registration, notification, or other procedures that are a necessary precondition for the marketing of the UCI in Luxembourg (see Chapter 12) if they are only seeking a listing.

13.3.4. General rules and conditions for admission to the Euro MTF

To enable admission to the Euro MTF, a UCI must generally comply with the conditions set out in Section 13.3.3. However, the LuxSE may grant a waiver to these conditions if they deem such a waiver is not detrimental to the principle of fair trading and a contravention of any other relevant listing provision.

13.3.5. General rules and conditions for admission to the official list

An application for admission to the official list without an application for admission to trading is possible subject to the conditions set out in the Rulebook - LuxSE Securities Official List. This Rulebook is not applicable for securities which are also intended to be admitted to trading on one of the markets operated by the LuxSE.

A closed-ended UCI is required to meet certain conditions before its securities are admitted to the official list. These include:

- The UCI must comply with the laws and regulations applicable to its constitution and its operation
- Minimum capital of EUR 1 million (a lower amount may be accepted if the UCI can demonstrate that there is an adequate market in the securities)
- The UCI has existed for the preceding three years and has filed its annual reports and audited financial statements for the preceding three years in accordance with relevant national laws (a derogation is possible subject to certain conditions)
- Sufficient public distribution (generally defined as 25%) of the entity's securities to the public has been made at the time of the admission to the official list (or confirmation that this will be achieved shortly thereafter) (applicable to BdL and Euro MTF)
- Securities must be freely transferable
- All securities of the same category must be listed
- Where physical form of securities exist, there must be appropriate disclosures and sufficient procedures to safeguard and protect investors

The admission to the official list of securities issued by UCIs other than a closed-end type is not subject to these conditions.

An application for admission to the official list without an application for admission to trading is possible subject to the conditions set out in the Rulebook - *LuxSE Securities Official List*. This Rulebook is not applicable for securities which are also intended to be admitted to trading on one of the markets operated by the LuxSE.

13.4. Continuing obligations for issuers of securities

13.4.1. Information to be made available to the public

UCIs must ensure equal treatment of all security holders (generally shareholders and unitholders) who are in identical situations.

13.4.1.1. UCIs admitted to the Bourse de Luxembourg

A closed-ended UCI admitted to the *Bourse de Luxembourg* is subject to the Transparency Directive, implemented in Luxembourg through the Law of 11 January 2008, as amended, (the "Transparency Law") and must comply with certain information requirements including the following:

- Periodic information:
 - Annual report, which must be made public within four months of each financial year-end. The report should comprise financial statements and the related audit report, a management report and a corporate governance statement
 - Semi-annual report, which must be made public within three months of the half year. The report should comprise a condensed set of financial statements, an interim management report and a corporate governance statement

On 5 October 2015, ESMA issued its *Guidelines on Alternative Performance Measures* aimed at promoting the usefulness and transparency of Alternative Performance Measures (APMs) included in prospectuses or regulated information, including management reports. The guidelines set out a common approach towards the use of APMs and are expected to benefit users and promote market confidence.

- Ongoing information:
 - Information on major holdings
 - Information for holders of securities admitted to trading on a regulated market

Open-ended UCIs admitted to the *Bourse de Luxembourg* are not within the scope of the Transparency Law. The periodic reporting requirements for open-ended UCIs are outlined in Section 10.5.

13.4.1.2. UCIs admitted to the Euro MTF

UCIs admitted to the Euro MTF are also subject to ongoing obligations. They must make available to the public:

- Financial statements prepared in accordance with the UCI's national legislation, related audit report thereon, and management report

- A semi-annual report on activities and results within four months of the end of the half year, except where the applicable national legislation does not require this. This report should include results of income and profit and a statement covering the six month period discussing significant information enabling investors to make an informed assessment of the UCI's activities and results and, as far as possible, referring to the UCI's expected future developments in the current financial year
- Information on any new developments including changes to structure (holders and breakdown of holders) of the major holdings of its capital
- Any amendments to the rights attached to the different categories of securities

13.4.1.3. UCIs admitted to the LuxSE SOL

Except equal treatment of all security holders (generally shareholders and unitholders) who are in identical situations, and the additional information to be provided to the LuxSE, as listed in Section 13.4.2., there are no other particular continuing obligations for issuers of UCIs admitted to the LuxSE SOL.

13.4.2. Information to be provided to the LuxSE

In addition to the information required to be made available to the public, UCIs whose securities are listed on one of the three securities markets operated by LuxSE must communicate to the LuxSE as early as possible and, in any case in advance of the event, any events affecting the listed securities. Such communications may include:

- Amendments to the rights of the securities
- Any merger or demerger
- Any change of transfer or paying agent
- Announcement of any distribution
- Payment and detachment of dividends
- Change of name of the UCI
- Important changes in activities or any modifications to the constitutional documents
- Notices of shareholders' meetings
- Any other useful information for investor protection

13.5. Listing of SIFs and RAIFs on the BdL and Euro-MTF

Because of their particular features, specifically that ownership of shares or units of SIFs and RAIFs is limited only to well-informed investors, specific and *ad hoc* solutions are required to ensure shares or units are distributed only to well-informed investors (see Sections 2.4.2. and 2.4.3.).

13.6. Transfer, suspension, withdrawal, and delisting

Securities of a UCI may be transferred, suspended, or withdrawn from trading at the request of the issuer or by decision of the LuxSE. A decision to withdraw or delist from trading is also taken to mean a decision to remove from the official list. If the issuer requests securities be transferred, suspended, or withdrawn, reasons justifying the request must be provided.

The LuxSE may decide to suspend or withdraw securities of a UCI from trading/listing if the securities or their issuers no longer comply with the relevant rules and regulations.

The LuxSE may decide to transfer the securities from the *Bourse de Luxembourg* to the Euro MTF when the issuer does not comply with the regulatory provisions applicable to securities admitted to trading on a regulated market.

The LuxSE may also decide to delist a security if it believes that a normal and consistent market for the security cannot be maintained.

The failure to comply with AML/KYC obligations is also a potential cause for termination of membership by the LuxSE.

Decisions to transfer, suspend, withdraw, or delist securities will be published on the LuxSE's internet site and will also be communicated to the CSSF. LuxSE may request the issuer to publish a press release to this effect and to make such an announcement sufficiently in advance to give a reasonable timeframe between the announcement and the date on which the suspension or withdrawal becomes effective.

14

Sustainable finance

EY supports IFMs and UCIs in integrating sustainability factors throughout the value chain, including:

- ▶ Setting up policies and procedures on the integration of sustainability risks for fund products
- ▶ Setting up processes to identify and monitor adverse sustainability impacts of investments
- ▶ Implementing due diligence of investee companies regarding their sustainability performance
- ▶ Reporting on sustainability-related performance
- ▶ Providing assurance on sustainability indicators and related processes (ISAE 3000)



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14.1. Introduction

This chapter describes the minimal upcoming requirements applicable to IFMs and UCIs with regards to Environment, Social and Governance (ESG) factors and risks, as well as the requirements applicable to UCIs which aim to make a positive contribution to those factors.

To meet the ambitious targets set by the UN 2030 Sustainable Development Goals (SDGs) and the EU's environmental and climate action objectives by 2050, the capital markets are becoming an essential channel of savings into investments which enable sustainable projects and allow access to wider sources of capital. In this context, the European Commission published an action plan for financing sustainable growth (the "EU Action Plan") in March 2018. The European Commission adopted a package of measures on sustainable finance, with the aim to:

- Reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth
- Assess and manage relevant financial risks stemming from climate change, resource depletion, environmental degradation and social issues
- Foster transparency and long-termism in financial and economic activity

In December 2019, the European Commission renewed its commitment to Sustainable Development with the European Green Deal. To achieve its ambitions, the EU aims to mobilise investment and help to unlock private funds through the EU budget and associated instruments - the "Green Deal Investment Plan". In addition, in April 2020, the Commission launched a consultation to update its sustainable finance strategy.

The UCITS Directive and AIFMD draft delegated acts published on 8 June 2020 clarify notably the duties of IFMs to take into account the social and environmental factors and risks in their governance, organization, conflicts of interest policies, investment due diligence as well as their risk policies and procedures.

Pursuant to MiFID draft delegated acts published on 8 June 2020, investment firms will be required to integrate investors' sustainability preferences, i.e., the appetite of their clients for dark green and light green products, as defined in sustainable finance disclosure regulation, in product governance, financial advice, portfolio management and distribution activities. *Ex-post* information disclosure, relying on UCI and IFM disclosures, will be required to explain how a recommendation to the client to purchase an investment fund meets his investment objectives, risk profile, capacity for loss bearing and sustainability preferences.

The sustainable finance action plan will bring significant changes in the investment fund value chain:

Impact on the whole asset management chain

		EU Taxonomy	MiFID II	AIFMD/UCITS	Disclosure	Benchmark
		31.12.2021	Q3 2021	Q3 2021	March 2021	30.04.2020
Asset Manager Value Generation	Strategy & Organization	Indirect	Indirect	Direct	Indirect	Indirect
	Products & Distribution	Direct	Direct	Indirect	Direct	Indirect
	Risk & Performance	Direct	Indirect	Direct	Indirect	Indirect
	Data & Reporting	Direct	Direct	Direct	Direct	Indirect

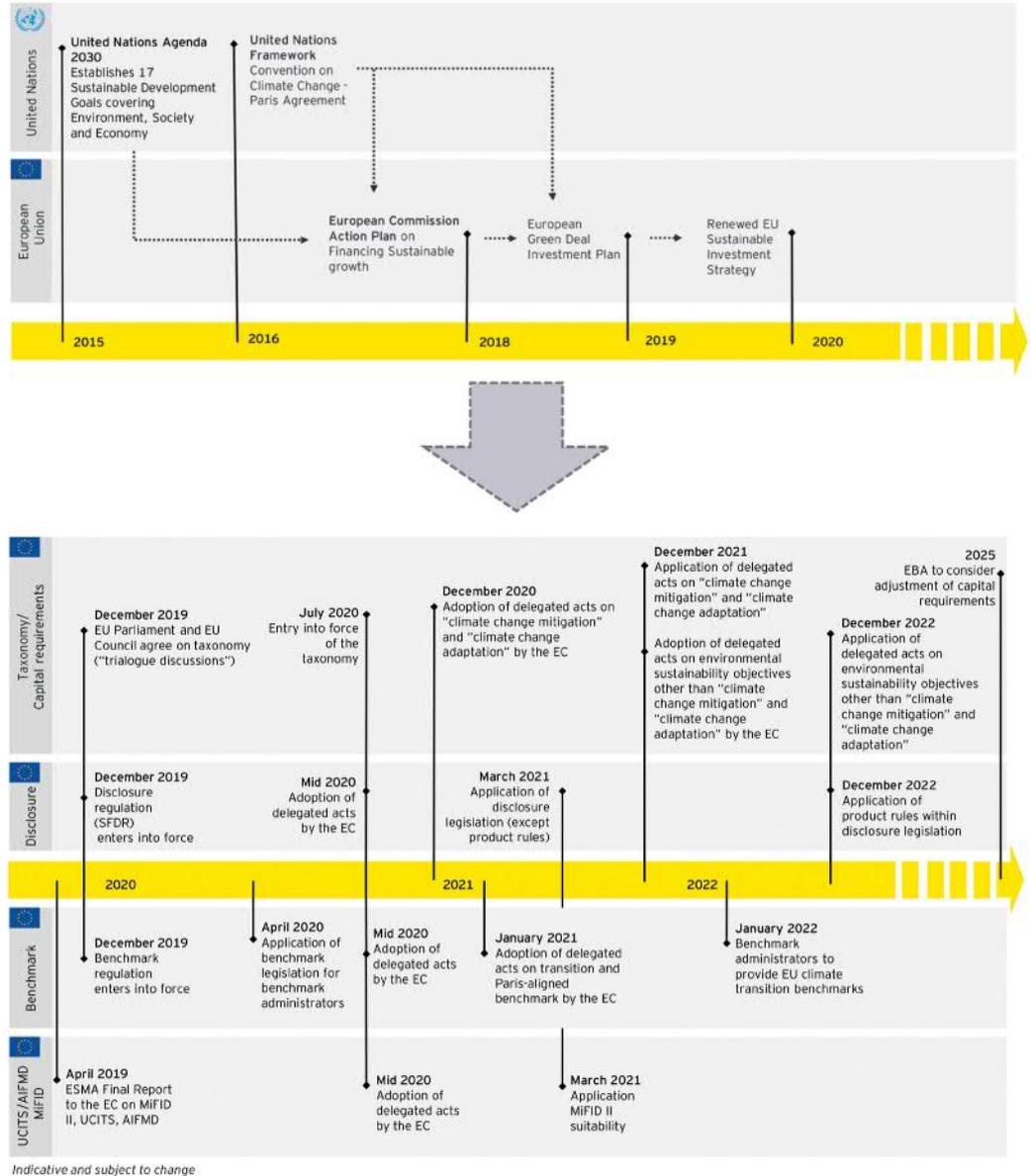
This chapter focuses on the obligations directly impacting IFMs and UCIs, arising from the following regulations:

- Regulation (EU) 2019/2088 of 27 November 2019 on *sustainability - related disclosures in the financial services sector* (the "sustainable finance disclosure regulation" or "SFDR")
- Regulation (EU) 2020/852 of 18 June 2020 on *the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088* (the "Taxonomy regulation" or "Taxonomy")
- UCITS Directive and AIFMD draft delegated acts amending, respectively:
 - Delegated Regulation No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU (the AIFMD) as regards sustainability risks and sustainability factors to be taken into account by alternative investment fund managers
 - Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC (the UCITS Directive) as regards the sustainability risks and sustainability factors to be taken into account for undertakings for collective investment in transferable securities

Other regulations that may also impact EU-based IFMs and UCIs are mentioned in Section 14.6.

The graphic below summarizes the international sustainability initiatives and the expected timeline of related EU regulatory developments:

The impact of international sustainability commitments on the EU investment fund regulatory framework



14.2. EU legislative initiatives regulating the ESG framework for UCIs and their IFMs

14.2.1. Sustainability related disclosures in the financial services sector

SFDR aims to harmonise disclosures for end investors on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives and on the promotion of environmental or social characteristics in investment decisionmaking and in advisory processes.

By setting specific disclosure requirements at the IFM and UCI level, this regulation sets out the various minimum operational elements to consider in order to integrate ESG factors, for all financial products, throughout the product lifecycle.

Disclosure requirements of the SFDR are covered in Section 14.5.

Key dates	
27 November 2019	Publication in the Official Journal of the EU
30 December 2020	ESAs ³¹⁰ to develop Regulatory Technical Standards (RTS) on the application of the requirements for the disclosures of: <ul style="list-style-type: none"> ▸ Information relating to the principle of “do no significant harm” ▸ Entity level adverse sustainability impacts on environmental and climate factors ▸ Information relating to the promotion of environmental or social characteristics promoted by a financial product in the product’s pre-contractual disclosures, on its product’s website and in its periodic report ▸ Information relating to the sustainable investment objective of a financial product in the product’s pre-contractual disclosures, on its product’s website and in its periodic report
10 March 2021	All requirements are applicable, except for those specifically listed below in this table
30 June 2021	Large IFMs (more than 500 employees) to publish a statement on the principal adverse impacts of their investment decisions on sustainability factors
30 December 2021	ESAs to develop RTS on the application of the requirements for the disclosures of entity level adverse sustainability impacts on social and governance factors
1 January 2022	Requirements regarding the information to be included in the periodic reports of products that promote environmental or social characteristics and products with a sustainable investment objective are applicable
30 December 2022	Requirements regarding the consideration of principal adverse sustainability impacts of investment decisions at the product level are applicable

In January 2020, ALFI issued a first edition of *ALFI Guidance on sustainability - related disclosures*, focused on Level 1 Regulation and providing, *inter alia*:

- Clarification on meaning and definition of sustainability intensity
- Definitions
- Detailed disclosure requirements
- Guidance on the integration of ESG data
- Selected examples of sustainability factors

The document is expected to evolve to reflect future regulatory developments such as the related RTS and the EU Taxonomy.

³¹⁰ European Supervisory Agencies (European Securities and Market Authority, European Banking Authority and European Insurance and Occupational Pensions Authority)

14.2.2. The Taxonomy

The European Commission set up a Technical Expert Group on sustainable finance (TEG) to assist it in developing, amongst other matters, an EU classification system - the so-called EU taxonomy - to determine whether an economic activity is environmentally sustainable.

This initiative resulted in the Regulation (EU) 2020/852 on *the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088* (the Taxonomy regulation).

The EU Taxonomy Regulation should enable investment fund managers (“IFMs”) to gather reliable, consistent and comparable sustainability related indicators from investee companies and incorporate this data into their investment decision and risk management process and fulfil their disclosure duties under SFDR.

The EU Taxonomy Regulation also provides further details on the content of sustainability-related disclosures required in pre-contractual and periodic reports of environmentally sustainable investment funds and investment funds promoting environmental characteristics.

The Taxonomy regulation defines the minimum criteria which economic activities must comply with in order to be considered environmentally sustainable:

- ▶ An environmentally sustainable economic activity contributes substantially to one or more of the following environmental objectives:
 - ▶ Climate change mitigation
 - ▶ Climate change adaptation
 - ▶ Sustainable use and protection of water and marine resources
 - ▶ Transition to a circular economy
 - ▶ Pollution prevention and control
 - ▶ Protection and restoration of biodiversity and ecosystems
- ▶ It does not significantly harm any of the other environmental objectives
- ▶ It is carried out in compliance with minimum safeguards set out in the regulation (including the OECD Guidelines for Multinational Enterprises, the International Labour Organisation, etc.)
- ▶ It complies with the technical screening criteria developed by the Technical Expert Group (delegated acts, applicable from 1 January 2022 for climate-related objectives and from 1 January 2023 for the other objectives)

An activity, referred to as “enabling activity”, can be considered to be contributing substantially to one or more environmental objective(s) laid down by the Taxonomy if it directly enables other activities to contribute to these objectives, provided that such economic activity:

- ▶ Does not lead to a lock-in of assets that undermine long-term environmental goals, considering the economic lifetime of those assets
- ▶ Has a substantial positive environmental impact, on the basis of life-cycle considerations

An activity, referred to as a “transitional activity”, can be considered to be contributing substantially to the environmental objective of climate change mitigation under the following conditions:

- ▶ There is no technologically and economically feasible low-carbon alternative
- ▶ It supports the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1.5°C above pre-industrial levels
- ▶ That activity:
 - ▶ Has greenhouse gas emission levels that correspond to the best performance in the sector or industry
 - ▶ Does not hamper the development and deployment of low-carbon alternatives, and
 - ▶ Does not lead to a lock-in of carbon-intensive assets, considering the economic lifetime of those assets

The Taxonomy regulation also lays down disclosure obligations that supplement the SFDR and the Non Financial Reporting Directive (“NFRD”) with regards to activities that contribute to an environmental objective:

- ▶ Undertakings that are required to report on non-financial information under the NFRD must include in their non-financial statement:
 - ▶ The proportion of their turnover derived from products or services associated with environmentally sustainable economic activities
 - ▶ The proportion of their capital expenditures (“CAPEX”) and of their operating expenditures related to assets or processes associated with environmentally sustainable activities

- Financial products that invest in environmentally sustainable economic activities must disclose the proportion of investments in environmentally sustainable activities selected for the financial product, including the proportion of enabling and transitional activities, as a percentage of all investments selected for the financial product. This information shall be disclosed in the pre-contractual disclosures and in the periodic report³¹¹

The Taxonomy regulation will be further developed over time to cover economic activities that are socially sustainable.

Key dates	
18 June 2020	Publication in the Official Journal of the EU
31 December 2020	Adoption of delegated acts for the technical screening criteria with respect to climate-related objectives
31 December 2021	1) Adoption of delegated acts for the technical screening criteria with respect to all other environment-related objectives 2) Commission to publish a report describing the provisions that would be required to extend the scope of the Taxonomy to cover: <ul style="list-style-type: none"> ▸ Economic activities that do not have a significant impact on environmental sustainability ▸ Economic activities that significantly harm environmental sustainability ▸ Specific disclosure requirements related to enabling and transitional activities ▸ Other sustainability objectives, such as social objectives
1 January 2022	Application of the requirements for climate-related objectives
1 January 2023	Application of the requirements for all other environment-related objectives

14.2.3. Incorporation of sustainability risks and factors in the UCITS/AIFM Directives

The European Commission published amendments to the UCITS and the AIFM Directives so that management entities will be expected to integrate sustainability risks and, where applicable, the principal adverse impacts of their investment decisions on sustainability factors (see Section 14.3.1.).

On 8 June 2020, the European Commission published UCITS Directive and AIFMD draft delegated acts providing very similar requirements.

UCITS (delegated directive)	AIFMD (delegated regulation)
Alignment of definition of sustainability risks with SFDR	
Requirement to consider sustainability risks in management companies or AIFMs:	
<ul style="list-style-type: none"> ▸ Establishment, implementation and maintenance of clear and document decision-making procedures and organizational structure specifying reporting lines ▸ Allocation of responsibilities with proper discharge ▸ Internal control mechanisms to ensure compliance with decisions and procedures ▸ Internal reporting and communication and effective information flows with any third party involved ▸ Maintenance of adequate and orderly records of business and internal organization 	
Requirement to maintain resources and expertise for the effective integration of sustainability risks	
Requirement to integrate sustainability risks in the management of UCITS in a proportionate manner	

³¹¹ Annual report as defined in UCITS Directive, AIFMD, EuVeCA Regulation and EuSEF Regulation

UCITS (delegated directive)	AIFMD (delegated regulation)
<p>Requirement to ensure that senior management of the management company is responsible to take sustainability risks into account in:</p> <ul style="list-style-type: none"> ▶ The implementation of the investment policy in the prospectus, the fund rules, the instrument of incorporation or the offering documents ▶ The investment strategies' approval process ▶ The compliance function ▶ The investment policy/strategy/risk limits implementation/compliance for each managed UCITS ▶ The approval/periodic review of the adequacy of internal procedures for undertaking investment decisions for each managed UCITS ▶ The approval/periodic review of the risk management policy, arrangements, processes and techniques, including the risk limit system 	<p>Requirement to ensure that senior management of the AIFM is responsible to take sustainability risks into account in:</p> <ul style="list-style-type: none"> ▶ The implementation of the investment policy in the prospectus, the fund rules, the instrument of incorporation or the offering documents ▶ The investment strategies' approval process ▶ The valuation policies ▶ The compliance function ▶ The investment policy/strategy/risk limits implementation/compliance for each managed AIF ▶ The approval/periodic review of the adequacy of internal procedures for undertaking investment decisions for each managed AIF ▶ The approval/periodic review of the risk management policy, arrangements, processes and techniques, including the risk limit system ▶ The remuneration policy
<p>Requirement to identify conflicts of interest arising from the integration of sustainability risks in processes, systems and controls</p>	
<p>Consideration of sustainability risks and, where applicable, principal adverse impacts of investment decisions on sustainability factors when applying investment due diligence requirements</p>	
<p>Requirement to consider sustainability risks in the risk management policy</p>	

14.3. Rules applicable to IFMs

This section presents the SFDR rules which will become progressively applicable to IFMs. Organizational rules contained in UCITS Directive and AIFMD delegated acts are in draft form and are subject to change.

14.3.1. Investment decision-making process

Financial market participants and advisors are expected to integrate relevant sustainability risks in their assessment of financial risks. A sustainability risk is a risk resulting from an environmental, social or governance event or condition that, if it occurs, could cause a material negative impact on the value or the financial return of an investment.

All IFMs must publish on their website information about their policies on the integration of sustainability risks in their investment decision-making processes. When IFMs amend that information, they must publish a clear explanation of such amendment on the same website.

14.3.2. Remuneration policies

IFMs must include in their remuneration policies how those policies are consistent with the integration of sustainability risks. The aim is to ensure that remuneration policies do not encourage excessive risk-taking with respect to sustainability risks and that these policies are linked to risk-adjusted performance.

This information must be disclosed and kept up to date on the IFM's website. When IFMs amend this information, an explanation of such amendment is also required on the IFM's website.

As part of the EU Action Plan on financing sustainable growth, the ESAs have been mandated to collect evidence and stakeholders' views on undue short-term pressure from financial markets on corporations that may lead to unnecessary exposure in the long term to sustainability risks.

ESMA believes that sustainability risks could include risks associated with short-termism. ESMA advises the Commission to monitor the effects of the SFDR and of the new requirements on remuneration policies, as it believes it could have a positive impact on fostering long-termism in investment decisions.

14.3.3. Consideration of adverse sustainability impacts

An activity is considered sustainable when it does not significantly harm any sustainability objective. One of the objectives of the SFDR is to ensure that entities disclose relevant information regarding their actual adherence to this principle where their financial products invest in sustainable investments. Information on principal adverse impacts is thus particularly helpful to assess whether and how investments comply with the principle of “do no significant harm” (“DNSH”).

The SFDR also aims at harmonising the disclosures on the adverse impacts of investments on sustainability factors to increase the level of comparability of information.

IFMs should define whether and how they consider the principal adverse impacts (“PAIs”) of their investments and investment decisions on sustainability factors and disclose such information.

A. Scope and exemptions

The requirements apply to:

- ▶ IFMs and parent IFMs employing less than 500 persons. If IFMs and parent IFMs between 3 and 500 persons do not consider PAIs, they must provide on their website an explanation of why PAIs are not considered by 10 March 2021
- ▶ IFMs and parent IFMs employing more than 500 persons on a mandatory basis. They must comply with the requirements by 30 June 2021

B. Requirements for management entities that must or wish to comply

Information on PAIs must be made available on the managing entity's website along with a description of the related due diligence policy and the PAIs considered.

The Joint Committee of the European Supervisory Agencies launched a consultation on 23 April 2020 including draft regulatory technical standards (“draft RTS”) covering the information required to comply with the disclosures relating to PAIs.

C. Requirements for management entities that do not consider PAIs

Entities should assess the relevance of considering at least the mandatory PAIs. Where IFMs do not consider PAIs, they should disclose the clear reasons why not by 10 March 2021.

If they intend to consider those PAIs in the future, they shall be able to define when they intend to do so.

14.4. Rules applicable to UCIs

This section introduces the rules which will progressively become applicable at the level of UCIs.

14.4.1. Requirements for all UCIs

The SFDR requires that pre-contractual documents (or offering documents) of UCIs include information regarding:

- The integration of sustainability risks in the investment decisions of the investment vehicle
- The consideration of the adverse impacts of the investments of the UCI on sustainability factors

The pre-contractual disclosures (or offering documents) referred to in the SFDR are:

- For PEPPs, IORPs and all individual pension products: short consumer-facing documents, including a KID in the case of the PEPP
- For other products: longer pre-contractual documentation, such as a UCI prospectus

A. *Integration of sustainability risks*

UCIs should identify where, and to what extent, the consideration of sustainability risks for their financial products is deemed relevant and define due diligence processes accordingly for underlying investments and investment decisions. The due diligence set up should allow UCIs to assess the likely impacts of sustainability risks on its returns.

From 10 March 2021, pre-contractual documents of UCIs must include descriptions of:

- How sustainability risks are integrated into their investment decisions
- The results of the assessment of the likely impacts of sustainability risks on the UCI's returns

Where the consideration of sustainability risks is deemed not relevant to the UCI, the descriptions should include a clear and concise explanation of why not.

B. *Consideration of adverse sustainability impacts*

UCIs should define whether and how they consider the adverse sustainability impacts of their investments, consistently with the policy defined at the IFM level (see Section 14.2.3.).

From 30 December 2022, pre-contractual documents of UCIs shall include a clear and reasoned explanation of whether, and, if so, how the UCI considers the principle adverse impacts ("PAIs") of its investments on sustainability factors.

Where the management entity does not consider PAIs (see Section 14.3.3.C.), the pre-contractual documents of its managed UCIs should include a statement that the management entity does not consider the adverse impacts of investment decisions on sustainability factors, and the reasons thereof.

14.4.2. Requirements for ESG products

Since the final SFDR RTS have not been defined at the time of this publication, certain rules described in this section are subject to change.

A. *Defining and launching the product*

The EU legislation recognizes, through the SFDR, different levels of sustainability intensity that a UCI may apply when it comes to the integration of ESG factors into its investment strategy.

ESG Strategy	EU definition
Financial products commonly referred to as “light green” products	Financial products that take into account sustainability factors in investment decisions, among other characteristics, but which do not have sustainable investment as an objective
Financial products commonly referred to as “dark green” products	<p>Financial product that have sustainable investment as an objective.</p> <p>A sustainable investment is an investment in:</p> <ul style="list-style-type: none"> ▸ Economic activities that contribute to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or ▸ Economic activities that contribute to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or ▸ Human capital or economically or socially disadvantaged communities <p>provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance</p>

The Taxonomy regulation provides a legal definition of economic activities that contribute to environmental objectives (see Section 14.2.2.).

When UCIs define their investment strategies, they must clearly define the strategy’s binding elements to select the investments, to attain the environmental or social characteristics, or the sustainable investment objectives. This strategy must be implemented in the investment process on a continuous basis.

Where the IFM commits to reduce the UCI’s investment universe by a minimum rate prior to the application of the strategy, that rate must be clearly defined by IFMs.

The product committee review of the UCI should:

- Consider and understand the legislative requirements relevant to the chosen strategy
- Review the technical criteria of the environmental or social characteristics, or the sustainable investment objectives

The UCI should be able to provide a description of the environmental or social characteristics, or the sustainable objective of the product.

Where UCIs consider using a reference benchmark index, the degree of alignment of the benchmark with the environmental or social characteristics promoted or the sustainable investment objective of the product needs to be assessed.

UCIs that choose to pursue one of the EU-recognized ESG strategies must take operational measures throughout the financial product lifecycle to ensure that it attains the environmental or social characteristics promoted by the product, or its sustainability objectives. These are covered in the following subsections.

B. Investment process

UCIs must set up due diligence processes to be carried out on the underlying assets on specific ESG aspects related to the environmental or social characteristics promoted by the product, or its sustainability objectives.

To this end, UCIs must define a policy to assess good governance practices of investee companies. For dark green products, the UCIs should assess good governance practices in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

As part of their risk-based due diligence, IFMs should pay attention to what extent investee companies, and other issuers disclosures cover Taxonomy required information on whether they:

- Comply with minimum safeguards
- Embed responsible business conduct into their policies and management systems
- Identify, assess, prevent or mitigate actual or potential adverse impacts
- Gain and use leverage to prevent and mitigate the impacts
- Track performance
- Communicate and report publicly
- Enable remediation when appropriate

Significant challenges are expected for investments in EU companies and bond issuers that do not fall under the scope of the NFRD, and non-EU companies. In such situations, the EU Technical Expert Group recommends a five-step approach:

- Identify the activities conducted by the company or issuer or those covered by the financial product (e.g., projects, use of proceeds) that could be aligned, and for which environmental objective(s)
- For each potentially aligned activity, verify whether the company or issuer meets the relevant screening criteria - e.g., electricity generation <100 g CO₂e/kWh
- Verify that the DNSH criteria are being met by the issuer. IFMs would most likely use a due diligence-type process for reviewing the performance of underlying investees and would rely on the legal disclosures of eligibility from those investees
- Conduct due diligence to avoid any violation of the social minimum safeguards
- Calculate alignment of investments with the Taxonomy and prepare disclosures at the investment product level

By 10 March 2021, UCIs making available light or dark green products shall publish details of the due diligence and screening criteria on their websites.

Due diligence processes and policies on good governance practices should be particularly relevant when investing internationally as standards in areas of governance and sustainability-related performance may differ across countries.

C. Monitoring the UCI's ESG performance through sustainability indicators

UCIs that choose to adopt one of the EU recognized ESG strategies must monitor the ESG performance of their product and the attainment of the environmental or social characteristics, or the sustainability objectives of the UCI throughout its lifecycle.

To this end, UCIs must:

- Define methodologies that permit the measurement of the attainment of the environmental or social characteristics, or the sustainability objective of the product
- Identify sustainability indicators that will be used consistently with the methodologies to quantitatively measure the attainment of the environmental or social characteristics, or the sustainability objective of the product (see point "Sustainability indicators" below)
 - UCIs must identify suitable data sources, or estimate data, to monitor sustainability indicators, and take appropriate measures to ensure data quality
 - The chosen indicators must allow historical comparison
 - UCIs may consider having sustainability indicators assured or reviewed by a third party
- Set up processes to monitor the environmental or social characteristics or the sustainable objectives and the sustainability indicators throughout the lifecycle
- Set up internal and external control mechanisms on those monitoring processes

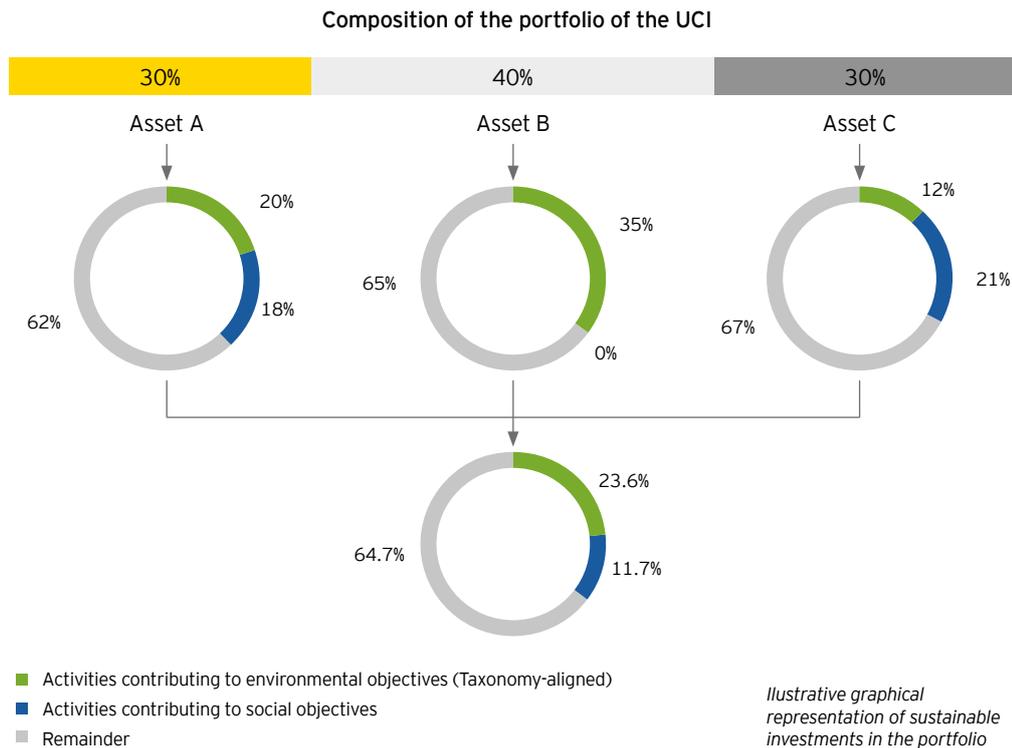
UCIs must identify any limitations to the methodologies and the data sources as well as how such limitations may or may not impact the attainment of its environmental or social characteristics. UCIs must take actions to address such limitations.

Light green or dark green UCIs must also monitor the composition of their portfolio to reflect the proportion of investments that are sustainable investments, with a subdivision between environmentally and socially sustainable investments. UCIs must plan this composition and disclose it in pre-contractual information and on the UCI's website. The periodic report should contain the proportions during the reference period.

The disclosures of investee companies should enable investment funds to report the proportion of their fund invested in Taxonomy-aligned activities for each investee company. For climate change mitigation, turnover can be recognised where an economic activity meets the Taxonomy technical screening criteria for substantial contribution to climate change mitigation and relevant DNSH criteria. For climate change adaptation, turnover can be recognised only for activities enabling adaptation but not for adapted activities.

Companies that disclose their capital expenditures in economic activities in a Taxonomy-aligned manner will be providing invaluable information for constructing green portfolios, and for analysing companies' transition plans and/or environmental sustainability performance and strategies.

The proportion of sustainable investments of a portfolio may be calculated and graphically represented as follows:



UCIs must monitor the PAIs of their investments to ensure that they comply with the principle of “do no significant harm”.

Where an index has been designated as a reference benchmark for the financial product, the UCI must be able to compare the performance of the financial product with regards to the indicators measuring the sustainability factors of the index.

The draft RTS of the SFDR details the disclosure requirements relating to the monitoring of the ESG performance of light green and dark green products.

D. Fund management

Internal audit

The internal audit function of the IFM, the self-managed UCITS or the internally managed AIF choosing to pursue one of the EU-recognised ESG strategies must assess whether the UCI complies with:

- ▶ All relevant and specific regulations
- ▶ The binding elements of the UCI's strategy and its commitments in terms of ESG

UCIs should set up appropriate internal controls and consider all relevant ESG-related knowledge and expertise when reviewing the UCI's compliance with the above.

Risk Management, AML and KYC

UCIs should identify where and to what extent the consideration of sustainability risks on their financial products is deemed relevant.

Additional safeguards regarding AML and KYC rules to integrate the specificities of investments in sustainability-related projects should also be considered and established .

With a potentially enhanced attractiveness or visibility of sustainability-related activities, financial products such as UCIs that invest in such activities may be subject to greater risks of money laundering and may justify enhanced due diligence measures.

Compliance

The compliance function of UCIs should integrate processes to control the UCI's compliance with the ESG-related regulations and should be able to take appropriate remediation actions, in cases of non-compliance.

E. Distribution

The SFDR requires financial advisers to disclose how they take sustainability risks into account in the selection process of the financial product that is presented to the end investors before providing the advice, regardless of the sustainability preferences of the end investors.

The European Commission intends to require financial product distributors to include the ESG preferences of their clients in suitability assessments through the amendment of MiFID II (see Section 14.6.3.). Therefore, financial products promoting environmental or social characteristics or financial products with a sustainable investment objective may easily meet their target markets.

The future EU Ecolabel for financial products should provide clarity for financial advisors and retail investors as per which products are the best environmentally performing products.

14.5. Summary of reporting and disclosure requirements

Sustainability disclosures are required to be made in the following:

- Manager's website,
- UCI prospectus/offering documentation, and
- UCI periodic reporting.

As a general consideration, marketing communications must not contradict sustainability-related disclosures included in other supporting infrastructure and documentation.

14.5.1. IFM level disclosures

Supporting infrastructure and documentation	Disclosure item	Level 1 requirements	Level 2 requirements	Application date
Website	Integration of sustainability risks	<ul style="list-style-type: none"> ▸ Information on how policies embed sustainability risks in the investment decision-making process for financial market participants (and financial advisers) ▸ Information on how the remuneration policies are consistent with the integration of sustainability risks 	None	10/03/2021 Comply
	Consideration of principal adverse impacts	<ul style="list-style-type: none"> ▸ Information on whether PAIs are considered and a statement on due diligence policies with respect to those impacts (identification, prioritization, mitigation actions, engagement policy, reference to conduct codes or standards for due diligence and reporting) 	Draft RTS by 30/12/2020 for environmental impacts and 30/12/2021 for social impacts	10/03/2021 Comply or explain 30/06/2021 Large IFMs to comply
UCI prospectus/ offering document	Integration of sustainability risks	<ul style="list-style-type: none"> ▸ Information on how policies embed sustainability risks in the investment decision-making process ▸ The results of the assessment of the likely impacts of sustainability risks on the returns of the financial products IFMs make available ▸ Where IFMs deem sustainability risks not to be relevant, a clear and reasonable explanation of the reasons should be provided through pre-existing disclosures as referred to in the relevant sectoral legislation (e.g., AIFMD/ UCITS/MIFID) 	None	10/03/2021 Comply or explain

14.5.2. UCI level disclosures

Supporting infrastructure and documentation	Disclosure item	Level 1 requirements	Level 2 requirements	Application date
Website	Financial products with environmental or social characteristics or with a sustainable investment objective	<ul style="list-style-type: none"> ▸ Description of the environmental or social characteristics or their sustainable investment objective ▸ Information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investment, including the data sources, screening criteria and the relevant sustainability indicators ▸ Information which is required in pre-contractual documentation and the periodic reports ▸ When amending the information above, IFMs must publish a clear explanation of such amendments on the same webpage 	Drafts RTS by 30/12/2020	10/03/2021 Comply
UCI prospectus/ offering document	Integration of sustainability risks	<ul style="list-style-type: none"> ▸ Information on how policies embed sustainability risks in the investment decision-making process ▸ The results of the assessment of the likely impacts of sustainability risks on the returns of the financial products IFMs make available ▸ Where IFMs deem sustainability risks not to be relevant, a clear and reasonable explanation of the reasons should be provided through pre-existing disclosures as referred to in the relevant sectoral legislation (e.g., AIFMD/ UCITS/MIFID) 	None	10/03/2021 Comply or explain
	Consideration of principal adverse impacts	<ul style="list-style-type: none"> ▸ IFMs, whether they consider PAIs on a voluntary or mandatory basis, should provide a clear and reasoned explanation of whether, and if so how a UCI they manage considers PAIs. Offering documents should include a statement that information on PAIs is available in periodic reports . For IFMs who do not consider PAIs, each UCI prospectus/offering document should include a statement that the IFM does not consider PAIs and the reasons therefore 	None	30/12/2022 Comply or explain

Supporting infrastructure and documentation	Disclosure item	Level 1 requirements	Level 2 requirements	Application date
UCI prospectus/ offering document (cont'd)	Financial products with environmental or social characteristics or with a sustainable investment objective	<ul style="list-style-type: none"> ▶ Information on how these characteristics are met or on how the sustainable objective is to be attained should be included in the offering documentation ▶ Where an index has been designated as a reference benchmark, information should be provided on whether and how this index is consistent with those characteristics or this objective. Offering documents should indicate where the methodology used for the calculation of that index can be found ▶ Where the objective of the UCI is to reduce carbon emissions, disclosure should include the objective of low carbon exposure in view of achieving the long-term global warming objectives of the Paris Agreement. Where no EU CTB³¹² or EU PAB³¹³ is available, a detailed explanation must be provided concerning the continued effort undertaken to attain the objective to reduce carbon emissions in view of achieving the long-term global warming objective of the Paris Agreement 	Draft RTS by 30/12/2021	10/03/2021 Comply
Periodic reports	Financial products with environmental or social characteristics or with a sustainable investment objective	<ul style="list-style-type: none"> ▶ Where a UCI is promoting environmental or social characteristics, the periodic report should include a description of the extent to which those characteristics are met ▶ Where a UCI has a sustainable investment objective, the periodic report should describe the sustainability impact of the product and disclose relevant sustainability indicators ▶ Where an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the UCI with the impact of the designated index and of a broad market index through sustainability indicators ▶ Luxembourg UCIs may use the information in management reports in accordance with Article 1720-1(1) of the Law of 10 August 1915, as amended, or the information in non-financial statements in accordance with Article 1730-1(2), where appropriate 	Draft RTS by 30/12/2020	01/01/2022 Comply
	Consideration of principal adverse impacts	<ul style="list-style-type: none"> ▶ Information on PAIs should be included in periodic reports 	None	30/12/2022 Comply or explain

³¹² EU Climate Transition Benchmarks

³¹³ EU Paris-Aligned Benchmarks

14.6. Other legislative initiatives impacting IFMs and UCIs

14.6.1. The non-financial reporting directive

Directive (EU) 2014/95 on non-financial reporting, published in the Official Journal of the EU on 22 October 2014, transposed into Luxembourg law by the law of 26 July 2016 and applicable since 1 January 2017, requires large undertakings which are public interest entities (PIEs) to disclose information on:

- Environmental, social and employee matters
- Respect for human rights
- Anti-corruption and bribery matters

The information disclosed should include:

- A brief description of the undertaking's business model
- A description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented
- The outcome of those policies
- The principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks
- Non-financial key performance indicators relevant to the particular business

The NFRD is supplemented by non-binding guidelines on methodology for reporting non-financial information.

The NFRD is applicable to PIEs, which are primarily:

- Listed companies
- Credit institutions

Stakeholders had been invited to provide feedback before 11 June 2020 to the European Commission on the policy options envisaged to address the short comings of the current NFRD. The revision notably aims at addressing the current lack of available adequate non-financial information for investors to be able to take account of sustainability-related risks, opportunities and impacts in their investment decisions. The revision also aims at widening the scope to require a wider range of undertakings to report non-financial information.

14.6.2. The low-carbon benchmark regulation

The European Parliament and the Council adopted Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 *amending Regulation (EU) 2016/1011* (hereinafter the "Benchmark regulation") *as regards EU Climate Transition Benchmarks, EU Paris-Aligned Benchmarks and sustainability-related disclosures for benchmarks*.

It introduces two types of benchmarks whose main characteristics are:

- EU Climate Transition Benchmarks (EU CTB)
 - The whole portfolio of the benchmark must be on a decarbonization trajectory
 - Decarbonized trajectory must be measurable, science-based and time-bound towards alignment with the objectives of the Paris Agreement
 - Underlying assets do not significantly harm any other ESG objectives
- EU Paris-Aligned Benchmarks (EU PAB)
 - The whole portfolio's carbon emissions must be aligned with the objectives of the Paris Agreement
 - Underlying assets should not significantly harm any other ESG objectives

The regulation also covers new sustainability-related disclosures for benchmark providers and administrators.

Key dates

27 November 2019	Publication in the Official Journal of the EU
30 April 2020	Benchmark administrators which provide an EU CTB or an EU PAB should comply with the LCBR
1 January 2021	Adoption of delegated act for identifying the sectors to be excluded for EU PAB
1 January 2022	Benchmark administrators located in the EU to provide one or more EU CTB
31 December 2022	Administrators of EU CTB to comply with the related requirements for selecting, weighting or excluding underlying assets

14.6.3. Amendments to MiFID II

The European Commission intends to amend the delegated directives of MiFID II to require MiFID firms selling UCIs to integrate their clients' preferences in terms of ESG considerations.

On 8 June 2020, the European Commission published the drafts of the Regulation and Directive respectively amending:

- ▶ Delegated Regulation No 2017/565/EU supplementing MiFID II³¹⁴ as regards the integration of sustainability factors, risks and preferences into certain organizational requirements and operating conditions for investment firms
- ▶ Delegated Directive 2017/593/EU supplementing MiFID II as regards the integration of sustainability factors and preferences into the product governance obligations

The draft amendments to the Delegated Directive and Regulation display the European Commission's intent to require MiFID II companies to:

- ▶ Take sustainability risks into account when:
 - ▶ Complying with general organizational requirements
 - ▶ Setting up risk management policies
 - ▶ Identifying conflicts of interest
- ▶ Carry out an assessment of sustainability preferences of their clients
- ▶ Take these sustainability preferences into account in the selection process of investments offered to clients
- ▶ Report to clients how the investment recommendation made to them meets their sustainability preferences

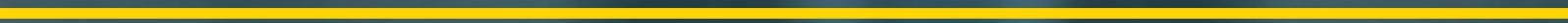
14.6.4. Development of an EU Ecolabel for financial products

Action 2 of the EU Action Plan proposes to create standards and labels for sustainable financial products, in order to:

- ▶ Increase the accessibility of sustainable financial products
- ▶ Facilitate the research of investors who seek to invest in sustainable financial products
- ▶ Facilitate the choice of retail investors who would like to express their investment preferences on sustainable activities

The Joint Research Centre is currently in the process of developing an EU Ecolabel, the criteria of which are currently being discussed with relevant stakeholders. The EU Ecolabel for financial products is expected to be available by April 2021.

³¹⁴ Directive 2014/65/EU



Appendices





Understanding UCIs

I.1. Introduction

This appendix introduces investment funds (referred to in this guide as Undertakings for Collective Investment - UCIs), describes the key characteristics of UCIs, the various types of funds, the asset classes in which they invest, and the structures of UCIs.

I.2. What is a UCI?

A UCI has the following characteristics:

- ▶ There is collective investment of funds
- ▶ The capital is raised from a number of investors
- ▶ The capital is invested in accordance with a defined investment policy for the benefit of those investors, generally in accordance with the principle of risk spreading

The shares or units of some UCIs may be distributed to the general public while others are reserved for certain circles of investors, such as informed, qualified or institutional investors. Depending on the structure of the UCI, these shares or units may be obtained through private placement, direct distribution, distributors, or through stock exchanges.

The portfolio of collective investments may consist of transferable securities and/or other assets. Risk spreading is required to prevent excessive concentration of investments.

A UCI can offer investors the possibility to:

- ▶ Generate current income or capital appreciation, or both
- ▶ Access a diversified portfolio of investments
- ▶ Benefit from professional management of the portfolio
- ▶ Share the associated costs
- ▶ Gain exposure to specific investments in the case of investors who are not able to access the investment directly, for example due to investor qualification requirements

I.3. Types of UCI

The following table summarizes the key characteristics of different types of UCI, the typical asset classes in which they invest, the typical types of investors to whom they are offered and the typical investment horizon.

Summary of key characteristics of different types of UCI

	Typical asset classes	Typical investor types	Typical investment horizon
Equity	Shares/stocks		Medium to long-term
Fixed income			
▸ Money market	High quality short-term money market instruments (MMIs) and deposits with credit institutions	▸ Retail ▸ High net worth individuals (HNWIs)	Short to medium-term
▸ Bonds	Longer term fixed income securities (e.g., government bonds, corporate bonds, convertible bonds, mortgage backed securities)	▸ Institutional (e.g., pension funds and insurance)	Medium to long-term
Mixed	Mixture of instruments (e.g., equity and fixed income securities)		Medium to long-term
Hedge funds	Wide range of financial instruments (e.g., equities, fixed income securities, financial derivative instruments (FDIs) such as options, futures, swaps, contracts for differences, etc) May use techniques (securities lending and borrowing, repurchase and reverse repurchase) May use short selling		Medium to long-term
Real estate	Property assets or structures holding property assets	▸ High net worth individuals (HNWIs)	Long-term
Infrastructure	Development infrastructure (e.g., new transport or utility infrastructure), operational infrastructure (e.g., operating motorways) or infrastructure technology (e.g., water treatment)	▸ Institutional (e.g., pension funds and insurers)	Long-term
Private equity	Equity, debt or other exposures to non-listed companies		Long-term
Thematic	Exposures to investments with a specific theme such as responsible investment, specific segments such as healthcare, collectible goods and intangibles		Long-term
Exchange traded	Exposures to baskets of equity, fixed income or other securities or commodities tracking an underlying index	▸ Retail ▸ High net worth individuals (HNWIs) ▸ Institutional (e.g., pension funds and insurers)	Short to long-term
European long-term investment fund	Equity, quasi-equity, debt, money market instruments, shares/units of other UCIs/ELTIFs/EuSEF/EuVECA, loans, real estate	▸ Retail ▸ High net worth individuals (HNWIs) ▸ Institutional (e.g., pension funds and insurers)	Long-term

The principal types of UCIs are described in more detail hereafter.

I.3.1. Equity

Equity funds invest predominantly in equities, otherwise known as stocks or shares. The investment strategies of equity funds are generally geared towards long-term growth through capital appreciation and/or receiving income from the underlying equities, in the form of dividends which can be reinvested in the UCI or paid out to the investors.

According to the European Fund Classification (EFC)³¹⁵, an equity fund must invest at least 85% of its assets in equities. For a fund to be classified in a specific investment category, it must invest a minimum of 80% of its assets in equities in that investment category. Investment categories can be briefly illustrated as follows:

- ▶ Country or geographic region, e.g.:
 - ▶ Global: Equity Global, Equity Global Advanced Markets
 - ▶ Americas: Equity Americas, Equity North America
 - ▶ Asia Pacific: Equity Asia Pacific, Equity Asia Pacific Ex Japan, Equity Greater China
 - ▶ Europe: Equity Europe, Equity Advanced Europe, Equity Eurozone, Equity Europe Ex UK, Equity Nordic, Equity Iberia
 - ▶ Emerging Markets: Equity Emerging Market Global, Equity Emerging Latin America, Equity Emerging Asia Pacific, Equity Emerging Asia Sub Continent, Equity Emerging Europe, Equity Emerging Middle East and North Africa, Equity Emerging Africa
 - ▶ Country: Equity Belgium, Equity Germany, Equity France
- ▶ Sector, e.g.: Consumer discretionary, Consumer staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Natural Resources, Real Estate, Telecommunication Services, Utilities
- ▶ Market capitalization - Small Cap: equity funds investing at least 80% of their assets in small capitalization stocks as defined by the following regional limits: United States: US\$ 4 billion, United Kingdom: £ 1 billion, Eurozone: EUR 3 billion, Asia Pacific: US\$ 1.5 billion, Global: US\$ 2.5 billion

Being exposed to variations in share prices, equity funds are generally more volatile than fixed income and mixed funds (see Sections I.3.2. and I.3.3.) - they offer investors higher potential returns but with a higher level of risk.

I.3.2. Fixed income

Fixed income funds invest mainly in fixed income instruments such as bonds and money market instruments (MMIs). These investments generate regular fixed income.

I.3.2.1. Money Market

Money market funds generally invest in high quality MMIs or deposits with credit institutions. They do not take direct or indirect exposures to equities or commodities, including via derivatives. Therefore, they are generally considered as low risk funds which pay dividends reflecting the money market rates.

According to the EFC, money market funds can be classified as follows:

- ▶ Short-term money market funds:
 - ▶ Short weighted average maturity (max. 60 days) and weighted average life (max. 120 days)
 - ▶ Currency exposure mentioned in the name and fully exposed or hedged to a single currency
 - ▶ Constant net asset value (CNAV) or variable net asset value (VNAV) valuation method e.g.: short-term money market DKK – CNAV, short-term money market EUR – CNAV, short-term money market EUR – VNAV, short-term money market USD – CNAV, short-term money market USD – VNAV
- ▶ Money market funds:
 - ▶ Weighted average maturity (max. 6 months) and weighted average life (max. 12 months)
 - ▶ Currency exposure mentioned in the name and fully exposed or hedged to a single currency
 - ▶ Variable net asset value method to be applied
e.g.: Money Market AUD, Money Market CHF, Money Market DKK, Money Market EUR, Money Market GBP, Money Market SEK, Money Market USD

³¹⁵ The EFC is a pan-European classification system for investment funds developed by the European Fund Categorization Forum (EFCF), a working group of the European Fund and Asset Management Association (EFAMA). In April 2012, EFAMA published its updated publication *The European Fund Classification Categories*. The general rule applying to the classification structure is that one fund can only be classified in one category according to the assets in which it invests. The main types of funds can be classified: equity, bond, multi-asset and money market - according to nine criteria: country/region, sector, market capitalization, currency exposure, credit quality, interest rate exposure, emerging market exposure, asset allocation and structural characteristics (e.g., fund of funds, ETF instruments, responsible investment or style). The EFC also describes Absolute Return Innovative Strategies (ARIS) and other types of funds falling outside the five broad categories (e.g., capital protection, convertibles, real estate). In this appendix we refer on, a number of occasions, to the EFC.

On 30 June 2017, the final text of Regulation (EU) No 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds was published in the Official Journal of the European Union. The regulation applies from 21 July 2018 for funds set up on or after this date.

The Regulation stipulates that money market funds must be set up as one of the following types:

- ▶ A variable net asset value (“VNAV”) money market fund
- ▶ A public debt constant net asset value (“CNAV”) money market fund
- ▶ A low volatility net asset value (“LVNAV”) money market fund

It also foresees two categories of MMFs:

- ▶ Standard MMFs
- ▶ Short-term MMFs

European money market funds are covered in Section 2.6.1.

I.3.2.2. Bond

Bond funds focus primarily on generating income by investing in fixed income securities with maturities of more than approximately one year.

Bond funds may also be characterized by:

- ▶ Credit quality
- ▶ Interest rate exposure
- ▶ Currency exposure

According to the EFC, bond funds must invest a minimum of 80% of their assets in fixed income securities. Investment in other assets should not exceed 10%, and should be limited to ensure that the 80% minimum investment in fixed income securities is always respected. Convertible bonds are limited to 20% of assets. Asset-backed and mortgage-backed securities are permitted and may be held up to a maximum of 20%. Equity exposure is not permitted.

A bond fund’s credit quality will be classified as follows:

- ▶ A government bond fund must invest at least 80% in such government bonds (issued or explicitly guaranteed by a national government) with a maximum of 10% exposure to corporate bonds. The exposure to emerging market debt should be less than 30%. The maximum exposure to non-investment grade bonds is 30%, of which a maximum of 10% can be emerging market bonds
- ▶ A corporate bond fund must invest at least 70% in corporate bonds with a maximum exposure of 30% to non-investment grade bonds, of which a maximum of 10% can be emerging market bonds. The maximum exposure to emerging market debt is 30%
- ▶ An aggregate bond fund invests in government and corporate bonds and in emerging market bonds (maximum 30%) with a maximum exposure of 30% to non-investment grade bonds, of which a maximum of 10% can be emerging market bonds
- ▶ An aggregate high yield bond fund invests between 30% and 70% of its assets in non-investment grade bonds, of which up to 30% can be in emerging market bonds
- ▶ A high yield bond fund invests at least 70% of its assets in non-investment grade bonds (less than 30% can be in emerging market debt)

A bond fund’s interest rate exposure will be classified as follows:

- ▶ Short-term: more than 1 year and less than 3 years average modified duration
- ▶ Medium-term: more than 3 years and less than 7 years average modified duration
- ▶ Long-term: more than 7 years average modified duration

Currency exposure is referred to in the name of the category when the fund has at least 70% exposure to the stated currency (with or without currency hedging).

Other types of bond funds include:

- ▶ Emerging market bond funds
- ▶ Floating rate funds
- ▶ Inflation linked bond funds
- ▶ Flexible bond funds

The risk and return of bond funds are generally lower when the securities invested in are investment grade, and higher when the fund invests in non-investment grade securities.

I.3.3. Mixed

Mixed funds invest in a mixture of variable income securities, debt securities, cash and cash equivalents. Debt securities include, among other things, floating rate notes, convertible bonds, high yield and corporate bonds. Real estate and commodity securities should be treated as variable income securities.

According to the EFC, mixed funds (which the EFC calls “multi-asset” funds) can be classified according to:

- ▶ Geographical exposure: this reflects the local or regional exposure of the fund investments. A single country fund must invest at least 80% of its assets in securities of companies established in the country or region
- ▶ Asset allocation:
 - ▶ Defensive: less than 35% variable income securities
 - ▶ Balanced: between 35% - 65% variable income securities
 - ▶ Aggressive: more than 65% variable income securities
 - ▶ Flexible: may invest up to 100% in any asset class
- ▶ Currency exposure, where applicable, a minimum of 70% exposure to a stated currency (with or without currency hedging)

Other mixed funds³¹⁶ will adapt the portfolio mix to market conditions or investor aims. For example, life-cycle funds offer investors the possibility to adapt their investment to their changing life circumstances - typically, in view of retirement, by gradually decreasing exposure to equities and increasing exposure to fixed income investments over time, progressively providing more stable income at less risk.

The risk/return profile of a mixed fund is generally between that of an equity fund and a fixed income fund.

I.3.4. Hedge funds

Although several bodies have attempted to provide a definition of a hedge fund, there is no official definition. Hedge funds vary widely in investment strategy, risk levels, types of securities owned, etc. However, one could describe a hedge fund by looking at the common or similar characteristics of hedge funds.

While traditional investment funds aim for “relative returns” - i.e., a return relative to a benchmark - hedge funds often aim for “absolute returns” i.e., positive returns that are linked not to a benchmark but to particular assets. Hedge fund portfolios are commonly a basket of securities that have been “cherry picked” as a result of the hedge fund manager employing investment strategies that differ from the traditional investment fund and that often make extensive use of derivatives.

The EFC defines such funds as absolute return innovative strategies (ARIS) funds. ARIS funds are classified on the basis of the fund promoters' declaration on strategy style:

- ▶ Directional strategies: broad range of strategies with a bias triggered by macro factors
- ▶ Long/short: funds that implement analytical techniques to capture the direction of price movement regardless of whether prices are rising or falling
- ▶ Relative value: relative value techniques to exploit a valuation discrepancy (i.e., price discrepancies)
- ▶ Event driven: investment in securities of companies currently or prospectively involved in corporate transactions or subject to other corporate events
- ▶ Multi-strategy: different types of strategies (e.g., equity long/short, commodities, volatility arbitrage)
- ▶ Index trackers: replicate the performance of a particular index made by a minimum of five different ARIS funds
- ▶ Fund of ARIS funds: investment in a portfolio of other ARIS funds rather than directly in securities (see also Section I.4.2.)

Over recent years, many hedge and traditional asset managers have pursued investment fund strategies referred to as “liquid alternatives”. These strategies are generally created within a UCITS structure and use many of the investment fund techniques previously associated with the hedge fund industry such as shorting using synthetic shorts through the use of total return swaps. Previously such products were only available to professional and institutional investors. If a liquid alternative strategy is created within a UCITS structure, it must comply with all the UCITS requirements. The UCITS liquid alternative products may be more expensive to operate than the traditional off-shore hedge fund and performance may also be impacted by the requirement to comply with all the UCITS risk diversification and leverage requirements. However, such products do benefit from the brand associated with UCITS including the well-established regulatory framework, transparency and liquidity.

³¹⁶ Here we are no longer referring to the EFC.

1.3.5. Real estate

There are two main categories of real estate UCIs: direct real estate funds and indirect real estate funds.

Direct real estate funds invest in property assets or structures holding property assets, generally in sectors such as:

- ▶ Retail (e.g., shopping centers)
- ▶ Offices
- ▶ Residential (e.g., apartments)
- ▶ Parking
- ▶ Industrial premises
- ▶ Leisure (e.g., hotels, leisure parks)
- ▶ Logistics (e.g., warehouses)

They generally generate returns from the increases in the value of the assets and from rental income. Other potential investments include land, construction activities, real estate financing activities and distressed real estate debt securities.

Diversified direct funds invest in more than one sector.

INREV, the European Association for Investors in Non-Listed Real Estate Vehicles, defines three “styles” of direct real estate funds, depending on the fund characteristics:

- ▶ Core funds tend to be less risky real estate funds. Core funds invest less than 15% of the gross asset value in non-income producing investment. Their development exposure may not exceed 5% of the gross asset value. Core funds use low leverage (up to 40% of the fund gross asset value). They are required to have at least 60% of the target return derived from income distribution
- ▶ Value added funds are funds whose non-income producing investments ranges between 15% and up 40% of the fund gross asset value. The percentage of development exposure cannot exceed 25% of the gross asset value. The capital leverage ratio ranges between 40% and 60%
- ▶ Opportunity funds tend to be riskier real estate funds. They invest more than 40% of fund gross asset value in non-income producing investments. They have a development exposure that may exceed 25% of the fund gross asset value. The capital leverage ratio may exceed 60% of the gross asset value

Direct real estate funds are required to meet all the aforementioned ratios to be classified as the particular style of fund. Otherwise, the fund will be classified as the riskiest style into which it falls, considering its characteristics.

The table below summarizes the different criteria determining the style of direct real estate funds:

	Core <40%	Core > 40%	Value added	Opportunity
Target percentage non-income producing investments	≤15%		15% > - ≤40%	>40%
Target percentage of (re)development exposure	≤5%		>5% - ≤25%	>25%
Target return derived from income	≤60%			
Maximum loan-to-value (LTV)	≤40%	>40%	>40% - ≤60%	>60%

Source: INREV Style Classification

Indirect funds invest in listed real estate securities or in other real estate funds.

1.3.6. Infrastructure

“Infrastructure” is a term covering multiple types of investments, and segments, with very varied inherent risks. There is no single definition of infrastructure³¹⁷.

The following are typical types of infrastructure investment funds:

- ▶ Development infrastructure focusing mainly on participating in the development of new infrastructure. Examples include:
 - ▶ Building transport infrastructure, such as motorways, train and tramlines, airports, ports
 - ▶ Building utility infrastructure such as dams, hospitals, waste treatment plants

³¹⁷ The European Parliament has defined “infrastructure” as “basic physical and intangible organizational structures and facilities needed for the operation of a society or enterprise.”

Such infrastructure investments often present some of the following characteristics and risks:

- ▶ Significance in the context of their local environment, and dependency on administrative decisions for their approval
- ▶ Complexity, increasing the challenge of setting and meeting budget and deadline
- ▶ In the case of public private partnerships, dependency on both the private and public participants (e.g., state or local authorities) for continued long-term financing
- ▶ Operational infrastructure focusing mainly on participating in operating existing infrastructure, such as motorways or water treatment plants

Such operational infrastructure investments often offer relatively stable and predictable returns. Operational infrastructure funds often present some of the following characteristics and risks:

- ▶ Less diversification than many other types of AIF, focusing on a limited number of projects
- ▶ Dependency on authorities for continuation of licenses to operate
- ▶ Good liquidity characteristics due to stable revenue streams
- ▶ Counterparty risk, related to financing infrastructure projects
- ▶ Infrastructure technology focusing on investment into companies developing infrastructure technology, such as tunneling and water treatment technology

Such infrastructure technology investments are close to private equity investments.

Some of the segments which may be considered within the infrastructure asset class, include, for example:

- ▶ Environment, such as water and waste storage, treatment and recycling
- ▶ Energy, such as electricity grids and power generation facilities including wind farms and photovoltaic plants
- ▶ Healthcare including hospitals, medical centers and other facilities
- ▶ Logistics centers
- ▶ Office buildings
- ▶ Urban infrastructure, such as roads, drainage, street lighting, water distribution
- ▶ Public and local utility facilities, such as buildings used by authorities, schools, student accommodation, custodial buildings, sports facilities, defence infrastructure
- ▶ Telecommunications, such as communications systems
- ▶ Transport, such as motorways, airports, rail and waterways

Certain infrastructure segments overlap between each other and/or with private equity or real estate.

1.3.7. Private equity

Private equity generally refers to the acquisition of a company or a stake in a company through a transaction involving privately held equity or other non-public securities by an investor or group of investors; private equity investments are usually medium to long-term.

The strategies adopted by private equity funds/vehicles will depend on the maturity of the target company:

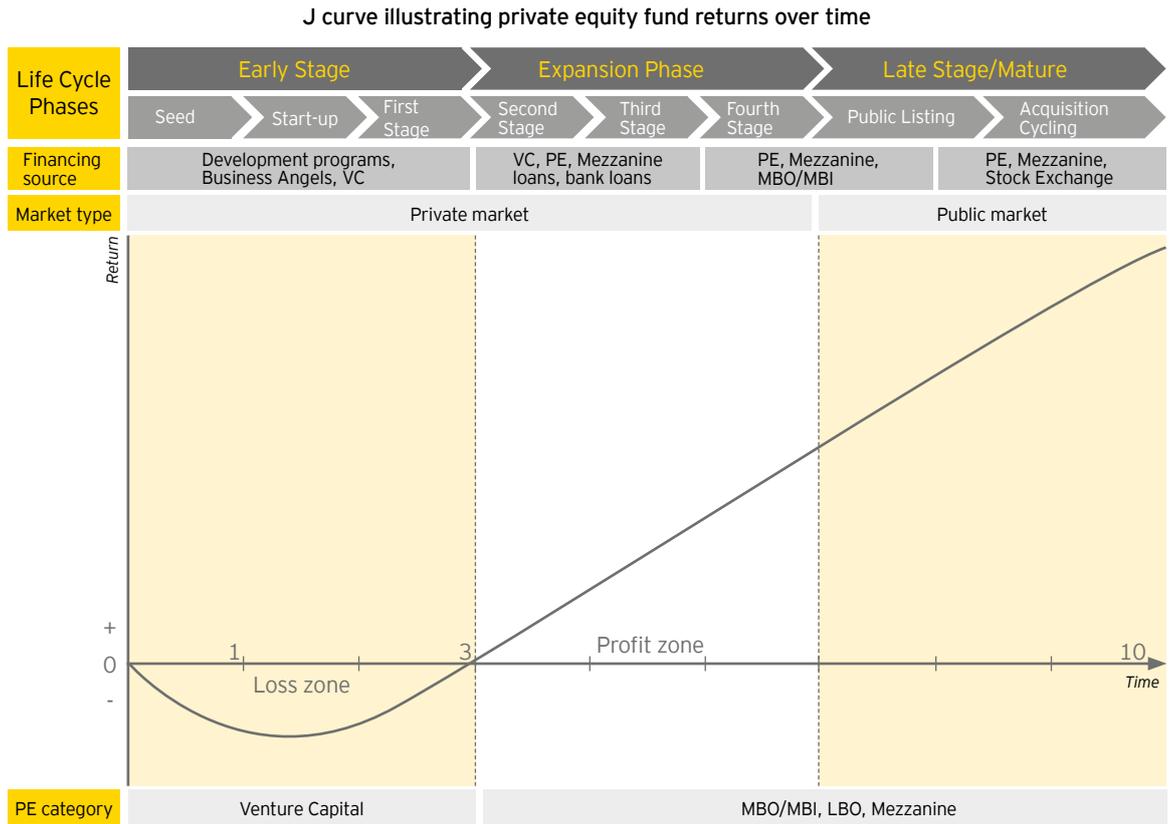
- ▶ Early stage: at this stage, the company is at the beginning of its activity and needs financing to develop its product (seed financing, start-up...)
- ▶ Expansion phase: at this stage, the product is developed and the company needs money to make it (post-creation...). In this phase, there may be leveraged buyout (LBO), management buy-out (MBO) or management buy-in (MBI) activities, involving the acquisition of a company, business unit or business asset
- ▶ Late stage/mature stage: at this stage, the company may want to raise money from the public (via Initial public offering), develop a new product or enter a new market, manage generation handover issues where there is no successor, turn around or de-list (go private)

The lifecycle of a private equity fund may be represented by a J curve. A key characteristic of a private equity fund, as well as, in certain cases, a direct real estate fund, is the draw-down. The private equity fund will collect or "call" capital from the investors in a series of tranches - i.e., when the fund manager wants to invest, he requests the cash he needs from investors. The goal is to have a minimum amount of cash held in the fund in order to optimize performance.

At the beginning of the fund activity, during the investment period, the fund will invest and pay management fees, set-up cost, etc.

During the realization period, income (e.g., capital gains, dividends) will be generated.

The following figure illustrates the J curve:



A private equity fund/vehicle is generally a “partnership” between a private equity firm (general partner) and investors in the fund/vehicle (limited partners). In many cases, the general partner of a private equity fund takes the form of an unregulated entity.

Private equity vehicles can be set up as funds; there are, however, also other vehicles specifically designated for private equity instruments.

1.3.8. Thematic funds

Thematic funds specialize in areas such as specific segments, exotic assets or meet specific criteria.

Thematic funds may offer investors potentially higher returns than certain other types of funds, opportunities to diversify a portfolio and exposure to asset classes which may have a low correlation with traditional asset classes.

There are few commonly agreed definitions of the types of thematic funds. In many cases, the categories of thematic fund types overlap:

- ▶ Responsible investment - generally funds meeting certain environmental³¹⁸, social and/or governance criteria (ESG)³¹⁹. They have a long-term perspective (with an emphasis on sustainable development)
 - ▶ Environment³²⁰, including
 - ▶ Renewable energy and environmental technologies, such as solar, wind and biomass
 - ▶ Carbon investments, related to carbon credits
 - ▶ Environmental technology, such as water and waste treatment technology

³¹⁸ For example, meeting the United Nations Principles for Responsible Investment.

³¹⁹ The Luxembourg Fund Labeling Agency (LuxFLAG) offers an ESG Label designed to reassure investors that the Investment Fund actually invest its assets in a manner which incorporates ESG considerations throughout its investment process. The eligibility criteria for the ESG Label require applicant funds to screen 100% of their invested portfolio according to one of the ESG strategies and standards recognized by LuxFLAG.

³²⁰ The Luxembourg Fund Labeling Agency (LuxFLAG) offers an Environment Label designed to reassure investors that the funds actually primarily invest their assets in environment-related sectors in a responsible manner. The eligibility criteria for the Environment Label require eligible funds to have a portfolio of investments in environment-related sectors corresponding to at least 75% of the fund's total assets.

- ▶ Sustainable investment, such as fair trade, sustainable agriculture and infrastructure
- ▶ Impact finance, covering areas such as education, health and food
- ▶ Social entrepreneurship - funds which have the achievement of measurable, positive social impacts as a primary objective (see Section 2.4.4.3.)
- ▶ Microfinance³²¹ - funds which invest in microfinance institutions
- ▶ Ethical funds. These funds invest in compliance with religious guidelines and are not only driven by financial gains purpose. Ethical funds include such as Catholic, Sharia and Dharma funds
- ▶ Specific segments, such as:
 - ▶ Energy, such as equity in energy companies and energy commodities
 - ▶ Technology, such as mechanical technologies, materials, electronics and information technologies
 - ▶ Biotechnology
 - ▶ Life sciences
 - ▶ Natural resources, such as forestry, plantations and water supply
 - ▶ Transportation, such as ships, aircraft, containers
 - ▶ Commodities, generally including a combination of commodities, commodity futures and options
- ▶ Collectible goods such as luxury goods, including art objects, jewelry, racing and breeding animals (such as horses), expensive alcohols (wines and spirits), and vehicles (such as cars and motorbikes)
- ▶ Intangible assets such as patents, marketing rights, and libraries of intellectual property (e.g., music libraries)

Following global efforts towards a more sustainable economy, the EU Commission published on 8 March 2018 an Action Plan on Financing Sustainable Growth. The European Commission adopted a package of measures on sustainable finance, with the aim to:

- ▶ Reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth
- ▶ Assess and manage relevant financial risks stemming from climate change, resource depletion, environmental degradation and social issues
- ▶ Foster transparency and long-termism in financial and economic activity

The legislation should ensure that financial market participants including UCITS management companies, AIFMs, Insurance undertakings, IORPs (institutions for occupational retirement provision), EuVECA managers, EuSEF managers, insurance distributors, and investment advisors, who receive a mandate from their clients or beneficiaries to take investment decisions on their behalf, integrate ESG considerations into their internal processes and inform their clients accordingly.

Framework to facilitate sustainable investment

The legislative proposals set out uniform criteria for determining whether an economic activity is environmentally sustainable. The purpose of the proposals is to standardize the concept of environmentally sustainable investment across the European Union, thereby facilitating investment in environmentally sustainable economic activities, both nationally and in more than one EU country. The proposals are designed to address the divergence of existing national taxonomies and market-based initiatives at national level, in order to tackle the risk of “greenwashing”, make it easier for economic operators to raise funds for environmentally sustainable activities across borders, and to try to establish a level playing field for all market participants.

Environmentally sustainable economic activities will need to comply with all of the following criteria:

1. The economic activity contributes substantially to one of more of the environmental objectives set out below
2. The economic activity does not significantly harm any of the environmental objectives set out below
3. The economic activity is carried out in compliance with minimum safeguards
4. The economic activity complies with technical screening criteria

³²¹ The Luxembourg Fund Labeling Agency (LuxFLAG) offers a Microfinance Label designed to reassure investors that the microfinance investment vehicle (MIV) actually invests, directly or indirectly, in the Microfinance sector. Investing indirectly means that the MIV can, rather than giving direct loans to Microfinance Institutions (MFIs), invest into other MIVs themselves investing more than 50% in Microfinance.

The environmental objectives established by the Regulation are:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

In December 2019, the European Commission renewed its commitment to Sustainable Development with the European Green Deal. To achieve its ambitions, the EU aims to mobilise investment and help to unlock private funds through the EU budget and associated instruments - the "Green Deal Investment Plan". In addition, in April 2020, the Commission launched a consultation to update its sustainable finance strategy.

Obligations directly impacting IFMs and UCIs are set out in the following regulations:

- Regulation (EU) 2019/2088 of 27 November 2019 on *sustainability - related disclosures in the financial services sector* (the "sustainable finance disclosure regulation" or "SFDR")
- Regulation (EU) 2020/852 of 18 June 2020 on *the establishment of a framework to facilitate sustainable investment* (the "Taxonomy regulation" or "Taxonomy")
- UCITS Directive and AIFMD draft delegated acts amending, respectively:
 - Delegated Regulation No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU (the AIFMD) as regards sustainability risks and sustainability factors to be taken into account by alternative investment fund managers, and
 - Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC (the UCITS Directive) as regards the sustainability risks and sustainability factors to be taken into account for undertakings for collective investment in transferable securities

The UCITS Directive and AIFMD draft delegated acts published on 8 June 2020 clarify notably the duties of IFMs to take into account the social and environmental factors and risks in their governance, organization, conflicts of interest policies, investment due diligence as well as their risk policies and procedures.

Pursuant to MiFID draft delegated acts published on 8 June 2020, investment firms will be required to integrate investors' sustainability preferences, i.e., the appetite of their clients for dark green and light green products, as defined in sustainable finance disclosure regulation, in product governance, financial advice, portfolio management and distribution activities. *Ex-post* information disclosure, relying on UCI and IFM disclosures, will be required to explain how a recommendation to the client to purchase an investment fund meets his investment objectives, risk profile, capacity for loss bearing and sustainability preferences.

The sustainable finance action plan will bring significant changes in the investment fund value chain.

Impact on the whole asset management chain

		EU Taxonomy	MiFID II	AIFMD/UCITS	Disclosure	Benchmark
		31.12.2021	Q3 2021	Q3 2021	March 2021	30.04.2020
Asset Manager Value Generation	Strategy & Organization	Indirect	Indirect	Direct	Indirect	Indirect
	Products & Distribution	Direct	Direct	Indirect	Direct	Indirect
	Risk & Performance	Direct	Indirect	Direct	Indirect	Indirect
	Data & Reporting	Direct	Direct	Direct	Direct	Indirect

Please refer to Chapter 14 for further details.

I.4. Structuring of UCIs

UCIs may be structured in different ways depending on the investment policy elected by the manager and the type of investors to whom the units/shares are addressed.

I.4.1. Single and multiple compartment UCIs

The simplest UCIs are single funds. The UCI has one investment compartment with one investment policy, and is managed by one portfolio manager. In this case, if the asset manager wishes to offer investors another investment policy, then another UCI must be created.

Multiple compartment UCIs (otherwise known as umbrella funds) are UCIs which comprise, or may comprise, two or more compartments (sub-funds), each with different features – generally a different investment policy. Different compartments may, for example, invest in different asset classes and be managed by different portfolio managers.

Multiple compartment structures are favored by the larger promoters and initiators of UCIs.

The assets of each compartment of a multiple compartment UCI are generally segregated, and the accounting records of each compartment are kept separate.

It is also possible to create funds with interlinked compartments. For example, a multiple compartment UCI can include private equity and hedge fund portfolios, whereby the hedge fund portfolio provides the liquidity for flexible draw-down and cash management that private equity general partners are seeking and the hedge fund managers gain access to the potential returns from private equity investment.

Multiple compartment UCIs and cross investment are covered in Sections 2.3.2. and 2.3.5.

I.4.2. Fund of funds

A fund of funds invests in several other investment funds. Some funds of funds allocate their assets to diverse or geographical fund strategies while others focus on just one or two.

A key role of the manager of a fund of funds is the selection and monitoring of the underlying UCIs.

Funds of funds generally offer a more diversified and lower risk investment opportunity than the underlying funds themselves. They may also offer exposure to investment funds to some investors who would not be able to invest in the underlying funds directly.

Funds of funds are covered in Sections 1.3.5.1.

I.4.3. Master-feeder structures

In master-feeder structures, the feeder UCI invests most of its assets – at least 85% – in a master UCI.

A feeder UCI is a non-diversified investment structure investing into a diversified product (master UCI), permitting the pooling of assets.

The management of a significant portion of the portfolio of the feeder UCI is effectively performed by the manager of the master UCI.

The master UCITS, or one or more of the feeder UCITS, can be located in different Member States.

Master-feeder structures may be used by asset managers as a distribution mechanism to facilitate access to certain markets.

Master-feeder structures are covered in Sections 1.3.5.2.

I.4.4. Holding structures of UCIs

Alternative assets are often held through holding vehicles, typically holding companies (often referred to as special purpose vehicles – “SPVs” or special purpose entities). Such holding vehicles may be owned either exclusively by the AIF or its AIFM on its behalf, or as joint ventures, for example with other AIF.

Typically, holding vehicles are used in AIF structures to hold assets such as:

- ▶ Real estate in real estate AIF
- ▶ Unlisted companies in private equity AIF

Holding structures are covered in Section 2.7.

I.4.5. Exchange traded funds

Exchange traded funds (ETFs) are investment funds investing in a basket of securities or commodities generally designed to track the performance of an underlying index. They are listed on stock exchanges and can be traded in the same way as any other listed transferable security.

The shares or units of ETFs are not issued or repurchased in the same way as traditional funds. Institutional investors create and redeem ETF shares directly from the ETF, in large blocks, called “creation units”. The transaction is generally in kind, with the institutional investor swapping a basket of securities or commodities for units of the ETF in the case of a creation or vice versa in the case of a redemption. Some ETFs may require or permit a purchasing or redeeming shareholder to substitute cash for some or all of the securities or commodities in the basket. The creation and redemption mechanism means that units are normally traded at a price close to the net asset value (NAV).

The shares or units of ETFs are traded on the secondary market where prices are available from market makers on an intra-day basis.

ETFs combine advantages of stocks (tradability and liquidity) and of index funds (low costs and diversification) into one product:

- ▶ **Trading flexibility:** Unlike traditional investment funds, which can only be traded at the end of the trading day, ETFs can be bought and sold at current market prices and at any time during the trading day, and market makers quote continuous prices on them. This allows investors to react to adverse or beneficial market conditions on an intra-day basis
- ▶ **Transparency:** ETFs combine the diversity of an investment fund with the transparency, ease of use and low trading costs of listed stock. Because asset managers can trade ETFs throughout the trading day, ETF investment performance can be monitored continuously and holdings published daily, providing transparency to the market
- ▶ **Lower costs:** As most ETFs are not actively managed, ETF total expense ratios are much lower than those of other forms of investment vehicles. In addition, most ETFs are shielded from the costs of having to buy and sell securities to accommodate shareholder purchases and redemptions
- ▶ **Diversification:** In a single transaction, ETFs provide exposure to a diversified index

ETFs traditionally replicate an index by directly holding all the constituents of the underlying index. This is referred to as “physical replication”. Managers of ETFs using physical replication have to rebalance the portfolio to match periodic changes in the composition of the index. This approach has worked successfully for the main plain vanilla indices.

Second generation ETFs resort to “swap-based” or “synthetic” replication: rather than directly holding all constituents of the tracking index in its portfolio, the fund uses swaps to replicate the performance of the index. This more recent form of ETF offers a number of advantages.

Physical vs synthetic ETFs

	Physical	Synthetic
Tracking responsibility	Fund manager	Swap counterparty
Tracking efficiency	Varies according to index being tracked	Minimal tracking error ³²² before fees
Sources of counterparty risk	Securities lending	Swap counterparty (for UCITS, the maximum exposure is 10% of net assets)
Product types available	Equity, bond and money market indices	Equity, bond, money market, credit, currency, commodity, hedge fund, leveraged, short indices, real estate, etc.
UCITS compliant	Yes	Yes
Advantages	<ul style="list-style-type: none"> ▶ Efficient for indices with few constituents such as the DAX, CAC 40 or FTSE ▶ Transparency ▶ Direct holding of index constituents easy to understand for investors 	<ul style="list-style-type: none"> ▶ Efficient for indices with many constituents, such as the MSCI World, which has over 1,800 constituents ▶ Minimized tracking error ▶ Offer exposure to a wide range of indices from equity, to hedge fund and real estate³²³ ▶ Provide access to markets such as emerging countries (e.g., Brazil, Russia, India, China, Vietnam) which would not otherwise be directly accessible to many investors
Disadvantages	<ul style="list-style-type: none"> ▶ Re-balancing necessary after changes in constituents or weights ▶ Index turnover costs ▶ Tax treatment of dividends ▶ Tracking issues related to timing of dividend payments ▶ Limited to equity, bond and money market indices 	<ul style="list-style-type: none"> ▶ Exposure to swap counterparty risk ▶ More complex derivatives that need to be understood by investors ▶ Leveraged and short ETFs are carefully scrutinized by regulators concerned about their suitability and appropriateness for retail investors ▶ Some stock exchanges are more reluctant to list synthetic ETFs

While passive ETFs track the performance of an underlying index, actively managed ETFs seek to outperform a benchmark. These ETFs could aim to outperform through an algorithmic process, such as ranking stocks under certain criteria at set intervals and automatically rebalancing the portfolio accordingly, or by linking performance to the discretionary trading expertise of a particular manager.

See also Section 2.6.2.

³²² A tracking error can be defined as the difference in performance between the index to be replicated and the ETF. Part of the tracking error will be explained by the fees paid by the ETF to the service providers.

³²³ Such ETFs are simply UCITS using a number of investment techniques permitted by the UCITS Directive, which enable them to pursue alternative strategies. Exposure is gained through financial indices.

I.4.6. Structured products

A structured product is normally a “packaged” product with a pre-defined investment objective. The “package” will normally include a combination of traditional financial instruments, derivatives and/or insurance products.

Within the context of investment funds, there are two categories of structured products:

- (1) Structured funds, or structured compartments (sub-funds) of funds, which offer investors a predefined payoff depending on different scenarios based on the value of the underlying assets
- (2) Structured products based on funds

There are two main types of structured funds:

- ▶ **Guaranteed funds:** guaranteed funds offer partial or full capital or income protection - i.e., some or all of the investment in the fund or income generated therefrom is guaranteed (e.g., at maturity). At the same time, guaranteed funds offer some exposure to specific financial instruments. Some guaranteed funds implement a lock-in mechanism, whereby at certain times, or when certain thresholds are met, the gains are “locked in” - i.e., guaranteed. Guarantees are generally achieved by using financial instruments and/or by dynamically adjusting exposures to risky assets; a guarantor may also be involved. Guaranteed funds are generally long-term investments
- ▶ **Leveraged funds:** leveraged funds take risk exposure exceeding the amount of capital invested, by borrowing or through the use of financial derivative instruments (FDIs). Thus, the potential returns, but also the risk inherent in leveraged funds, is greater

For more information on structured UCITS, see Section 2.6.6.

Structured products based on funds include capital protection products, products offering leveraged exposure to a basket of funds or products dynamically allocating assets to a basket of funds, for example to top performing funds. Structured products based on funds are outside the scope of this guide.

I.4.7. Pension Fund Pooling Vehicles (PFPVs)

PFPVs are collective investment schemes (e.g., common funds) created by international groups in order to pool the assets of different pension funds that they manage in various jurisdictions where they have operations.

Pooling assets of multiple pension funds, often in different jurisdictions, offers benefits such as reduced operational fees and costs, efficient management of assets, access to a wider range of potential investments, a centralized governance structure and consistency between pension funds. However, to offer these advantages to investors, the PFPV must allow investors the same fiscal treatment as if they had invested in their home jurisdiction.

I.4.8. European Long-Term Investment Funds (ELTIF)

On 29 April 2015, the European Parliament and the Council of the European Union adopted Regulation (EU) 2015/760 that created a new investment fund vehicle, namely the European long-term investment fund (ELTIF). The purpose of this regulation is to boost European long-term investments in the real economy.

The regulation applies to EU AIFs that are marketed in the European Union under the ELTIF label. Only authorized EU AIFMs may manage and market ELTIFs. ELTIFs will be subject to additional rules requiring them, *inter alia*, to invest at least 70% of their capital in clearly-defined categories of eligible assets (generally illiquid assets including, *inter alia*, infrastructure, research and development, private equity, other ELTIFs, EuSEF and EuVECA) and up to 30% in assets other than long term investments.

Due to the illiquid nature of most investments in long-term projects, ELTIFs are precluded from offering regular redemptions to its investors. The commitment of the individual investor to an investment in such assets is, by its nature, made to the full term of the investment. ELTIFs should, consequently, be structured in principle so as not to offer regular redemptions before the end of the life of the ELTIF. In order to incentivize investors, in particular retail investors who might not be willing to lock their capital up for a long period of time, an ELTIF should be able to offer, under certain conditions, early redemption rights, meaning that the manager of the ELTIF should be given discretion to decide whether to establish ELTIFs with or without redemption rights.

See also Section 2.4.5.

Key regulations and reference texts

II.1. Introduction

The regulations applicable to the Luxembourg fund industry include:

- Primary legislation - “Level 1”:
 - Luxembourg Laws
 - European Union (EU) Regulations
- Implementing measures - “Level 2”:
 - Grand-Ducal Regulations
 - Commission for the Supervision of the Financial Sector (CSSF) Regulations
 - Commission Regulations
- Guidelines - “Level 3”:
 - CSSF Circulars
 - Luxembourg Central Bank (BCL) Circulars
 - European Securities and Markets Authority (ESMA, formerly CESR³²⁴) Guidelines
 - VAT Circulars

The following table provides a brief overview of the relationship between EU and Luxembourg regulations, and how EU regulations become applicable in Luxembourg:

	European Union regulation	How applied by Member State	Regulation applicable in Luxembourg
Legislation (level 1)	EU Directives	National transposition and implementation	Luxembourg Law
	EU Regulations	Direct application	EU Regulations
Implementing measures (level 2)	Commission Directives	National transposition and implementation	Grand-Ducal Regulations CSSF Regulations Ministerial Regulations
	Commission Regulations	Direct application	Commission Regulations
Guidelines (level 3)	ESMA guidelines	Direct application and, in some cases, national implementation	ESMA guidelines CSSF Circulars BCL Circulars

Other rules, clarifications and guidance can be found in:

- Luxembourg Stock Exchange rules and regulations
- Additional regulatory guidance, including:
 - CSSF questions and answers (Q&A), Press Releases, Newsletters and Annual Reports
 - ESMA and European Commission Q&A and opinions
 - Applications for authorization and related forms
- Industry guidance: guidelines and publications from, for example, the Association of the Luxembourg Fund Industry (ALFI) and the Luxembourg Bankers’ Association (ABBL)

Luxembourg Laws, Grand-Ducal and CSSF Regulations are published in the Official Gazette (*the Mémorial*). Most key Laws and Regulations are available on the CSSF website, along with CSSF Circulars and available translations (<http://www.cssf.lu/en>).

³²⁴ The Committee of European Securities Regulators (CESR) became the ESMA on 1 January 2011.

Section II.2. aims to provide an overview of the key regulations, guidelines and reference texts applicable to UCIs and their management entities – management companies or AIFM. Section II.3. covers regulations, guidelines and reference texts in areas such as taxation, anti-money laundering or derivatives which are, in general, mainly non-UCI specific and which may be applicable in addition to those outlined in Section II.2.

Both sections distinguish between Luxembourg and EU regulations, guidelines and reference texts; for EU regulations, Luxembourg transposition or direct application of the EU regulations, guidelines and reference texts in Luxembourg is indicated.

II.2. Key EU and Luxembourg investment fund regulations and reference texts

This section aims to provide an overview of the key EU and Luxembourg regulations, guidelines and reference texts applicable to:

- ▶ UCITS and 2010 Law Part II UCIs, UCITS (Chapter 15) and other (Chapter 16) management companies (ManCos)
- ▶ Alternative Investment Fund Managers (AIFM) and internally managed AIF
- ▶ Specialized investment funds (SIFs)
- ▶ European venture capital funds (EuVECA) and European social entrepreneurship funds (EuSEF)
- ▶ Islamic UCIs
- ▶ European long-term investment funds (ELTIFs)
- ▶ Reserved alternative investment funds (RAIFs)

The applicability of some regulations may depend on the specific situation or be subject to legal interpretation. For example, the requirements on money market funds are specific to that type of UCI, while the key investor information (KII) documents are required for all UCITS but generally not for other UCIs (although there are exceptions to this).

These lists are intended to provide general guidance only; they are not intended to be exhaustive.

II.2.1. UCITS and 2010 Law Part II UCIs, UCITS (Chapter 15) and other (Chapter 16) management companies (ManCos)

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
UCIs and ManCos: General	Level 1: Directive 2009/65/EC of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, as amended (recast UCITS Directive – UCITS IV)	Level 1: Law of 17 December 2010 relating to undertakings for collective investment, as amended (the 2010 Law)	The general Law on UCIs, which also incorporates the UCITS Directive (the UCITS IV recast). It is structured as follows: <ul style="list-style-type: none"> ▸ Part I: UCITS (European passport) ▸ Part II: Other UCIs ▸ Part III: Foreign UCIs ▸ Part IV: Management companies ▸ Part V: General provisions 	X	X
	Level 1: Directive 2014/91/EU of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (UCITS V)	Level 1: Law of 10 May 2016 modifying the 2010 Law	This Law introduces new rules for UCITS depositaries, such as the entities eligible to assume this role, their tasks, delegation arrangements and the depositaries' liability as well as general remuneration principles that apply to fund managers, and sanctions.	X	X
		Level 1: Law of 10 August 1915 on commercial companies, as amended (the 1915 Law)	The 1915 Law is the basic law on commercial companies. It is applicable to investment companies, management companies and AIFM where the law they are under does not derogate from it.	X	X
		Level 1: Law of 27 May 2016 modernising the Luxembourg legal publication regime	This Law, <i>inter alia</i> : <ul style="list-style-type: none"> ▸ Creates a central electronic platform: RESA ▸ Introduces new registration requirements for common funds (FCPs) ▸ Clarifies costs for late filling of annual accounts 	X	X
		Level 3: CSSF Circular 11/498 of 10 January 2011 relating to the entry into force of the 2010 Law and CSSF Regulations 10-4 and 10-5	This Circular outlines certain implementation measures adopted by Luxembourg with respect to the 2010 Law.	X	
		Additional regulatory guidance: ESMA Q&A on the application of the UCITS Directive	This Q&A consolidates the previous Q&As issued on the UCITS Directive and includes: <ul style="list-style-type: none"> ▸ General - covering master-feeder structures, regulated markets, investment limits, issuer concentration, UCITS investing in other UCITS, supervision of branches ▸ Guidelines on ETFs and other UCITS issues ▸ Key Investor Information Document (KIID) ▸ Notification of UCITS and UCITS management companies and exchange of information between competent authorities ▸ Risk measurement and calculation of global exposure and counterparty risk for UCITS ▸ Impact of SFTR on the UCITS Directive ▸ Impact of EMIR on the UCITS Directive ▸ Independence of management boards and supervisory functions ▸ Remuneration ▸ Depositary 	X	

³²⁵ Where the UCI is managed by an authorized AIFM, or is an internally managed AIF, then the AIFM requirements also apply - see Section II.2.2.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
2010 Law UCIs: General		Level 3: CSSF Circular 03/88 of 22 January 2003 on the classification (Part I or Part II) of UCIs governed by the 2002 Law (now the 2010 Law)	This Circular clarifies the distinction between UCIs falling under Part I or Part II of the 2010 Law.	X	X
		Level 3: IML ³²⁶ Circular 91/75 of 21 January 1991 on UCIs, as amended by CSSF Circular 05/177	This Circular, which clarified the 1988 Law, a precursor to the 2010 Law, <i>inter alia</i> : <ul style="list-style-type: none"> ▸ Clarifies the meaning of UCI under the Law ▸ Outlines the rules concerning the central administration and the depositary ▸ Outlines the rules applicable to redemptions of shares or units of UCIs ▸ Provides certain definitions and detailed investment restrictions ▸ Outlines the rules applicable to multiple compartment UCIs 	X	X
		Additional regulatory guidance: CSSF Q&A on undertakings for collective investment	This Q&A covers eligible assets, diversification rules, delegation to third parties, public-interest entities, independence requirements, impact of PRIIPs regulation, obligation of professional secrecy, disclosure of certain types of fees to investors of UCITS and the ESMA opinion on share classes of UCITS.	X	X
ManCo sponsor vs UCI promoter		Additional regulatory guidance: CSSF Press Release 12/45 of 31 October 2012 on UCI and promoter	This Press Release covers the abolition of status of “promoter” of UCITS and Part II UCIs which are managed by a UCITS (Chapter 15) management company.	X	(X)
Governance of UCIs	Level 1: Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (“SRD II”)	Level 1: Law of 1 August 2019 modifying the Law of 24 May 2011 as regards the encouragement of long-term shareholder engagement	The Law requires IFMs to develop an engagement policy and to disclose how such engagement policy is implemented in practice.	X	X
		Industry guidance: ALFI Code of Conduct for Luxembourg Investment Funds	The objective of the Code of Conduct is to provide Boards of Directors with a framework of high-level principles and best practice recommendations for the governance of Luxembourg investment funds and of management companies, where appropriate.	X	X
		Industry guidance: ALFI Principles of oversight of financial intermediaries in distribution of funds, May 2017	This document provides parties charged with the responsibility for oversight of financial intermediaries in the distribution chain with a set of high-level common principles for their consideration.	X	X
		Industry guidance: ALFI Code of Conduct guidance, May 2017	This document provides guidance on the process for the implementation and ongoing adherence to the ALFI code of conduct for Luxembourg investment funds and management companies.	X	X
		Industry guidance ALFI Code of Conduct guidance, October 2017	ALFI provided guidance in separate papers covering: board member independence, board evaluations, board member time capacity, board member letters of appointment, conflicts of interest and directors’ reports.	X	X
		Industry guidance: EFAMA’s Stewardship code covering Principles for asset managers’ monitoring, voting of, engagement with investee companies.	The Code is meant to help asset managers adopt best practices in respect of stewardship of the companies in which they invest on behalf of their own clients.	X	X
		Industry guidance: ALFI SRDII Q&A, May 2020	This document contains clarifications on SRD II obligations and timeline, engagement policy and implementation disclosures as well as transparency towards Institutional Investors.	X	X

³²⁶ The Luxembourg Monetary Institute (IML) was the predecessor of the CSSF.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
UCI investment rules	Level 2: Commission Directive 2007/16/EC implementing the UCITS Directive as regards the clarification of certain definitions, March 2007	Level 2: Grand-Ducal Regulation of 8 February 2008 concerning certain definitions of the 2002 Law (now the 2010 Law)	This Regulation sets out the criteria to be considered when assessing whether a specific financial instrument can be considered as an eligible asset for investment by a UCITS.	X	
	Level 3: ▸ ESMA ³²⁷ Guidelines concerning eligible assets for investment by UCITS, March 2007, as amended in September 2008 ▸ ESMA guidelines on Eligible assets for investment by UCITS – The classification of hedge fund indices as financial indices, July 2007	Level 3: CSSF Circular 08/339 of 19 February 2008 on the ESMA Guidelines concerning eligible assets for investment by UCITS. The Circular was updated by Circular 08/380 of 26 November 2008 on ESMA guidelines concerning eligible assets for investment by UCITS, in light of the September 2008 amendments to the guidelines.	ESMA's guidelines and the Circulars define criteria additional to those in Commission Directive 2007/16/EC and Grand-Ducal Regulation of 8 February 2008 to be considered when assessing whether a specific financial instrument can be considered as an eligible asset for investment by a UCITS. The CSSF Circulars reproduce ESMA's guidelines.	X	
	Level 1: Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012		It creates a general system to simplify rules for all securitisations and to identify simple, transparent and standardised securitisations. This includes: (i) common definitions for all key concepts in a securitisation; (ii) requirements for due diligence, risk-retention, transparency and credit-granting criteria; (iii) requirements for the sale of securitisations to retail clients; (iv) a ban on resecuritisation; (v) rules for securitisation special purpose entities (SSPEs) and securitisation repositories; (vi) a structure for simple, transparent and standardised (STS) securitisation; (vii) a system for administrative sanctions and remedial measures in cases of non-compliance.	X	X
	Level 2: Commission Delegated Regulation (C(2019) 7334 final) supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical standards specifying the information and the details of a securitisation to be made available by the originator, sponsor and securitisation special purpose entities ("SSPEs")		The Transparency RTS specify the information to be made available to various parties by originators, sponsors and/or securitisation special purpose entities (SSPEs).	X	X
		Level 3: CSSF Circular 02/80 of 5 December 2002 on UCIs with alternative investment strategies	This Circular sets out a framework and specifies rules applicable to Part II UCIs (not UCITS) which have alternative investment strategies (hedge funds).		X
	Additional regulatory guidance: ESMA Opinion on Article 50(2) (A) of the UCITS Directive, November 2012	Additional regulatory guidance: CSSF Press Release 12/46 of 23 November 2012 on Opinion by ESMA with regard to investments in open-ended funds subject to Article 50(2)(A) of the UCITS Directive ("Trash Ratio")	ESMA's opinion and the CSSF Press Release prohibit investment in open-ended UCIs as non-core investments (i.e., they cannot be included in the "trash ratio").	X	
	Additional regulatory guidance: ESMA Q&A on the application of the UCITS Directive		This Q&A consolidates the previous Q&As issued on the UCITS Directive and includes, <i>inter alia</i> : ▸ General – covering master-feeder structures, regulated markets, investment limits, issuer concentration, UCITS investing in other UCITS, supervision of branches ▸ Guidelines on ETFs and other UCITS issues ▸ Risk measurement and calculation of global exposure and counterparty risk for UCITS	X	
		Additional regulatory guidance: CSSF Frequently Asked Questions concerning the 2010 Law relating to undertakings for collective investment	The Q&A provides, <i>inter alia</i> , some clarifications on eligible assets and diversification rules for UCITS.	X	
	Additional regulatory guidance: ESMA Q&A on the Securitisation Regulation		The Q&A provides, <i>inter alia</i> , some information on the templates and the frequency of reporting on the underlying assets of a securitisation.	X	X
		Industry guidance: ALFI guidance on the UCITS borrowing principles, August 2009	The guidance clarifies practical application of the UCITS borrowing restrictions.	X	

³²⁷ Committee of European Securities Regulators (CESR) Guidelines. CESR became the ESMA on 1 January 2011.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
Use of efficient portfolio management techniques and rules for specific types of UCIs	Level 3: ESMA guidelines on ETFs and other UCITS issues, December 2012, as amended by ESMA's Revision of the provisions on diversification of collateral in ESMA Guidelines on ETFs and other UCITS issues, March 2014	Level 3: CSSF Circular 13/559 of 18 February 2013 on ESMA guidelines on ETFs and other UCITS issues	ESMA's Guidelines cover: <ul style="list-style-type: none"> ▸ UCITS using efficient portfolio management techniques such as securities lending transactions, sale with the right of repurchase transactions and reverse repurchase and repurchase agreement transactions ▸ UCITS entering into OTC derivative transactions ▸ Specific categories of UCITS: ETFs, index tracking UCITS (including leveraged index tracking UCITS), UCITS entering into total return swaps and UCITS investing in financial indices The Circular implements, in Luxembourg, ESMA's guidelines on ETFs and other UCITS issues.	X	
	Level 3: ESMA further updated its guidelines on ETFs and other UCITS issues, in August 2014	Level 3: CSSF Circular 14/592 of 30 September 2014 on ESMA guidelines on ETFs and other UCITS issues	ESMA's Guidelines and the CSSF Circular clarify and amend certain aspects of the initial ESMA guidelines.	X	
		Level 3: CSSF Circular 08/356 of 4 June 2008 on rules applicable to UCIs when they employ certain techniques and instruments relating to transferable securities and money market instruments	This Circular outlines the rules applicable to UCIs when they employ securities lending transactions, sale with the right of repurchase transactions and reverse repurchase and repurchase agreement transactions.	X	X
	Additional regulatory guidance: ESMA Q&A on the application of the UCITS Directive		This Q&A consolidates the previous Q&As issued on the UCITS Directive and includes further clarifications on the guidelines on ETFs and other UCITS issues.	X	
Money market funds	Level 1: Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds		This Regulation sets out new requirements for UCIs meeting the definition of money market funds.	X	X
	Level 3: Commission Delegated Regulation (EU) 2018/990 of 10 April 2018 amending and supplementing Regulation (EU) 2017/1131 of the European Parliament and of the Council with regard to simple, transparent and standardised (STS) securitizations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies		This Regulation amends and supplements Regulation (EU) 2017/1131 with respect to simple, transparent and standardised (STS) securitizations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies.	X	X
	Level 3: Commission Implementing Regulation (EU) 2018/708 of 17 April 2018 laying down implementing standards with regard to the template to be used by managers of money market funds when reporting to competent authorities as stipulated by Article 37 of Regulation (EU) 2017/1131 of the European Parliament and of the Council		This Regulation provides clarifications for managers of money market funds on implementation of reporting to competent authorities.	X	X
	Level 3: ESMA guidelines on stress test scenarios under Article 28 of the MMF Regulation, March 2018	Level 3: CSSF Circular 18/696 of 20 July 2018 on ESMA's guidelines on stress test scenarios	These guidelines establish common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of Regulation (EU) 2017/1131.	X	X
		Level 3: CSSF Circular 20/734	The Circular provides the technical details to submit files required by Art 37 of the money market fund regulation. The appendices to the Circular provide the specifications for the content of the reporting files, transmission channels to be used and return files sent by the CSSF. It also establishes the general rules and the naming convention for the MMF reporting files.	X	X
	Level 3: ESMA Guidelines on stress test scenarios under Article 28 of the Money Market Fund Regulation - Update 2019	Level 3: CSSF Circular 20/735	The 2019 Guidelines, when compared to the 2018 version, now also include common reference stress test scenarios as well as common reference parameters for those scenarios. This provides MMFs and their managers with the necessary information to calculate and fill in the corresponding fields on the results of the stress tests of the MMF in the reporting template.	X	X
Level 3: ESMA Guidelines on the reporting to competent authorities under Article 37 of the MMF Regulation	Level 3: CSSF Circular 20/736	The specifications on the reporting template, as set forth in Section V of the Guidelines, outline in a first subsection the general principles that apply to the entire MMF reporting, with the aim of providing guidance on aspects such as the reporting and submission periods, the procedure for the first reporting as well as the procedures relating to a change of the reporting frequency.	X	X	

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application		
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵	
Money market funds (cont'd)		Additional industry guidance: CSSF's Frequently Asked Questions concerning the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market fund, of 28 August 2018	The Frequently Asked Questions (FAQs) aim at highlighting some of the key aspects of the Money Market Fund Regulation ("MMFR") from a Luxembourg perspective. The FAQs are therefore primarily addressed to managers of money market funds and money market funds ("MMFs") that are established in Luxembourg.	X	X	
	Money market instruments	Industry guidance: ALFI guidance entitled calculation of amortised cost vs market value deviation for funds requiring such assessment according to their prospectus, February 2009	This guidance covers the conditions under which sub-3 month paper may be valued at amortized cost price.	X	X	
Fund classification	Industry guidance: The European Fund Classification Categories, European Fund Categorization Forum (EFCF), EFAMA, April 2012		The European Fund Classification (EFC) is a pan-European classification system for investment funds developed by the European Fund Categorization Forum (EFCF), a working group of the European Fund and Asset Management Association (EFAMA).	X	X	
Risk management	The Board of the International Organization of Securities Commissions (IOSCO)'s Recommendations for Liquidity Risk Management for Collective Investment Schemes (FR01/2018), February 2018		This publication contains recommendations on the principles of liquidity risk management for UCIs.	X	X	
	IOSCO's Statement of IOSCO Liquidity risk management recommendations for investment funds of 18 July 2019		This statement explains why IOSCO's recommendations of February 2018 do, in fact, provide a comprehensive framework for regulators to deal with liquidity risks in investment funds.	X	X	
	Level 3: ESMA guidelines on stress test scenarios under Article 28 of the MMF Regulation, March 2018	Level 3: CSSF Circular 18/696 of 20 July 2018 on ESMA's guidelines on stress test scenarios		These guidelines establish common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of Regulation (EU) 2017/1131.	X	X
	Level 3: ESMA guidelines: ▸ Risk management principles for UCITS, February 2009 ▸ Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS, July 2010 ▸ Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS, April 2011			These guidelines on risk management cover, <i>inter alia</i> : ▸ Supervision ▸ Governance and organization of the risk management process ▸ Identification and measurement of risks relevant to the UCITS, including calculation of global exposure and counterparty risk ▸ Management of risks relevant to the UCITS ▸ Monitoring and reporting	X	
	Level 3: ESMA guidelines on liquidity stress testing in UCITS and AIFs			▸ These guidelines provide guidance on the practice to be followed by IFMs for stress testing of liquidity risk for individual AIFs and UCITS	X	X
		Level 3: CSSF Circular 11/512 of 30 May 2011 on the main regulatory changes in risk management for Luxembourg UCITS		This Circular clarifies the risk management requirements applicable to Luxembourg UCITS management companies and Luxembourg domiciled UCITS (including self-managed UCITS) including: ▸ The main regulatory changes in risk management following publication of CSSF Regulation 10-4 and ESMA clarifications ▸ Further clarifications from the CSSF on risk management rules ▸ The content and format of the risk management process to be communicated to the CSSF	X	
		Level 3: CSSF Circular 19/733 - IOSCO recommendations - Liquidity Risk Management for open-ended undertakings for collective investment		▸ The Circular implements the IOSCO recommendations and good practices on liquidity risk management developed to address UCIs' vulnerabilities into Luxembourg regulation. The CSSF expects entities to implement a robust effective liquidity risk management process for each of their managed open-ended UCIs. The main elements covered by the Circular are (1) the design process of UCIs, (2) the day to day liquidity management of UCIs and (3) the contingency planning.	X	X

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
Risk management (cont'd)	Additional regulatory guidance: ESMA Q&A on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS, July 2012 as amended	Additional regulatory guidance: CSSF Press Release 12/29 of 31 July 2012 on UCITS: Publication of the document "Questions and Answers: Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS" by ESMA and further CSSF clarifications	This Q&A provides clarification on hedging strategies, disclosure of leverage by UCITS, concentration rules, calculation of global exposure for funds of funds and calculation of counterparty risk for exchange-traded derivatives and centrally-cleared OTC transactions. The CSSF Press Release covers the requirements in relation to leverage disclosed in the prospectus and annual report by UCITS determining global exposure through a Value-at-Risk (VaR) approach.	X	
	Industry guidance: International Capital Market Association's (ICMA) Asset Management and Investors Council (AMIC) and the European Fund and Asset Management Association (EFAMA), Use of Leverage in Investment Funds in Europe Paper, July 2017		The paper analyses how leverage is used, how the European legislative framework addresses leverage, and how the related risks are addressed from a technical perspective. In order to contribute to recent debates launched by regulators and supervisors, it also looks at the updates and improvements that could be proposed to ensure that the European regulation remains a cutting-edge framework at global level.	X	X
		Industry guidance: ALFI Risk Management guidelines	These guidelines include a best practice approach to the organization of the risk function of a UCITS management company or UCITS investment company, provide guidance on the risk monitoring of functions outsourced/delegated by a management company or investment company and include an industry work paper on collateral management.	X	
		Industry guidance: ALFI Guidelines for UCITS Liquidity Risk Management, March 2013	These guidelines outline principles of liquidity risk management for UCITS, elements of a sound liquidity risk management framework and approaches for measuring liquidity risk (market and funding risk).	X	
		Industry guidance: ALFI Principles for Sound Stress Testing Practices, April 2013	The guidelines cover, <i>inter alia</i> , use of stress testing in UCITS risk governance, stress testing methodologies and scenario selection, stress testing of specific risks and reporting and management actions.	X	
		Industry guidance: ALFI guidelines on Operational Risk Management within UCITS, April 2014	The guidelines cover, <i>inter alia</i> operational risk legal and regulatory framework, governance and management, assessment, monitoring and tracking and reporting.	X	
		Industry guidance: ALFI Considerations for the Management of Operational Risks Associated with the Distribution of Funds, June 2016	These considerations present to Board members and senior management those areas that they may wish to consider when looking at the management of Operational Risks associated with the Distribution/ Marketing of funds.	X	X
		Industry guidance: ALFI and ALRiM ABC of VaR model backtesting, March 2017	This guidance provides practical guidelines on how to perform and interpret backtests. This will help practitioners extract more value from VaR models and better understand the market risk of their UCITS.	X	X
		Industry guidance: ALFI and ALRiM VaR model backtesting C.S.I., May 2017	This guidance discusses how to handle the all-too-common situation where a VaR model fails regular backtests.	X	X
		Industry guidance: ALFI guidance on liquidity stress testing considerations for real estate funds, May 2018	This guidance aims at supporting the practical implementation of stress testing arrangements for real estate investment funds.		X
Fund mergers, master-feeder structures and notification procedure	Level 2: Commission Directive 2010/42/EU implementing Directive 2009/65/EC as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure, July 2010		This Regulation lays down the implementing measures of the Law of 17 December 2010 relating to undertakings for collective investment as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure.	X	
	Level 2: Commission Regulation (EU) No 584/2010 of July 2010 implementing Directive 2009/65/EC as regards the form and content of the standard notification letter and UCITS attestation, the use of electronic communication between competent authorities for the purpose of notification, and procedures for on-the-spot verifications and investigations and the exchange of information between competent authorities		This Regulation contains measures on the form and contents of standardized notification and attestation letters, electronic communication between competent authorities for notification purposes, procedures for on-the-spot verifications and investigations and the exchange of information between competent authorities.	X	

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
Fund mergers, master-feeder structures and notification procedure (cont'd)		Level 3: CSSF Circular 11/509 of 15 April 2011 relating to the new notification procedures to be followed by a UCITS governed by Luxembourg law wishing to market its units in another Member State of the European Union and by a UCITS of another Member State of the European Union wishing to market its units in Luxembourg	This Circular clarifies the practical and technical procedures that UCITS must follow for cross-border marketing – i.e., the notification procedures to be followed by a Luxembourg UCITS intending to market its units in another Member State of the European Union and by a UCITS of another Member State of the European Union wishing to market its units in Luxembourg.	X	
		Level 3: CSSF Circular 07/277 of 9 January 2007 on the new notification procedure in line with the guidelines of the CESR regarding the simplification of the UCITS notification procedure	This Circular clarifies specific topics with regard to the notification procedure.	X	
	Additional regulatory guidance: ESMA Q&A on the application of the UCITS Directive		This Q&A consolidates the previous Q&As issued on the UCITS Directive and includes, <i>inter alia</i> : ▸ Notification of UCITS and UCITS management companies and exchange of information between competent authorities	X	
		Additional regulatory guidance: CSSF Q&A on the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment	This Q&A covers eligible assets, diversification rules, delegation to third parties, public-interest entities, independence requirements, impact of PRIIPs regulation, obligation of professional secrecy, disclosure of certain types of fees to investors of UCITS and the ESMA opinion on share classes of UCITS.	X	
		Additional regulatory guidance: CSSF FAQ on Master/Feeder Structures, July 2013	This FAQ covers financial reporting issues in the context of master-feeder structures.	X	
Dormant compartments of UCIs		Level 3: CSSF Circular 12/540 of 9 July 2012 on non-launched compartments, compartments awaiting reactivation and compartments in liquidation	This Circular covers compartments under both the 2010 Law and the SIF Law. Shares or unit classes within compartments are not covered.	X	X
Net Asset Value (NAV), share classes and subscriptions and redemptions		Level 3: ESMA Opinion on Share Classes of UCITS, January 2017	ESMA's opinion covers the extent to which different types of units or shares (share classes) of the same UCITS fund can differ from one another, having found diverging approaches in different EU countries.	X	
		Level 3: CSSF Circular 04/146 of 17 June 2004 on the protection of UCIs and their investors against Late Trading and Market Timing practices	This Circular clarifies the protective measures to be adopted by UCIs and certain of their service providers, fixes more general rules of conduct for all professionals subject to CSSF supervision and extends the role of the auditor regarding Late Trading and Market Timing.	X	X
		Additional regulatory guidance: CSSF Q&A on the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment	This Q&A covers eligible assets, diversification rules, delegation to third parties, public-interest entities, independence requirements, impact of PRIIPs regulation, obligation of professional secrecy, disclosure of certain types of fees to investors of UCITS and the ESMA opinion on share classes of UCITS.	X	X
		Industry guidance: ALFI reports entitled Swing Pricing guidelines and update 2015, December 2015	These reports present the results of a survey of swing pricing practices and updated swing pricing guidelines, originally released in 2006.	X	X
		Industry guidance: CSSF's Frequently Asked Questions (FAQ) - Swing Pricing Mechanism of 30 July 2019	This FAQ clarifies certain aspects of swing pricing including reference thereto in constitutional documents, disclosure to investors, error handling and organizational requirements.	X	X
		Industry guidance: ALFI Position Paper on the CSSF Regulation No 10-4: Treatment of subscription and redemption orders under UCITS IV, January 2012	This ALFI Position Paper provides guidance on the treatment of subscription and redemption orders.	X	

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
Key investor information (KII)	Level 1: Regulation (EU) 1286/2014 of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)		PRIIPs is a Regulation which composes the wider consumer protection package, together with UCITS V, MiFID II, and Insurance Mediation Directive 2. The key objective of PRIIPs is to reduce or “eliminate” the asymmetries of information which exist among retail investment products. It closes gaps and creates consistent rules applying to all PRIIPs by creating a standardized and pre-contractual document for retail investors, the Key Information Document (KID), which is written in a clear language and completely separated from marketing materials. PRIIPs is applicable as of 31 December 2016. UCITS benefit from an exemption until 2020.	(X)	X
	Level 1: Regulation (EU) 2016/2340 of the European Parliament and of the Council of 14 December 2016 amending Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products as regards the date of its application		This Regulation provides further clarification on the KID for PRIIPs.	(X)	X
	Level 2: Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents		This Commission delegated regulation lays down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents.	(X)	X
	Level 2: Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website		This Regulation contains rules on the form and content of key investor information.	X	(X)
	Level 2: Commission Delegated Regulation (EU) 2019/1866 of 3 July 2019 amending Delegated Regulation (EU) 2017/653 to align the transitional arrangement for PRIIP manufacturers offering units of funds referred to in Article 32 of Regulation (EU) No 1286/2014 of the European Parliament and of the Council as underlying investment options with the prolonged exemption period under that Article		This Regulation extends the exemption to produce a PRIIPs KII for UCITS until 31 December 2021.	X	(X)
	Level 3: ESMA guidelines (published by CESR): ▶ Guide to clear language and layout for the KII document, December 2010 ▶ Template for the KII document, December 2010 ▶ Guidelines on the methodology for the calculation of the synthetic risk and reward indicator (SRRRI) in the KII Document, July 2010 ▶ Guidelines on the selection and presentation of performance scenarios in the KII document for structured UCITS, December 2010 ▶ Guidelines on the methodology for calculation of the ongoing charges figure in the KII Document, July 2010		ESMA’s guidelines on the KII.	X	(X)
	Additional regulatory guidance: ESMA Q&A document on Key Investor Information Document (KIID) for UCITS		ESMA Q&A amendments cover the past performance to disclose in case of merger.	X	(X)
		Regulatory guidance: CSSF FAQ on Key Investor Information Document - Frequently Asked Questions	This CSSF FAQ clarifies specific questions in relation to the KII.	X	(X)
		Industry guidance: ALFI Q&A on PRIIPs KID, Issue 3 October 2017	This Q&A provides guidance on key information documents for packaged retail and insurance-based investment products.	(X)	X
	Other fund documentation, and communication thereof	Level 3: CSSF Circular 03/97 of 28 February 2003 on simplified and full prospectuses and annual and semi-annual reports	This Circular clarifies the procedure for the publication of simplified and full prospectuses and annual and semi-annual reports under the 2010 Law. Such documents are made available electronically by means of a fund registry set up by Centrale de Communications Luxembourg S.A. (now FundSquare).	X	X
Level 3: CSSF Circular 19/708 of 28 January 2019 on the electronic transmission of documents to the CSSF		This Circular contains an appendix listing which documents must be sent to the CSSF in electronic form only.	X	X	

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
Other fund documentation, and communication thereof (cont'd)		Level 3: CSSF Circular 02/81 of 6 December 2002 on the external audit and specifically the requirement of a long form report	This Circular introduced the requirement of a long form report for each UCI (institutional UCIs are exempted) and specifies the topics to be addressed.	X	X
		Level 3: CSSF Circular 11/503 of 3 March 2011 relating to the obligations applicable to the transmission and publication of financial information and related deadlines	This Circular acts as a reminder on the obligations applicable to the transmission and publication of financial information and related deadlines given certain deficiencies noted by the CSSF.	X	X
		Additional regulatory guidance: CSSF Newsletter No. 130 of November 2011	This Newsletter introduces the requirement to include a paragraph relating to the exercise of the rights of investors towards the UCI in the UCI prospectuses.	X	X
UCI reporting to the authorities		Level 3: IML ³²⁸ Circular 97/136 of 13 June 1997 (as amended by Circular 08/348) concerning financial reports to be prepared on a monthly and yearly basis	This Circular outlines the requirement for all Luxembourg UCIs to produce monthly and annual financial information for the attention of the CSSF (previously the IML) and STATEC to be submitted via Centrale de Communications Luxembourg S.A. (CCLux, now FundSquare).	X	X
		Level 3: CSSF Circular 08/348 of 17 April 2008 concerning changes to Circulars IML 97/136 and CSSF Circular 07/310	This Circular modifies IML Circular 97/136 on the financial information which UCIs have to communicate to CCLux (now FundSquare). The delay for communication of monthly financial information is reduced from 20 to 10 days.	X	X
		Level 3: CSSF Circular 15/627 of 3 December 2015 concerning new monthly reporting to the CSSF - U 1.1. reporting	This circular implements new monthly reporting - U 1.1. reporting. The Circular repeals the monthly reporting required by Circulars 97/136, 07/130 (monthly table 0 1.1), as amended by Circular 08/348, from June 2016.	X	X
		Level 3: BCL Circular 2014/237 and CSSF Circular 14/588 of 28 May 2014 on modification of the statistical data collection for money market funds and non-money market funds	This Luxembourg Central Bank (BCL) and CSSF Circular covers monthly and quarterly information reporting requirements.	X	X
		Level 3: CSSF Circular 19/721 of 1 July 2019 on the dematerialisation of requests to the CSSF.	The purpose of this circular is to inform the in scope of the implementation of the eDesk portal which must be used for all the requests to the CSSF laid down in the Circular in accordance with the applicable legal and regulatory provisions.	X	X
		Additional regulatory guidance: CSSF FAQ concerning O 1.1. reporting	The FAQ provides additional clarification and guidance on making financial reporting for UCIs, to the CSSF.	X	X
		Additional regulatory guidance: CSSF FAQ concerning U 1.1. reporting	The FAQ provides additional clarification and guidance on financial reporting for UCIs.	X	X
Errors		Level 3: CSSF Circular 02/77 of 27 November 2002 on NAV errors and active breaches of investment restrictions	This Circular establishes rules to be followed in the case of material net asset value (NAV) calculation errors and active breaches of investment rules.	X	X
		Additional Guidance: CSSF FAQ on CSSF Circular 02/77	This FAQ provides, <i>inter alia</i> , additional clarification on the application of the Circular, selection of the correct method and tolerance threshold of Circular 02/77.	X	X
Depository	Level 1: Directive 2014/91/EU of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depository functions, remuneration policies and sanctions (UCITS V)	Level 1: Law of 10 May 2016 modifying the 2010 Law.	This Directive introduces new rules on UCITS depositories, such as the entities eligible to assume this role, their tasks, delegation arrangements and the depositories' liability as well as general remuneration principles that apply to fund managers, and sanctions.	X	X

³²⁸ The Luxembourg Monetary Institute (IML) was the predecessor of the CSSF.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
Depository (cont'd)	Level 2: Commission Delegated Regulation 438/2016 of 17 December 2015 on the depositary obligations		This regulation supplements the provisions of the Directive 2009/65/EC.	X	X
	Level 2: Commission Delegated Regulation 2018/1619 amending Delegated Regulation 2016/438 on safe-keeping duties of depositaries		This regulation introduces new rules notably on asset segregation and delegate/third-parties oversight.	X	X
		Level 3: CSSF Circular 16/644 on Provisions applicable to credit institutions acting as UCITS depositary subject to Part I of the law of 17 December 2010 relating to undertakings for collective investment and to all UCITS, where appropriate, represented by their management company	The Circular covers UCITS depositary appointment, duties delegation of functions, governance and conflict of interest rules and information flows between the depositary and the UCITS and between the depositary and the authorities.	X	
		Level 3: CSSF Circular 18/697 on 23 August 2018 on the organisational arrangements applicable to fund depositaries which are not subject to Part I of the Law of 17 December 2010 relating to undertakings for collective investment, and, where appropriate, to their branches; amendment to CSSF Circular 16/644 regarding the provisions applicable to credit institutions acting as UCITS depositary subject to Part I of the 2010 Law, where appropriate, represented by their management company; and amendment to IML Circular 91/75 (as amended by Circular CSSF 05/177) regarding the revision and recast of the rules to which Luxembourg undertakings governed by the Law of 30 March 1988 on undertakings for collective investment ("UCIs") are subject.	This Circular provides a set of requirements on the duties of the depositaries regarding the safekeeping of assets, oversight duties as well as the monitoring of cash flows and they have introduced a liability regime of depositaries towards alternative investment funds and their investors.	X	X
	Additional regulatory guidance: ESMA Q&A on the application of the UCITS Directive		This Q&A consolidates the previous Q&As issued on the UCITS Directive and includes, <i>inter alia</i> : ▸ Depositary	X	
		Industry guidance: ALFI Best practice guidelines for depositary banks: ▸ In relation to the safekeeping of assets from UCITS funds held through the traditional custody network ▸ In relation to the safekeeping of assets from UCITS funds not held through the traditional custody network September 2009	ALFI's Best practice guidelines for depositary banks cover the safekeeping of the assets of UCITS funds.	X	
		Industry guidance: ALFI and ABBL guidelines and recommendations for depositaries, May 2018	This document provides oversight duties and cash monitoring for AIFs and UCITS.	X	X
		Industry Guidance: ALFI and ABBL Guidelines - Financial instruments held in custody	This document provides clarification on safekeeping obligations of assets held-in-custody.	X	X
		Industry Guidance: ALFI and ABBL Guidelines on new AIFM UCITS CDRs	This document provides impact assessment and implementation guidelines for Commission Delegated Regulations 2018/1618 and 2018/1619.	X	X

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
UCI authorization and updates to authorization		Level 3: CSSF Circular 14/591 of 22 July 2014 on Protection of investors in case of a material change to an open-ended undertaking for collective investment	The Circular covers the process by which UCIs may be required to notify investors before implementing material changes to the UCI.	X	X
		Application for authorization: CSSF document on Setting up a Luxembourg based undertaking for collective investment or additional sub-fund(s) to an existing undertaking for collective investment and application questionnaires for the setup of an undertaking and additional sub-fund(s) and specific sub-fund investment policy questionnaire.	This document covers the legal requirements, procedure to be followed and list of documents and information to be submitted in the application for authorization process.	X	X
		Application for authorization: CSSF document on Amending a Luxembourg based undertaking for collective investment on the official list	This document covers the updates to applications for authorization.	X	X
General provisions applicable to management companies and, where applicable, self-managed UCIs	Level 2: Commission Directive 2010/43/EU implementing Directive 2009/65/EC as regards organizational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company, July 2010	Level 2: CSSF Regulation 10-04 of 24 December 2010 as regards organizational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company	This Regulation lays down the implementing measures of the Law of 17 December 2010 concerning undertakings for collective investment as regards organizational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company.	X	(X)
		Level 3: CSSF Circular 18/698 of 23 August 2018 on the authorisation and organisation of investment fund managers incorporated under Luxembourg law. Specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent	The purpose of the Circular is to provide additional clarifications on certain conditions for authorisation, more particularly the shareholding structure, the minimum own funds requirements, the administrative bodies, the arrangements concerning the central administration and governance and the rules governing the delegation framework. This Circular repeals Circular 12/546.	X	X
Complaints handling		Level 2: CSSF Regulation No 16-07 of October 2016 relating to the out-of-court resolution of complaints	The Regulation specifies the obligations incumbent on financial sector entities in relation to the handling of complaints including complaints handling policy, procedure and responsibility for complaints handling and communication of information to the CSSF. It also covers the rules applicable to the request for the out-of-court resolution of complaints filed with the CSSF.	X	X
		Level 3: CSSF Circular 14/589 of 27 June 2014 on Details concerning CSSF Regulation No 13-02 relating to the out-of-court resolution of complaints	The Circular clarifies CSSF Regulation No 13-02 (replaced by CSSF Regulation 16-07).	X	X
		Level 3: CSSF Circular 17/671 on specifications regarding CSSF Regulation 16/07 of 26 October 2016 relating to out-of-court complaint resolution	This Circular revises and further develops the content of Circular 14/589.	X	X
Remuneration	Level 1: Directive 2014/91/EU of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions (UCITS V)	Level 1: Law of 10 May 2016 modifying the 2010 Law.	This Directive introduces new rules on UCITS depositaries, such as the entities eligible to assume this role, their tasks, delegation arrangements and the depositaries' liability as well as general remuneration principles that apply to fund managers, and sanctions.	X	

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	Application	
				UCITS and/ or UCITS ManCos	2010 Law Part II UCIs and/or their ManCos ³²⁵
Remuneration (cont'd)	Level 3: ESMA Guidelines of 31 March 2016 on sound remuneration policies under the UCITS Directive and AIFMD		The guidelines provide clarity on the requirements under UCITS V and clarify the remuneration rules under AIFMD.	X	X
		Level 3: CSSF Circular 10/437 of 1 February 2010 on guidelines concerning the remuneration policies in the financial sector	This Circular implements European Commission Recommendation 2009/384/EC on remuneration policies in the financial sector of 30 April 2009 and is applicable to all entities subject to CSSF supervision.	X	X
	Level 3: ESMA Guidelines on performance fees in UCITS and certain types of AIFs		The Guidelines introduce requirements with regard to performance fee calculation methodology, governance and consistency with UCI's investment strategy, crystallization frequency, loss recovery and disclosures.	X	X
	Additional regulatory guidance: ESMA Q&A on the application of the UCITS Directive		This Q&A consolidates the previous Q&As issued on the UCITS Directive and includes, <i>inter alia</i> : ▸ Remuneration	X	
		Additional regulatory guidance: CSSF FAQ of 21 May 2010 on guidelines concerning the remuneration policies in the financial sector	The FAQ clarifies certain elements of CSSF Circular 10/437.	X	X
ManCo reporting to the authorities		Level 3: CSSF Circular 10/467 of 1 July 2010 on electronic transmission of financial information to be transmitted to the CSSF on a periodic basis by management companies subject to Chapter 13 of the 2002 Law (now Chapter 15 of the 2010 Law) and modifying certain periodic tables	This Circular outlines the technical requirements relating to electronic transmission of financial information to the CSSF by Chapter 15 management companies and modifies the periodic reporting templates, updated by CSSF Circular 12/546.	X	(X)
		Level 3: CSSF Circular 11/504 on Frauds and incidents due to external computer attacks, March 2011	This Circular requires all establishments under the supervision of the CSSF to report as soon as possible any frauds and any incidents due to external computer attacks and to keep, at their own initiative, this information up to date after the date of the report concerned.	X	X
ManCo authorization		Application for authorization: CSSF document on setting up a Luxembourg UCITS (Chapter 15) management company	This is the application form to set up a UCITS management company.	X	(X)
		Application for authorization: CSSF document on setting up a Luxembourg Chapter 16 management company	This is the application form to set up a non-UCITS (Chapter 16) management company.		X
		Application for authorization: CSSF Registration form for an alternative investment fund manager and CSSF Declaration for a registered AIFM ³²⁹	In cases of a management company managing AIF and internally managed AIF, which are not required to and do not choose to apply for authorization as AIFM (see Section II.2.2.), they will be required to register as a registered AIFM using the form and declaration for registered AIFM.	(X)	X
Marketing	Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014		Regulation (EU) 2019/1156 is intended to facilitate cross-border distribution of collective investment undertakings and amending the European Venture Capital Funds Regulation, the European Social Entrepreneurship Funds Regulation, and the Regulation on key information documents for packaged retail and insurance-based investment products.	X	X
	Level 1: Directive (EU) 2019/1160 of the European Parliament and of the Council of 20 June 2019 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings		This Directive amends the UCITS and AIFM Directives and harmonizing various aspects of cross-border distribution.	X	X

³²⁹ Where AIF are not managed by an authorized AIFM and are not authorized as internally managed AIF.

II.2.2. Alternative Investment Fund Managers (AIFM) and internally managed AIF

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
General	Level 1: Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers (AIFM) (the AIFMD)	Level 1: The Law of 12 July 2013 on Alternative Investment Fund Managers (the AIFM Law)	The AIFM Law transposes the Alternative Investment Fund Managers Directive (AIFMD), and amends a number of existing Laws including the 2010 Law, the SIF Law and the 1993 Law.
		Level 1: Law of 10 August 1915 on commercial companies, as amended (the 1915 Law)	The 1915 Law is the basic law on commercial companies. It is applicable to AIFM where the law they are under does not derogate from it.
		Level 1: Law of 27 May 2016 modernising the Luxembourg legal publication regime	This Law, <i>inter alia</i> : <ul style="list-style-type: none"> ► Creates a central electronic platform: RESA ► Introduces new registration requirements for common funds (FCPs) ► Clarifies costs for late filling of annual accounts
		Level 2: Commission Delegated Regulation (EU) No 231/2013 of December 2012 supplementing Directive 2011/61/EU on exemptions, general operating conditions, depositaries, leverage, transparency and supervision	This implementing Regulation clarifies certain aspects of the AIFMD on exemptions, general operating conditions, depositaries, leverage, transparency and supervision and ensures the direct applicability of detailed uniform rules concerning the operation of AIFM.
		Level 3: CSSF Circular 18/698 of 23 August 2018 on the authorisation and organisation of investment fund managers incorporated under Luxembourg law. Specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent	The purpose of the Circular is to provide additional clarifications on certain conditions for authorisation, more particularly the shareholding structure, the minimum own funds requirements, the administrative bodies, the arrangements concerning the central administration and governance and the rules governing the delegation framework. This Circular repeals Circular 12/546.
		Additional regulatory guidance: CSSF Frequently Asked Questions concerning the Luxembourg Law of 12 July 2013 on alternative investment fund managers updated in April 2019 as well as the Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012, June 2013, as updated (AIFM FAQ)	The CSSF's FAQ covers, <i>inter alia</i> , scope of application of the AIFM Law, AIFM application for authorization or registration, the relationship between AIFM and credit institutions and investment firms, delegation by AIFM, scope of authorized activities of AIFM, depositary aspects, reporting requirements, exemptions, general operating conditions, supervision, valuation, leverage transparency, transaction cost disclosure and cooperation agreements signed between Luxembourg and third countries.
		Additional regulatory guidance: ESMA Q&A on the application of the AIFMD	ESMA Q&A covers, <i>inter alia</i> , applicability of remuneration requirements to delegates, reporting, notification, MIFID securities under AIFMD, depositary, delegation, calculation of leverage, impact of EMIR and SFTR on AIFMD, branches and additional own funds.
AIFMD definitions	Additional regulatory guidance: European Commission, Questions and Answers (Q&A) on the Alternative Investment Fund Managers Directive	The Q&A covers a wide range of topics on the implementation of the AIFMD, such as scope, own funds, delegation, valuation, depositary, and reporting.	
	Level 2: Commission Delegated Regulation (EU) No 694/2014 of 17 December 2013 supplementing Directive 2011/61/EU with regard to regulatory technical standards determining types of alternative investment fund managers	This Delegated Regulation distinguishes between AIFM managing AIFs of the open-ended or closed-ended type or both, in order to apply correctly the AIFMD rules on liquidity management and valuation procedure and specific exemptions.	
	Level 3: ESMA Guidelines on key concepts of the AIFMD, August 2013	These Guidelines aim to ensure common, uniform and consistent application of the concepts in the definition of "AIF" under the AIFMD by providing clarification on each of these concepts.	
Opt in	Commission Implementing Regulation (EU) No 447/2013 of 15 May 2013 establishing the procedure for AIFMs which choose to opt in under Directive 2011/61/EU	This regulation establishes the procedure for AIFMs which choose to opt in under the AIFMD.	
Late transposition	ESMA Opinion on practical arrangements for the late transposition of the AIFMD, August 2013	ESMA's opinion covers the exercise of the AIFM Directive passports for cross-border marketing of AIF and cross-border management of AIF in host Member States which have not yet transposed the AIFMD.	
Governance of AIFs		ALFI Code of Conduct for Luxembourg Investment Funds, update June 2013	The objective of the updated Code of Conduct is to provide Boards of Directors with a framework of high-level principles and best practice recommendations for the governance of Luxembourg investment funds and of management companies, where appropriate.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	
Governance of AIFs (cont'd)		ALFI Principles of oversight of financial intermediaries in distribution of funds, April 2017	This document provides parties charged with the responsibility for oversight of financial intermediaries in the distribution chain with a set of high-level common principles for their consideration.	
		Industry guidance: ALFI Code of Conduct guidance, May 2017	This document provides guidance on the process for the implementation and ongoing adherence to the ALFI code of conduct for Luxembourg investment funds and management companies.	
		Industry guidance ALFI Code of Conduct guidance, October 2017	ALFI provided guidance in separate papers covering: board member independence, board evaluations, board member time capacity, board member letters of appointment, conflicts of interest and directors' reports.	
		Industry guidance: EFAMA's Stewardship code covering Principles for asset managers' monitoring, voting of, engagement with investee companies.	The Code is meant to help asset managers adopt best practices in respect of stewardship of the companies in which they invest on behalf of their own clients.	
Money market funds		Level 1: Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds.	This Regulation sets out new requirements for UCIs meeting the definition of money market funds.	
		Level 3: Commission Delegated Regulation (EU) 2018/990 of 10 April 2018 amending and supplementing Regulation (EU) 2017/1131 of the European Parliament and of the Council with regard to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies	This Regulation amends and supplements Regulation (EU) 2017/1131 with respect to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies.	
		Level 3: Commission Implementing Regulation (EU) 2018/708 of 17 April 2018 laying down implementing standards with regard to the template to be used by managers of money market funds when reporting to competent authorities as stipulated by Article 37 of Regulation (EU) 2017/1131 of the European Parliament and of the Council	This Regulation provides clarifications for managers of money market funds on implementation of reporting to competent authorities.	
		Level 3: ESMA guidelines on stress test scenarios under Article 28 of the MMF Regulation, March 2018	Level 3: CSSF Circular 18/696 of 20 July 2018 on ESMA's guidelines on stress test scenarios	These guidelines establish common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of Regulation (EU) 2017/1131.
			Additional industry guidance: CSSF's Frequently Asked Questions concerning the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market fund, of 28 August 2018	The Frequently Asked Questions (FAQs) aim at highlighting some of the key aspects of the Money Market Fund Regulation ("MMFR") from a Luxembourg perspective. The FAQs are therefore primarily addressed to managers of money market funds and money market funds ("MMFs") that are established in Luxembourg.
Fund classification		Industry guidance: The European Fund Classification Categories, European Fund Categorization Forum (EFCF), EFAMA, April 2012	The European Fund Classification (EFC) is a pan-European classification system for investment funds developed by the European Fund Categorization Forum (EFCF), a working group of the European Fund and Asset Management Association (EFAMA).	
Risk management		Level 3: The Board of the International Organization of Securities Commissions (IOSCO)'s Recommendations for Liquidity Risk Management for Collective Investment Schemes (FR01/2018), February 2018.	This publication contains recommendations on the principles of liquidity risk management for UCIs.	
		IOSCO's Statement of IOSCO Liquidity risk management recommendations for investment funds of 18 July 2019	This statement explains why IOSCO's recommendations of February 2018 do, in fact, provide a comprehensive framework for regulators to deal with liquidity risks in investment funds.	
		Industry guidance: International Capital Market Association's (ICMA) Asset Management and Investors Council (AMIC) and the European Fund and Asset Management Association (EFAMA) , Use of Leverage in Investment Funds in Europe Paper, July 2017	The paper analyses how leverage is used, how the European legislative framework addresses leverage, and how the related risks are addressed from a technical perspective. In order to contribute to recent debates launched by regulators and supervisors, it also looks at the updates and improvements that could be proposed to ensure that the European regulation remains a cutting-edge framework at global level.	
		Level 3: ESMA guidelines on stress test scenarios under Article 28 of the MMF Regulation, March 2018	Level 3: CSSF Circular 18/696 of 20 July 2018 on ESMA's guidelines on stress test scenarios	These guidelines establish common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of Regulation (EU) 2017/1131.
			Industry guidance: ALFI guidance on Risk Management under AIFMD, May 2014	The guidance covers, <i>inter alia</i> , risk management areas addressed by AIFMD and suggests high level principles when implementing a risk management function on governance, identification, measurement, management and reporting of risks.
		Industry guidance: ALFI Q&A on Risk Management for AIF under AIFMD, May 2014,	The Q&A covers, <i>inter alia</i> , leverage and the risk governance and risk processes.	
		Industry guidance: ALFI guidance on liquidity stress testing considerations for real estate funds, May 2018	This guidance aims at supporting the practical implementation of stress testing arrangements for real estate investment funds.	

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Complaints handling		Level 2: CSSF Regulation No 16-07 of October 2016 relating to the out-of-court resolution of complaints	The Regulation specifies the obligations incumbent on financial sector entities in relation to the handling of complaints including complaints handling policy, procedure and responsibility for complaints handling and communication of information to the CSSF. It also covers the rules applicable to the request for the out-of-court resolution of complaints filed with the CSSF.
		Level 3: CSSF Circular 14/589 of 27 June 2014 on Details concerning Regulation CSSF No 13-02 relating to the out-of-court resolution of complaints	The Circular clarifies CSSF Regulation No 13-02 (replaced by CSSF Regulation 16-07).
		Level 3: CSSF Circular 17/671 on specifications regarding CSSF Regulation 16/07 of 26 October 2016 relating to out-of-court complaint resolution	This Circular revises and further develops the content of Circular 14/589.
Remuneration	Level 3: ESMA Guidelines on sound remuneration policies under the AIFMD, February 2013, as amended		These Guidelines on remuneration policies required by the AIFMD cover scope of application, proportionality principle, AIFM which are part of a group, impact of variable remuneration on the AIFM, governance roles in relation to remuneration, risk alignment and internal and external disclosure.
		Level 3: CSSF Circular 10/437 of 1 February 2010 on guidelines concerning the remuneration policies in the financial sector	This Circular implements European Commission Recommendation 2009/384/EC on remuneration policies in the financial sector of 30 April 2009 and is applicable to all entities subject to CSSF supervision.
	Additional regulatory guidance: ESMA Q&A on the application of the AIFMD		ESMA Q&A covers, <i>inter alia</i> , applicability of remuneration requirements to delegates, reporting, notification, MiFID securities under AIFMD, depositary, delegation, calculation of leverage, impact of EMIR and SFTR on AIFMD, branches and additional own funds.
		Additional regulatory guidance: CSSF FAQ of 21 May 2010 on guidelines concerning the remuneration policies in the financial sector	The FAQ clarifies certain elements of CSSF Circular 10/437.
NAV and Subscriptions and redemptions		Level 3: CSSF Circular 04/146 of 17 June 2004 on the protection of UCIs and their investors against Late Trading and Market Timing practices	This Circular clarifies the protective measures to be adopted by UCIs and certain of their service providers, fixes more general rules of conduct for all professionals subject to CSSF supervision and extends the role of the auditor regarding Late Trading and Market Timing.
		Additional industry guidance: CSSF's Frequently Asked Questions (FAQ) - Swing Pricing Mechanism of 30 July 2019	This FAQ clarifies certain aspects of swing pricing including reference thereto in constitutional documents, disclosure to investors, error handling and organizational requirements.
		Industry guidance: ALFI reports entitled Swing Pricing guideline and updated 2015, December 2015	These reports present the results of a survey of swing pricing practices and updated swing pricing guidelines, originally released in 2006.
		Industry guidance: ALFI Position Paper on the treatment of subscription and redemption orders under AIFMD	ALFI's paper covers the subscription and redemption recording and reporting obligations under AIFMD.
Marketing	Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014		Regulation (EU) 2019/1156 is intended to facilitate cross-border distribution of collective investment undertakings and amending the European Venture Capital Funds Regulation, the European Social Entrepreneurship Funds Regulation, and the Regulation on key information documents for packaged retail and insurance-based investment products.
	Level 1: Directive (EU) 2019/1160 of the European Parliament and of the Council of 20 June 2019 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings		This Directive amends the UCITS and AIFM Directives and harmonizing various aspects of cross-border distribution.
		Level 2: CSSF Regulation 15-03 of 26 November 2015 on the marketing of foreign Alternative Investment Funds to retail investors in Luxembourg	The regulation describes the modalities of application of Article 46 of the AIFM Law concerning the marketing of Alternative Investment Funds to retail investors in Luxembourg.
Reporting to the authorities	Level 3: ESMA Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD, as amended, November 2013		These guidelines cover, among others, the AIFM obligations in relation to reporting to national competent authorities (NCAs).
		Level 3: CSSF Circular 19/708 of 28 January 2019 on the electronic transmission of documents to the CSSF	This Circular contains an appendix listing which documents must be sent to the CSSF in electronic form only.
		Level 3: CSSF Circular 15/633 of 29 December 2015 on electronic transmission of financial information to be transmitted to the CSSF on a periodic basis by the authorized external alternative investment fund managers	This Circular extends the scope of CSSF Circular 10/467 to alternative investment fund managers. It outlines the technical requirements relating to electronic transmission of financial information to the CSSF.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Reporting to the authorities (cont'd)		Level 3: CSSF Circular 15/612 of 5 May 2015 on the information to be submitted to the CSSF in relation to unregulated alternative investment funds (established in Luxembourg, in another Member State of the European Union or in a third country) and/or regulated alternative investment funds established in a third country.	This Circular clarifies the information to be communicated by Luxembourg-established AIFMs on additional non-regulated AIFs and regulated non-EU AIFs they start to manage.
		Level 3: CSSF Circular 14/581 of January 2014 on the new reporting obligations for Alternative Investment Fund Managers	This Circular defines technical specifications in relation to the reporting files, transmission of the reporting files to the CSSF and naming conventions to be used.
		Level 3: CSSF Circular 11/504 on Frauds and incidents due to external computer attacks, March 2011	This Circular requires all establishments under the supervision of the CSSF to report as soon as possible any frauds and any incidents due to external computer attacks and to keep, at their own initiative, this information up to date after the date of the report concerned.
		Level 3: CSSF Circular 19/721 of 1 July 2019 on the dematerialisation of requests to the CSSF.	The purpose of this circular is to inform the in scope of the implementation of the eDesk portal which must be used for all the requests to the CSSF laid down in the Circular in accordance with the applicable legal and regulatory provisions.
		Additional regulatory guidance: ESMA Q&A on the application of the AIFMD	ESMA Q&A covers, <i>inter alia</i> , applicability of remuneration requirements to delegates, reporting, notification, MiFID securities under AIFMD, depositary, delegation, calculation of leverage, impact of EMIR and SFTR on AIFMD, branches and additional own funds.
		Industry guidance: ALFI Q&A on the reporting under the AIFMD , October 2014	The Q&A proposes answers to technical questions on AIFMD reporting, complementing both ESMA's Q&A document on application of the AIFMD and the FAQ document on AIFM published by the CSSF.
Reporting to investors	Level 1: Regulation (EU) 1286/2014 of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs)		PRIIPs is a Regulation which composes the wider consumer protection package, together with UCITS V, MiFID II, and Insurance Mediation Directive 2. The key objective of PRIIPs is to reduce or "eliminate" the asymmetries of information which exist among retail investment products. It closes gaps and creates consistent rules applying to all PRIIPs by creating a standardized and pre-contractual document for retail investors, the Key Information Document (KID), which is written in a clear language and completely separated from marketing materials. PRIIPs is applicable as of 31 December 2016. UCITS benefit from an exemption until 2020.
	Level 1: Regulation (EU) 2016/2340 of the European Parliament and of the Council of 14 December 2016 amending Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products as regards the date of its application		This Regulation provides further clarification on the KID for PRIIPs.
	Level 2: Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents		This Commission delegated regulation lays down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents.
		Industry guidance: ALFI's Q&A on Reporting to investors and annual reports under the AIFMD, October 2014	The Q&A provides guidance for the preparation of Luxembourg annual reports of regulated AIFs (mainly UCI Part II and SIFs) under the AIFMD. It focuses on the annual report to investors as well as on periodic disclosure to investors.
Fund documentation and communication		Level 3: CSSF Circular 11/503 of 3 March 2011 relating to the obligations applicable to the transmission and publication of financial information and related deadlines	This Circular acts as a reminder on the obligations applicable to the transmission and publication of financial information and related deadlines given certain deficiencies noted by the CSSF.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Depository		Level 3: CSSF Circular 18/697 of 23 August 2018 on the organisational arrangements applicable to fund depositaries which are not subject to Part I of the Law of 17 December 2010 relating to undertakings for collective investment, and, where appropriate, to their branches; amendment to CSSF Circular 16/644 regarding the provisions applicable to credit institutions acting as UCITS depository subject to Part I of the 2010 Law, where appropriate, represented by their management company; and amendment to IML Circular 91/75 (as amended by Circular CSSF 05/177) regarding the revision and recast of the rules to which Luxembourg undertakings governed by the Law of 30 March 1988 on undertakings for collective investment ("UCIs") are subject.	This Circular provides a set of requirements on the duties of the depositaries regarding the safekeeping of assets, oversight duties as well as the monitoring of cash flows and they have introduced a liability regime of depositaries towards alternative investment funds and their investors.
		Industry guidance: ALFI and ABBL Depository Banking Guidelines on look-through and control, March 2020	These guidelines provide an overview of various control situations and the consequences when applying the look-through principle anchored in the AIFMD framework as well as practical examples.
AIFM authorization		Application for authorization: CSSF Application questionnaire for the setup of a fully licensed AIFM and CSSF Declaration for a fully licensed AIFM	
		Application for authorization: CSSF Registration form for an alternative investment fund manager and CSSF Declaration for a registered AIFM ³³⁰	
Relations with third countries	Level 2: Commission Implementing Regulation (EU) No 448/2013 of 15 May 2013 establishing a procedure for determining the Member State of reference of a non-EU AIFM pursuant to Directive 2011/61/EU		This regulation establishes a procedure for determining the Member State of reference of a non-EU AIFM. Such procedure differs from the procedure for applying for a passport under the AIFMD.
	Level 2: ESMA's advice to the European Parliament, the Council and the Commission on the application of the AIFMD passport to non-EU AIFMs and AIFs, July 2015		The Advice relates to the possible extension of the passport, currently only available to EU entities, to non-EU AIFMs and AIFs which are currently subject to EU National Private Placement Regimes. ESMA conducted a country-by-country assessment, as this allowed it flexibility to take into account the different circumstances of each non-EU jurisdiction regarding the regulatory issues to be considered i.e., investor protection, competition, potential market disruption and the monitoring of systemic risk.
	ESMA list of AIFMD MoUs signed by EU authorities with non-EU regulators	List of the cooperation arrangements required under the AIFMD signed by the CSSF with non-EU regulators	<p>The Memoranda of Understanding (MoU) with third country regulators are relevant in relation to:</p> <ul style="list-style-type: none"> ▸ Delegation of portfolio management and risk management by an AIFM to a third country entity ▸ Marketing in the EU/EEA under national private placement regimes (NPPRs) and the passport: of non-EEA AIF managed by EEA AIFM and of AIF managed by non-EEA AIFM ▸ Management of EEA AIF by non-EEA AIFM <p>The CSSF FAQ on AIFM now includes a link to the ESMA website with an overview of MoU between EU Member States and third countries which are compliant with AIFMD requirements.</p>

³³⁰ Where AIF are not managed by an authorized AIFM and are not authorized as internally managed AIF.

II.2.3. Specialized investment funds (SIFs)³³¹

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
General		Level 1: Law of 13 February 2007 on Specialized Investment Funds, as amended (the SIF Law)	The Law on Specialized Investment Funds (SIFs).
		Level 1: Law of 10 August 1915 on commercial companies, as amended (the 1915 Law)	The 1915 Law is the basic law on commercial companies. It is applicable to SIFs where the SIF Law does not derogate from it.
		Level 1: Law of 27 May 2016 modernising the Luxembourg legal publication regime	This Law, <i>inter alia</i> : <ul style="list-style-type: none"> ▸ Creates a central electronic platform: RESA ▸ Introduces new registration requirements for common funds (FCPs) ▸ Clarifies costs for late filling of annual accounts
		Level 3: CSSF Circular 07/283 of 28 February 2007 on the entry into force of the Law of 13 February 2007 relating to Specialized Investment Funds	This Circular presents a summary of the main elements of the legal framework introduced by the SIF Law.
Governance of SIFs		Level 3: CSSF Circular 18/698 of 23 August 2018 on the authorisation and organisation of investment fund managers incorporated under Luxembourg law. Specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent	The purpose of the Circular is to provide additional clarifications on certain conditions for authorisation, more particularly the shareholding structure, the minimum own funds requirements, the administrative bodies, the arrangements concerning the central administration and governance and the rules governing the delegation framework. This Circular repeals Circular 12/546.
		Industry guidance: ALFI Code of Conduct for Luxembourg Investment Funds, update June 2013	The objective of the updated Code of Conduct is to provide Boards of Directors with a framework of high-level principles and best practice recommendations for the governance of Luxembourg investment funds and of management companies, where appropriate.
		Industry guidance: ALFI Code of Conduct guidance, May 2017 Industry guidance: ALFI Code of Conduct guidance, May 2017	This document provides guidance on the process for the implementation and ongoing adherence to the ALFI code of conduct for Luxembourg investment funds and management companies.
		Industry guidance ALFI Code of Conduct guidance, October 2017	ALFI provided guidance in separate papers covering: board member independence, board evaluations, board member time capacity, board member letters of appointment, conflicts of interest and directors' reports.
Money market funds		Level 1: Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds.	This Regulation sets out new requirements for UCIs meeting the definition of money market funds.
		Level 3: Commission Delegated Regulation (EU) 2018/990 of 10 April 2018 amending and supplementing Regulation (EU) 2017/1131 of the European Parliament and of the Council with regard to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies	This Regulation amends and supplements Regulation (EU) 2017/1131 with respect to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies.
		Level 3: Commission Implementing Regulation (EU) 2018/708 of 17 April 2018 laying down implementing standards with regard to the template to be used by managers of money market funds when reporting to competent authorities as stipulated by Article 37 of Regulation (EU) 2017/1131 of the European Parliament and of the Council	This Regulation provides clarifications for managers of money market funds on implementation of reporting to competent authorities.
		Level 3: ESMA guidelines on stress test scenarios under Article 28 of the MMF Regulation, March 2018	Level 3: CSSF Circular 18/696 of 20 July 2018 on ESMA's guidelines on stress test scenarios
		Additional industry guidance: CSSF's Frequently Asked Questions concerning the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market fund, of 28 August 2018	The Frequently Asked Questions (FAQs) aim at highlighting some of the key aspects of the Money Market Fund Regulation ("MMFR") from a Luxembourg perspective. The FAQs are therefore primarily addressed to managers of money market funds and money market funds ("MMFs") that are established in Luxembourg.

³³¹ Where the SIF is managed by an authorized AIFM, or is an internally managed AIF, then the AIFM requirements also apply - see Section II.2.2.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	
Investment rules	Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012		It creates a general system to simplify rules for all securitisations and to identify simple, transparent and standardised securitisations. This includes: (i) common definitions for all key concepts in a securitisation; (ii) requirements for due diligence, risk-retention, transparency and credit-granting criteria; (iii) requirements for the sale of securitisations to retail clients; (iv) a ban on resecuritisation; (v) rules for securitisation special purpose entities (SSPEs) and securitisation repositories; (vi) a structure for simple, transparent and standardised (STS) securitisation; (vii) a system for administrative sanctions and remedial measures in cases of non-compliance.	
		Level 3: CSSF Circular 07/309 of 3 August 2007 on risk spreading in the context of Specialized Investment Funds	This Circular clarifies the definition of risk diversification in the context of funds under the SIF Law.	
Fund classification	Industry guidance: The European Fund Classification Categories, European Fund Categorization Forum (EFCF), EFAMA, April 2012		The European Fund Classification (EFC) is a pan-European classification system for investment funds developed by the European Fund Categorization Forum (EFCF), a working group of the European Fund and Asset Management Association (EFAMA).	
Risk management and conflicts of interest		Level 2: CSSF Regulation 15-07 published on 31 December 2015 laying down detailed rules for the application of Article 42 bis of the SIF Law concerning the requirements regarding risk management and conflicts of interest	This Regulation clarifies the risk management and conflicts of interest requirements of the SIF Law.	
		The Board of the International Organization of Securities Commissions (IOSCO)'s Recommendations for Liquidity Risk Management for Collective Investment Schemes (FRO1/2018), February 2018.	This publication contains recommendations on the principles of liquidity risk management for UCIs.	
		Level 3: ESMA guidelines on stress test scenarios under Article 28 of the MMF Regulation, March 2018	Level 3: CSSF Circular 18/696 of 20 July 2018 on ESMA's guidelines on stress test scenarios	These guidelines establish common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of Regulation (EU) 2017/1131.
		Industry guidance: International Capital Market Association's (ICMA) Asset Management and Investors Council (AMIC) and the European Fund and Asset Management Association (EFAMA), Use of Leverage in Investment Funds in Europe Paper, July 2017		The paper analyses how leverage is used, how the European legislative framework addresses leverage, and how the related risks are addressed from a technical perspective. In order to contribute to recent debates launched by regulators and supervisors, it also looks at the updates and improvements that could be proposed to ensure that the European regulation remains a cutting-edge framework at global level.
			Industry guidance: CSSF's Frequently Asked Questions (FAQ) - Swing Pricing Mechanism of 30 July 2019	This FAQ clarifies certain aspects of swing pricing including reference thereto in constitutional documents, disclosure to investors, error handling and organizational requirements.
			Industry guidance: ALFI Recommendation on the Risk management system for Specialized Investment Funds, June 2012	The document outlines proposals on how market participants may establish and document an adequate risk management system for SIFs, covering the risk management function, and risk identification, measurement and monitoring.
Remuneration		Industry guidance: ALFI guidance on liquidity stress testing considerations for real estate funds, May 2018	This guidance aims at supporting the practical implementation of stress testing arrangements for real estate investment funds.	
		Level 3: CSSF Circular 10/437 of 1 February 2010 on guidelines concerning the remuneration policies in the financial sector	This Circular implements European Commission Recommendation 2009/384/EC on remuneration policies in the financial services sector of 30 April 2009 and is applicable to all entities subject to CSSF supervision.	
		Additional regulatory guidance: CSSF FAQ of 21 May 2010 on guidelines concerning the remuneration policies in the financial sector	The FAQ clarifies certain elements of CSSF Circular 10/437.	
NAV and subscriptions and redemptions		Level 3: CSSF Circular 04/146 of 17 June 2004 on the protection of UCIs and their investors against Late Trading and Market Timing practices	This Circular clarifies the protective measures to be adopted by UCIs and certain of their service providers, fixes more general rules of conduct for all professionals subject to CSSF supervision and extends the role of the auditor regarding Late Trading and Market Timing.	
		Industry guidance: ALFI reports entitled Swing Pricing guideline and updated 2015, December 2015	These reports present the results of a survey of swing pricing practices and updated swing pricing guidelines, originally released in 2006.	
		Industry guidance: CSSF's Frequently Asked Questions (FAQ) - Swing Pricing Mechanism of 30 July 2019	This FAQ clarifies certain aspects of swing pricing including reference thereto in constitutional documents, disclosure to investors, error handling and organizational requirements.	

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Dormant compartments of SIFs		Level 3: CSSF Circular 12/540 of 9 July 2012 on non-launched compartments, compartments awaiting reactivation and compartments in liquidation	This Circular covers compartments under both the 2010 Law and the SIF Law. Shares or unit classes within compartments are not covered.
Fund documentation and communication thereof		Level 3: CSSF Circular 19/708 of 28 January 2019 on the electronic transmission of documents to the CSSF	This Circular contains an appendix listing which documents must be sent to the CSSF in electronic form only.
		Level 3: CSSF Circular 11/503 of 3 March 2011 relating to the obligations applicable to the transmission and publication of financial information and related deadlines	This Circular acts as a reminder on the obligations applicable to the transmission and publication of financial information and related deadlines given certain deficiencies noted by the CSSF.
		Industry guidance: ALFI guidelines entitled Real Estate Investment Funds: Financial Reporting, March 2012	These guidelines for real estate investment funds (REIF) cover property valuation, valuation uncertainty, accounting, net asset value calculation, financial statements and disclosures, specific vehicles, organization of the calculation of the NAV of a Fund of REIF (FoREIF), and the impact of increased valuation uncertainty on fund NAV production.
Reporting to the authorities		Level 3: CSSF Circular 07/310 of 3 August 2007 on the financial information to be provided by Specialized Investment Funds	This Circular sets out the financial information that SIFs must provide to the CSSF on a monthly and annual basis.
		Level 3: CSSF Circular 08/348 of 17 April 2008 concerning changes to Circulars IML 97/136 and CSSF Circular 07/310	This Circular modifies CSSF Circular 07/310 on the financial information which SIFs have to communicate to CCLux (now FundSquare). The delay for communication of monthly financial information is reduced from 20 to 10 days.
		Level 3 CSSF Circular 15/627 of 3 December 2015 concerning new monthly reporting to the CSSF - U.I. reporting	This Circular implements new monthly reporting - U.I. reporting. The Circular repeats the monthly reporting required by Circulars 97/136, 07/130 (monthly table 01.1) as amended by circular 08/348, from June 2016.
		Level 3: CSSF Circular 18/698 of 23 August 2018 on the authorisation and organisation of investment fund managers incorporated under Luxembourg law. Specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent	The purpose of the Circular is to provide additional clarifications on certain conditions for authorisation, more particularly the shareholding structure, the minimum own funds requirements, the administrative bodies, the arrangements concerning the central administration and governance and the rules governing the delegation framework. This Circular repeals Circular 12/546.
		Level 3: BCL Circular 2014/237 and CSSF Circular 14/588 of 28 May 2014 on modification of the statistical data collection for money markets funds and non-money market funds	This Luxembourg Central Bank (BCL) and CSSF Circular covers monthly and quarterly information reporting requirements.
		Additional regulatory guidance: CSSF FAQ concerning O 1.1. Reporting	The FAQ provides additional clarification and guidance on financial reporting by UCIs to the CSSF.
		Additional regulatory guidance: CSSF FAQ concerning U.I.	The FAQ provides additional clarification and guidance on financial reporting for UCIS.
Errors		Level 3: CSSF Circular 02/77 of 27 November 2002 on NAV errors and active breaches of investment restrictions	This Circular establishes rules to be followed in the case of material net asset value (NAV) calculation errors and active breaches of investment rules. This Circular is in principle not applicable to SIFs.
		Additional Guidance: CSSF FAQ on CSSF Circular 02/77	This FAQ provides, <i>inter alia</i> , additional clarification on the application of the Circular to SIFs.
Depositary		Level 3: CSSF Circular 08/372 of 5 September 2008 on guidelines for depositaries of Specialized Investment Funds adopting alternative investment strategies, where those funds use the services of a prime broker	This Circular clarifies the rules applicable to a SIF's depositary in the specific case of a SIF with alternative investment strategies appointing a prime broker.
		Industry guidance: ALFI guidelines entitled Real Estate Investment Funds: Best Practices - Depositary, March 2012	These guidelines for depositaries of real estate investment funds (REIF) cover, <i>inter alia</i> , the role of the depositary of REIF, appointment and removal, duties (safekeeping and oversight), and practical implementation of the depositary's role.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Complaints handling		Level 2: CSSF Regulation No 16-07 of October 2016 relating to the out-of-court resolution of complaints	The Regulation specifies the obligations incumbent on financial sector entities in relation to the handling of complaints including complaints handling policy, procedure and responsibility for complaints handling and communication of information to the CSSF. It also covers the rules applicable to the request for the out-of-court resolution of complaints filed with the CSSF.
		Level 3: CSSF Circular 14/589 of 27 June 2014 on Details concerning Regulation CSSF No 13-02 relating to the out-of-court resolution of complaints	The Circular clarifies CSSF Regulation No 13-02 (replaced by CSSF Regulation 16-07).
		Level 3: CSSF Circular 17/671 on specifications regarding CSSF Regulation 16/07 of 26 October 2016 relating to out-of-court complaint resolution	This Circular revises and further develops the content of Circular 14/589.
UCI authorization and updates to authorization		Application for authorization: CSSF document on Setting up a Luxembourg based undertaking for collective investment or additional sub-fund(s) to an existing undertaking for collective investment	This document covers the legal requirements, procedure to be followed and list of documents and information to be submitted in the application for authorization process.
		Application for authorization: CSSF document on Amending a Luxembourg based undertaking for collective investment on the official list	This document covers the updates to applications for authorization.

II.2.4. European venture capital funds (EuVECA) and European social entrepreneurship funds (EuSEF)³³²

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
EuVECA	Level 1: Regulation (EU) No 345/2013 of 17 April 2013 on European venture capital funds (EuVECA)		This regulation aims at laying down a common framework of rules regarding the use of the designation "EuVECA" for qualifying venture capital funds, in particular the composition of the portfolio of funds that operate under that designation, their eligible investment targets, the investment tools they may employ and the categories of investors that are eligible to invest in them by uniform rules in the European Union.
	Level 2: Commission Implementing Regulation (EU) No 593/2014 of 3 June 2014 laying down implementing technical standards with regard to the format of the notification according to Article 16(1) of Regulation (EU) No 345/2013 on European venture capital funds		This Regulation covers passport notifications between Member State competent authorities in relation to EuVECA's.
EuSEF	Level 1: Regulation (EU) No 346/2013 of 17 April 2013 on European social entrepreneurship funds (EuSEF).		This regulation lays down a necessary common framework of rules regarding the use of the designation "EuSEF" for qualifying social entrepreneurship funds, in particular on the composition of the portfolio of funds that operate under that designation, their eligible investment targets, the investment tools they may employ and the categories of investors that are eligible to invest in them by uniform rules in the European Union.
	Level 2: Commission Implementing Regulation (EU) No 594/2014 of 3 June 2014 laying down implementing technical standards with regard to the format of the notification according to Article 17(1) of Regulation (EU) No 346/2013 on European social entrepreneurship funds		This Regulation covers passport notifications between Member State competent authorities in relation to EuVECA's.
General	Additional regulatory guidance: ESMA Q&A on the application of EuSEF and EuVECA Regulations		The Q&A covers management of EuSEF and EuVECA by AIFM, registration of EuSEF and EuVECA managers and management and marketing of AIF by EuSEF and EuVECA managers.
		Additional regulatory guidance: CSSF Press Release 13/36 entitled Guidance in relation to regulation (EU) No 345/2013 (EuVECA) and regulation (EU) No 346/2013 (EuSEF), August 2013	This Press Release provides guidance for managers who wish to obtain the designations European venture capital fund (EuVECA) or European social entrepreneurship fund (EuSEF).

³³² These requirements will apply in addition to those of the UCI regime under which the EuVECA or EuSEF is set up - e.g., the SIF requirements.

General (cont'd)	Additional regulatory guidance: ESMA's technical advice to the European Commission on the delegated acts of the Regulations on European Social Entrepreneurship Funds and European Venture Capital Funds (EuSEF and EuVECA), February 2015.	<p>The technical advice addresses:</p> <ul style="list-style-type: none"> ▸ Types of goods and services, methods of production for goods and services and financial support embodying a social objective ▸ Conflicts of interest of EuSEF and EuVECA managers ▸ Methods for the measurement of the social impact ▸ Information that EuSEF managers should provide to investors
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II.2.5. Islamic UCIs

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Industry guidance: ALFI Islamic Funds - Collection of best practices for setting-up and servicing Islamic funds, December 2012	These guidelines cover legal aspects of Luxembourg Shariah or Islamic law funds, fund set-up, administration, depositary and custody, and eligibility of Shariah compliant instruments in a UCITS context.

II.2.6. European long-term investment funds (ELTIFs)

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Regulation (EU) 2015/760 of 29 April 2015 on European long-term investment funds (ELTIFs)		This regulation lays down uniform rules on the authorization, investment policies, and operating conditions of ELTIFs.

II.2.7. Reserved alternative investment funds (RAIFs)³³³

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
General		Level 1: Law of 23 July 2016 on Reserved Alternative Investment Funds (the RAIF Law)	The RAIF Law provides a complementary alternative investment fund vehicle which is similar to the Luxembourg SIF regime. Unlike the SIF, the RAIF does not require approval of the Luxembourg regulator, the CSSF, but is supervised via its alternative investment fund manager (AIFM), which must submit regular reports to the regulator.
		Level 1: Law of 10 August 1915 on commercial companies, as amended (the 1915 Law)	The 1915 Law is the basic law on commercial companies. It is applicable to RAIFs where the RAIF Law does not derogate from it.
		Level 1: Law of 27 May 2016 modernising the Luxembourg legal publication regime	This Law, <i>inter alia</i> : <ul style="list-style-type: none"> ▸ Creates a control electronic platform: RESA ▸ Introduces new registration requirements for common funds (FCPs) ▸ Clarifies costs for late filling of annual accounts
		Level 1: Law of 16 July 2019 modifying, <i>inter alia</i> , the Law on Reserved Alternative Investment Funds	The RAIF law is modified in order to formally authorise chapter 15, 16 and 18 management companies to manage common funds and to provide requirements to convert a common fund into a SICAV.
Governance		ALFI Code of Conduct for Luxembourg Investment Funds, update June 2013	The objective of the updated Code of Conduct is to provide Boards of Directors with a framework of high-level principles and best practice recommendations for the governance of Luxembourg investment funds and of management companies, where appropriate.
		Industry guidance: ALFI Code of Conduct guidance, May 2017	This document provides guidance on the process for the implementation and ongoing adherence to the ALFI code of conduct for Luxembourg investment funds and management companies.

³³³ A RAIF will be managed by an authorized AIFM. Consequently the AIFM requirements also apply - see Section II.2.2.

	European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description	
Governance (cont'd)		Industry guidance ALFI Code of Conduct guidance, October 2017	ALFI provided guidance in separate papers covering: board member independence, board evaluations, board member time capacity, board member letters of appointment, conflicts of interest and directors' reports.	
		Industry guidance: EFAMA's Stewardship code covering Principles for asset managers' monitoring, voting of, engagement with investee companies.	The Code is meant to help asset managers adopt best practices in respect of stewardship of the companies in which they invest on behalf of their own clients.	
Money market funds		Level 2: Commission Delegated Regulation (EU) 2018/990 of 10 April 2018 amending and supplementing Regulation (EU) 2017/1131 of the European Parliament and of the Council with regard to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies	This Regulation amends and supplements Regulation (EU) 2017/1131 with respect to simple, transparent and standardised (STS) securitisations and asset-backed commercial papers (ABCPs), requirements for assets received as part of reverse repurchase agreements and credit quality assessment methodologies.	
		Level 2: Commission Implementing Regulation (EU) 2018/708 of 17 April 2018 laying down implementing standards with regard to the template to be used by managers of money market funds when reporting to competent authorities as stipulated by Article 37 of Regulation (EU) 2017/1131 of the European Parliament and of the Council	This Regulation provides clarifications for managers of money market funds on implementation of reporting to competent authorities.	
		Level 3: ESMA guidelines on stress test scenarios under Article 28 of the MMF Regulation, March 2018	Level 3: CSSF Circular 18/696 of 20 July 2018 on ESMA's guidelines on stress test scenarios	These guidelines establish common reference parameters of the scenarios to be included in the stress tests, taking into account the factors specified in Article 28(1) of Regulation (EU) 2017/1131.
			Additional industry guidance: CSSF's Frequently Asked Questions concerning the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market fund, of 28 August 2018	The Frequently Asked Questions (FAQs) aim at highlighting some of the key aspects of the Money Market Fund Regulation ("MMFR") from a Luxembourg perspective. The FAQs are therefore primarily addressed to managers of money market funds and money market funds ("MMFs") that are established in Luxembourg.
Risk Management		The Board of the International Organization of Securities Commissions (IOSCO)'s Recommendations for Liquidity Risk Management for Collective Investment Schemes (FR01/2018), February 2018.	This publication contains recommendations on the principles of liquidity risk management for UCIs.	
		IOSCO's Statement of IOSCO Liquidity risk management recommendations for investment funds of 18 July 2019	This statement explains why IOSCO's recommendations of February 2018 do, in fact, provide a comprehensive framework for regulators to deal with liquidity risks in investment funds.	
		Industry guidance: International Capital Market Association's (ICMA) Asset Management and Investors Council (AMIC) and the European Fund and Asset Management Association (EFAMA) , Use of Leverage in Investment Funds in Europe Paper, July 2017	The paper analyses how leverage is used, how the European legislative framework addresses leverage, and how the related risks are addressed from a technical perspective. In order to contribute to recent debates launched by regulators and supervisors, it also looks at the updates and improvements that could be proposed to ensure that the European regulation remains a cutting-edge framework at global level.	
		Industry guidance: ALFI guidance on liquidity stress testing considerations for real estate funds, May 2018	This guidance aims at supporting the practical implementation of stress testing arrangements for real estate investment funds.	
Fund classification		Industry guidance: The European Fund Classification Categories, European Fund Categorization Forum (EFCF), EFAMA, April 2012	The European Fund Classification (EFC) is a pan-European classification system for investment funds developed by the European Fund Categorization Forum (EFCF), a working group of the European Fund and Asset Management Association (EFAMA).	
Subscriptions redemptions		Industry guidance: ALFI reports entitled Swing Pricing guidelines and update 2015, December 2015	These reports present the results of a survey of swing pricing practices and updated swing pricing guidelines, originally released in 2006.	
		Industry guidance: CSSF's Frequently Asked Questions (FAQ) - Swing Pricing Mechanism of 30 July 2019	This FAQ clarifies certain aspects of swing pricing including reference thereto in constitutional documents, disclosure to investors, error handling and organizational requirements.	
Complaints handling		Level 3: CSSF Circular 17/671 on specifications regarding CSSF Regulation 16/07 of 26 October 2016 relating to out-of-court complaint resolution	This Circular revises and further develops the content of Circular 14/589.	
Reporting		Level 3: BCL Circular 2018/241 on the new statistical data collection for non-regulated alternative investment funds	The purpose of this Circular is to inform non-regulated alternative investment funds of their reporting obligations under regulation ECB/2013/38 concerning statistics on the assets and liabilities of investment funds as well as the ECB guideline on monetary and financial statistics (ECB/2014/15).	

II.3. Other key reference texts applicable in Luxembourg

This section covers regulations on specific areas which may apply in addition to those covered in Section II.2.

The areas covered in this section are:

- ▶ Fees and taxation
- ▶ Value-added tax (VAT)
- ▶ Anti-money laundering and counter-terrorist financing (AML/CFT)
- ▶ Credit institutions, investment firms and management entities providing additional services - authorization, own funds and reporting
- ▶ Credit institutions, investment firms and financial markets - conduct of business obligations, organizational requirements and financial markets
- ▶ Stock exchange listing - prospectus and transparency
- ▶ Takeover bids, squeeze-outs and sell-outs
- ▶ Market abuse
- ▶ Derivatives - European Market Infrastructure Regulation (EMIR) and Securities and Financing Transactions Regulation (SFT Regulation)
- ▶ Short selling
- ▶ Credit ratings
- ▶ Title, securities, covered bonds, and collateral
- ▶ Companies, SOPARFIs and securitization vehicles
- ▶ Acquisitions in the financial sector
- ▶ Competition
- ▶ Marketing in Luxembourg

It is not intended to be exhaustive.

II.3.1. Fees and taxation

International/European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 1: Law of 4 December 1967 concerning income tax, as amended	This Law is Luxembourg's general income tax law.
Level 1: Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation	Level 1: The Law of 29 March 2013 transposing the Directive 2011/16/EU on administrative cooperation in the field of taxation	The Law lays down the rules and procedures under which Luxembourg will cooperate with other EU Member States on the exchange of tax related information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Member States. The Law complements Luxembourg's legislation enabling the exchange of information provided for by double taxation treaties (DTTs). The Law applies to all taxes except value added tax (VAT), customs duties, and excise duties covered by other EU legislation on administrative cooperation between EU countries. It does not apply to social security contributions.
	Level 1: The Law of 26 March 2014 implementing automatic exchange of information in accordance with Article 8 of the Directive 2011/16/EU on administrative cooperation in the field of taxation	The Law implements almost all provisions of the Council Directive. The Law introduces the automatic and mandatory exchange of information for specific categories of income. Luxembourg tax authorities will communicate information on 2014 employment income (falling within the scope of Luxembourg withholding tax on wages), pension income and directors fees. The tax authorities have also released new forms to be used for the declaration of withholding tax on directors' fees.
	Level 1: Law of 19 December 2008 modifying certain provisions relating to direct taxation	This Law introduced a series of tax measures aimed at improving the competitiveness and attractiveness of Luxembourg's tax environment. The Law, <i>inter alia</i> : extended the application of the withholding tax exemption to dividends paid to qualifying entities residing in a State that has a double taxation treaty with Luxembourg, abolished capital duty, and introduced a registration duty.

International/European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Standard for Automatic Exchange of Financial Account Information in Tax Matters – Common reporting standard (CRS), February 2014		<p>The G20 endorsed the CRS prepared by the OECD as the global standard for the automatic exchange of financial account information in tax matters. It refers to global anti-money laundering standards and, in particular, is similar to the Model 1 FATCA IGA.</p> <p>The CRS sets out the financial information to be exchanged, the financial institutions required to report, along with common due diligence procedures to be followed by financial institutions.</p>
	Level 1: Luxembourg – USA intergovernmental agreement (IGA) implementing the Foreign Account Tax Compliance Act (FATCA), 28 March 2014; Law of 24 July 2015 approving the IGA and the exchange of related notes signed 31 March 2015 and 1 April 2015	The agreement requires that a broad range of entities considered to be Luxembourg financial institutions to apply, from 1 July 2014, specified account identification and documentation procedures and report mainly certain US accounts annually to the Luxembourg tax authorities who will exchange such information with the US IRS.
Level 1: Council Directive 2014/107/EU amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, 9 December 2014		The Directive extends cooperation between the different tax authorities through the automatic exchange of financial account information, in line with the CRS. Account holder details, interest, dividends as well as account balances and sales proceeds from financial assets are within the scope of the automatic exchange of information by way of amendment of the Directive 2011/16/EU.
	Level 1: General Tax Law of 22 May 1931, as amended	The provisions of the General Tax Law apply to direct taxes and certain other taxes to the extent that such taxes are administered by the direct tax administration, <i>inter alia</i> , the provisions on liability, the crediting of taxes, procedural aspects (e.g., the tax notices), the liable parties.
	Level 1: Law of 23 July 2016 on the electronic filing of tax returns for <i>taxe d'abonnement</i>	This Law introduces an obligation for all UCIs to electronically file tax returns from 1 January 2018.
	Level 1: Law of 23 December 2016 on the 2017 Luxembourg tax reform	This Law implements into law the 2017 Luxembourg tax reform.
Level 1: Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (known as the Anti-Tax Avoidance Directive or ATAD)	Level 1: Law of 21 December 2018 transposes European Union (“EU”) Anti-Tax Avoidance Directive (2016/1164) (“ATAD Law”) into Luxembourg Law	The Law introduces a limitation to interest deductibility, Controlled Foreign Company (CFC) rules and rules countering hybrid mismatches within the EU. It also amends the existing exit taxation regime (including provisions relating to inbound transfers) as well as the General Anti-Abuse Rule (GAAR). The Law also amends two existing domestic provisions regarding the tax-neutral conversion of debt into equity and the definition of permanent establishments (PEs).
Level 1: Council Directive (EU) 2017/952 of 29 May 2017 amending Directive 2016/1164 (known as ATAD) as regards hybrid mismatches with third countries (known as ATAD 2)	Level 1: Law of 20 December 2019 transposing into Luxembourg Law ATAD 2 (Directive 2017/952) amending ATAD as regards hybrid mismatches with third countries (the “ATAD 2 Law”)	The law expands the rules countering hybrid mismatches by expanding the types of mismatches covered and extending to hybrid mismatches with non-EU countries.
Level 1: Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU (known as DAC) as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements (known as DAC 6)	Level 1: Law of 25 March 2020 transposing Directive 2018/822 into Luxembourg Law (the “Mandatory Disclosure Requirements Law” or “MDR Law”)	This law requires intermediaries to report cross-border arrangements that meet specified Hallmarks, designed to be indicative of aggressive tax planning, to the Luxembourg tax authorities, who will exchange the information with other EU Member States.
	Level 2: Grand-Ducal Regulation of 14 April 2003 on UCIs eligible for the reduced rate of subscription tax (<i>taxe d'abonnement</i>) under the 2002 Law (now the 2010 Law)	This Regulation clarifies conditions and procedures for UCIs (subject to the 2010 Law) to obtain the reduced subscription tax.
	Level 2: Grand-Ducal Regulation of 27 February 2007 determining the conditions and criteria for the exemption from the subscription tax referred to in Article 68 of the law of 13 February 2007 relating to specialized investment funds	This Regulation determines the conditions and criteria for SIFs to obtain the exemption from subscription tax.
	Level 2: Grand-Ducal Regulation of 14 July 2010 relating to the exemption from subscription tax of UCIs (under the 2002 Law (now the 2010 Law) or the SIF Law) investing in microfinance institutions	This Regulation outlines the criteria to be met for UCIs to be exempt from subscription tax.
	Level 2: Grand-Ducal Regulation of 21 December 2017 relating to the fees to be levied by the CSSF	This Regulation lays down, <i>inter alia</i> , the CSSF fees applicable to the authorization and supervision of UCIs, management companies and AIFM.
	Level 2: Grand-Ducal Regulation of 2 July 2018, relating to fees to be levied by the CSSF, amending Grand-Ducal Regulation of 21 December 2017	This Regulation amends certain provisions of the Grand-Ducal Regulation of 21 December 2017.
	Level 2: Grand-Ducal Regulation (GDR) of 1 March 2019 amending Grand-Ducal Regulation of 21 December 2017	This regulation amends certain provisions of the GDR of 21 December 2017.

International/European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 3: CSSF Circular 15/609 of 27 March 2015 on the developments in automatic exchange of tax information and anti-money laundering in tax matters	This Circular aims to remind the relevant persons of the importance to put in place the necessary procedures and infrastructures on automatic exchange. The Circular also provides a reminder of certain amendments to the European regulatory framework, in particular the amendment of the Savings Directive law (now repealed) replacing withholding with exchange of information, the Administrative Co-operation Directive and the proposal for a new "anti-money-laundering" directive.
	Level 3: Luxembourg Tax Authorities Circular No 95/2, as amended	The Circular provides for a simplified beneficial tax regime for expatriates relocating to Luxembourg; it clarifies the conditions under which certain compensation items (e.g., relocation allowance, housing, school fees) expenses and charges in relation to the engagement of expatriates can be tax deductible considered tax exempt income (while remaining deductible for the employer). The updated Circular expands the scope of potential beneficiaries to employees who work in Luxembourg for companies established in the European Economic Area (EU Member States, including Luxembourg, plus Iceland, Liechtenstein and Norway).
	Industry guidance: ALFI interpretations and recommendations on the European Savings Directive, June 2005 (which has since been repealed)	The paper covered aspects of the now repealed Law of 21 June 2005 implementing the EU Savings Directive, including, <i>inter alia</i> , the concept of paying agent in the context of the fund industry, requirements of a paying agent, distributions and capital gains treated as interest payments, look through principle, role of Luxembourg paying agents and treatment of specific transactions.
	Industry guidance: ALFI FATCA Q&A, as amended	The Q&A introduces FATCA, covers registration requirements for reporting financial institutions and non-reporting financial institutions, due diligence on individuals and entities and roles and responsibilities under FATCA.
	Level 3: CSSF Circular 17/650 of 17 February 2017 providing details on the extension of the AML/CFT Law to predicate tax offences	The Circular provides general guidance for all entities falling under the supervision of the CSSF to raise suspicions of tax evasion or money laundering through a non-exhaustive list of 21 common indicators set out under Annex 1 to the Circular.
	Level 3: CSSF Circular 20/744 of 3 July 2020	The Circular has amended Annex 1 to CSSF Circular 17/650 by listing additional indicators more specific to the context of collective investment activities, still with the aim of detecting possible cases of money laundering offences relating to aggravated tax fraud or tax evasion.

II.3.2. Value-added tax (VAT)

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax	Level 1: Law of 12 February 1979 concerning value added tax, as amended	This Law lays down the Luxembourg legal framework for value added tax (VAT).
Level 1: Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC in the common system of value added tax		This Regulation lays down new implementing measures for the VAT Directive. This Regulation became effective on 1 July 2011.
	Level 3: VAT Circular 723 of 29 December 2006	This Circular confirms that investment vehicles whose management is VAT exempt by virtue of Article 44(1)(d) of the Luxembourg VAT Law have the status of "taxable persons" for VAT purposes and also specifies the scope of the VAT exempt management services by excluding the control and supervisory services rendered within the framework of depository services. This Circular entered into force on 1 April 2007.
	Level 3: VAT Circular 723bis of 30 April 2010	This Circular clarifies certain elements of Circular 723.
	Level 3: VAT Circular 723ter of 7 November 2013	This Circular clarifies that risk management services for funds may be exempt from VAT.
	Level 3: VAT Circular 781 of 30 September 2016	This Circular clarifies the treatment of the activities rendered by independent directors from a VAT perspective. Indeed, the Circular confirms that such activity should be considered as a supply of services and it should be taxable at the standard rate of 17%.
	Level 3: VAT Circular 765-1 of 11 June 2018	This Circular clarifies certain elements of Circular 765 dated 15 May 2013. In particular, the Circular clarifies the methodology to be used by companies carrying out both economic activities (VAT taxable or VAT exempt) and activities that fall outside the scope of VAT. (e.g., passive holding of shares).

II.3.3. Anti-money laundering and counter-terrorist financing (AML/CFT)

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 1: Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended	This Law provides legal provisions in the fight against money laundering and terrorist financing (AML/CFT Law).
	Level 1: Law of 10 August 2018 on information to be obtained and held by trustees and transposing Article 31 of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC	This law transposes Article 31 of the 4th AMLD introducing new obligations for fiduciary arrangements, <i>inter alia</i> , changes for fiduciary agents to obtain and hold adequate, accurate and up-to-date information on the beneficial owner. This Law allows supervisory authorities to have, <i>inter alia</i> , access to all documents and to carry out on-site inspections or investigations.
	Level 1: Law of 10 August 2018 amending: (i) the Code of Criminal Procedure; (ii) the Law of 7 March 1980 on the organisation of the judicial system, as amended; (iii) the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended; (iv) the Law of 25 March 2015 determining the salaries and the advancement conditions and rules for civil servants for the purpose of organising the Financial Intelligence Unit	This Law transposed into national law Directive 2014/41/EU on the European Investigation Order in criminal matters.
	Level 1: Law of 13 January 2019 establishing a Register of Beneficial Owners	This Law partially implements the 4th EU AML Directive and Directive (EU) 2018/843 (the 5th EU AML Directive) on anti-money laundering. The Law requires a register of beneficial owners for all companies and similar entities registered with the Luxembourg trade and companies register. The Law entered into force on 1 March 2019 with a transition period of 6 months, ending on 31 August 2019.
	Level 1: Law of 25 March 2020 amending: 1° the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended; 2° the Law of 9 December 1976 on the organisation of the profession of notary, as amended; 3° the Law of 4 December 1990 on the organisation of bailiffs, as amended; 4° the Law of 10 August 1991 on the legal profession, as amended; 5° the Law of 10 June 1999 on the organisation of the accounting profession, as amended; 6° the Law of 23 July 2016 concerning the audit profession, as amended	The aim of the 1st Law of 25 March 2020 is to implement the majority of the 5th EU AML Directive (certain sections of the Directive have already been implemented via the law of 13 January 2019) and to expand the scope of the amended Law of 12 November 2004 on the fight against money laundering and terrorist financing.
	Level 1: Law of 25 March 2020 establishing a central electronic data retrieval system related to payment accounts and bank accounts identified by IBAN and safe-deposit boxes held by credit institutions in Luxembourg and amending: 1° the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended; 2° the Law of 5 July 2016 reorganising the State Intelligence Service, as amended; 3° the Law of 30 May 2018 on markets in financial instruments; 4° the Law of 13 January 2019 establishing a Register of beneficial owners	The Law of 25 March 2020 introduces a Luxembourg central electronic data retrieval system which gathers data about payment and bank accounts identified by an IBAN number and safe deposit boxes.
	Level 1: Law of 10 July 2020 establishing a register of fiducies and trusts.	
Level 1: Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law.		This Directive on money laundering establishes minimum standards for offences and penalties. The directive sets out specific obligations regarding predicate offences, money laundering offences, liability of legal persons and double criminality requirement restrictions. The directive will need to be transposed into national law by 3 December 2020.
Level 1: Directive (EU) 2019/1153 of 20 June 2019 lays down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences.		The Directive will need to be transposed into national law by 1 August 2021.

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Directive (EU) 2017/541 of the European Parliament and of the Council of 15 March 2017 on combating terrorism and replacing Council Framework Decision 2002/475/JHA and amending Council Decision 2005/671/JHA		This Directive, <i>inter alia</i> , expands and improves the provisions of previous legislation relating to terrorist acts and includes additional provisions governing specific support measures to victims of terrorism.
Level 1: Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU		This, the Fifth Anti-Money Laundering Directive, was published on 19 June 2018 and will enter into force on 9 July. EU Member States will then have until 10 January 2020 to implement the Fifth Anti-Money Laundering into national law. The main changes brought by this Directive are: <ul style="list-style-type: none"> ▶ An extension of the scope of persons subject to anti-money laundering and terrorist financing ▶ Enhanced customer due diligence measures ▶ Increased transparency measures, including access to beneficial owner registers ▶ Enhanced powers for relevant supervisory authorities and EU financial intelligence units
Level 1: Directive (EU) 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, 20 May 2015	Level 1: Law of 13 February 2018, which entered into force on 18 February 2018, and amends, <i>inter alia</i> , the Law of 12 November 2004, as amended	This Law partially transposes Directives 2015/849 (the Fourth Anti-Money Laundering Directive), This Law brought the following principal changes: <ul style="list-style-type: none"> ▶ Amendment to the definition of beneficial owner of corporate entities and trusts ▶ Setting of different thresholds with respect to the carrying out of customer due diligence measures ▶ Enhanced requirement for professionals carry out a risk assessment ▶ Requirements regarding politically exposed persons ▶ Emphasis on data protection requirements and employee training ▶ Record-keeping of documents and information at the request of competent authorities ▶ Whistleblowing ▶ Increased sanctions and new injunction and sanction powers for supervisory authorities ▶ Increase of criminal sanctions
Level 1: Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union		
Level 1: Regulation (EU) 2018/1672 of the European Parliament and of the Council of 23 October 2018 on controls on cash entering or leaving the Union and repealing Regulation (EC) No 1889/2005		
Level 1: Council Regulation (EU) 2018/1542 of 15 October 2018 concerning restrictive measures against the proliferation and use of chemical weapons		
Level 1: Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC		
Level 1: Regulation (EU) 2015/847 of the European Parliament and of the Council on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006, 20 May 2015	Level 1: Law of 27 October 2010 on the anti-money laundering and counter terrorist financing legal framework	This Law enhances the AML/CFT legal framework, organizes the controls of physical transport of cash entering, transiting through or leaving Luxembourg, implements United Nations Securities Council resolutions and acts adopted by the EU concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing, modifying, <i>inter alia</i> , the Law of 12 November 2004.
Level 1: Regulation (EU) 2015/847 of the European Parliament and of the Council on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006, 20 May 2015		This regulation completes the Directive 2015/849 and focuses on the transfer of funds.
Level 1: Criminal Code		The Criminal Code covers, <i>inter alia</i> , money laundering and terrorist financing offences, and other provisions relating to the criminal liability of natural and legal persons.
Level 2: Commission Delegated Regulation (EU) 2019/758 of 31 January 2019 supplements Directive (EU) 2015/849 of the European Parliament and of the Council with regard to regulatory technical standards for the minimum action and the type of additional measures credit and financial institutions must take to mitigate money laundering and terrorist financing risk in certain third countries		
Level 2: Commission Delegated Regulation (EU) 2016/1675 of 14 July 2016 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council by identifying high-risk third countries with strategic deficiencies		This Delegated Regulation supplements the Fourth Anti-Money Laundering Directive by identifying the following countries as high-risk third countries with strategic deficiencies: Afghanistan, Bosnia & Herzegovina, Guyana, Iraq, Lao PDR, Syria, Uganda, Vanuatu, Yemen, Iran, Democratic People's Republic of Korea

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 2: Commission Delegated Regulation (EU) 2018/105 of 27 October 2017 amending Delegated Regulation (EU) 2016/1675, as regards adding Ethiopia to the list of high-risk third countries in the table in point I of the Annex	This Delegated Regulation adds Ethiopia to the list of high-risk third countries with strategic deficiencies.	
Level 2: Commission Delegated Regulation (EU) 2018/212 of 13 December 2017 amending Delegated Regulation (EU) 2016/1675 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council, as regards adding Sri Lanka, Trinidad and Tobago, and Tunisia to the table in point I of the Annex	This Delegated Regulation adds Sri Lanka, Trinidad & Tobago and Tunisia to the list of high-risk third countries with strategic deficiencies.	
Level 2: Commission Delegated Regulation (EU) 2018/1108 of 7 May 2018 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council with regulatory technical standards on the criteria for the appointment of central contact points for electronic money issuers and payment service providers and with rules on their functions	This Regulation supplements the Fourth Anti-Money Laundering Directive and is based on the draft regulatory technical standards of the European Supervisory Authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority) to the EU Commission on the criteria for the appointment of central contact points for electronic money issuers and payment service providers and with rules on their functions.	
Level 2: Council Implementing Regulation (EU) 2019/84 of 21 January 2019 implementing Regulation (EU) 2018/1542 concerning restrictive measures against the proliferation and use of chemical weapons		
Level 2: Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC as regards the definition of "politically exposed person" and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis		
	Level 2: Grand-Ducal Regulation of 15 February 2019 on the arrangements regarding registration, payment of administrative costs, and access to the information contained in the Register of Beneficial Owners	This Regulation covers, <i>inter alia</i> , the arrangements for access to the register, which is free of charge and accessible to the general public.
	Level 2: Ministerial Regulation of 16 November 2018 amending Ministerial Regulation of 9 July 2009 creating a committee on the prevention of money laundering and terrorist financing	
	Level 2: Grand-Ducal Regulation of 1 February 2010 providing details on certain provisions of the amended law of 12 November 2004 on the fight against money laundering and terrorist financing	This Regulation clarifies provisions of the AML/CFT Law.
	Level 2: CSSF Regulation 12-02 of 14 December 2012 on the fight against money laundering and terrorist financing	This Regulation clarifies and completes certain elements of Luxembourg's AML/CFT framework and makes certain existing professional obligations legally binding.
	Level 2: Grand-Ducal Regulation of 29 October 2010 enforcing the law of 27 October 2010 implementing United Nations Security Council resolutions as well as acts adopted by the European Union	The regulation implements the Law of 27 October 2010 implementing United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the fight against terrorist financing.
	Level 2: Ministerial regulations amending Annex I C of Grand-Ducal Regulation of 29 October 2010	These regulations relate to the implementation of United Nations Security Council resolutions as well as acts adopted by the European Union concerning prohibitions and restrictive measures in financial matters in respect of certain persons, entities and groups in the context of the combat against terrorist financing.
	Level 3: CSSF Circular 20/738 of 6 March 2020 on FATF statements concerning: 1) high-risk jurisdictions on which enhanced due diligence and, where appropriate, counter-measures are imposed 2) jurisdictions under increased monitoring of the FATF	The purpose of this Circular is to inform all the persons and entities under the CSSF's supervision of the FATF statements on the jurisdictions that require enhanced due diligence and the jurisdictions under increased monitoring of the FATF.
	Level 3: CSSF Circular 18/684 of 13 March 2018 on the entry into force of the Law of 13 February 2018 amending, <i>inter alia</i> , the Law of 12 November 2004 on the fight against money laundering and terrorist financing	This Circular highlights the entry into force of the Law of 13 February 2018 which partially amends the Law of 12 November 2004, as amended.
	Level 3: CSSF Circular 18/680 of 23 January 2018 on the joint guidelines of the three European Supervisory Authorities on the measures payment service providers should take to detect missing or incomplete information on the payer or the payee	This purpose of this Circular is to highlight the guidelines on the measures payment service providers should take to detect missing or incomplete information on the payer or the payee, by ESMA, EBA and EIOPA.

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 3: CSSF Circular 17/661 of 24 July 2017 on Adoption of the joint guidelines issued by the three European Supervisory Authorities (EBA/ESMA/EIOPA) on money laundering and terrorist financing risk factors	This Circular draws attention to the adoption of the joint guidelines by the EBA, ESMA and EIOPA on money laundering and terrorist risk factors.
	Level 3: CSSF Circular 17/660 of 5 July 2017 on Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006	This Circular draws attention to the application of Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006.
	Level 3: CSSF Circular 17/650 on the application of the Law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended, and Grand-Ducal Regulation of 1 February 2010 providing details on certain provisions of the AML/CFT Law to predicate tax offences	Following the new criminal provisions laid down in the Law of 23 December 2016 implementing the 2017 tax reform which specifically concern the extension of the money laundering offences to include aggravated tax evasion and tax evasion, this Circular aims to (i) provide further details concerning the practical application of these new provisions and (ii) provide a list of indicators to assist professionals.
	Level 3: CSSF Circular 20/744 of 3 July 2020 amending the annex 1 of Circular 17/650	The Circular provides specific indicators concerning collective investment activities, with the aim of detecting possible cases of money laundering offences related to aggravated tax fraud or tax evasion.
	Level 3: CSSF Circular 15/609 of 27 March 2015 on the developments in automatic exchange of tax information and anti-money laundering in tax matters	This Circular aims to remind the relevant persons of the importance to put in place the necessary procedures and infrastructures on automatic exchange. The Circular also presents certain amendments to the European regulatory framework, in particular the Savings Directive, the Administrative Co-operation Directive and the proposal for an "anti-money-laundering" directive.
	Level 3: CSSF Circular 13/556 of 16 January 2013 on the entry into force of CSSF Regulation No 12-02 of 14 December 2012 on the fight against money laundering and terrorist financing and repeal of Circulars CSSF 08/387 and CSSF 10/476	This Circular covers the entry into force of CSSF Regulation 12-02 on AML/CFT.
	Level 3: CSSF Circular 11/529 of 22 December 2011 on risk analysis regarding the fight against money laundering and terrorist financing (AML/CFT)	This Circular provides details of the CSSF's requirements on the application of Article 3(3) of the AML/CFT Law, and on the risk analysis to be carried out by financial sector entities subject to supervision by the CSSF (except credit institutions).
	Level 3: CSSF Circular 11/519 of 19 July 2011 on Risk analysis regarding the fight against money laundering and terrorist financing (AML/CFT)	This Circular provides details on CSSF requirements on the application of Article 3 (3) of the AML/CFT Law, and on the risk analysis to be carried out by credit institutions.
	Level 3: CSSF Circular 10/495 of 9 December 2010 relating to the entry into force of the Law of 27 October 2010 on the fight against money laundering and terrorist financing	This Circular highlights the entry into force of the Law of 27 October 2010 which enhances the anti-money laundering and counter terrorist financing legal framework, organizes the controls of physical transport of cash entering, transiting through or leaving Luxembourg, and implements United Nations Securities Council resolutions and acts adopted by the EU.
	Level 3: CSSF Circular 19/732 - Clarifications on the Identification and Verification of the Identity of the Ultimate Beneficial Owner(-s)	The purpose of this Circular is to provide guidance on the practical implementation of the identification requirements of the ultimate beneficial owner for customers that are either natural persons, legal persons or legal arrangements. The Circular also outlines the reasonable measures that should be taken to verify the identity requirements so that the professionals are satisfied that they know who the beneficial owner(s) is (are). A third part provides indicators to help detect potential concealment of beneficial ownership information.
	Level 3: CSSF Circular 20/740	This Circular provides guidelines on AML/CFT during COVID-19 pandemic.
	Level 3: CSSF Circular 20/742 of 4 May 2020 - Laws of 25 March 2020	The Circular clarifies the primary changes introduced by the Laws of 25 March 2020 into the Law of 12 November 2004.
	Additional regulatory guidance: CSSF FAQ - Persons involved in AML/CFT for a Luxembourg Investment Fund or Investment Fund Manager supervised by the CSSF for AML/CFT purposes	CSSF FAQ clarify the requirements in article 4 (1) of the Law of 12 November 2004 as amended to appoint two different persons in charge of AML/CFT for supervised UCIs and IFMs, and their obligations.

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Industry guidance: Practices and Recommendations aimed at reducing the risk of money laundering and terrorist financing in the Luxembourg Fund Industry, published by ALFI, in association with ABBL, ALCO and ALRiM, issued in 2006 and updated in July 2013	The updated Practices and Recommendations provide guidance on a risk-based approach in relation to customer identification and transaction monitoring, in line with international standards, which includes the Financial Action Task Force (FATF) "40 Recommendations" updated in February 2012. They also provide a methodology for assessing the equivalence of legal and regulatory know your customer (KYC) requirements of foreign jurisdictions by comparing them to FATF standards.

II.3.4. Credit institutions, investment firms and management entities providing additional services - authorization, own funds and reporting

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 1: Law of 5 April 1993 on the Financial Sector, as amended (the 1993 Law)	General Law on the financial sector ("LFS") structured as follows: <ul style="list-style-type: none"> ▸ Part I: Access to professional activities in the financial sector ▸ Part II: Professional obligations, prudential rules and rules of conduct in the financial sector ▸ Part III: Prudential supervision of the financial sector ▸ Part IV: Reorganization and winding up of certain professionals of the financial sector ▸ Part V: Penalties ▸ Part VI: Amendments, repeals and transitional provisions
Level 1: Directive 2013/36/EU of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms	The Directive had not been transposed at the time of writing, it was foreseen that it would be transposed by amending the 1993 Law.	This Directive lays down rules on, <i>inter alia</i> , access to the activity of credit institutions and investment firms, the supervision of institutions.
Level 1: Regulation (EU) No 575/2013 of the European and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012		The Regulation lays down uniform rules concerning general prudential requirements that institutions supervised under Directive 2013/36/EU must comply with in relation to own funds, large exposures, liquidity, reporting requirements, leverage, and public disclosure.
	Level 1: CSSF Regulation N° 20-02 of 29 June 2020 on the equivalence of certain third countries with respect to supervision and authorisation rules for the purpose of providing investment services or performing investment activities and ancillary services by third-country firms	For the purposes of the second subparagraph of Article 32-1(1) of the LFS, the countries listed in the Annex to this regulation shall be considered as applying LFS-equivalent supervision and authorisation rules to firms having their central administration or registered office in these third countries. Where appropriate, the equivalence of the third country may be limited to the services listed in the Annex.
	Level 3: CSSF Circular 07/290 of 3 May 2007 (as amended by CSSF Circulars 10/451, 10/483, 10/497 and 13/568) on the definition of capital ratios pursuant to article 56 of the 1993 Law	This Circular covers the definition of capital ratios pursuant to Article 56 of the amended Law of 5 April 1993 on the financial sector; it applies to investment firms and management companies subject to Chapter 15 of the 2010 Law which provide investment portfolio management services where such portfolios include one or several financial instruments.
	Level 3: CSSF Circular 19/716 of 10 April 2019 on the provision in Luxembourg of investment services or performance of investment activities and ancillary services in accordance with Article 32-1 of the LFS	The aim the Circular is to operationalise Article 32-1 of the LFS and to clarify the procedure that third-country firms must comply with in order to benefit from the regime laid down in the second subparagraph of Article 32-1(1) of the LFS. Like the MiFIR Regulation, CSSF Circular 19/716 did not address questions regarding the location of the services provided.
	Level 3: CSSF Circular 20/743 of 1 July 2020 amending CSSF Circular 19/716 on the provision in Luxembourg of investment services or performance of investment activities and ancillary services in accordance with Article 32-1 of the LFS	The purpose of the amendments introduced by this Circular is to clarify the concept of service provided "in Luxembourg" in relation to the investment services or the performance of investment activities and ancillary services in accordance with Article 32-1 of the LFS.
	Additional regulatory guidance: CSSF Press Releases 13/02 of 10 January 2013 and 13/12 of 6 March 2013 to all Luxembourg advisers of undertakings for collective investment referred to in the 2010 Law or of specialized investment funds referred to in the SIF Law (the "Advisers")	These Press Releases cover the authorization of investment advisers to Luxembourg UCIs.

II.3.5. Credit institutions, investment firms and financial markets - conduct of business obligations, organizational requirements and financial markets

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (MiFID)	Level 1: Law of 13 July 2007 on markets in financial instruments	This Law transposes the "Level 1" Markets in Financial Instruments Directive (MiFID - Directive 2004/39/EC). It also modifies, <i>inter alia</i> , the 1993 Law.
Level 1: Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II)	Level 1: Law of 30 May 2018 on market in financial instruments	MiFID II was applicable on 3 January 2018 and repeals MiFID. Some key elements of the new regime are: <ul style="list-style-type: none"> ▸ Stronger investor protection ▸ Confirmation of ban of inducements ▸ Migrating derivatives trading to regulated platforms ▸ New market: the Organized Trading Facility (OTF) ▸ Limits on algorithmic trading and direct market access ▸ Position limits on commodity derivatives ▸ Broader scope of market transparency regime
Level 1: Regulation (EU) 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (MiFIR)	Level 1: Regulation (EU) 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (MiFIR)	MiFIR applies with the European Union Member States as of 3 January 2018. The regulation completes MiFID II.
Level 2: Commission Delegated Directive of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.	Level 2: Commission Delegated Directive of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.	The Commission Directive completes some sections of MiFID II.
Level 2: Commission Implementing Regulation (EU) 2017/2382 of 14 December 2017 lays down implementing technical standards with regard to standard forms, templates and procedures for the transmission of information in accordance with Directive 2014/65/EU of the European Parliament and of the Council	Level 2: Commission Implementing Regulation (EU) 2017/2382 of 14 December 2017 lays down implementing technical standards with regard to standard forms, templates and procedures for the transmission of information in accordance with Directive 2014/65/EU of the European Parliament and of the Council	
Level 2: Commission Delegated Regulation (EU) 2017/2417 of 17 November 2017 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the trading obligation for certain derivatives	Level 2: Commission Delegated Regulation (EU) 2017/2417 of 17 November 2017 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the trading obligation for certain derivatives	
Level 2: Commission Delegated Regulation (EU) 2017/2154 of 22 September 2017 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements	Level 2: Commission Delegated Regulation (EU) 2017/2154 of 22 September 2017 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements	
Level 2: Commission Delegated Regulation (EU) 2017/2194 of 14 August 2017 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to package orders	Level 2: Commission Delegated Regulation (EU) 2017/2194 of 14 August 2017 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to package orders	
Level 2: Commission Delegated Regulation (EU) 2017/1946 of 11 July 2017 supplements Directives 2004/39/EC and 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for an exhaustive list of information to be included by proposed acquirers in the notification of a proposed acquisition of a qualifying holding in an investment firm	Level 2: Commission Delegated Regulation (EU) 2017/1946 of 11 July 2017 supplements Directives 2004/39/EC and 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for an exhaustive list of information to be included by proposed acquirers in the notification of a proposed acquisition of a qualifying holding in an investment firm	
Level 2: Commission Implementing Regulation (EU) 2017/1111 of 22 June 2017 (ITS 8) lays down implementing technical standards with regard to procedures and forms for submitting information on sanctions and measures in accordance with Directive 2014/65/EU of the European Parliament and of the Council	Level 2: Commission Implementing Regulation (EU) 2017/1111 of 22 June 2017 (ITS 8) lays down implementing technical standards with regard to procedures and forms for submitting information on sanctions and measures in accordance with Directive 2014/65/EU of the European Parliament and of the Council	
Level 2: Commission Implementing Regulation (EU) 2017/1110 of 22 June 2017 (ITS 3) lays down implementing technical standards with regard to the standard forms, templates and procedures for the authorization of data reporting services providers and related notifications pursuant to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments	Level 2: Commission Implementing Regulation (EU) 2017/1110 of 22 June 2017 (ITS 3) lays down implementing technical standards with regard to the standard forms, templates and procedures for the authorization of data reporting services providers and related notifications pursuant to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments	
Level 2: Commission Implementing Regulation (EU) 2017/1093 of 20 June 2017 (ITS 4) lays down implementing technical standards with regard to the format of position reports by investment firms and market operators	Level 2: Commission Implementing Regulation (EU) 2017/1093 of 20 June 2017 (ITS 4) lays down implementing technical standards with regard to the format of position reports by investment firms and market operators	
Level 2: Commission Implementing Regulation (EU) 2017/1945 of 19 June 2017 lays down implementing technical standards with regard to notifications by and to applicant and authorized investment firms according to Directive 2014/65/EU of the European Parliament and of the Council	Level 2: Commission Implementing Regulation (EU) 2017/1945 of 19 June 2017 lays down implementing technical standards with regard to notifications by and to applicant and authorized investment firms according to Directive 2014/65/EU of the European Parliament and of the Council	
Level 2: Commission Implementing Regulation (EU) 2017/1005 of 15 June 2017 (ITS 2) lays down implementing technical standards with regard to the format and timing of the communications and the publication of the suspension and removal of financial instruments pursuant to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments	Level 2: Commission Implementing Regulation (EU) 2017/1005 of 15 June 2017 (ITS 2) lays down implementing technical standards with regard to the format and timing of the communications and the publication of the suspension and removal of financial instruments pursuant to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments	

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 2: Commission Delegated Regulation (EU) 2017/1799 of 12 June 2017 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council as regards the exemption of certain third countries central banks in their performance of monetary, foreign exchange and financial stability policies from pre- and post-trade transparency requirements	
	Level 2: Commission Implementing Regulation (EU) 2017/981 of 7 June 2017 (ITS 7) lays down implementing technical standards with regard to standard forms, templates and procedures for the consultation of other competent authorities prior to granting an authorization in accordance with Directive 2014/65/EU of the European Parliament and of the Council	
	Level 2: Commission Implementing Regulation (EU) 2017/980 of 7 June 2017 (ITS 6) lays down implementing technical standards with regard to standard forms, templates and procedures for cooperation in supervisory activities, for on-site verifications, and investigations and exchange of information between competent authorities in accordance with Directive 2014/65/EU of the European Parliament and of the Council	
	Level 2: Commission Implementing Regulation (EU) 2017/988 of 6 June 2017 (ITS 1) lays down implementing technical standards with regard to standard forms, templates and procedures for cooperation arrangements in respect of a trading venue whose operations are of substantial importance in a host Member State	
	Level 2: Commission Implementing Regulation (EU) 2017/953 of 6 June 2017 (ITS 5) lays down implementing technical standards with regard to the format and the timing of position reports by investment firms and market operators of trading venues pursuant to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments	
	Level 2: Commission Delegated Regulation (EU) 2017/592 of 1 December 2016 (RTS 20) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the criteria to establish when an activity is considered to be ancillary to the main business	
	Level 2: Commission Delegated Regulation (EU) 2017/591 of 1 December 2016 (RTS 21) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the application of position limits to commodity derivatives	
	Level 2: Commission Delegated Regulation (EU) 2017/590 of 28 July 2016 (RTS 22) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the reporting of transactions to competent authorities	
	Level 2: Commission Delegated Regulation (EU) 2017/589 of 19 July 2016 (RTS 6) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the organizational requirements of investment firms engaged in algorithmic trading	
	Level 2: Commission Delegated Regulation (EU) 2016/2022 of 14 July 2016 supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards concerning the information for registration of third-country firms and the format of information to be provided to the clients	
	Level 2: Commission Delegated Regulation (EU) 2017/1943 of 14 July 2016 supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on information and requirements for the authorization of investment firms	
	Level 2: Commission Delegated Regulation (EU) 2017/588 of 14 July 2016 (RTS 11) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the tick size regime for shares, depositary receipts and exchange-traded funds	
	Level 2: Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 (RTS 1) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser	
	Level 2: Commission Delegated Regulation (EU) 2017/586 of 14 July 2016 supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the exchange of information between competent authorities when cooperating in supervisory activities, on-the-spot verifications and investigations	
	Level 2: Commission Delegated Regulation (EU) 2017/585 of 14 July 2016 (RTS 23) supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the data standards and formats for financial instrument reference data and technical measures in relation to arrangements to be made by the European Securities and Markets Authority and competent authorities	
	Level 2: Commission Delegated Regulation (EU) 2017/584 of 14 July 2016 (RTS 7) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying organizational requirements of trading venues	
	Level 2: Commission Delegated Regulation (EU) 2017/583 of 14 July 2016 (RTS 2) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives	

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 2: Commission Delegated Regulation (EU) 2017/1018 of 29 June 2016 supplements Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying information to be notified by investment firms, market operators and credit institutions	
	Level 2: Commission Delegated Regulation (EU) 2017/582 of 29 June 2016 (RTS 26) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards specifying the obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing	
	Level 2: Commission Delegated Regulation (EU) 2017/581 of 24 June 2016 (RTS 15) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on clearing access in respect of trading venues and central counterparties	
	Level 2: Commission Delegated Regulation (EU) 2017/580 of 24 June 2016 (RTS 24) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the maintenance of relevant data relating to orders in financial instruments	
	Level 2: Commission Delegated Regulation (EU) 2017/579 of 13 June 2016 (RTS 5) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the direct, substantial and foreseeable effect of derivative contracts within the Union and the prevention of the evasion of rules and obligations	
	Level 2: Commission Delegated Regulation (EU) 2017/578 of 13 June 2016 (RTS 8) supplements Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards specifying the requirements on market making agreements and schemes	
	Level 2: Commission Delegated Regulation (EU) 2017/577 of 13 June 2016 (RTS 3) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the volume cap mechanism and the provision of information for the purposes of transparency and other calculations	
	Level 2: Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 (RTS 28) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution	
	Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 (RTS 27) supplements Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions	
	Level 2: Commission Delegated Regulation (EU) 2017/574 of 7 June 2016 (RTS 25) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the level of accuracy of business clocks	
	Level 2: Commission Delegated Regulation (EU) 2017/573 of 6 June 2016 (RTS 10) supplements Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on requirements to ensure fair and non-discriminatory co-location services and fee structures	
	Level 2: Commission Delegated Regulation (EU) 2016/2021 of 2 June 2016 (RTS 16) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on access in respect of benchmarks	
	Level 2: Commission Delegated Regulation (EU) 2017/572 of 2 June 2016 (RTS 14) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on the specification of the offering of pre-and post-trade data and the level of disaggregation of data	
	Level 2: Commission Delegated Regulation (EU) 2017/571 of 2 June 2016 (RTS 13) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on the authorization, organizational requirements and the publication of transactions for data reporting services providers	
	Level 2: Commission Delegated Regulation (EU) 2016/2020 of 26 May 2016 (RTS 4) supplements Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on criteria for determining whether derivatives subject to the clearing obligation should be subject to the trading obligation	
	Level 2: Commission Delegated Regulation (EU) 2017/570 of 26 May 2016 (RTS 12) supplements Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards for the determination of a material market in terms of liquidity in relation to notifications of a temporary halt in trading	
	Level 2: Commission Implementing Regulation (EU) 2016/824 of 25 May 2016 (ITS 19) lays down implementing technical standards with regard to the content and format of the description of the functioning of multilateral trading facilities and organized trading facilities and the notification to the European Securities and Markets Authority according to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments	

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 2: Commission Delegated Regulation (EU) 2017/569 of 24 May 2016 (RTS 18) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the suspension and removal of financial instruments from trading		
Level 2: Commission Delegated Regulation (EU) 2017/568 of 24 May 2016 (RTS 17) supplements Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the admission of financial instruments to trading on regulated markets		
Level 2: Commission Delegated Regulation (EU) of 18 May 2016 supplementing Regulation (EU) 600/2014 of the European Parliament and of the Council with regards to definitions, transparency, portfolio compression and supervisory measures on product intervention and positions		This Delegated Regulation aims at specifying, in particular, the rules relating to determining liquidity for equity instruments, the rules on the provision of market data on a reasonable commercial basis, the rules on publication, order execution and transparency obligations for systematic internalisers, and the rules on supervisory measures on product intervention by ESMA, EBA and national authorities, as well as on position management powers by ESMA.
	Level 2: Grand-Ducal Regulation of 30 May 2018 on the protection of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits	
	Level 2: CSSF Regulation No 19-05 of 26 June 2019 prohibiting the marketing, distribution or sale of binary options to retail clients	
	Level 2: CSSF Regulation No 19-06 of 26 June 2019 restricting the marketing, distribution or sale of contracts for differences to retail clients	
Level 2: Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive	Level 2: Grand-Ducal Regulation of 13 July 2007 on the organizational requirements and operating conditions for investment firms	This Regulation transposes the "Level 2" MiFID Directive (2006/73/EC). It lays down implementing measures for certain articles of the 1993 Law, as amended, <i>inter alia</i> , by the Law of 13 July 2007.
Level 2: Commission Delegated Regulation (EU) 2017/566 of 18 May 2016 (RTS 9) supplements Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards for the ratio of unexecuted orders to transactions in order to prevent disorderly trading conditions		
Level 2: Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive		
Level 3: ESMA Questions and Answers on MiFID II/MiFIR Investor Protection		This Q&A promotes common supervisory approaches and practices in the application of MiFID II and MiFIR in relation to investor protection topics. It provides responses to questions posed by the general public, market participants and competent authorities in relation to the practical application of MiFID II and MiFIR.
Level 3: ESMA Guidelines of 4 February 2016 on complex debt instruments and structured deposits		The guidelines specify the criteria for the assessment of debt instruments and structured deposits on the risks involved by these instruments.
	Level 3: CSSF Circular 18/691 of 19 April 2018 updating CSSF Circular 17/668 on ESMA's guidelines on calibration of circuit breakers and publication of trading halts under Directive 2014/65/EU on markets in financial instruments ("MiFID II") and details on reporting of circuit breakers' parameters	This Circular amends Circular CSSF 17/668 by taking into account the publication by ESMA of the revised procedure "Reporting of circuit breakers' parameters by NCAs to ESMA (ref.: ESMA70-156-181)" published on 19 December 2017 and the revised form attached thereto "Template for reporting trading halt parameters to ESMA". The revised procedure is attached as an Annex to the Circular.
	Level 3: CSSF Circular 18/690 of 13 April 2018 on ESMA's guidelines on the management body of market operators and data reporting services providers	This Circular draws attention to ESMA's guidelines on the management body of market operators and data reporting services providers.

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 3: CSSF Circular 17/674 of 1 December 2017 on ESMA's guidelines on transaction reporting and order record keeping under Regulation (EU) No 600/2014 on markets in financial instruments ("MiFIR") and clock synchronization pursuant to Directive 2014/65/EU on markets in financial instruments ("MiFID II") and details on transaction reporting on financial instruments under MiFIR	The purpose of this Circular is: <ul style="list-style-type: none"> ▸ To transpose the ESMA Guidelines in relation to the submission of transaction reports pursuant to Article 26 of MiFIR, record keeping of orders pursuant to Article 25 of MiFIR and synchronization of business clocks pursuant to Article 50 of MiFID II into the Luxembourg regulatory framework ▸ To provide details on the obligation to report transactions pursuant to Article 26 of MiFIR with regard to the reporting of transactions involving branches and the modalities to be observed for the transmission of transaction reports to the CSSF
	Level 3: CSSF Circular 17/668 (as amended by Circular CSSF 18/691) of 22 August 2017 on ESMA's guidelines on calibration of circuit breakers and publication of trading halts under Directive 2014/65/EU (MiFID II) and details on reporting of circuit breakers' parameters	This Circular transposes the ESMA Guidelines on calibration of circuit breakers and publication of trading halts under Article 48(5) of MiFID II into Luxembourg law and specifies the reporting obligation under the second subparagraph of Article 48(5) of MiFID II. This provision requires regulated markets to report the parameters for halting trading and any material changes to those parameters to the competent authority. In accordance with Article 18(5) of MiFID II, said Article 48 of MiFID II also applies to operators operating an MTF or an OTF.
Level 3: ESMA Guidelines on the application of C6 and C7 of Annex 1 of MiFID II, June 2019	Level 3: CSSF Circular 19/723 of 18 July 2019 transposing ESMA Guidelines on the application of the definitions of commodity derivatives in Sections C6 and C7 of Annex I of MiFID II	The Guidelines focus on the consistent and uniform application of the definition of commodity derivatives and their classification under Sections C6 and C7 of Annex I of the MiFID Directive. These guidelines are transposed by CSSF Circular 19/723.
Level 3: Additional regulatory guidance: ESMA's technical advice to the Commission on MiFID II and MiFIR, December 2014		The Report provides technical advice on the possible content of the delegated acts required by several provisions of MiFID II and MiFIR.
Level 3: Guidelines on remuneration policies and practices (MiFID), ESMA, June 2013	Level 3: CSSF Circular 14/585 of 25 February 2014 transposing ESMA's Guidelines on remuneration policies and practices (MiFID), amending CSSF Circular 07/307	The Guidelines focus on the remuneration of "relevant persons", <i>inter alia</i> , persons who are involved in the provision of investment or ancillary services, client-facing front-line staff, sales force staff.
Level 3: Guidelines on certain aspects of the MiFID suitability requirements, ESMA, July 2012	Level 3: CSSF Circular 13/560 of 19 February 2013 on Addition of an Annex IV to Circular CSSF 07/307, transposing the guidelines of the European Securities and Markets Authority (ESMA) concerning Chapter 6 - Suitability test - of Circular 07/307	ESMA's Guidelines are designed to address a number of issues observed regarding compliance with MiFID suitability requirements with respect to investment advice. The Circular implements ESMA's Guidelines in Luxembourg.
	Level 3: Circular CSSF 12/552 of 11 December 2012 on Central administration, internal governance and risk management, as amended	The Circular covers, <i>inter alia</i> , composition, role and responsibilities of the Board of Directors, Luxembourg as a decision center in a group context, qualification, independence and prerogatives of internal control functions, roles and responsibilities of finance, accounting and IT, alert mechanisms including whistleblowing and specific guidelines for business lines.
Level 3: Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities, ESMA, February 2012	Level 3: Circular CSSF 12/536 of 27 March 2012 on Guidelines of the ESMA on systems and controls in an automated trading environment	These Guidelines cover organizational requirements for investment firms and regulated markets and multilateral trading facilities. These guidelines are transposed by CSSF Circular 12/536.
	Level 3: CSSF Circular 07/307 of 31 July 2007 (as amended by CSSF Circulars 13/560 and 13/568) on MiFID: Rules of conduct in the financial sector	This Circular provides clarification regarding certain provisions of the Law and Grand-Ducal Regulation, both of 13 July 2007, implementing MiFID.
Additional regulatory guidance: ESMA Q&A relating to the provision of CFDs and other speculative products to retail investors under MiFID		This Q&A provides clarification on the marketing and sale of CFDs and other speculative products to retail investors.
Additional regulatory guidance: ESMA Q&A relating to market structures topics, 29 May 2018		This Q&A covers, <i>inter alia</i> , <ul style="list-style-type: none"> ▸ Data disaggregation ▸ Direct electronic access and algorithmic trading ▸ Ticket size regime ▸ Multi-lateral and bilateral systems ▸ Access to CCPs and trading venues
Additional regulatory guidance: ESMA Q&A relating to transparency topics, 12 July 2018		This Q&A covers, <i>inter alia</i> , <ul style="list-style-type: none"> ▸ General transparency topics ▸ Equity transparency ▸ Non-equity transparency ▸ Pre-trade transparency waivers ▸ Double volume cap mechanism ▸ Systematic internaliser regime ▸ Data reporting services providers ▸ Third country issues

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Additional regulatory guidance: ESMA Q&A relating to commodity derivatives topics, 27 March 2018		This Q&A covers, <i>inter alia</i> , <ul style="list-style-type: none"> ▸ Position limits ▸ Ancillary activity ▸ Position reporting ▸ Position management controls ▸ Third country issues
Additional regulatory guidance: ESMA Q&A relating to investor protection and intermediaries topics, 12 July 2018		This Q&A covers, <i>inter alia</i> , <ul style="list-style-type: none"> ▸ Best execution ▸ Investment advice on an independent basis ▸ Inducements ▸ Information on costs and charges
Additional regulatory guidance: ESMA Q&A relating to MiFIR data reporting, 25 May 2018		This Q&A covers the data reporting required under MiFIR
Additional regulatory guidance: ESMA Q&A relating to post trading topics, 14 December 2017		This Q&A covers, <i>inter alia</i> , <ul style="list-style-type: none"> ▸ Straight through processing ▸ Indirect clearing
	Additional regulatory guidance: CSSF Q&A on MiFID II and MiFIR, 9 August 2018	This Q&A covers questions relating to: <ul style="list-style-type: none"> ▸ Data processing ▸ Commodity derivatives contracts ▸ Post trade transparency under MiFIR ▸ Algorithmic trading and direct electronic access

II.3.6. Stock exchange listing - prospectus and transparency

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC		
	Level 1: Law of 16 July 2019 on prospectuses on securities implementing EU Regulation 2017/1129 concerning the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC	
Level 1: Directive 2004/109/EC of 15 December 2004, as amended by the Directive 2013/50/EC of 22 October 2013 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (the Transparency Directive)	Level 1: Law of 11 January 2008 on transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, (the Transparency Law) modified by the Law of 10 May 2016	This Law transposes, <i>inter alia</i> , the Transparency Directive.
Level 1: Directive 2010/73/EU of 24 November 2010 amending the Prospectus Directive and the Transparency Directive	Level 1: Law of 3 July 2012 implementing Directive 2010/73/EU amending the Prospectus Law and the Transparency Law	This Law modifies the Prospectus Law and the Transparency Law.
Level 1: Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012		The Regulation lays down the requirements on transparency for securities financing transactions and the conditions for the reuse. The Regulation introduces three major obligations: <ul style="list-style-type: none"> ▸ Requirements to counterparties that intend to reuse financial instruments received under a collateral arrangement ▸ New disclosure requirements applicable to UCITS, AIFM management companies and self-managed AIFMs and internally managed AIFs in relation to Securities Financing Transaction (SFTs) and total return swaps ▸ New reporting obligation for all SFTs concluded, modified or terminated by a financial counterparty (UCITS Management Companies and AIFMs are mandated to report on behalf of the funds that they manage)

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Directive 2007/14/EC of the European Commission of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.	Level 2: Grand-Ducal Regulation of 11 January 2008 relating to the transparency requirements for issuers of securities modified by the Law of 10 May 2016	This Regulation transposes Directive 2007/14/EC.
Level 2 Regulations, <i>inter alia</i> :		
<ul style="list-style-type: none"> ▸ Commission Delegated Regulation (EU) 2019/979 of 14 March 2019 with regard to technical standards on key financial information in the summary of a prospectus, the publication and classification of prospectuses ▸ Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation 2017/1129 as regards the format, content, scrutiny and approval of the prospectus to be published 		
	Level 2: Grand-Ducal Regulation of 21 December 2017 relating to the fees to be levied by the CSSF	This Regulation lays down, <i>inter alia</i> , the CSSF fees applicable to the authorization and supervision of UCIs, management companies and AIFM.
	Level 2: Grand-Ducal Regulation of 2 July 2018, relating to fees to be levied by the CSSF, amending Grand-Ducal Regulation of 21 December 2017	This Regulation amends certain provisions of the Grand-Ducal Regulation of 21 December 2017.
	Level 3: CSSF Circular 05/210 of 10 October 2005 on the drawing-up of a simplified prospectus within the scope of Chapter 1 of Part III of the law on prospectuses for securities	
	Level 3: CSSF Circular 05/225 of 16 December 2005 on the notion “offer to the public of securities” as defined in the law on prospectuses for securities and the “obligation to publish a prospectus” that may ensue	
	Level 3: Circular CSSF 08/337 on the entry into force of the law of 11 January 2008 and of the Grand-Ducal Regulation of 11 January 2008 on transparency requirements for issuers of securities, as amended by CSSF Circular 12/542	
	Level 3: Circular CSSF 08/349 providing details regarding the information to be notified with respect to major holdings in accordance with the law of 11 January 2008 on transparency requirements for issuers of securities	
	Level 3: CSSF Circular 12/542 amending Circular CSSF 08/337 concerning the entry into force of the law of 11 January 2008 and the Grand-Ducal regulation of 11 January 2008 on transparency requirements for issuers of securities	
	Level 3: CSSF Circular 12/549 of 9 November 2012 on technical specifications regarding the submission to the CSSF of documents under the law on prospectuses for securities for offers to the public of units or shares of Luxembourg closed-end undertakings for collective investment and/or admissions of units or shares of Luxembourg closed-end undertakings for collective investment to trading on a regulated market	This Circular outlines, among others, technical specifications regarding the submission to the CSSF of different types of documents.
	Level 3: CSSF Circular 16/637 updating CSSF Circular CSSF 08/337 on the entry into force of the law of 11 January 2008 and of the Grand-Ducal Regulation of 11 January 2008 on transparency requirements for issuers of securities	This Circular modifies CSSF Circular 08/337 taking into consideration the changes brought about by the law of 10 May 2016.
	Level 3: CSSF Circular 16/638 updating CSSF Circular 08/349 relating to details regarding the information to be notified with respect to major holdings in accordance with the law of 11 January 2008 on transparency requirements for issuers of securities	This Circular modifies CSSF Circular 08/349 taking into consideration the changes brought about by the law of 10 May 2016.

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 3: CSSF Circular 19/724 - Technical specifications regarding the submission of documents to the CSSF under Regulation (EU) 2017/1129 and the Law of 16 July 2019 on prospectuses for securities and presentation of the regulatory framework governing prospectuses	The first part of this Circular presents the regulatory framework governing prospectuses and the CSSF's competences and missions in this context. The second part details the technical procedures governing the submission of documents to the CSSF for the purpose of approval, notification or filing in the context of offers of securities to the public and admissions of securities to trading on a regulated market.
	Level 3: ESMA's Guidelines on Alternative Performance Measures (APMs), October 2015	The Guidelines apply in relation to Alternative Performance Measures disclosed by issuers or persons responsible for the prospectus when publishing regulated information or prospectuses for securities (and supplements) on or after 3 July 2016. The Guidelines are aimed at promoting the usefulness and transparency of APMs included in prospectuses for securities or regulated information.
	Level 3: CSSF Circular 16/636 re ESMA Guidelines on Alternative Performance Measures	This Circular implements ESMA's Guidelines issued on 15 October 2015 into Luxembourg regulations.
	Level 3: CSSF Circular 18/679 of 23 January 2018 updating Circular CSSF 08/337 on the entry into force of the Law of 11 January 2008 and of the Grand-Ducal Regulation of 11 January 2008 on transparency requirements for issuers, as amended	
	Rules and regulations of the Luxembourg Stock Exchange	This rulebook is split into three main sections. Part 1 covers the admission of securities to trading on the securities markets of the Luxembourg Stock Exchange, and admission to its official list. Part 2 details the prospectus requirements, and Part 3 lists the market rules of the Luxembourg Stock Exchange.
	Additional regulatory guidance: ESMA Questions and Answers on the Prospectus Regulation	The purpose of this document is to promote common, uniform and consistent supervisory approaches and practices in the day-to-day application of the Prospectus Regulation.
	Additional regulatory guidance: CSSF FAQ: The Prospectus regime, 12 March 2013	
	Additional regulatory guidance: CSSF FAQ: The Transparency Law and the Grand-Ducal transparency regulation, 27 June 2016	
	Additional regulatory guidance: ESMA FAQ - Prospectuses - Common positions agreed by ESMA Members, as amended, March 2018	
	Additional regulatory guidance: ESMA Frequently asked questions regarding the Transparency Directive, October 2015	

II.3.7. Takeover bids, squeeze-outs and sell-outs

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Directive 2004/25/EC of 21 April 2004 on takeover bids (the Takeover Bids Directive)	Level 1: Law of 19 May 2006 implementing Directive 2004/25/EC of 21 April 2004 on takeover bids (the Takeover Bids Law)	<p>The Takeover Bids Directive sets out minimum requirements for the conduct of takeover bids for securities of companies where all or some of the securities are admitted to trading on a regulated market, <i>inter alia</i>, in order to protect minority shareholders.</p> <p>The Takeover Bids Law applies to takeover bids for the securities of companies governed by the laws of a Member State of the European Union or the European Economic Area where all or some of those securities are admitted to trading on a regulated market in one or more Member States.</p>
	Level 1: Law of 21 July 2012 on mandatory squeeze-out and sell-out of securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public (the Squeeze-outs and sell-outs Law)	<p>The Takeover Bids Directive also provides for a “squeeze-out right” enabling a majority shareholder to require the remaining minority shareholders to sell him their securities. In summary, the majority shareholder can exercise the “squeeze-out right” in situations where he holds more than 95% of the capital carrying voting rights. The squeeze-out right is combined with a “sell-out right” enabling minority shareholders to require a majority shareholder which holds more than 90% of the capital carrying voting rights to buy their securities following a takeover bid.</p> <p>The Squeeze-outs and sell-outs Law governs the mandatory squeeze-out, the mandatory sell-out and certain notification and disclosure obligations, where a company has its registered office in Luxembourg and all or part of its securities are admitted to trading on a regulated market in one or several Member States or were admitted on a regulated market or were offered to the public.</p>
	Level 2: Grand-Ducal Regulation of 21 December 2017 relating to the fees to be levied by the CSSF	This Regulation lays down, <i>inter alia</i> , the CSSF fees applicable to the authorization and supervision of UCIs, management companies and AIFM.
	Level 2: Grand-Ducal Regulation of 2 July 2018, relating to fees to be levied by the CSSF, amending Grand-Ducal Regulation of 21 December 2017	This Regulation amends certain provisions of the Grand-Ducal Regulation of 21 December 2017.
	Level 2: Grand-Ducal Regulation (GDR) of 1 March 2019 amending Grand-Ducal Regulation of 21 December 2017	This Regulation amends certain provisions of the GDR of 21 December 2017.
	Level 3: CSSF Circular 06/258 of 18 August 2006 on coming into force of the law of 19 May 2006 on the implementation of Directive 2004/25/EC of 21 April 2004 on takeover bids	The Circular covers the implementation of the Takeover Bids Law including, <i>inter alia</i> , scope, competent authority and applicable law, protection of minority shareholders, the mandatory bid and the equitable price, offer document, and right of squeeze-out and right of sell-out.
	Level 3: CSSF Circular 12/545 of 1 October 2012 on the entry into force of the law of 21 July 2012 on mandatory squeeze-out and sell-out of securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public	This Circular outlines the main provisions of the Law on mandatory squeeze-out and sell-out of securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public, and describes the squeeze-out and sell-out procedures, the notification, publication and communication requirements, and the role of the CSSF. It also includes the form to be used for notification to the CSSF.

II.3.8. Market abuse

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Directive 2014/57/EU of 16 April 2014 on criminal sanctions for market abuse (MAD II)	Level 1: Law of 23 December 2016 on Market Abuse	MAD II introduces common criminal sanctions for insider dealing/market manipulation and aligns international interpretations of the directive into a harmonised approach. MAD II is applicable as from 3 July 2016 and repeals Market Abuse Directive 2003/6/EC.
Level 1: Regulation (EU) No 596/2014 of the European Parliament of the Council of 16 April 2014 on market abuse (Market Abuse Regulation - MAR)		The provisions of MAR apply to organized trading facilities, SME growth markets, emission allowances or auctioned products based thereon as of 3 July 2016.
Level 1: Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014		
Level 1: Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories		
Level 2: Commission Implementing Directive (EU) 2015/2392 of 17 December 2015 on Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards reporting to competent authorities of actual or potential infringements of that Regulation		
Level 2: Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards an exemption for certain third countries public bodies and central banks, the indicators of market manipulation, the disclosure thresholds, the competent authority for notifications of delays, the permission for trading during closed periods and types of notifiable managers' transactions		
Level 2: Commission Delegated Regulation (EU) 2016/908 of 26 February 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council laying down regulatory technical standards on the criteria, the procedure and the requirements for establishing an accepted market practice and the requirements for maintaining it, terminating it or modifying the conditions for its acceptance		
Level 2: Commission Delegated Regulation (EU) 2016/909 of 1 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the content of notifications to be submitted to competent authorities and the compilation, publication and maintenance of the list of notifications		
Level 2: Commission Delegated Regulation (EU) 2016/1052 of 8 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures		
Level 2: Commission Delegated Regulation (EU) 2016/957 of 9 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures as well as notification templates to be used for preventing, detecting and reporting abusive practices or suspicious orders or transactions		
Level 2: Commission Delegated Regulation (EU) 2016/958 of 9 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy and for disclosure of particular interests or indications of conflicts of interest		
Level 2: Commission Delegated Regulation (EU) 2016/960 of 17 May 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the appropriate arrangements, systems and procedures for disclosing market participants conducting market soundings		
Level 2: Commission Implementing Regulation (EU) 2016/347 of 10 March 2016 laying down implementing technical standards with regard to the precise format of insider lists and for updating insider lists in accordance with Regulation (EU) No 596/2014 of the European Parliament and of the Council		
Level 2: Commission Implementing Regulation (EU) 2016/523 of 10 March 2016 laying down implementing technical standards with regard to the format and template for notification and public disclosure of managers' transactions in accordance with Regulation (EU) No 596/2014 of the European Parliament and of the Council		
Level 2: Commission Implementing Regulation (EU) 2016/378 of 11 March 2016 laying down implementing technical standards with regard to the timing, format and template of the submission of notifications to competent authorities according to Regulation (EU) No 596/2014 of the European Parliament and of the Council		

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 2: Commission Implementing Regulation (EU) 2016/959 of 17 May 2016 laying down implementing technical standards for market soundings with regard to the systems and notification templates to be used by disclosing market participants and the format of the records in accordance with Regulation (EU) No 596/2014 of the European Parliament and of the Council		
Level 2: Commission Implementing Regulation (EU) 2016/1055 of 29 June 2016 laying down implementing technical standards with regard to the technical means for appropriate public disclosure of inside information and for delaying the public disclosure of inside information in accordance with Regulation (EU) No 596/2014 of the European Parliament and of the Council		
Level 2: Commission Implementing Regulation (EU) 2017/1158 of 29 June 2017 laying down implementing technical standards with regards to the procedures and forms for competent authorities exchanging information with the European Securities Market Authority as referred to in Article 33 of Regulation (EU) No 596/2014 of the European Parliament and of the Council		
Level 2: Commission Implementing Regulation (EU) 2018/292 of 26 February 2018 laying down implementing technical standards with regard to procedures and forms for exchange of information and assistance between competent authorities according to Regulation (EU) No 596/2014 of the European Parliament and of the Council on market abuse		
Level 3: ESMA Guidelines of 5 October 2015 on Alternative Performance measures		These guidelines provide additional guidance on the calculation and the presentation of alternative performance measures.
Level 3: ESMA Guidelines of 13 July 2016 on the Market Abuse Regulation - market soundings and delay of disclosure of inside information		These guidelines clarify the implementation of the Market Abuse Regulation for persons receiving market soundings and on delayed disclosure of inside information.
Level 3: ESMA Guidelines of 20 October 2016 on the Market Abuse Regulation - delay in the disclosure of inside information		These guidelines provide a non-exhaustive and indicative list of legitimate interests of the issuers that are likely to be prejudiced by immediate disclosure of inside information and situations in which delay of disclosure is likely to mislead the public.
Level 3: ESMA Guidelines of 10 November 2016 on the Market Abuse Regulation - persons receiving market soundings		These guidelines apply in relation to the factors, the steps and the records that the persons receiving the market soundings will have to consider and implement according to Article 11(11) of Regulation (EU) No 596/2014 of the European Parliament and of the Council.
Level 3: ESMA Guidelines of 17 January 2017 on the Market Abuse Regulation - Information relating to commodity derivatives markets or related spot markets for the purpose of the definition of inside information on commodity derivatives		These guidelines provide a non-exhaustive and indicative list of information which is reasonably expected or is required to be disclosed in accordance with legal or regulatory provisions in Union or national law, market rules, contract, practice or custom, on the relevant commodity derivatives markets or spot markets.
	Level 3: CSSF Circular 16/646 of 20 December 2016 on ESMA's Guidelines on the delay in the disclosure of inside information in accordance with Article 17(4) of Regulation (EU) No 596/2014 on market abuse ("MAR")	The purpose of this Circular is to transpose the <i>MAR Guidelines - Delay in the disclosure of inside information</i> (Ref.: ESMA/2016/1478) published on 20 October 2016 by ESMA, into Luxembourg law.
	Level 3: CSSF Circular 17/648 of 11 January 2017 on guidelines of the European Securities and Markets Authority (ESMA) in relation to the factors, the steps and the records that the persons receiving the market soundings will have to consider and implement according to Article 11(11) of Regulation (EU) No 596/2014 on market abuse ("MAR")	The purpose of this Circular is to implement <i>MAR Guidelines - Persons receiving market soundings</i> (Ref.: ESMA/2016/1477) published on 10 November 2016 by ESMA, into Luxembourg regulation.
	Level 3: CSSF Circular 17/653 of 14 March 2017 on the guidelines of the European Securities and Markets Authority (ESMA) on the definition of inside information relating to commodity derivatives in accordance with Article 7(1)(b) of Regulation (EU) No 596/2014 on market abuse ("MAR")	The purpose of this Circular is to implement <i>MAR Guidelines - Information relating to commodity derivatives markets or related spot markets for the purpose of the definition of inside information on commodity derivatives</i> (Ref.: ESMA/2016/1480), published on 17 January 2017 by ESMA, into Luxembourg regulation.
Additional regulatory guidance: ESMA Q&A on the common operation of the Market Abuse Directive, April 2016		This Q&A provides clarifications on the implementation of the Market Abuse Directive.
Additional regulatory guidance: ESMA Q&A on the Market Abuse Regulation		

II.3.9. Derivatives - European Market Infrastructure Regulation (EMIR)

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Regulation (EU) 2019/834 of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories	Level 1: Law of 6 June 2018 on the transparency of securities financing transactions	This regulation clarifies, <i>inter alia</i> , the classification of AIFs, introduces a new category (small financial counterparties), removes backloading obligation and limits the requirement to exchange variation margin for FX Swaps and FX Forwards to the Global Systematically Important Financial Institutions.
Level 1: Regulation (EU) 2015/2365 of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012	Level 1: Law of 6 June 2018 on the transparency of securities financing transactions	The Regulation lays down the requirements on transparency for securities financing transactions and the conditions for the reuse. The Regulation introduces three major obligations: <ul style="list-style-type: none"> ▸ Requirements to counterparties that intend to reuse financial instruments received under a collateral arrangement ▸ New disclosure requirements applicable to UCITS management companies self-managed UCITS, AIFMs and internally managed AIF, in relation to Securities Financing Transaction (SFTs) and total return swaps ▸ New reporting obligation for all SFTs concluded, modified or terminated by a financial counterparty (UCITS Management Companies and AIFMs are mandated to report on behalf of the funds that they manage)
Level 1: Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories completed by Commission Delegated Regulation (EU) No 2015/2205 of 6 August 2015 and by Commission Delegated Regulation (EU) No 2016/592 of 1 March 2016 ,and modified by Regulation (EU) No 2015/2365 of 25 November 2015	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	This Regulation contains rules on introducing a reporting obligation for OTC derivatives; a clearing obligation for eligible OTC derivatives; measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives; common rules for central counterparties (CCPs) and for trade repositories; and rules on the establishment of interoperability between CCPs. The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Delegated Regulation (EU) 2017/751 of 16 March 2017 amends Delegated Regulations (EU) 2015/2205, (EU) 2016/592 and (EU) 2016/1178 as regards the deadline for compliance with clearing obligations for certain counterparties dealing with OTC derivatives	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Delegated Regulation (EU) 2017/610 of 20 December 2016 amends Regulation (EU) No 648/2012 of the European Parliament and of the Council as regards the extension of the transitional periods related to pension scheme arrangements	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Delegated Regulation (EU) 2017/323 of 20 January 2017 corrects Delegated Regulation (EU) 2016/2251 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Implementing Regulation (EU) 2017/105 of 19 October 2016 amends Implementing Regulation (EU) No 1247/2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Delegated Regulation (EU) 2017/104 of 19 October 2016 amends Delegated Regulation (EU) No 148/2013 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplements Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Corrigendum to Commission Delegated Regulation (EU) 2016/1178 of 10 June 2016 supplements Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Delegated Regulation (EU) 2016/1178 of 10 June 2016 supplements Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.
Level 2: Commission Delegated Regulation (EU) 2016/592 of 1 March 2016 supplements Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation	Level 1: Law of 15 March 2016 on OTC Derivatives and CCPs	The law describes the role of the <i>Commission de Surveillance du Secteur Financier</i> regarding the supervision of the EMIR Regulations.

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 2: Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP		This Commission Delegated Regulation clarifies, <i>inter alia</i> , indirect clearing arrangements, the clearing obligation, access to a trading venue, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP under EMIR.
Level 2: Commission Delegated Regulation (EU) No 148/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories		This Commission Delegated Regulation clarifies reporting to trade repositories under EMIR.
Level 2: Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012 laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012		This Commission Implementing Regulation lays down implementing technical standards with regard to the format and frequency of trade reports to trade repositories.
Level 2: Commission Delegated Regulation (EU) 2019/356 of 13 December 2018 supplementing Regulation (EU) 2015/2365 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of securities financing transactions (SFTs) to be reported to trade repositories		The Delegated Regulation provides the details of securities financing transactions, clearing actions and collateral and its reuse to be reported.
Level 2: Commission Implementing Regulation (EU) 2019/363 of 13 December 2018 laying down implementing technical standards with regard to the format and frequency of reports on the details of securities financing transactions (SFTs) to trade repositories in accordance with Regulation (EU) 2015/2365 of the European Parliament and of the Council and amending Commission Implementing Regulation (EU) No 1247/2012 with regard to the use of reporting codes in the reporting of derivative contracts		The Delegated Regulation provides the details to be reported for securities financing transaction ("SFT") counterparties to trade repositories or the European Securities and Markets Authority ("ESMA") in a harmonised format.
	Level 3: CSSF Circular 13/557 of 23 January 2013 on Regulation (EU) No 648/2012 of 4 July 2012 on OTC derivatives, central counterparties and trade repositories	The Circular covers, <i>inter alia</i> , EMIR scope of application and definitions, requirements, exemptions, trade repositories and CCPs.
Level 3: ESMA Guidelines - Reporting under Articles 4 and 12 SFTR	Level 3: CSSF Circular 20/739 of 9 April 2020	These Guidelines aim to clarify a number of provisions of SFTR and to provide practical guidance on the implementation of some of those provisions.
Level 3: ESMA Guidelines on the application of C6 and C7 of Annex 1 of MiFID II, June 2019	Level 3: CSSF Circular 19/723 of 18 July 2019 transposing ESMA Guidelines on the application of the definitions of commodity derivatives in Sections C6 and C7 of Annex I of MiFID II	The Guidelines focus on the consistent and uniform application of the definition of commodity derivatives and their classification under Sections C6 and C7 of Annex I of the MiFID Directive. These guidelines are transposed by CSSF Circular 19/723.
Additional regulatory guidance: ESMA Q&A on the implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)		The document promotes common supervisory approaches and practices in the application of EMIR and provides responses to questions posed by the general public, market participants and competent authorities in relation to the practical application of EMIR.
	Industry guidance: ALFI guidance on EMIR/OTC Derivatives: Frequently asked Questions (FAQ)	The FAQ covers, <i>inter alia</i> : <ul style="list-style-type: none"> ▸ Scope ▸ Trade reporting ▸ Legal Entity Identifiers (LEIs)
	Industry guidance: ALFI guidance on clearing and collateral arrangements in relation to OTC derivatives under EMIR Refit requirements, June 2019	The guidelines provide a description of the 3 main obligations required by EMIR: 1. Clearing: mandatory clearing for OTC transactions 2. Risk mitigation techniques with a focus on the exchange of collateral 3. Trade reporting through trade repositories
	Industry guidance: ALFI guidelines on uncleared margin rules, July 2020	The Guidelines provide practical guidance on the implementation of the margining obligation.

II.3.10. Short selling

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Regulation (EU) No 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps (the Short Selling Regulation)		The Short Selling Regulation contains rules on short selling and certain aspects of credit default swaps (CDS) with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events.
	Level 1: Law of 12 July 2013 on short selling of financial instruments	The Law, <i>inter alia</i> , confirms that the CSSF is the competent authority in relation to short selling.

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
<p>Level 2: Commission Delegated Regulations on short selling and certain aspects of credit default swaps:</p> <ul style="list-style-type: none"> ▸ Commission Delegated Regulation (EU) No 826/2012 of 29 June 2012 supplementing Regulation (EU) No 236/2012 with regard to regulatory technical standards on notification and disclosure requirements with regard to net short positions, the details of the information to be provided to ESMA in relation to net short positions and the method for calculating turnover to determine exempted shares ▸ Commission Implementing Regulation (EU) No 827/2012 of 29 June 2012 laying down implementing technical standards with regard to the means for public disclosure of net position in shares, the format of the information to be provided to ESMA in relation to net short positions, the types of agreements, arrangements and measures to adequately ensure that shares or sovereign debt instruments are available for settlement and the dates and period for the determination of the principal venue for a share according to Regulation (EU) No 236/2012 ▸ Commission Delegated Regulation (EU) No 918/2012 of 5 July 2012 supplementing Regulation (EU) No 236/2012 with regard to definitions, the calculation of net short positions, covered sovereign credit default swaps, notification thresholds, liquidity thresholds for suspending restrictions, significant falls in the value of financial instruments and adverse events ▸ Commission Delegated Regulation (EU) No 919/2012 of 5 July 2012 supplementing Regulation (EU) No 236/2012 with regard to regulatory technical standards for the method of calculation of the fall in value for liquid shares and other financial instruments 	<p>Level 3: CSSF Circular 12/548 of 30 October 2012 (as amended by Circular 13/565) on the entry into force of Regulation (EU) No 236/2012 of 14 March 2012 on short selling and certain aspects of credit default swaps and details on certain practical aspects of notification, disclosure and exemption procedures, as modified by CSSF Circular 13/565</p>	<p>These implementing Regulations clarify certain aspects of the Short Selling Regulation.</p> <p>This Circular provides practical details and guidance in relation to the notification or disclosure of significant net short positions to the CSSF, the exemption for market making activities and primary market operations and the publication, by ESMA and by the CSSF, of relevant information in application of the Regulation.</p>
<p>Additional regulatory guidance: ESMA Q&A on the implementation of the Regulation on short selling and certain aspects of credit default swaps, as amended</p>		<p>The Q&A covers, <i>inter alia</i>, scope, transparency of net short positions, calculating the net short position, net short positions when different entities in a group have long or short positions or for fund management activities, handling of notification and disclosure of net short positions, uncovered short sales and uncovered sovereign CDS.</p>
	<p>Additional regulatory guidance: CSSF Press Release of 19 September 2008 introducing a ban on naked short sales and of 29 September 2008 clarifying the prohibition of uncovered short selling</p>	<p>These Press Releases cover the ban on uncovered (naked) short sales of shares or any other instrument giving rise to an exposure to the issued share capital of a credit institution or insurance undertaking traded on a regulated market, whether on own account or on behalf of clients.</p>

II.3.11. Credit ratings

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
<p>Level 1: Regulation (EC) No 1060/2009 of 16 September 2009 on credit rating agencies, as amended by Regulation (EU) 513/2011 of 11 May 2011 and Regulation (EU) 462/2013 of 21 May 2013</p>		<p>This Regulation contains rules aiming at ensuring that credit rating activities are conducted in accordance with the principles of integrity, transparency, responsibility and good governance in order to ensure that resulting credit ratings used in the European Community are independent, objective and of adequate quality.</p>
<p>Level 1: Regulation (EU) No 462/2013 of 21 May 2013 as amending Regulation (EC) No 1060/2009 on credit rating agencies</p>		<p>This Regulation introduces a common regulatory approach in order to enhance the integrity, transparency, responsibility, good governance and independence of credit rating activities, contributing to the quality of credit ratings issued in the European Union and to the smooth functioning of the internal market, while achieving a high level of consumer and investor protection.</p>
	<p>Level 1: Law of 28 October 2011 implementing Regulation (EC) No. 1060/2009 of 16 September 2009 on credit rating agencies and amending the law of 5 April 1993 on the financial sector, as amended and the law of 8 December 1994 on annual accounts and consolidated and on the obligations regarding the drawing up and publication of accounting documents</p>	<p>This Regulation contains rules as regards the transposition of Article 36 of Regulation (EC) No. 1060/2009 of 16 September 2009 on credit rating agencies, the amendment of the law of 5 April 1993 on the financial sector, as amended and the transposition, for the insurance sector, of Directive 2009/49/EC of 18 June 2009.</p>
<p>Additional regulatory guidance: ESMA Q&A on credit rating agencies</p>		<p>This Q&A provides clarifications on the application of the Credit Rating Agencies Regulation.</p>

II.3.12. Title, securities, covered bonds and collateral

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 1: Civil Code	The Civil Code covers, in Book III, the manners in which property is acquired, including, <i>inter alia</i> , sale, exchange, lending and deposit.
	Level 1: Law of 1 August 2001 concerning the circulation of securities, as amended	This Law covers the concept of transfer of ownership by way of securities and the terms and obligations thereto.
	Level 1: Law of 5 August 2005 on financial collateral arrangements	This Law on financial collateral arrangements transposes Directive 2002/47/EC of 6 June 2002.
	Level 1: Law of 24 October 2008 enhancing the legislative framework of the financial center of Luxembourg	This Law updates Luxembourg's legal framework for covered bonds under 1993 Law (see Section II.3.4.). The updated framework, <i>inter alia</i> , permits loans to be granted by covered bond banks in the form of investments in debt securities issued by securitization vehicles, permits loan coverage in the form of any type of guarantee provided by a public institution, and extends the collateral of covered bonds to moveable property, such as rolling stock, provided certain conditions are met.
	Level 1: Law of 6 April 2013 on dematerialized securities	The Law defines the Luxembourg legal framework applicable to dematerialized securities. It lays down, <i>inter alia</i> , the requirements relating to issuance of dematerialized securities, conversion of existing securities into dematerialized form and transmission of dematerialized securities.
	Level 1: Law of 28 July 2014 regarding immobilization of bearer shares and units	This Law relates to the immobilization of bearer shares and units and the keeping of the register of registered shares and the register of bearer shares and amends 1) the law of 10 August 1915 on commercial companies, as amended, and 2) the law of 5 August 2005 on financial collateral arrangements, as amended.

II.3.13. Companies, SOPARFIs and securitization vehicles

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 1: Law of 10 August 1915 on commercial companies, as amended (the 1915 Law)	The 1915 Law is the basic law on commercial companies. It is applicable, <i>inter alia</i> , to Luxembourg companies whose main corporate purpose is the holding of participations in other companies.
	Level 1: Law of 27 May 2016 modernising the Luxembourg legal publication regime	This Law, <i>inter alia</i> : <ul style="list-style-type: none"> ▸ Creates a central electronic platform: RESA ▸ Introduces new registration requirements for common funds (FCPs) ▸ Clarifies costs for late filling of annual accounts
	Level 1: Law of 25 August 2006 on the European company, as amended	This Law introduces the concept of the European company (<i>Societas Europaea</i> or S.E.) and modernizes the 1915 Law.
	Level 1: Law of 19 December 2002 on the Trade and Companies Register and the accounting and annual accounts of companies, as amended	
	Level 1: Law of 10 December 2010 on the introduction of international financial reporting standards for companies	This Law introduces the possibility for commercial companies to prepare and present their annual and consolidated accounts under International Financial Reporting Standards (IFRS).
	Level 1: Law of 22 March 2004 on securitization, as amended	The Law defines the Luxembourg legal framework applicable to securitization vehicles in Luxembourg.
Level 1: Regulation (EU) 2017/2402 of 12 December 2017 laying down a general framework for securitization and creating a specific framework for simple, transparent and standardised securitization, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012		The regulation introduces a comprehensive framework for securitization including, <i>inter alia</i> , a preferential capital for some simple transparent and standardised ("STS") transactions, risk retention rules, disclosure and due diligence requirement and a ban on certain types of resuritizations.
Additional Regulatory Guidance: ESMA Q&A on the Securitization Regulation		The purpose of this document is to promote common, uniform and consistent supervisory approaches and practices in the day-to-day application of Securitization Regulation.

II.3.14. Acquisitions in the financial sector

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 3: Guidelines for the prudential assessment of acquisitions and increase of holdings in the financial sector required by Directive 2007/44/EC, CESR, CEBS and CEIOPS, December 2008		These joint Guidelines define cooperation arrangements in order to ensure an adequate and timely flow of information between supervisors. They also establish an exhaustive and harmonized list of information that proposed acquirers should include in their notifications to the competent supervisory authorities.

II.3.15. Competition

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
	Level 1: Law of 17 October 2011 on competition	The Law covers unauthorized agreements between undertakings, decisions by an association of undertakings and concerted parties that have as their object or effect the prevention, restriction or distortion of competition and abuse of dominant position.

II.3.16. Marketing³³⁴

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Directive 2002/65/EC of September 2002 concerning the distance marketing of consumer financial services (the Distance Marketing Directive)	Level 1: Law of 8 April 2011 introducing a Consumer Code	The Consumer Code covers, <i>inter alia</i> , consumer information, unfair commercial practices, and consumer contracts. It implements, <i>inter alia</i> , the Distance Marketing Directive.
Level 1: Directive 97/55/EC amending Directive 84/450/EEC concerning misleading advertising so as to include comparative advertising	Level 1: Law of 30 July 2002 regulating certain trade practices, penalizing unfair competition, as amended	This Law transposes Directive 97/55/EC amending Directive 84/450/EEC concerning misleading advertising so as to include comparative advertising.
	Level 1: Law of 16 July 1987 on door-to-door selling, itinerant trade, display of goods and soliciting of orders, as amended	This Law covers door-to-door selling, itinerant trade, display of goods and soliciting of orders.
	Level 3: Circular 07/281 on the Law of 18 December 2006 concerning the distance marketing of financial services	This Circular outlines the essential elements of the Law of 18 December 2006 concerning the distance marketing of consumer financial services (replaced by the Consumer Code).
Regulation (EU) 2019/1156 of the European Parliament and of the Council of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014		Regulation (EU) 2019/1156 is intended to facilitate cross-border distribution of collective investment undertakings and amending the European Venture Capital Funds Regulation, the European Social Entrepreneurship Funds Regulation, and the Regulation on key information documents for packaged retail and insurance-based investment products.
Level 1: Directive (EU) 2019/1160 of the European Parliament and of the Council of 20 June 2019 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings		This Directive amends the UCITS and AIFM Directives and harmonizing various aspects of cross-border distribution.
	Additional text: Memorandum of Understanding (MoU) concerning Mutual Fund Recognition of Covered Funds of 15 January 2019	This MoU was entered into by the CSSF and the Hong Kong Securities and Futures Commission and provides a framework for mutual recognition of Luxembourg funds and Hong Kong domiciled AIFs to be offered, marketed and distributed to retail investors in Luxembourg and to the public in Hong Kong.

³³⁴ See also Section II.3.5.

II.3.17. Sustainable Finance

European Union text	Luxembourg text, Luxembourg implementation of EU text, or direct application in Luxembourg	Brief description
Level 1: Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector		The Regulation provides a definition of sustainable investment and aims to ensure a minimum harmonization of the level of transparency required from investment fund managers (“IFMs”), asset managers and advisors towards end investors
Level 1: Regulation (EU) 2019/2089 of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-Aligned Benchmarks and sustainability-related disclosures for benchmarks		The Regulation amends the Benchmarks Regulation and sets a high-level framework designed to ensure the development and good governance of EU Climate Transition Benchmarks and EU Paris-Aligned Benchmarks
Level 1: Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector		The EU Taxonomy Regulation is the unified classification system for sustainable activities. It also provides further details on the content of sustainability-related disclosures required in pre-contractual and periodic reports of environmentally sustainable investment funds and investment funds promoting environmental characteristics
	Industry Guidance: ALFI Guidance on Sustainability-related disclosures	This document provides, <i>inter alia</i> : <ul style="list-style-type: none"> ▸ Clarification on meaning and definition of sustainability intensity ▸ Definitions ▸ Detailed disclosure requirements ▸ Guidance on the integration of ESG data ▸ Selected examples of sustainability factors

III Glossary

III.1. Introduction

The glossary provides:

- ▶ A list of acronyms and abbreviations and the full meanings and the French translations of terms used in this *Technical Guide*, where relevant
- ▶ A list of other common UCI-related terms used in this *Technical Guide* in English, with French translations



III.2. Acronyms and abbreviations, and French translations

Acronyms and abbreviations, full meanings and French translations		
Abbreviation	English Name	French Name
1915 Law	Law of 10 August 1915 on commercial companies, as amended	Loi de 1915 concernant les sociétés commerciales, telle que modifiée
1993 Law	Law of 5 April 1993 on the Financial Sector, as amended	Loi du 5 avril 1993 sur le secteur financier, telle que modifiée
2002 Law	Law of 19 December 2002 on the companies and trade register and the accounting and annual accounts of undertakings, as amended	Loi du 19 décembre 2002 concernant le registre de commerce et des sociétés ainsi que la comptabilité et les comptes annuels des entreprises, telle que modifiée
2010 Law	Law of 17 December 2010 relating to undertakings for collective investment, as amended	Loi du 17 décembre 2010 concernant les organismes de placement collectif, telle que modifiée
2010 Law Part I UCI	UCIs under Part I of the 2010 Law (UCITS)	OPC régis par la Partie I de la Loi de 2010 (OPCVM)
2010 Law Part II UCI	UCIs under Part II of the 2010 Law	OPC régis par la Partie II de la Loi de 2010
2016 Law	Law of 10 May 2016 relating to undertakings for collective investment	Loi du 10 Mai 2016 concernant les organismes de placement collectif
ABBL	Luxembourg Bankers' Association	Association des Banques et Banquiers, Luxembourg
ABCP	Asset-backed commercial paper	Papier commerciaux adossés à des actifs
ABS	Asset backed securities	Titres adossés à des actifs
AGM	Annual general meeting	Assemblée générale annuelle
AIF	Alternative Investment Fund	Fonds d'investissement alternatifs (FIA)
AIFM	Alternative Investment Fund Manager	Gestionnaire de fonds d'investissement alternatifs
AIFMD	Alternative Investment Fund Managers Directive	Directive sur les gestionnaires de fonds d'investissement alternatifs
AIFM Law	The Law of 12 July 2013 on Alternative Investment Fund Managers	Loi du 12 juillet 2013 relative aux gestionnaires de fonds d'investissement alternatifs
ALCO	Association of Luxembourg Compliance Officers	Association luxembourgeoise des Compliance Officers
ALFI	Association of the Luxembourg Fund Industry	Association luxembourgeoise des fonds d'investissement
ALRIM	Luxembourg Association for Risk Management	Association Luxembourgeoise de Risk Management
AML/CFT	Anti-money laundering (AML) and counter-terrorist financing (CFT)	Lutte anti-blanchiment de capitaux et contre le financement du terrorisme (LAB/CFT)
APM	Alternative performance measures	Indicateurs alternatifs de performance
ARIS	Absolute return innovative strategies	
BCL	Luxembourg Central Bank	Banque centrale du Luxembourg
CaA	Luxembourg Insurance Supervisory Authority	Commissariat aux Assurances
CAPEX	Capital expenditures	Dépenses en capital
CCLux	CCLux	Centrale de Communications Luxembourg S.A.
CCP	Central counterparty	Contrepartie centrale
CDO	Collateralized debt obligation	
CDS	Credit default swap	
CEBS ³³⁵	Committee of European Banking Supervisors	

³³⁵ | Now EBA.

Acronyms and abbreviations, full meanings and French translations

Abbreviation	English Name	French Name
CEIOPS ³³⁶	Committee of European Insurance and Occupational Pensions Supervisors	
CES ³³⁷	Committee of European Securities Regulators	Comité européen des régulateurs des marchés de valeurs mobilières (CERVM)
CIS	Collective investment scheme	Organisme de placement collectif
CIT	Corporate income tax	Impôt sur les sociétés
CIU ³³⁸	Collective Investment Undertaking	Organisme de placement collectif (OPC)
CJEU	Court of Justice of the European Union	Cour de justice de l'Union européenne
CNAV	Constant NAV	Valeur nette d'inventaire indicative
CRA	Credit rating agency	Agence de notation de crédit
CRD	Capital Requirements Directive	Directive sur les exigences de fonds propres
CRF	Financial intelligence unit (FIU)	Cellule de renseignement financier
CRR	Capital Requirements Regulation	Règlement sur les exigences de fonds propres
CRS	Common Reporting Standard	Norme Commune de Déclaration
CRS Law	Law of 18 December 2015 on the automatic exchange of financial account information in tax matters	Loi concernant l'échange automatique de renseignements relatifs aux comptes financiers en matière fiscale
CSD	Central securities depository	Dépositaire central de titres
CSSF	Commission for the Supervision of the Financial Sector	Commission de Surveillance du Secteur Financier
CVaR	Conditional Value-at-Risk	Valeur-sous-risque conditionnelle
DNSH	Do No Significant Harm	Ne cause pas de préjudice important
DTT	Double taxation treaty	Convention contre la double imposition
EBA	European Banking Authority	Autorité bancaire européenne
ECB	European Central Bank	Banque centrale européenne
EEA	European Economic Area	Espace économique européen (EEE)
EFAMA	European Fund and Asset Management Association	Association européenne des sociétés de gestion de fonds et d'actifs
EFC	European Fund Classification	Classification européenne des fonds
EFCF	European Fund Categorization Forum	
EGM	Extraordinary general meeting	Assemblée générale extraordinaire (AGE)
EIOPA	European Insurance and Occupational Pensions Authority	Autorité européenne des assurances et des pensions professionnelles
ELTIF	European Long-Term Investment Funds	Fonds européens d'investissement à long terme (FEILT)
EMIR	European Market Infrastructure Regulation	
EPM	Efficient Portfolio Management	Gestion de portefeuille efficace
ESA	European Supervisory Authorities	Autorités Européennes de Surveillance
ESG	Environmental, social and governance (responsibilities)	(Responsabilités) environnementales, sociales et de gouvernance
ESMA	European Securities and Markets Authority	Autorité européenne des marchés financiers
ETF	Exchange traded funds	Fonds négociés en bourse (FNB)
EU	European Union	Union européenne (UE)
EU CTB	EU Climate Transition Benchmarks	Indices de référence «transition climatique» de l'UE
EU PAB	EU Paris-Aligned Benchmarks	Indices de référence «accord de Paris» de l'UE
EuSEF	European Social Entrepreneurship Funds	Fonds d'entrepreneuriat social européens
EuVECA	European Venture Capital Funds	Fonds de capital-risque européens
EVT	Extreme Value Theory	Théorie des valeurs extrêmes
FAQ	Frequently asked questions	Questions fréquemment posées
FATCA	Foreign Account Tax Compliance Act	
FATF	Financial Action Task Force	Groupe d'Action financière (GAFI)
FCP	Common fund	Fonds commun de placement
FDAP	Fixed or determinable annual or periodical	
FDI	Financial derivative instrument	Instrument financier dérivé
FFI	Foreign Financial Institutions	

³³⁶ Now EIOPA.

³³⁷ Now ESMA.

³³⁸ See also UCI.

Acronyms and abbreviations, full meanings and French translations

Abbreviation	English Name	French Name
FGDL	Deposit Guarantee Fund, Luxembourg	Fonds de Garantie des Dépôts, Luxembourg
FSB	Financial Stability Board	
FTT	Financial Transaction Tax	Taxe sur les transactions financières
HNWI	High net worth individual	
IFAC	International Federation of Accountants	Fédération internationale des comptables
IFM	Investment Fund Manager	Gestionnaire de fonds d'investissement
IFRS	International Financial Reporting Standards	Normes internationales d'information financière
IGA	Inter-Governmental Agreement	
ILA	Luxembourg Institute of Directors	Institut luxembourgeois des administrateurs
ILNAS	Luxembourg Institute of Normalization, Accreditation, Security and Quality of Products and Services	Institut Luxembourgeois de la Normalisation, de l'Accréditation, de la Sécurité et Qualité des Produits et Services
IMD	Insurance Mediation Directive	Directive sur l'intermédiation en assurance
IML ³³⁹	Luxembourg Monetary Institute	Institut monétaire luxembourgeois
IMMFA	Institutional Money Market Funds Association	Association des fonds monétaires institutionnels
iNAV	Indicative Net Asset Value	Valeur nette d'inventaire indicative
IORP	Institutions for Occupational Retirement Provision	Institutions de retraite professionnelle
IOSCO	International Organization of Securities Commissions	Organisation internationale des commissions de valeurs (OICV)
IRE	Luxembourg Institute of Auditors	Institut des réviseurs d'entreprises
IRS	Internal Revenue Service	
ISA	International Standards on Auditing	Normes internationales d'audit
ISAE 3402	International Standard on Assurance Engagements (ISAE) 3402, <i>Assurance Reports on Controls at a Service Organization</i> issued by the International Auditing and Assurance Standards Board	
ISIN	International Security Identification Number	Numéro international d'identification des valeurs mobilières
KII	Key Investor Information	Informations clés pour l'investisseur (ICI)
KYC	Know Your Customer	Connaître son client
LCBR	Low Carbon Benchmark Regulation	Règlement sur les indices de référence à faible intensité de carbone
LPEA	Luxembourg Private Equity + Venture Capital Association	
LuxFLAG	Luxembourg Fund Labeling Agency	Association luxembourgeoise de labellisation des fonds d'investissement
LuxGAAP	Luxembourg Generally Accepted Accounting Principles	Principes comptables généralement reconnus (PCGR) au Luxembourg
LuxSE	Luxembourg Stock Exchange	Bourse de Luxembourg
LVNAV	Low Volatility Net Asset Value	Fonds monétaire à valeur liquidative à faible volatilité
MIFID	Markets in Financial Instruments Directive	Directive sur les Marchés d'instruments financiers
MIFIR	Markets in Financial Instruments Regulation	Règlement du Parlement européen et du Conseil concernant les instruments financiers
MBS	Mortgage backed securities	
MMF	Money Market Funds	Fonds monétaires
MMI	Money market instruments	Instruments du marché monétaire
MTF	Multilateral Trading Facility	Système de négociation multilatéral
NAV	Net asset value	Valeur nette d'inventaire (VNI)
NCA	National competent authority	Autorité nationale compétente
NCCT	Non-cooperative country or territory	Pays et territoires non coopératifs (PTNC)
NFFE	Non-financial foreign entity	
NFRD	Non Financial Reporting Directive	Directive sur la publication d'informations non financières
NPPR	National Private Placement Regime	Régime national de placement privé
NWT	Net worth tax	Impôt sur la fortune
OECD	Organization for Economic Co-operation and Development	Organisation de coopération et de développement économiques (OCDE)

³³⁹ The predecessor of the BCL and the CSSF.

Acronyms and abbreviations, full meanings and French translations

Abbreviation	English Name	French Name
OEREF	Open-ended real estate funds	Fonds immobiliers de type ouvert
ORSA	Own Risk and Solvency Assessment	
OTC	Over-the-counter	De gré à gré
OTF	Organized trading facility	Système organisé de négociation
PAIs	Principal adverse impacts	Principales incidences négatives
PEP	Politically exposed person	Personne politiquement exposée
PEPP	Pan-European personal pension product	Produit paneuropéen d'épargne-retraite individuelle
PFPV	Pension fund pooling vehicles	Véhicules <i>Pension Pooling</i>
PIE	Public Interest Entity	Entité d'Intérêt Public
PRIP	Packaged retail investment product	Produit d'investissement de détail packagé
PRIIPS	Packaged retail and insurance-based investment products	Produits d'investissement packagés de détail et fondés sur l'assurance
PSDC	Dematerialization and preservation service provider	Prestataire de services de dématérialisation ou de conservation
PSF	Financial sector professional	Professionnel du secteur financier
Q&A	Questions and Answers	Questions réponses
RAIF	Reserved Alternative Investment Fund	Fonds d'investissement alternatifs réservé
RAIF Law	Law of 23 July 2016 relating to reserved alternative investment funds	Loi du 23 juillet 2016 concernant les fonds d'investissement alternatifs réservés
RCS	Trade and Companies Register	Registre de commerce et des sociétés
REIF	Real Estate Investment Fund	
RESA		Receuil Électronique des Sociétés et Associations
RMP	Risk management process	Processus de gestion de risque
RTS	Regulatory technical standards	Normes techniques de réglementation
S.à r.l.	Private limited company	Société à responsabilité limitée
S.A.	Public limited company	Société anonyme
S.C.A	Partnership limited by shares	Société en commandite par actions
S.C.S.	Limited partnership	Société en commandite simple
S.C.Sp.	Special limited partnership	Société en commandite spéciale
S.E.	European company	Société européenne
SCI	Single Commodity Index	Indice sur Matière Première Individuelle
SDGs	Sustainable Development Goals	Objectifs de développement durable
SFDR	Sustainable finance disclosure regulation	Règlement sur la publication d'informations en matière de durabilité dans le secteur des services financiers
SFI	Structured Financial Instrument	Instrument financier structuré
SFP	Structured Financial Products	Produits structurés
SFT	Securities Financing Transaction	Opérations de financement sur titres
SICAF	Investment company with fixed capital	Société d'investissement à capital fixe
SICAR	Investment company in risk capital	Société d'investissement en capital à risque
SICAR Law	Law of 14 June 2004 relating to the investment company in risk capital (SICAR)	Loi du 14 juin 2004 relative à la Société d'investissement en capital à risque (SICAR)
SICAV	Investment company with variable capital	Société d'investissement à capital variable
SIF	Specialized Investment Fund	Fonds d'investissement spécialisé (FIS)
SIF Law	Law of 13 February 2007 on Specialized Investment Funds, as amended	Loi du 13 février 2007 sur les Fonds d'Investissement Spécialisés, telle que modifiée (Loi FIS)
SLA	Service level agreement	Accord de niveau de service
SME	Small and medium-sized enterprises	Petites et moyennes entreprises (PME)
SOPARFI	Luxembourg financial holding company	Société de participations financières
SPV	Special Purpose Vehicle	Fonds commun de créances (FCC)
SRRI	Synthetic Risk and Reward Indicator	Indicateur de risque et de rémunération
STATEC	Central Service for Statistics and Economic Studies	Service central de la statistique et des études économiques
T2S	Target2-Securities	
TEG	Technical Expert Group	Groupe d'experts techniques
TER	Total expense ratio	Total des frais sur encours

Acronyms and abbreviations, full meanings and French translations

Abbreviation	English Name	French Name
TID	Taxable income distributed	Bénéfices distribués imposables
TIS	Taxable income per share	Bénéfice par action imposable
TRS	Total Return Swap	
UCI	Undertaking for Collective Investment	Organisme de placement collectif (OPC)
UCITS	Undertakings for Collective Investment in Transferable Securities	Organismes de placement collectif en valeurs mobilières (OPCVM)
US	United States of America	États-Unis d'Amérique
VaR	Value-at-Risk	Valeur-sous-risque
VNAV	Variable Net Asset Value	
VAT	Value Added Tax	Taxe sur la valeur ajoutée (TVA)
WAL	Weighted average life	Durée de vie moyenne pondérée
WAM	Weighted average maturity	Maturité moyenne pondérée
WHT	Withholding tax	Retenue d'impôt à la source

III.3. Other common UCI-related terms, and French translations

Other common UCI-related terms, and French translations

English Name	French Name
Administrator	Administration centrale
Approved statutory auditor ³³⁹	Réviseur d'entreprises agréé
Compartment	Compartiment
Cooperative company	Société coopérative
Cooperative company organized as a public limited company	Société coopérative organisée sous la forme d'une société anonyme
Depositary	Dépositaire
Distributor	Distributeur
Domiciliation agent	Agent domiciliataire
Management company	Société de gestion
Master-feeder	Maîtres-nourricier
Official Gazette	Mémorial
Paying agent	Agent payeur
Private portfolio manager	Gérant de fortunes
Promoter	Promoteur
Registrar	Agent teneur de registre
Repurchase agreement (Repo)	Achat de titre à réméré
Repurchase transaction	Opérations de mise en pension
Sale with right of repurchase transaction	Opération à réméré
Reverse repurchase agreement (Reverse repo)	Vente de titre à réméré
Securities lending	Prêt de titres
Securities borrowing	Emprunt de titres
Short selling	Vente à découvert
Subscription tax	Taxe d'abonnement
Transfer agent	Agent de transfert
Unlimited company	Société en nom collectif

³³⁹ In this Technical Guide, we use the term "independent auditor".

IV EY investment fund services

IV. 1. Introduction

Who we are

In Luxembourg, with over 1,500 professionals, we combine our European and global capability with our local knowledge to deliver a full range of services to meet our clients' business needs.

Our global asset management network encompasses key financial centers in EMEIA (Europe, Middle East, India and Africa), the Americas and Asia-Pacific comprising over 22,000 professionals, including 1,000 partners.

Our combination of talent and resources gives us the ability to anticipate and adapt to the rapid and accelerating changes of today's global economy.

How we support our clients

Being the most globally connected of the Big Four organizations, operating in four integrated regions – the Americas, EMEIA, Asia-Pacific, and Japan – enables our Luxembourg asset management practice to work effectively on a cross-border basis:

- ▶ Moving swiftly to bring together the best teams to serve our clients, working together on key issues, and leveraging our strengths, capabilities, and knowledge irrespective of geographies
- ▶ Providing seamless, consistent, high-quality services to our financial services clients across EMEIA and globally
- ▶ Responding quickly and effectively to market developments that impact our clients
- ▶ Providing our clients access to our perspective on current and emerging trends, industry issues, and regulation

Our Luxembourg investment fund services include audit, financial accounting, tax, transactions and advisory services covering the complete lifecycle of an investment fund from concept, through launch, to business as usual, and beyond.

IV. 2. Fund lifecycle services

EY offers a complete suite of services to:

- ▶ Asset managers, sponsors, initiators, general partners, promoters
- ▶ Management companies
- ▶ Investment managers
- ▶ Depository banks and sub-custodians
- ▶ Distributors
- ▶ Administrators and transfer agents
- ▶ Specialist providers, such as valuers, compliance, risk management, and fund information service providers

Our services generally relate to:

- ▶ Advice on establishing investment fund structures, setting-up traditional and alternative management companies and MiFID firms
- ▶ Regulatory compliance and CSSF Circulars
- ▶ Marketing
- ▶ Third party due diligence support
- ▶ Listing



- ▶ Operations
- ▶ Transactions
- ▶ Risk management and reporting
- ▶ Information technology
- ▶ ESG strategies, monitoring and reporting
- ▶ Ongoing regulatory support
- ▶ Ongoing tax support
- ▶ Migration of investment fund complexes
- ▶ Structuring and restructuring of investment funds and corporate asset management structures
- ▶ Liquidation and closure of investment funds

We tailor our approach to the unique needs of each client of the investment fund industry, serving as a business advisor to management while providing the objectivity demanded by regulators, boards, counterparties, and investors.

Our multi-disciplinary approach encompassing regulatory, tax, reporting, and other operational aspects allows us to provide a holistic answer to our clients' needs.

IV. 2.1. Investment fund, traditional and alternative management companies and MiFID firm set-up services

We adopt the following approach to support clients in setting up and launching an investment fund, or a management entity (a regulated management company or AIFM, or an unregulated general partner (GP)) or MiFID firm:

Feasibility study

Providing guidance on and assisting you in the determination of the most appropriate regime, legal form, and structure from regulatory and tax perspectives, corporate governance model, and other features of the fund as well as of its Management Company/AIFM/GP

Operational and regulatory advice

Providing you with operational, governance and regulatory advice in the process of setting up the fund, Management Company, AIFM or GP structure and related documentation

CSSF regulatory approval process

Professional coordination with the CSSF to obtain approval for the fund (and its Management Company /AIFM/GP, if applicable)

Incorporation and launch

Coordination of the incorporation of the fund and, where applicable, its Management Company/AIFM/GP before public notary

IV. 2.2. Services for Alternative Investment Fund Managers (AIFM)

The Alternative Investment Fund Managers Directive (AIFMD) regulates managers of Alternative Investment Funds (AIFs).

The AIFMD subjects AIFM to compulsory regulation in the EU and impacts the structures, strategies, operations, and EU distribution/marketing methods.

Non-EU managers are also impacted if they wish to distribute their AIF to EU investors.

EY offers the following services to AIFMs, their AIFs and service providers:

- ▶ Assistance in setup of new AIFMs and alternative asset service providers
- ▶ Assistance in operating model design and implementation
- ▶ Policies and procedures related to the Internal Governance Framework
- ▶ The delegation framework: Initial and ongoing due diligence
- ▶ Assistance in the selection of service providers
- ▶ Health check assessments regarding compliance with key regulatory requirements for AIFMs and alternative asset service providers
- ▶ Preparation for Supervisors on-site visits
- ▶ Training and regulatory workshops for AIFMs and alternative asset servicing companies

IV. 2.3. Regulatory compliance and CSSF Circulars

We can assist you to assess your management company and investment firm governance in light of the CSSF and European regulatory framework to ensure compliance with local and European regulation and to have knowledgeable and trained resources.

CSSF Circular 18/698, applicable to all investment fund managers (IFMs) incorporated under Luxembourg Law is a welcome addition to the Luxembourg regulatory regime. The strengthening and alignment of requirements is important given ESMA's opinion dated 13 July 2017 which called for supervisory convergence in the area of investment management in the context of Brexit as well as the assessment by the International Monetary Fund.

EY subject matter experts can help you with, *inter alia*:

- ▶ Gap analysis of the IFMs according to CSSF Circular 18/698
- ▶ Definition or review of Target Operation Model (TOM)
- ▶ Notification of branches and new services
- ▶ Policy and procedure review and gap analysis
- ▶ Review/documentation of governance arrangements and organizational process

IV. 2.4. Inspection readiness assessments

On-site inspections by Supervisors should be regarded by Investment Fund Managers (IFMs) as business as usual rather than *ad-hoc* events.

EY can assist you with your preparation for such on-site visits covering the following areas:

- ▶ Anti-Money Laundering/Counter Terrorist Financing
- ▶ Internal Governance of IFMs
- ▶ Compliance with MiFID/MiFID II
- ▶ Compliance with Money Market Funds Regulation
- ▶ Compliance with the requirements of CSSF Circular 02/77
- ▶ Risk Management (e.g., liquidity stress testing)

IV. 2.5. Regulatory reporting and fund registration services

IV. 2.5.1. Regulatory reporting

EY's cutting edge regulatory reporting service provides a full end-to-end service for regulatory reporting, including necessary calculations such as PRIIP transaction costs.

Our Regulatory Reporting services

The managed service can be tailored to the asset manager's individual needs and covers the end-to-end production of all kinds of reports using EY's regulatory reporting service platform such as:

- ▶ AIFMD Annex IV
- ▶ Alternatives risk monitoring
- ▶ BVI Property Return Method
- ▶ Basel III (GroMiKV, CRR, Solva)
- ▶ Investment simulator
- ▶ MiFID II (EMT, OpenFunds, WM Daten)
- ▶ Money Market Fund Reporting
- ▶ Pension reporting (Dutch FTK, German VAG, Austrian PKG, Italian COVIP, Sweden traffic light)
- ▶ PRIIPs EPT, CEPT
- ▶ PRIIPs KID for funds and insurer
- ▶ Shareholder and Short selling disclosure
- ▶ Solvency II TPT
- ▶ Sustainability-related and non-financial reporting
- ▶ Transaction cost calculation
- ▶ Transaction reporting (MiFIR, EMIR, SFTR)
- ▶ UCITS KIIDs
- ▶ UK Pension (DCPT, FVPT, CTI)
- ▶ US: N-Port, CPO-PQR, FormPF

The platform is embedded with the following key features:

- ▶ Flexible interfaces and connections to third party administrators
- ▶ Calculation engine including transaction costs
- ▶ Sourcing of required market data
- ▶ Client dashboard through EY's managed service platform

IV. 2.5.2. Fund registration

Fund registration relies on a dedicated team whose specialist distribution skills and client-focused style can help you perform and monitor the effective registration and maintenance of your UCITS and AIFs in European and non-European jurisdictions.

Our fund registration services:

- ▶ Online fund registration platform
- ▶ For all countries not covered by the e-file platform, direct submission of application files to regulators
- ▶ Centralized follow-up of cross border application files
- ▶ *Ad-hoc* registration and distribution related services
- ▶ Extended dash-boarding functionalities allowing you to monitor the registration status of your funds on an ongoing basis

IV. 2.5.3. Marketing support

- ▶ Assistance with the preparation of commercial documentation
- ▶ Analysis and the determination of the fund target investors' universe
- ▶ Customization of Fund's features to investors' needs

IV. 2.6. Service Provider oversight

In the context of CSSF Circular 18/698, we provide an oversight platform which supports our clients with the following:

- ▶ Management of delegation and outsourcing
- ▶ Service provider due diligence
- ▶ KPI monitoring

IV. 2.7. Listing services

- ▶ Feasibility analysis and determination of the listing process and requirements
- ▶ Support with the selection of a local listing agent, calculation agent, and any other service providers

IV. 2.8. Anti-Money Laundering and Counter Terrorist Financing services

Our services:

- ▶ AML/KYC/KYT testing for the EY audited clients (Banks, Funds, Management companies, other professionals of the financial sector and insurances)
- ▶ All AML/CFT related issues (Law of 12 November 2004 as amended, CSSF or CRF Circulars/regulations, etc.)
- ▶ Regulatory compliance with AML/CFT
- ▶ Specialized department focusing on enhancing client AML and sanctions compliance framework
- ▶ Support to avoid sanctions and long-lasting reputational damage and to mitigate the severe financial and commercial damage brought by non-compliance with regulations, or association with money laundering

AML/KYC/Tax services:

- ▶ Gap analysis
- ▶ AML/CFT remediation support
- ▶ Process and procedure calibration
- ▶ AML/CFT robotic process automation
- ▶ AML/KYC IT solutions selection
- ▶ Assessment of existing AML/CFT IT tools
- ▶ Managed services (AML/CFT)
- ▶ Staff/BoD training

- ▶ Review of specific relationships (clients, distributors, investors, etc.)
- ▶ Onboarding assistance
- ▶ AML tax services (with the tax department)
- ▶ Due diligence services

IV. 2.9. Forensic and Integrity Services

We assist our clients to achieve their integrity agenda, thereby resulting in increased protection of their reputation and respect of the applicable laws and regulations, in order that they maintain their stakeholder's trust.

Managing unethical behavior risks:

- ▶ Investigations/fact-finding missions
- ▶ Assistance in case of judicial and/or regulatory inquiries, including on-site controls

Corporate compliance:

- ▶ Analysis and assessment of existing company prevention infrastructure, activities and behaviors
- ▶ Development and/or assistance on improvement - locally and globally - of compliance and management systems, guidelines, code of conduct and ethics framework
- ▶ Business Integrity assessments and/or upgrades
- ▶ Forensic deep dive into client portfolios
- ▶ Assessment and/or development of whistle blowing processes and guidelines
- ▶ Forensic risk management assistance on third parties and distribution networks

Economic sanctions and export controls:

- ▶ Assessment and set-up of the Economic Sanctions compliance framework
- ▶ Review of specific operations or business relationships
- ▶ Full-scale look-back exercise in relation to communication to authorities
- ▶ Creation of specialized trainings

Crisis management assistance:

- ▶ "Lessons to be learned" assistance in objectively identifying the factors which contributed to the failure of capital expenditures or other important projects undertaken by a company
- ▶ Crisis Management assistance - either in a preventive context or in case of actual incident

Transaction forensic:

- ▶ Pre-acquisition due diligence focusing on corruption, money laundering, asset misappropriation, economic sanctions, export control and conflict of interest exposure risks
- ▶ Post-acquisition investigations and dispute

Forensic technology and discovery services:

- ▶ eDiscovery
- ▶ Forensic data analytics and data sciences
- ▶ Cyber breach response management and cybercrime investigation

IV. 2.10. Risk and quantitative services

- ▶ Risk system (identification, measurement, management, monitoring and disclosure) program designed for senior management and control functions
- ▶ Valuation services including pricing model review and OTC derivative valuation
- ▶ Risk management process review for UCITS management companies, AIFM, and SIFs
- ▶ Quantitative services in relation to:
 - ▶ Market risk (e.g., global risk exposure, portfolio hedging, leverage calculation)
 - ▶ Credit risk (e.g., internal rating system, default transition matrices, concentration risk)
 - ▶ Counterparty risk (e.g., exposures aggregation)
 - ▶ Liquidity risk (e.g., cash-flow modeling, LVaR, swing pricing)
 - ▶ Operational risk (e.g., risk and control self-assessments, SSAE/ISAE reports, key risk indicators, third party delegation/oversight delegation model)
 - ▶ Risk appetite and risk profiles definition
 - ▶ Risk reporting template definition
 - ▶ Synthetic risk and reward indicator (SRRI) model validation and calculation
- ▶ Model validation and review

IV. 2.11. Strategy and Transaction services

I. M&A and Transaction support

A. Support with investment acquisition activities:

- ▶ Assistance with identifying potential acquisition targets and advice on target approach
- ▶ Determining appropriate acquisition/deal structure, proposed offer for consideration payable, bid preparation and submission
- ▶ Advice and assistance with negotiating the purchase price and other commercial terms of the share purchase agreement, assistance with deal closing
- ▶ Buy - side financial and tax due-diligence
- ▶ Buy - side sustainability/ESG due diligence
- ▶ Review of completion accounts, SPA and other closing-related services

B. Support with divestment activities

- ▶ Assistance with identifying potential acquirers, PMO of the disposal process
- ▶ Development of the information memorandums and other marketing materials
- ▶ Advice and assistance with the bidding process, negotiation of the sales price and other commercial terms of the share purchase agreement, assistance with deal closing
- ▶ Vendor/sell-side financial due diligence, other types of sell-side reporting to facilitate divestment (white - paper reports, databooks, seller information documents)

C. Investor services

- ▶ Assessment of the strategic fit, value and performance of the funds' investments
- ▶ Market research on assets for performance benchmarking
- ▶ Review of the historical performance of the promoter/investment manager as part of the funds' capital raising (sell - side) or investment decision (buy-side) process

II. Valuation & Business Modelling

Our service offering covers a comprehensive range of situations where valuations play a key role in your daily business

A. Where we assist

1. Transactions

- ▶ Mergers, acquisitions and divestments
- ▶ Feasibility studies for investment decisions
- ▶ Capital allocation decisions
- ▶ Basis for price negotiations
- ▶ Corporate restructuring
- ▶ Intellectual property licensing
- ▶ Fund raising/borrowing

2. Financial reporting/compliance/good governance

- ▶ Valuations in the context of the AIFMD
- ▶ International Financial Reporting Standards
- ▶ Allocation of purchase price to tangible and intangible assets
- ▶ Impairment testing of goodwill and other assets including real estate
- ▶ Third party valuation reviews

3. Others

- ▶ Shareholder disputes
- ▶ Intellectual property disputes
- ▶ Project evaluation
- ▶ Rates of return and discount rates estimation
- ▶ Market research and benchmarking

B. What we value?

- Businesses and companies across a range of industries
- Shares and other equity
- Intangible assets and goodwill
- Capital equipment
- Commercial real estate
- Alternative assets

III. *Debt restructuring and liquidation*

A. Voluntary liquidation

- Acting as liquidators for investment funds to ensure that the winding-down is conducted in an orderly manner and in compliance with Luxembourg law.

B. Formal insolvency

- Acting as liquidators (if appointed by the court) for entities placed into bankruptcy proceedings or acting in an advisory role to recover value for stakeholders.

C. Debt restructuring

- Advising on debt restructuring options available in Luxembourg to distressed entities and stakeholders seeking to preserve value.

IV. 2.12. Internal audit

- Internal audit co-source and outsource: planning, performance of the risk assessment, execution of the fieldwork and reporting for the whole or part of your IA plan
- Special IA reviews/project-related: where we can supplement your resources with our subject-matter experts and carry out special requests from management, the audit committee and the Board
- IA diagnostic/quality assessment reviews: assessment of compliance with the Institute of Internal Auditors Standards and benchmarking your internal audit function performance.
- Set-up of your IA function: tailored to your organization, size, strategy, needs and resources.
- IA transformation: by leveraging a digital and purpose-driven approach to help companies develop a refreshed strategy, mandate and road map to their future digitally-enabled IA
- Collaboration between your existing teams and our qualified consultants to provide expertise on regulatory matters and leading practices. We provide project support on key issues:
 - Cash flow management
 - Breaches
 - GDPR assessments
 - IT and Cyber assessments
 - IT regulatory assessments

IV. 2.13. Operations

- Intelligent automation: improve operational efficiency through the deployment of the right mix of new technologies. Our toolbox includes: decision analytics and machine learning, natural language processing, chatbots, Robotics Process Automation, Optical Character Recognition, Interactive Voice Response
- Operating model design and review: design and review of operational strategy, target operating model design, regulatory feasibility assessment of envisaged operating models, target operating model implementation
- Benchmarking of operational excellence and operational excellence improvement (identification and implementation of process improvements)
- Service provider selection and assessment support: request-for-proposal management (set-up of short/long-list of providers, request for proposal (RFP) questionnaire set-up, RFP distribution, and RFP answers collection and analysis or second opinion on work performed) and service-level agreement (SLA) and key performance indicator (KPI) set-up and review
- Process transformation or organization change: support in set-up of business process management, policies and procedures
- Business analyst work: analysis of new requirements, business and future functional specifications, and testing thereof
- Pre and post-merger integration: operational due diligence (mapping of products, services, processes, systems and risks), merger benefit analysis (analysis of related operational costs and potential savings in different set-ups/situations)

- ▶ Program and project management: operate project management office (project lead, workstream lead, project management office (PMO) support) during e.g., merger, carve-out, outsourcing, integration, business migration, IT change projects or perform assessment, and monitoring of project services
- ▶ Supporting periodic reporting for UCIs, management companies, and AIFM to competent authorities
- ▶ Supporting distributor due diligence processes

IV. 2.14. Information technology and systems

- ▶ IT security services: improvement of the operational efficiency and effectiveness of the security efforts by obtaining a clearer understanding of the current state of your information security framework
- ▶ IT risk and controls: assistance in the development and implementation of a comprehensive IT risk and control framework, in terms of organization, processes, tools, dashboard, and reporting
- ▶ Data analysis and data management: assistance to improve the execution of your data management and governance activities
- ▶ IT internal audit: a cost-effective alternative for the development and execution of an internal audit plan aimed at addressing IT related business risks
- ▶ Assessment of IT effectiveness
- ▶ IT architecture: design of the target functional and technical IT architecture and identification of the required components and providers. In case of outsourcing, support in the selection of outsourcing service providers for all or part of the IT architecture
- ▶ IT transformation: support in benchmarking and selection of IT systems, system implementation and system release update, software testing. Support in the selection of outsourcing of certain elements
- ▶ Program advisory services: project assessment, assurance and support services to IT change programs (closing the gap between program failure and effective program management and controls)
- ▶ Robotics Process Automation: deployment of Software that emulates human agents doing manual tasks e.g., Blue Prism

IV. 2.15. Migration services

- ▶ Feasibility analysis of your migration project, including the determination of the most appropriate option to migrate your fund or management company
- ▶ Presentation to and pre-approval of the proposed migration project by the home and host country supervisory authorities and local service providers (as required)
- ▶ Support in the preparation and submission of an application file with the host country supervisory authority and assistance throughout the regulatory approval process
- ▶ Support in the planning and execution of the fund/management company migration (project management support, process alignment support, testing support)

IV. 2.16. Restructuring services

- ▶ Assistance with the merger, demerger and/or liquidation of funds, compartments or classes
- ▶ Assistance with the creation of new compartments or classes,
- ▶ Support in the change of custodian/central administration, including liaising with service providers and the supervisory authority

IV. 2.17. General Data Protection services

Our comprehensive service offering covers the following domains:

- ▶ Finalization of implementation (drafting of policies and procedures, system adaptations, etc.)
- ▶ Support to your Data Protection Officer on all their recurring activities (PIA execution, ROPA maintenance, etc.)
- ▶ Execution of GDPR remediation plans
- ▶ Post implementation health checks
- ▶ Training, e-learning deployment
- ▶ Data breach management including assessment, investigation and reporting services

IV. 2.18. Third party reporting

- ▶ Assurance that your company is operating IT systems and processes as well as financial controls according to your objectives and your third party contractual commitments and obligations. For example:
 - ▶ SOC-1: assurance reports on controls at a service organization by utilizing defined standards such as ISAE 3402, US Attestation Standard AT-C section 320, and CSAE 3416
 - ▶ SOC-2 and SOC-3: internationally recognized attestation reports on the AICPA Trust criteria for availability, security, confidentiality, privacy, and processing integrity
 - ▶ ISO 27001/27002: certification provided based on the International Organization for Standardization over the Information Security Management System (ISMS) standard
 - ▶ Agreed upon procedures: report of findings based on specified controls

IV. 2.19. Accounting, compliance and financial advisory services

Our accounting, compliance and financial advisory services include:

- ▶ Fund accounting
- ▶ Assistance with NAV calculation
- ▶ Preparation of consolidated financial statements
- ▶ GAAP conversions
- ▶ SPV accounting
- ▶ Management reporting
- ▶ Management company accounting
- ▶ Preparation and filing of statutory financial statements
- ▶ Treasury assistance
- ▶ Preparation and filing of tax and VAT returns
- ▶ Regulatory reporting (e.g., BCL, CSSF)
- ▶ Investor reporting (e.g., INREV, EVCA)
- ▶ Performance measures computations
- ▶ Reporting process design
- ▶ Accounting governance and compliance support
- ▶ Accounting support on specific technical matters
- ▶ Financial due diligence

IV. 2.20. Audit

We provide audit services that are based on an audit approach that includes a thorough examination of your organization's concerns and needs.

IV. 2.21. Ongoing tax services

The Luxembourg tax practice offers you:

- ▶ European fund tax reporting services
- ▶ VAT services
- ▶ Fund Tax services
- ▶ Local and international tax advisory and compliance services
- ▶ Base Erosion Profit Shifting (BEPS) and EU ATAD services
- ▶ Transfer pricing services
- ▶ Automatic exchange of information: FATCA and CRS services
- ▶ Mandatory Disclosure Regime/DAC6 services

IV. 2.21.1. European fund tax reporting services

Our European Fund Tax Reporting team can provide tax reporting services in the various jurisdictions. Our service offering provides:

- ▶ A customized approach considering the necessary flexibility of your operations to provide you with tailored services
- ▶ A proven operating model with a distinguished track record, supported by dedicated individuals and transparent processes and controls, all of which are scalable to meet your needs
- ▶ Dedicated experienced local teams with strong working relationships with local tax authorities, industry bodies, and legislators, while always operating as a single team through our EMEIA network
- ▶ A central point of contact to coordinate the offering and senior country contacts at your disposal
- ▶ A smooth transition from your current service provider due to our vast experience of transition arrangements in the past
- ▶ The most experienced provider of coordinated European tax reporting services in the market
- ▶ A local point of contact - the country lead partner- to provide related tax advice for each jurisdiction

IV. 2.21.2. VAT services

Our VAT team assists our clients with:

- ▶ The review of the VAT status of asset managers, funds, special purpose vehicles and third parties, including the determination of their VAT filing obligations and VAT recovery rights
- ▶ The review of agreements, invoices and other relevant documents, including suggestions to ensure the application of the proper VAT exemption, VAT accounting treatment and the potential impacts of a transfer pricing review
- ▶ The preparation of VAT registration files and reporting obligations (e.g., VAT returns)

In situations where intermediate holding/financing entities are set up, a similar analysis of the VAT status of these entities should be performed to determine whether they have to fulfil VAT obligations in Luxembourg. It could also include the review of the allocation of costs and resources between the fund and these entities.

IV. 2.21.3. Fund Tax Services

IV. 2.21.3.1. Tax reclaim services

EY offers an holistic approach to prepare and file eligible tax reclaims in the countries for which refunds have been granted, with or without limitations. We offer a “one-stop-shop” model whereby you will have:

- ▶ A CRM dedicated coordination point reporting to you and managing and monitoring actions
- ▶ A dedicated email address for all EY communications with you and your team
- ▶ A mixed team of experienced professionals in the tax reclaims process
- ▶ In contact with all the service providers
- ▶ EY managing the document and data collection, data reconciliation and quality checks as well as file compilation
- ▶ Team members focusing on quality assurance and issue resolution

We have a global network of experienced professionals dedicated to the asset management industry. Our ability to work across global locations in a coordinated and consistent way has significantly contributed to us delivering well-controlled and timely service to clients.

IV. 2.21.3.2. Rapid Security Analyzer (RSA)

Simplifying dividends, interest and capital gains tax complexities globally through the use of an automated tool.

Rapid Security Analyzer

The Rapid Security Analyzer (RSA) automates the process of analyzing your portfolios for interest, dividends and capital gains liabilities at the financial instrument level. The RSA's reports reflect the tax rate and associated rules (including netting rules), as well as the tax considerations noted with the status of each security.

Additional features include:

- ▶ An executive dashboard that provides a broad overview of the findings by country, region and RAG (red, amber or green) status
- ▶ Side-by-side comparison of taxation of different fund types and tax rates by date
- ▶ RSA Lite, an online version of RSA that enables one-off lookups and comparisons of capital gains tax rules, rates and statuses

IV. 2.21.3.3. Foreign Tax Representative

What is the business issue?

As large investors seek to diversify and make increasing foreign investments, many hold investments in countries where they may have no physical presence. Many countries have been increasing tax compliance requirements for non-resident investors. As a result, the tax compliance and reporting obligations for these investors have grown significantly in volume and complexity.

Local country requirements may demand that investors file returns and require them to use a service provider located in the country or have a registered tax agent. In addition, the increased complexity of the global tax landscape requires investors to consider the tax implications of the markets where they invest.

Global investors must therefore identify and coordinate with numerous local tax service providers to meet their compliance and reporting requirements.

The growing complexity of this responsibility is driving demand for a single globally coordinated service offering: EY Foreign Tax Representative (FTR) Services.

EY provides a globally centralized approach to the tax compliance services for direct investments into foreign markets (as non-resident investors), where in-country services are required.

Our Global Investor Services professionals understand the role of the tax service provider in various non-US markets, the interaction of the taxpayer with global and local custodians, and the compliance and reporting responsibilities that our clients face.

We have a proven methodology for global service management to provide greater visibility and control to our clients, and allows them to be more proactive in meeting and monitoring the growing tax requirements in the markets where they invest and manage risk.

- ▶ FTR service offering combines investor needs with EY resources
- ▶ Utilizes a well-established and proven online platform
- ▶ Leverages local country experience and resources
- ▶ Our FTR professionals have developed a detailed understanding of the role of the tax service provider in various markets
- ▶ Provides significant reduction in the administrative burden of working directly with various local teams; and managing multiple contracting and billing procedures with providers in each market

IV. 2.21.3.4. Global Withholding Tax Reporter (GWTR)

We also offer access to EY's Global Withholding Tax Reporter (GWTR), a subscription-based service that provides detailed technical information regarding withholding taxes, treaties and procedures in relation to portfolio dividends, portfolio interest, and capital gains in over 90 markets. The GWTR, which is tailored to the needs of global financial institutions, contains valuable information such as statutory withholding rates, treaty withholding rates, and tax relief procedures. The GWTR, a web-based tool, provides monthly updates that are based on quarterly reviews of information. Important tax alerts are e-mailed to licensees between updates. Please visit our sample website, www.globaltaxreporter.com, for more information regarding GWTR.

IV. 2.21.4. Local and international tax advisory and compliance

We provide, *inter alia*:

- (i). Fund and holding structure formation
 - ▶ Tax advice on the fund structuring and the setting up of Luxembourg holding and financing platforms or special purpose vehicles
 - ▶ Tax assistance on legal implementation including review of fund (e.g., Limited Partnership Agreements, Private Placement Memorandums), corporate and financing documents
 - ▶ Tax advice on cash and invoicing flows, repatriation strategies, withholding taxes
 - ▶ Advice on Luxembourg employee and governance structuring
 - ▶ Preparation of Tax Operational Memorandums for Luxembourg fund and holding structures
 - ▶ Advice and assistance with compliance of initial tax filings and registrations
- (ii). Tax advisory assistance during the life of the Fund
 - ▶ On-call tax teams specifically dedicated to assist asset managers, investors and fund industry professionals throughout the lifecycle of the funds
 - ▶ Tax advice on the acquisition and disposal of assets in domestic and/or cross-border transactions from a direct and indirect tax perspective
 - ▶ Buy-side and sell-side tax due diligences
 - ▶ Tax advice on the implications of complex financial products or transactions
 - ▶ Assistance in applying for tax clearances
 - ▶ On-going monitoring of new tax legislation and performing tax impact and opportunity assessments where relevant
 - ▶ Assistance in navigating the complex tax rules across jurisdictions in coordination with our foreign offices
- (iii). Tax compliance assistance during the life of the Fund
 - ▶ Assistance in managing your direct and indirect tax obligations
 - ▶ Assistance in handling queries from tax authorities
 - ▶ Assistance in the estimation or review of your tax provisions and analysis of your uncertain tax positions
 - ▶ Filing of functional tax currency requests

IV. 2.21.5. Base Erosion Profit Shifting (BEPS) and EU ATAD services

The legislative changes being brought by the OECD BEPS initiative and the EU Anti-Tax Avoidance Directive (ATAD) have significantly increased the complexity and tax controversy risk of the tax rules affecting fund and holding structures while requiring evidence of the business purposes of such structures.

In this context, EY can support you with:

- ▶ Tax impact assessments on fund and holding structures
- ▶ Review of fund structure and investor profile to assess impact of EU ATAD anti-hybrid rules
- ▶ Review of fund documentation to address provisions dealing with BEPS impact (e.g., neutralization of anti-hybrid rules between different investors)
- ▶ Preparation of support files with analysis of relevant complex tax provisions (e.g., anti-hybrid, interest limitation rules) to be used for the purposes of tax compliance, financial reporting and support in discussions with local tax authorities
- ▶ Advice on how to navigate from an operational and corporate governance perspective the BEPS and EU ATAD anti-abuse concepts (principal purpose test, general anti-abuse rule, beneficial ownership and substance) in line with business considerations.
- ▶ Principal Purpose Test support file to be used in discussions with local and foreign tax authorities documenting the business rationale of the structure and the application of relevant anti-abuse concepts.
- ▶ Assessment of appropriate debt-to-equity ratios in light of company characteristics and market circumstances
- ▶ Tax advice with regards to the impact of BEPS/ATAD on structures, specifically but not limited to the Identification of controlled foreign companies and analysis of the significant people functions

IV. 2.21.6. Transfer pricing services

Our transfer pricing services include:

- ▶ Review of business circumstances to identify, map and streamline dealings between related parties
- ▶ Design of transfer pricing policies and models
- ▶ Assistance with the operational implementation of transfer pricing policies
- ▶ Preparation of transfer pricing documentation and related support, including benchmarking analyses
- ▶ Transfer pricing analysis assessing specific transactions, in particular in light of the latest OECD guidance on financing transactions
- ▶ Assistance with tax audit and queries from tax authorities/regulators
- ▶ Transfer pricing planning to meet business developments

IV. 2.21.7. Automatic exchange of information: FATCA and CRS services

EY offers a global response to FATCA and CRS compliance. EY services include:

- ▶ Advice on the implementation of FATCA and CRS compliance procedures:
 - ▶ Provision of awareness and training sessions for FATCA and CRS
 - ▶ Assistance in the classification of investment funds and related entities (e.g., GP, Management Company) to comply with FATCA and CRS requirements
 - ▶ Assistance in the classification of the entities of Private Equity and Real Estate groups
 - ▶ Assistance with the FATCA registration on the IRS portal
 - ▶ Assistance to complete entity FATCA and CRS self-certification forms
 - ▶ Assistance to identify gaps and to ensure that written procedures are correct and complete
 - ▶ Spot checks of FATCA and CRS account due diligence and reporting implementation
- ▶ Assistance with investor due diligence:
 - ▶ Assistance with the amendments of procedures for FATCA and CRS due diligence
 - ▶ Assistance with the due diligence of pre-existing accounts
 - ▶ Review of investor self-certification forms and of the application of the reasonableness test
 - ▶ Assistance with ad hoc questions on account classification

- ▶ FATCA and CRS report filing and generation :
 - ▶ Assistance with data collection
 - ▶ Review of data quality
 - ▶ Generation of FATCA and CRS xml reports
 - ▶ Filing of FATCA and CRS declarations
- ▶ Provision of FATCA and CRS reporting services
 - ▶ Advice on information required to be reported
 - ▶ Review of information prepared for reporting purposes
 - ▶ Conversion of reports to the XML format required by the relevant tax authority
 - ▶ Transmission of reports to the relevant tax authority on behalf of Reporting FIs

IV. 2.21.8. Mandatory Disclosure Rules/DAC 6 services

EY provides an array of services in respect of compliance with the Mandatory Disclosure Rules, such as:

1. Provision of MDR introduction session
2. Assistance in the drafting and issuance of an Impact assessment analysis and report
3. Assistance through on call tax advisory services
4. Provision of tax technical training
5. Access to an EY Web enabled MDR tool
6. Assistance on the MDR implementation phase
7. Assistance in the “business as usual” stage

IV. 2.22. Climate Change and Sustainability Services

Throughout the Fund lifecycle, we can support as follows:

- ▶ Integration and understanding of sustainability and ESG factors
- ▶ Compliance with the regulatory framework

Strategy definition

- ▶ Assessment of ESG maturity, benchmarking of ESG-related practices
- ▶ Identification of sustainability factors that are material to portfolios
- ▶ Analysis of stakeholders and their relations with the IFM or the UCI
- ▶ Development and implementation of policies with respect to the ESG strategy
- ▶ Analysis of climate change-related scenarios and measurement of impacts on valuation/financial returns

Impact investing specifics

- ▶ Definition of the impact objectives
- ▶ Alignment with the EU Taxonomy regulation
- ▶ Analysis of the attainment of the impact objectives throughout the fund lifecycle

Investment process

- ▶ Definition and implementation of screening criteria
- ▶ Buy-side ESG due diligence

Risk Management

- ▶ Measurement and monitoring of sustainability-related risks
- ▶ Support in implementing organizational changes to account for sound sustainability risk management

Compliance

- ▶ Diagnostic, readiness analysis and gap assessment for compliance with ESG frameworks
- ▶ Implementation of remediation actions
- ▶ Compliance with:
 - ▶ Binding frameworks (e.g., SFDR, EU Taxonomy of sustainable activities)
 - ▶ Voluntary frameworks (e.g., PRI, GRI, TCFD)

ESG performance monitoring

- ▶ Definition of methodologies to monitor ESG performance
- ▶ Identification of data sources to feed sustainability indicators
- ▶ Set up of data flows and management systems
- ▶ Adoption or definition of ESG performance benchmarks and indices

Reporting and communications

- ▶ Ensure compliance with the SFDR (website communications, pre-contractual disclosures and periodic reports) and the Taxonomy regulation
- ▶ Non-financial and ESG/sustainability-related reporting process design
- ▶ Support in the adoption of specific reporting frameworks (e.g., INREV, GRI)

Assurance

- ▶ Assurance report on ESG-related processes and controls
- ▶ Assurance on sustainability indicators and investor report narratives

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