

REGULATORY AND TAX FRAMEWORK

Innovation from past to present

Jacques Elvinger

The success of the Luxembourg fund industry is, without any doubt, largely based on the fact that the contributing factors have been, and still are, numerous. Indeed, it would not have been realistic to expect that one single competitive advantage, be it of legal, regulatory, tax, geographic, commercial or other nature, could at medium or long term be by itself sufficient to attract fund promoters to Luxembourg.

One factor however which has been fundamentally important all over the fifty year period during which the Luxembourg fund industry has developed to the leading place in Europe and second in the world, is innovation: the ongoing effort to adapt to or anticipate the needs of fund promoters, fund managers and fund distributors.

Innovation in the various areas and at the pace described below was only possible due to the initiatives taken by the practitioners and the efficient support of the regulatory bodies and the government.

The range of different types of funds available has been extended continuously to satisfy the divergent needs of promoters from all over the world looking for the ideal fund structures investing in different asset classes for investors of varying status from all continents. Besides the legal framework for traditional public funds, Part I UCITS and Part II UCIs, a specific law for institutional investor funds was introduced in 1991, allowing more flexibility in the structuring for this type of investors which do not necessarily need the same level of protection than retail investors. The need for a separate legislation for the structuring of private equity/venture capital vehicles identified by practitioners, resulted in 2004 in the SICAR legislation. The range was completed in 2007 by the SIF legislation where the track record of about 500 newly created structures since February 2007 is clear evidence of success of this most recent example of innovation. With passportable UCITS, other public UCIs permitted to invest in any type of assets, the SICAR for private equity/venture capital investments

and, finally, the lightly regulated passe-partout SIF for well informed investors, Luxembourg offers now a complete range of types of funds that should suit the varying needs of promoters.

But also in the different legal forms available, there has been ongoing innovation. Besides the most frequently used fonds commun de placement (FCP or common fund) and société d'investissement à capital variable (Sicav or investment company with variable share capital), different other legal forms, such as the limited partnership, the cooperative company and limited company are available to accommodate the specific needs of promoters as regards, inter alia, control, tax (transparent/non-transparent) and other aspects.

The structuring of funds as so-called umbrella funds was possible on the basis of a pragmatic interpretation of relevant provisions of the company law even before it was felt appropriate in 1988 to include, for greater legal certainty, specific provisions to that effect in the fund legislation. Providing in 2000 in the law for ring-fencing amongst sub-funds also vis-à-vis third parties was a further step with positive consequences in various areas. The possibility for creating, closing and merging sub-funds by decision of the board of directors has developed to a key feature in the operation of the large umbrella funds. The recent use of the sub-fund technique to create side-pockets in the credit crunch environment is a further example of innovation.

Adapting and improving the tax environment for funds has always been a priority in Luxembourg. While an overall reduction of the capital duty (taxe d'abonnement) in a more significant manner than the reduction from 0.06% to 0.05% in 2001 has not been achieved due to the concern of the government for this substantial source of income to vanish, the industry has been able to achieve the reduction or exemption from the tax for either cost sensitive or new fund products such as money market funds, cash funds, pension pooling funds and, most recently, all SIFs which, regardless of their investment policy, are subject to the tax at a rate of 0.01% only. ALFI intends to innovate further in this area by engaging discussions with the government to reduce the tax for, or exempt from the tax microfinance funds and exchange traded funds. An ongoing dialogue is also maintained with the tax authorities to extend the range of double tax treaties of which Luxembourg corporate funds can prevail themselves.



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In an aim to take benefit of economies of scale and to increase efficiency in management, the fund industry has always been interested in various pooling techniques. Where master-feeder structures were not possible for legal (UCITS restrictions) or other reasons, alternative co-management techniques have been implemented in Luxembourg with the blessing of the regulator to permit pooling amongst sub-funds of the same umbrella and amongst separate funds on a national and international/cross-border basis.

While UCITS III and more specifically the product Directive has allowed extended investment powers and has been implemented in Luxembourg in a manner that funds can benefit thereof to the fullest extent permitted, the management company Directive gave rise to a challenge in terms of finding appropriate substance solutions for about 1,200 existing UCITS within the grand-fathering period of only 5 years or within a shorter time frame for certain UCITS wishing to make immediate use of the extended investment powers. Market participants immediately saw opportunities for new activities and both independent dirigeants (conducting officers) and third party management companies started to offer services to those funds where the fund promoters had made the choice not to establish their own physical presence in Luxembourg.

The specialisation of service providers and the creation of centres of excellences by fund managers and administrators in a cost efficient manner while avoiding multiplication of service centres have prompted the need for outsourcing arrangements. CSSF Circular 91/75 already evidenced numerous arrangements which had been approved by the regulator to permit managers, distributors and other parties to intervene from abroad in the administration of the Luxembourg funds. Outsourcing models of different kinds are implemented more and more frequently with the approval of the regulator provided the requirement for the head office of the funds to be based in Luxembourg and other applicable legal and regulatory requirements, including data protection rules, are complied with.

The creation in Luxembourg of a labelling agency for Microfinance funds (LUXFLAG) in July 2006 was yet another initiative not only to increase the visibility of Luxembourg as a suitable jurisdiction for creating funds investing in microfinance but also to show Luxembourg's commitment to this developing means of social investment.

Finally, over the last three years ALFI has, to a certain extent with the active support of the government, innovated in the means of promoting the Luxembourg fund industry. The holding of financial seminars in the major financial centres and other strategic locations aims at both updating professionals on recent developments in the Luxembourg fund industry and creating awareness of the existence of Luxembourg as a professional, performing, and attractive fund centre.

With UCITS IV at the horizon, improvements in the efficiency of cross-border activities and new opportunities are expected. We are confident that in this context, but also in the area of non UCITS products, there will be new opportunities for innovation which will contribute to the continuing successful development of the Luxembourg fund industry.