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Chapter 19

LUXEMBOURG

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I OVERVIEW OF RECENT ACTIVITY

Luxembourg is the second-largest investment funds centre in the world after the United States, and is one of the most experienced and dynamic global investment funds centres. Luxembourg is the most popular domicile for undertakings for collective investments in transferable securities (UCITS), and currently counts almost 4,200 undertakings for collective investments (UCIs) and other regulated investment vehicles. Luxembourg is characterised by a strong culture of investor protection and a competent and proactive supervisory authority, the Commission for the Supervision of the Financial Sector (CSSF).

The Luxembourg legal and regulatory system offers initiators and promoters three different regimes for incorporating a Luxembourg UCI:

a Part I of the law dated 17 December 2010 on UCIs, as amended (2010 Law);

b Part II of the 2010 Law; and

c the Law of 13 February 2007 on specialised investment funds, as amended (SIF Law).

Under the 2010 Law, Part I regulates investment funds that comply with the UCITS Directive,[2] whereas Part II of the 2010 Law covers investment funds that do not have a UCITS passport.

The SIF regime applies to UCIs whose securities are restricted to one or several well-informed investors, as further described below, and whose constitutive documents subject them to the SIF regime.

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2 Formerly Directive 85/611/EEC, repealed by Directive 2009/65/EC.

The following tables are based on information taken from the CSSF activity report 2014 showing that the number and net assets of UCIs (the figures do not include some other regulated investment vehicles, such as SICARs) has been growing constantly over the past few years.

Evolution of the number of UCIs and SICARs					
Year	*Number of UCIs and SICARs*	*Registrations on the official list*	*Withdrawals from the list*	*Net variation*	*In %*
2003*	1,870	175	246	-71	-3.7
2005	2,107	310	174	136	6.9
2007	3,050	895	198	697	29.6
2009	3,699	435	328	107	3
2011	4,121	509	302	207	5.3
2012	4,117	403	107	-4	-0.1
2013	4,181	384	320	64	1.6
2014	4,193	371	359	12	0.3

* Data without SICAR

Evolution of UCI and SICAR net assets in € billion					
Year	*Net assets*	*Net subscriptions*	*Net asset variation*	*In %*	*Average net assets per UCI/SICAR*
2003*	953.3	82.6	108.8	12.9	0.510
2005	1,527.7	237.2	421.4	38	0.725
2007	2,076.8	197.3	220.4	11.9	0.681
2009	1,858.4	86.4	281.9	17.9	0.502
2011	2,120	6.6	-100.4	-4.5	0.514
2012	2,413.7	126.5	293.7	13.9	0.586
2013	2,645.7	193.4	232	9.6	0.633
2014	3,127.7	249.1	482	18.22	0.746

* Data without SICAR

On 30 June 2015, 3,901 UCIs and (as of 8 July 2015) 292 SICARs were domiciled in Luxembourg. At the same date, Luxembourg-domiciled UCIs had €3,528.1 billion under management.

II GENERAL INTRODUCTION TO THE REGULATORY FRAMEWORK

The legal and regulatory framework in Luxembourg offers sponsors, initiators and promoters a large number of different types of investment vehicles that can generally be split into two main categories: regulated investment vehicles and non-regulated investment vehicles.

i Regulated investment vehicles

Luxembourg is the prime location for the pan-European and global distribution of UCITS. UCITS benefit from a European passport and can, by using a standardised notification procedure, be sold to the public in the different EEA Member States[3] once authorised by the CSSF. The UCITS label and the investor protection regime are further recognised by numerous non-EEA Member States, thus facilitating the registration of UCITS in these countries as well. UCITS can, in addition to institutional investors, be marketed to retail investors, and as such are subject to specific rules regarding the eligible assets and fairly constringent diversification and concentration rules. These rules ensure an appropriate level of liquidity, allowing investors in a UCITS to redeem their units at least twice a month.

Part II funds do not qualify as UCITS, either because of their investment policy or because of the rules applicable to the distribution of their units. Compared with UCITS, Part II funds have increased flexibilities as regards the type of assets they can invest in, the investment strategies they can employ, the diversification rules they are subject to and the liquidity they offer to investors.

SIFs have full flexibility regarding the type of assets in which they invest and the strategies that they employ. However, they must invest in accordance with the principle of risk spreading.

The investment restrictions applicable to Part II funds and SIFs are provided in CSSF circulars. These investment restrictions are more flexible than those applicable to UCITS, and derogations may be obtained on a case-by-case basis from the CSSF. SIFs are also subject to the ongoing supervision of the CSSF, but benefit from a lighter regulatory regime than UCITS and Part II funds.

A SICAR is an investment company in risk capital that is subject to the amended Luxembourg Law of 15 June 2004 regarding SICARs (June 2004 Law). The SICAR regime is customised for private equity and venture capital investment and SICARs are not subject to risk diversification requirements.

Securitisation vehicles (SVs) organised under the amended Law of 22 March 2004 on securitisation can in certain circumstances also be used as an alternative to the investment vehicles mentioned above, mainly depending on the objectives of the transaction and the way they are structured.

Part II funds can be sold to the public, whereas SIFs and SICARs are reserved to well-informed investors, which are in substance institutional investors, professional investors and investors subscribing for a minimum of €125,000. Well-informed investors are deemed able to adequately assess the risks associated with investments in a SIF. SVs may be offered to any type of investors, but those issuing securities to the public more than three times a year are also subject to the supervision of the CSSF.

3 The European Economic Area comprises the European Union Member States plus Norway, Iceland and Liechtenstein.

Like Part II funds, SIFs and SICARs do not benefit from a European passport to be marketed throughout the different EEA Member States *per se*, but they may benefit under certain circumstances from a passporting regime in line with certain conditions set out in the AIFMD, as described in Section II.iii, *infra*. They may also be sold on a private placement basis in line with the legal and regulatory requirements of the distribution country.

ii Non-regulated vehicles

In addition to the above-mentioned regulated vehicles, Luxembourg also offers a tax-efficient and tailor-made corporate structure commonly referred to as a SOPARFI. A SOPARFI is a financial participation company that is an ordinary commercial company subject to the Luxembourg Law of 10 August 1915 on commercial companies, as amended (1915 Law) and that is not subject to the control of any supervisory authority.

A SOPARFI is typically used for holding and financing private equity and venture capital investments. A SOPARFI is often used in combination with other investment structures as special purpose vehicles or joint venture vehicles. In accordance with the 1915 Law, Luxembourg commercial corporate entities may be incorporated as a public limited company (SA), private limited company, limited partnership, partnership limited by shares (SCA), special limited partnership (SLP) or cooperative company. However, they are usually incorporated as, *inter alia*, a public limited liability company, a private limited liability company or a partnership limited by shares.

iii Regulatory framework

All the above-mentioned regulated investment vehicles are subject to ongoing supervision by the CSSF. In addition to its supervisory functions, the CSSF also issues legally binding regulations, as well as circulars within the framework of the existing legislation.

The CSSF first carries out its supervisory function at the time of creation of the regulated investment vehicles. In this context, the CSSF approves the different documents important for the set up and functioning of these vehicles, the persons to be appointed as directors or managers, the central administration, the depositary and the auditor. Additional documents and information may be requested by the CSSF as part of the approval process. During the life of the regulated investment vehicles, any change to the constitutive documents, and any change of director or of the aforementioned service providers, requires prior CSSF approval. Depending on the vehicle, more or less frequent reporting must be made to the CSSF. When the investment vehicle is liquidated, the CSSF also approves the liquidator and remains competent for the supervision until the close of the liquidation.

The directors and service providers are approved by the CSSF on the basis of their good reputation and professional experience. The depositary must in principle be a Luxembourg credit institution or a foreign credit institution with a branch in Luxembourg, even if the June 2004 Law and the SIF Law provide for a lighter depositary regime in some cases. The auditor responsible for auditing the annual accounts must also have appropriate professional experience.

The CSSF can withdraw its authorisation for the relevant investment vehicle in the event of violation of the applicable laws and regulations.

SIFs and SICARs are subject to a lighter prudential regime than UCITS and UCIs. Even though the SIF Law requires in principle that the investment manager of a SIF is a regulated entity, in certain circumstances, and on a case-by-case basis, the CSSF may grant derogations for the approval of a non-regulated entity on the basis that it is of sufficiently good repute and has sufficient experience in view of the type of SIF concerned. For a SICAR, the financial or regulatory status of the investment manager does not need to be checked by the CSSF and only the directors who formerly represent a SICAR (i.e., in the case of a limited partnership, the general partners (GPs), and in the case of public limited companies and private limited companies, the members of the board of directors or managers), must be approved by the CSSF.

By means of a Law of 12 July 2013, Luxembourg has implemented AIFMD.[4] The AIFMD submits managers of alternative investment funds (AIFs) to organisational and transparency requirements.

The term AIF, as used in the AIFMD, refers to collective investment undertakings that do not qualify as UCITS and that raise capital from a number of investors with a view to investing it in accordance with a defined investment strategy for the benefit of those investors.

The AIFMD introduces a marketing passport to professional investors throughout the EEA subject to compliance with all the conditions set forth in the AIFMD.

The definition of AIF in the AIFMD is broad. It captures all non-UCITS regardless of their asset class (e.g., hedge funds, real estate funds, infrastructure funds, private equity and venture capital funds) and regardless of their legal form and regulatory regime (if any).

Because of their retail distribution features and investment strategies, Part II funds qualify *de jure* as AIFs. Other structures, whether regulated, such as SOPARFIs, SIFs or SICARs, may fall outside the scope of this definition.

The alternative investment fund manager (AIFM) is a legal person whose regular business is to manage one or more AIFs, and who provides at least portfolio and risk management functions to such AIFs.

The investment management function is identified in the AIFMD as the key function to be performed by the AIFM, and includes portfolio management and risk management. The AIFM may also perform administrative and marketing functions, as well as activities related to the assets of the AIF.

Delegation of some of the AIFM's functions is permitted, subject to prior notification to the regulator and appropriate disclosure. The AIFM may not, however, become a letterbox entity. The portfolio management or risk management can be delegated only to authorised and registered firms for the purpose of asset management, and cooperation between authorities must be ensured.

Other rules of conduct apply to AIFMs, including the obligation to set up remuneration policies that are consistent with effective risk management and do not encourage inconsistent risk-taking. Organisational arrangements must also be put in place to identify, prevent, manage and monitor conflicts of interest, as well as to structure

4 Directive 2011/61/EU on Alternative Investment Fund Managers.

the risk management function that must be functionally and hierarchically separated from the operating units, including from the portfolio management function.

The CSSF website has an FAQs section that aims to highlight some of the key aspects of the AIFMD from a Luxembourg perspective. At the end of the FAQs section, the CSSF has also published a list of the countries and supervisory authorities with whom it has entered into cooperation agreements that, from a Luxembourg perspective, are crucial to permit the delegation of portfolio management functions to investment managers located in such countries (as discussed above).

III COMMON ASSET MANAGEMENT STRUCTURES

The commonly used structures for asset management are, as set out in Section II, *supra*, UCITS, Part II funds, SIFs (collectively 'UCIs') and SICARs. The laws mentioned in Section II, *supra*, refer to the different legal forms for the relevant regulated investment vehicles.

UCIs may adopt the form of a fund of the contractual type (FCP) or a fund of the corporate type (SICAV or SICAF). A SICAR must be of the corporate type and adopt one of the forms listed in the June 2004 Law.

i Contractual-type vehicles

The FCP

In terms of structure, the FCP is similar to an English unit trust. It is not itself a legal entity, but rather a co-proprietorship of assets that must be managed by a management company. The individual investor is not by definition a shareholder, but is commonly referred to as a unitholder. Unitholders in an FCP are not entitled to vote unless and to the extent that the management regulations of an FCP provide otherwise. In an FCP structure, investors subscribe for units that represent a portion of the net assets of the fund, and unitholders are only liable up to the amount contributed by them. The management company takes all decisions on behalf of the FCP relating to the investment and the operation of the FCP, and the rights and obligations of the unitholders and their relationship with the management company are defined in the management regulations.

The management company must be established under either Chapter 15 of the 2010 Law (managing at least one UCITS) or Chapter 16 of the 2010 Law (exclusively managing SIFs or Part II funds).

The special limited partnership (SLP)

On the occasion of the implementation of the AIFMD, Luxembourg has completed its legal framework by introducing a new type of investment vehicle, namely the SLP.

The SLP is a partnership entered into by one or more GPs with unlimited and joint and several liability for all of the SLP's obligations, and with one or more limited partners (LPs) contributing only a specific amount pursuant to the provisions of the limited partnership agreement (LPA). It does not constitute a legal person separate from that of its partners.

The SLP may be used by regulated and non-regulated entities, whether qualifying as AIFs under the AIFMD or not. Thus, regulated investment vehicles such as SIFs and SICARs may adopt the legal form of an SLP with the inherent structural and tax advantages this type of investment vehicle will entail.

Mandatory rules – predominance of the LPA

The mandatory provisions relate, *inter alia*, to:

a the keeping and content of a register of partners;
b information (excluding about LPs) to be published;
c limited causes of voidance; and
d the manner in which inscriptions and other formalities regarding an SLP's assets are made.

All other aspects of the SLP can be determined by the LPA upon agreement by the partners, including:

a type of partnership interests;
b timing, method and type of contributions;
c timing and extent of distributions and reimbursements or exclusions therefrom;
d clawback rules;
e voting rights;
f LP matters and information; and
g reduction and redemption of partnership interests.

Management of the SLP and the role of LPs

The regime gives GPs the right to manage the SLP, but not the obligation to do so. If the appointed manager is not a GP, the manager is considered as an agent liable only for the execution of its mandate (with the possibility to arrange for delegation) and for any misconduct in the management of the SLP's affairs.

The new regime contains a non-exhaustive list of actions that may be taken by LPs that shall not be considered as management actions and thus shall not jeopardise their limited liability.

Tax features

The SLP is tax-transparent for Luxembourg tax purposes, to the extent that the GP, if it is a corporation, holds less than 5 per cent of the partnership interests and does not carry out a commercial activity (which could notably result from the management of its portfolio under an active speculative trading). SLPs qualifying as AIFs are deemed not to carry out a commercial activity. SLPs structured as SIFs are exempt from Luxembourg corporation taxes in any case, and are instead subject to an annual subscription tax at a rate of 0.01 per cent of their net assets, assessed on a quarterly basis.

Management services rendered to an SLP that is regulated (such as an SIF or a SICAR) or that qualifies as an AIF are exempt from Luxembourg VAT.

It is expected that this new type of vehicle will put Luxembourg on an equal footing with jurisdictions that offer the common law-type limited partnership that has traditionally been the favoured investment vehicle for structuring private equity investments.

ii Corporate-type vehicles

UCIs can, in addition to the FCP form, be incorporated as an investment company, whereas SICARs can only be established as a corporate-type fund.

Capital structure

UCIs and SICARs may be created either as a SICAV or SICAF.

The capital of a SICAV is always equal to its net assets. The SICAV's capital increases or reduces automatically as a result of new subscriptions or redemptions without any need for formalities such as the decision of the general shareholders' meeting or the intervention of a notary public.

A SICAF, however, requires more formalities to reduce or increase its share capital but, by means of an adequately structured capital comprising par value and premium, the SICAF can issue shares or redeem its own shares in a manner similar to the SICAV.

Usually the SICAV form is chosen, as SICAVs are easier to handle from an administrative point of view. A SICAF is only used in specific circumstances, such as vehicles closed for redemptions and where it is necessary to issue shares below the net asset value. Unlike SICAFs, SICAVs must issue their shares at a price based on the net asset value per share (i.e., the net asset value of the SICAV divided by the number of shares outstanding). Furthermore, a SIF or SICAR can, independent of their form, issue partially paid-up shares.

Common corporate forms

Different corporate forms are available for corporate-type vehicles, but this chapter focuses on the corporate forms commonly adopted in practice by the above-mentioned regulated vehicles, being either an SA or SCA.

The board of directors of an SA appointed from time to time by the shareholders of the company is in charge of the management and administration of the company, and may delegate investment management or advisory functions to local or foreign experts and administration to Luxembourg service providers.

A general shareholders' meeting must be convened at least once a year to approve the financial accounts and to appoint or reappoint the members of the board of directors. Furthermore, important decisions concerning the company (e.g., amendments to the articles of incorporation) must be taken or approved by the general shareholders' meeting.

An SCA is similar to the limited partnership in common law jurisdictions and has two categories of shareholders:

a limited shareholders subscribing for ordinary shares, whose liability is limited to the amounts of their investment; and

b at least one unlimited shareholder GP subscribing for management shares who, by operation of law, is indefinitely and jointly liable for all obligations of the SCA that cannot be met out of the assets of the company. The GP may be responsible for the management of the SCA, but an external manager may also be appointed who will not hold management shares and not face unlimited liability. However, to limit the unlimited liability arising from holding management shares and acting as manager, usually the promoter, initiator or manager subscribes to management shares through a limited liability company. Investors would subscribe for the ordinary shares.

The SCA is an ideal structure for promoters or initiators who would like to retain control over the investment vehicle, as the GP can only be removed as manager by amending the SCA's articles of incorporation. However, any such amendment, unless otherwise provided for in the articles of incorporation, would be subject to the approval of the GP; as a result, a replacement is not possible without the manager's approval.

A UCITS SICAV may only adopt the form of an SA.

iii Umbrella and multiple-class structures

All regulated investment vehicles may be established with multiple compartments (umbrella structures) provided that the constitutional documents provide for such a possibility.

Different compartments may be created within an umbrella structure. Each compartment is linked to a specific portfolio of investments that is segregated from the portfolio of investments of the other compartments, except if the constitutional documents provide otherwise. In accordance with the ring-fencing principle, the assets of a specific compartment are exclusively liable for their own debts and obligations.

In addition to this umbrella structure, different classes of shares may be created within a regulated investment vehicle or within the compartments. These classes may have different characteristics and features, such as whether they distribute dividends, sales charges or other fee structures, different currencies or hedging features, and the targeted investors. The underlying investments for all classes are the same, but the net asset value per share of each class may be different as a result of the class-specific assets and liabilities resulting from the specific features of each class being allocated to each such class. The ring-fencing principle is not applicable between classes of the same compartment.

iv Choice of available legal forms

There are several aspects influencing the choice of promoters and initiators between the different legal forms available.

One consideration is the fiscal situation of the targeted investors. Indeed, depending on the nationality or place of residence, they may be in a different tax situation depending on whether they own units in a UCI or SICAR; whether the vehicle is established as a contractual-type or corporate-type fund; or whether the vehicle is established as a SICAV or a SICAF.

Another aspect that may determine the choice of the legal form is the control the promoter or initiator wishes to exercise over the investment vehicle. In the case of an FCP, in principle there are no unitholders' meetings, and the unitholders cannot replace the management company or take control, by any other means, over the structure.

In the case of an investment company under the form of an SA, this is theoretically possible, as the shareholders appoint the directors at general meetings; therefore, a majority of shareholders could take control over the investment company. The risk of an unfriendly takeover is, however, reduced in the event that the vehicle is open-ended, since there is no assurance that the investors will remain in the vehicle.

Alternatively, the investment vehicle could be established in the form of an SCA (as explained above).

A third consideration is the habits and customs of the targeted investors, as in certain jurisdictions investors are more familiar with contractual-type funds, whereas in other jurisdictions they are more familiar with corporate-type funds.

The SLP is an appropriate vehicle for promoters or investors seeking the greatest contractual flexibility in the structuring of an investment vehicle meant for a limited number of sophisticated investors.

IV MAIN SOURCES OF INVESTMENT

As disclosed in the CSSF tables in Section I, *supra*, on 31 December 2014, 4,193 UCIs and SICARs were inscribed on the official list of the CSSF, and the net assets of these UCIs and SICARs increased in 2014 to €3,127.7 billion (an increase of 18.22 per cent compared with 2013).

As previously mentioned, SIFs and SICARs are reserved to well-informed investors. UCITS and Part II funds may be commercialised to both retail and institutional investors; UCITS are *per se* the most suitable vehicle for retail investors due to their higher protection and constringent investment and diversification rules. The CSSF table below shows the split of net assets between and total number of UCITS, Part II funds and SIFs.

Breakdown of UCIs (according to Parts I and II of the 2010 Law) and SIFs (in € billion)						
	Part I	*Assets*	*Part II*	*Assets*	*SIFs*	*Assets*
2003	1,149	741.1	583	169.3	138	42.9
2005	1,358	1,260	524	204	178	61.2
2007	1,653	1,646.4	643	295.9	572	117.1
2009	1,843	1,465.7	649	221.2	971	154.1
2011	1,870	1,655.5	601	201.7	1,374	239.3
2012	1,801	1,913.1	555	193.8	1,485	276.9
2013	1,817	2,121.5	523	187.4	1,562	306.5
2014	1,893	2,578.4	422	169	1,590	347.6

At the end of 2014, 288 SICARs were inscribed on the official list of the CSSF, with total net assets of over €32.7 billion.

V KEY TRENDS[5]

Luxembourg is a fund production centre with a very small national market for distribution, and the vast majority of Luxembourg funds are distributed principally outside of Luxembourg in the EEA and on a worldwide basis. The figures and trends below thus mainly reflect investors' behaviour outside of Luxembourg.

5 The information in this section is taken from the CSSF activity report 2014 and contains unofficial translations of selected passages.

Pursuant to the CSSF, the UCI and SICAR sector recorded an 18.22 per cent growth in net assets in 2014 and a small increase of 0.29 per cent of the number of UCIs and SICARs. The overall performance of the developed markets was broadly positive for 2014 in terms of both equity and bonds. In a context of low inflation, the European and Japanese central banks continued their accommodating monetary policy, unlike the US central bank, which has ended its asset buy-back programme in the face of good economic growth in the US. Accordingly, the yield rates of the eurozone have reached historically low levels, and the euro depreciated by more than 12 per cent against the US dollar in the reporting period. By contrast, financial markets of emerging countries have grown heterogeneously in 2014. The overall positive performances of Asian markets in connection with good macroeconomic figures contrast with the negative performance of the financial markets of Eastern Europe, which were impacted by geopolitical tensions linked to the crisis in Ukraine and low oil prices. The overall decline of the financial markets in Latin America is related to the structural problems of some countries in this region and the decline in commodity prices.

Through the inflow of new capital and positive developments in the financial markets, the total assets of Luxembourg UCIs grew by €482 billion to €3,127.7 billion by 31 December 2014. Net capital investment of €249.1 billion and a positive financial market impact of €232.9 billion were responsible for this increase.

In 2014, the majority of UCI categories experienced positive net capital investments, the most important inflow having been recorded by diversified UCIs for an amount of €93 billion. Despite very low, or even negative, rates of return in 2014, UCIs investing in liquidity, money market instruments and other short term assets experienced net subscriptions of €0.3 billion.

At the end of 2014, the number of UCITS, Part II funds and SIFs totalled 3,905 compared with 3,902 at the end of 2013. Taken separately, the number of SIFs grew by 28 entities. Out of 4,193 UCIs and SICARs registered on the official list as at 31 December 2014, 55.21per cent were UCITS and Part II funds.

VI SECTORAL REGULATION

i Insurance

Luxembourg law distinguishes between life insurance business and non-life insurance business, which may not be exercised simultaneously by the same legal entity.

Most of the annual premiums are derived from contracts written under the freedom of services regime, allowing any insurance company established in an EU Member State to sell its products in all other EU Member States and, with certain limitations, in Member States of the EEA, without having to open a local subsidiary.

Insurers in Luxembourg also offer an extensive range of unit-linked products.

Furthermore, Luxembourg is also a centre for reinsurance business covering the risks of an insurance company or another reinsurance company. The activity of a reinsurance company may not cover direct insurance.

The most important legislation in Luxembourg governing insurance business is the Law of 6 December 1991 on the insurance sector, as amended (1991 Law), the amended Grand-Ducal Regulation of 14 December 1994 implementing the 1991 Law and the Law of 27 July 1997 on insurance contracts, as amended.

For reinsurance companies, the amended Grand-Ducal Regulation of 5 December 2007 specifying the conditions for approval and the practice of reinsurance companies, and the Grand-Ducal Regulation of 5 December 2007 establishing the terms and conditions of the complementary supervision of insurance and reinsurance companies that are part of an insurance or reinsurance group, are of particular importance.

Within the insurance sector, all companies are supervised by the Commissioner of Insurance (CAA). Any physical or legal person that wants to carry out insurance operations in Luxembourg must be authorised by the CAA (to whom this power is delegated by the Minister of Finance). To ensure the financial solidity of insurance companies, there are very strict conditions of authorisation.

Luxembourg life insurance products offer a high level of protection to investors and great flexibility in the design of the contracts, as the assets underlying the technical provisions must be deposited within credit institutions also approved by the CAA. The depositary agreement with the depositary bank must also be approved by the CAA. As a result, there is a clear segregation between companies' assets and the deposits in respect of policyholders, which are held in separate bank accounts. In addition, the depositary bank must also segregate the assets and protect the interests of life insurance policyholders. This segregation of assets is monitored on a quarterly basis by the CAA.

Finally, the 1991 Law introduces the term super privilege, granting policyholders of a Luxembourg life insurance company the capacity of preferential first line creditors on the assets underlying the technical provisions. As a result of this privilege, the policyholders rank ahead of all other creditors when they need to recover the liabilities related to the insurance contracts in the event of bankruptcy of the insurance company.

ii Pensions

The Law of 13 July 2005 on institutions for occupational retirement provision in the form of a pension savings company with variable capital (SEPCAV) and a pension savings association (ASSEP) creates two pension vehicles that are regulated by the CSSF.

The SEPCAV is similar to a SICAV and can only be used for defined contribution schemes.

The ASSEP is a vehicle with an associative structure that can be used for both defined contribution schemes and defined benefit schemes. The ASSEP is similar to an ASBL (a non-profit-making association), subject to the Law of 21 April 1928.

For both the SEPCAV and ASSEP, prior approval is required from the CSSF regarding the directors, managers, asset managers, liability managers and the scheme rules. In addition, the assets must be deposited with a bank in Luxembourg or in another EU Member State, and an external auditor has to approve the annual accounts.

In addition to the SEPCAV and ASSEP, there is a third category of pension funds regulated by the CAA generally referred to as CAA pension funds.

The CAA pension fund, created within the above-mentioned insurance legislation and the amended Grand-Ducal Regulation of 31 August 2000, offers a vehicle for defined contributions, defined benefits or supplemental benefits in the event of the death or disability of members.

Different forms can be chosen for CAA pension funds, but the ASBL is most commonly used, as the applicable rules are simple and flexible.

iii Real property

Real property structures in Luxembourg may be divided into non-regulated real estate investment vehicles and regulated real estate investment vehicles, as further described in Section II, *supra*.

Most regulated real estate investment vehicles are set up as Part II funds.

CSSF Circular 91/75 provides that a real estate Part II fund may, in principle, not invest more than 20 per cent of its net assets in a single property. However, this rule does not apply during a start-up period, which may be up to four years. Furthermore, a real estate Part II fund is in principle not allowed to borrow more than 50 per cent of the valuation of all the properties, and the net asset value is calculated at least once a year. An independent valuer must be appointed to value the underlying properties.

All real estate Part II funds are subject to the CSSF's authorisation and ongoing supervision. A depositary bank must be appointed to supervise the assets, and a central administration must be located in Luxembourg.

Real estate funds may also be established as SIFs or SICARs. Real estate funds established as SICARs must have risk capital characteristics.

iv Hedge funds

Notwithstanding the fact that UCITS may, under certain circumstances, implement hedge fund-like strategies, hedge funds and funds of hedge funds are generally not compliant with the provisions of Part I of the 2010 Law.

Hedge funds or funds of hedge funds in Luxembourg are commonly established under Part II of the 2010 Law or the SIF Law, although a substantial majority are now incorporated under the latter regime.

CSSF Circular 02/80 sets forth specific rules applicable to Luxembourg UCIs pursuing alternative investment strategies (Hedge Fund Circular). The Hedge Fund Circular clarifies the investment restrictions generally applicable to these types of Luxembourg UCIs.

Although the SIF Law is not dedicated *per se* to hedge funds, it offers a flexible legal framework to allow an investment manager to apply all sorts of alternative strategies.

CSSF Circular 07/309 mainly provides for a risk spreading of 30 per cent maximum investment of the net assets in the securities or assets of the same type issued by the same issuer (except where a SIF is organised as a feeder fund). The CSSF has also enacted Circular 08/372 clearing up the rules on the appointment of a prime broker by a SIF, the relationship between the depositary and the appointed prime brokers, and the liability of the depositary in that respect.

v Private equity

Luxembourg offers a wide range of private equity and venture capital investment vehicles that can be either regulated vehicles or non-regulated vehicles as further described in Section II.ii, *supra*.

The SICAR is a regulated investment vehicle hosting private equity or venture capital investments.

The SICAR's purpose is limited to investing its assets in securities representing risk capital to provide its investors with benefits resulting from the management of its assets in consideration for the risk that they incur. More detailed information is described in CSSF Circular 06/241 on the concept of risk capital.

As the June 2004 Law does not impose any diversification rules, a SICAR may invest into one single target company.

Another investment vehicle commonly used for private equity or venture capital investment purposes is the SIF.

In addition to SICARs and SIFs, Part II funds, SVs or non-regulated vehicles (such as SLPs) could also serve private equity and venture capital purposes.

vi Other sectors

Luxembourg also offers an adequate legal, regulatory and fiscal framework for the incorporation of microfinance investment funds.

Microfinance originated from the finding that, while the vast majority of the world's poor are deprived of any access to financial services, facilitating their access to such services (and in particular to microcredit) enables them to launch or further develop an economic activity, and thereby increase their revenue, their social situation and the educational level of their children.

Luxembourg offers a wide range of microfinance investment vehicles, which are mainly Part II funds, SIFs, SICARs and SVs (further described in Section II, *supra*).

Pursuant to the CSSF activity report 2014, the net assets of UCIs investing in microfinance increased in 2014 to €4,423 million (compared with €3,599.3 million in 2013), and their number has slightly increased to 35 entities (compared with 34 entities in 2013).

In addition to microfinance investment vehicles, Luxembourg is also the domicile of shariah investment funds that are compliant with shariah principles. In its activity report 2014, the CSSF stated that there were 43 shariah UCIs and entities in Luxembourg, and that their net assets had increased by 20 per cent to €2,278 million in 2014, from €1,899 million in 2013. The most commonly used investment vehicles for shariah investment funds are UCITS, which are being increasingly accepted in many non-European countries, including the Middle East. In addition, SIFs or Part II funds can be used for shariah-compliant funds.

Moreover, in 2014, the net assets of UCIs investing primarily in the real estate field have increased of 11.1 per cent to €33.9 billion. Note that the SIF remains the preferred vehicle for real estate investments.

VII TAX LAW

This section focuses on the tax aspects of the most commonly used regulated investment vehicles: UCITS, Part II funds, SIFs and SICARs.

i UCITS, Part II funds and SIFs

UCITS and Part II funds are exempt from Luxembourg taxation. They are also exempted from the net wealth tax. However, they are subject to an annual subscription tax determined on their total net assets at the end of each quarter. For UCITS and Part II funds, the subscription tax rate is set at 0.05 per cent per annum, which is reduced to a rate of 0.01 per cent per annum applicable for the following investment funds:

a Luxembourg investment funds whose exclusive object is the collective investment in money market instruments, the placing of deposits with credit institutions, or both; and

b individual compartments of UCIs with multiple compartments referred to in the 2010 Law, as well as for individual classes of securities issued within a UCI or within a compartment of a UCI with multiple compartments, provided that the securities of such compartments or classes are reserved to one or more institutional investors.

For SIFs, the annual subscription tax rate is set in principle at 0.01 per cent.

Subscription tax exemption applies to:

a investments by a UCI in a Luxembourg UCI subject itself to the subscription tax;

b a UCI, compartments thereof or dedicated classes reserved to retirement pension schemes;

c money market UCIs; and

d UCITS and Part II funds qualifying as exchange traded funds (ETFs).

UCIs that adopt the legal form of an investment company may claim the benefit of a tax treaty on their own behalf, depending on the wording and the interpretation of the relevant tax treaty. With respect to more than 40 tax treaties signed by Luxembourg and currently in force, the Luxembourg tax authorities have specifically agreed with the local tax authorities that the tax treaty would be applicable to those investment companies. For a certain number of other countries with which Luxembourg has also entered into a tax treaty, no such agreement has been reached. In any case, the Luxembourg tax authorities will issue a certificate of tax residency to Luxembourg UCIs in corporate form.

Contractual-type UCIs are considered as tax-transparent in Luxembourg and may, therefore, with the exception of the double tax treaty concluded between Luxembourg and Ireland, not benefit from the advantages of any double tax treaty concluded by Luxembourg. From a Luxembourg standpoint, these contractual-type UCIs are considered as fully tax transparent, and therefore Luxembourg-resident investors of such UCIs may benefit therefrom.

Dividends and interest paid by UCIs to or capital gains realised upon the realisation of the shares or units in a UCI by a non-resident shareholder or unitholder are not subject to tax in Luxembourg, except if received by a permanent establishment within Luxembourg to which the shares or interest in the UCIs are allocated. Luxembourg-resident investors are taxable on any income received from any form of UCIs, whether by way on interest or by way of dividend.

Capital gains realised by individuals resident investors in Luxembourg in the management of their private wealth, other than speculative gains (i.e., the sale of the shares or units of a UCI within six months of their acquisition), are not taxable except if any such resident owns more than 10 per cent or more of the shares outstanding of the UCI if the UCI is set up as a corporate entity.

If the interest in the UCI is held as a business asset, capital gains are treated as income and will be subject to income tax at the ordinary rates.

An interest in a UCI is in any event an asset to be taken into account for the computation of the net wealth tax for Luxembourg resident corporations.

ii SICARs

For SICARs, the June 2004 Law provides for a tax regime that is fundamentally different from the one described above in relation to UCITS and Part II funds. The June 2004 Law provides for a tax regime under which an opaque SICAR is subject to corporate income tax and municipal business tax on worldwide profits, but the income resulting from securities invested into risk capital investments, as well as income resulting from the transfer, contribution or liquidation of these investments, does not constitute taxable income. As a result, if a SICAR is fully invested in a portfolio of risk capital investments, it will not be subject to tax on revenues resulting from that portfolio. A SICAR is also exempt from net wealth tax.

Being subject to corporate income tax, an opaque SICAR qualifies, from a Luxembourg tax point of view, as a Luxembourg-resident entity, and should thus benefit from any tax treaty concluded by Luxembourg. The Luxembourg tax authorities will issue a tax-resident certificate for the SICAR.

Apart from the application of the Savings Directive, no Luxembourg withholding tax applies on dividend distributions by a SICAR to Luxembourg and foreign investors. Indeed, non-resident shareholders are not subject to Luxembourg corporate income tax for dividends or capital gains derived from its shareholding in the SICAR.

iii VAT

Fees for management services provided in relation to UCITS, Part II funds, SIFs and SICARs are exempt from Luxembourg VAT. Within the European Union, since these vehicles will have a Luxembourg VAT number, the Luxembourg VAT regime with its exemptions will apply even on services rendered by service providers located in another Member State due to the reverse charge mechanism. Therefore, they are placed in a VAT neutral position wherever the service is located in Luxembourg or abroad.

VIII OUTLOOK

i UCITS

On 28 August 2014, UCITS V[6] was published in the Official Journal of the European Union. UCITS V must be implemented into national law by 18 March 2016 and will become applicable as from the same date. The new UCITS depositary framework is substantially aligned with the rules in relation to depositary under the AIFMD. Another element covered by UCITS V is the remuneration of UCITS management companies, again inspired by the AIFMD and Capital Requirements Directives. A third aspect covered by UCITS V is a new harmonised sanctions regime, as there are actually

6 Directive 2014/91/EU of 23 July 2014 on UCITS as regards depositary functions, remuneration policies and sanctions.

different regimes in the EEA Member States in relation to the application of sanctions for breaches of UCITS rules.

To allow depositaries to make the necessary operational adjustments in anticipation of the impact of the upcoming changes of UCITS V on the Luxembourg market, the CSSF issued Circular 14/587, as amended by Circular CSSF 15/608, which obliges depositaries of UCITS funds to comply with substantially the same requirements as those that will be introduced with UCITS V by 18 March 2016.

ii European long-term investment funds (ELTIFs)

On 29 April 2015, the European Parliament and the Council adopted Regulation (EU) 2015/760 on European long-term investment funds, which will be applicable as from 9 December 2015. ELTIFs are a new investment fund framework designed for investors across Europe that want to finance long-term projects in fields such as infrastructure, private equity and certain types of real estate that require commitments for long periods of time.

ELTIFs will be subject to the supervision of the CSSF. They will in principle be closed-ended AIFs, but may provide for specific scenarios allowing an early redemption of an investment. ELTIFs will be AIFs in the sense of the AIFMD, and consequently will have to be managed by an AIFM. They can be offered to professional investors, but may also be marketed, subject to stringent conditions, to retail investors throughout the EEA by using the passporting regime provided for under the AIFMD.

iii EuVECA and EuSEF

Luxembourg continues working on adapting the SICAR and SIF Laws to the new requirements of the EuVECA[7] and the EuSEF,[8] which introduce a marketing passport to AIFMs managing venture capital funds or social entrepreneurship funds whose assets under management do not exceed certain thresholds. The European Commission adopted two implementing regulations on 3 June 2014 on the format of the reporting to be made by the EuVECA and the EuSEF.

iv Money-market funds (MMFs)

On 19 March 2012, the European Commission published a green paper on shadow banking. In the paper, the Commission stated that it is carefully considering the evolution of both the ETF and the MMF markets in the context of shadow banking. It stated that in relation to MMFs, the main concerns identified relate to the risks of runs (i.e., massive simultaneous redemptions by investors) and the fact that such runs could seriously affect financial stability. The communication further states that the risks of runs increase when MMFs value their assets through the amortised cost approach in order to maintain a stable net asset value.

Since then, there have been numerous discussions on what type of measures could be proposed by the European Commission. The investment fund industry argues that,

7 Regulation (EU) 345/2013 of 17 April 2013 on European venture capital funds.

8 Regulation (EU) 346/2013 of 17 April 2013 on European social entrepreneurship funds.

in general, MMFs are already highly regulated investment vehicles (even more so if they are UCITS MMFs). The European institutions maintain, however, their initiatives for further regulation of MMFs, in particular in light of the systemic risk that such MMFs are deemed to represent. The most recent development in the legislative process was a proposed amended version of the draft regulation dated 29 April 2015 by the European Parliament. The amendments cover in particular the introduction of several specific sets of rules applicable to constant net asset value MMFs.

v Packaged retail and insurance-based investment products (PRIIPs) key investor documents (KIDs)

On 26 November 2014, Regulation (EU) 1286/2014, which aims at generalising the pre-contractual investor information for certain PRIIPs offered to retail investors, was adopted. Investment products will comprise shares or units of UCIs, certain types of insurance-based investment products, structured products and structured term deposits. The PRIIP-KIDs must have a standardised presentation and content, allowing investors to compare various products and make an adequate assessment of investment-related risks. The PRIIP Regulation will enter into force on 31 December 2016. It will replace the UCITS-KID with a common standardised PRIIP-KID at the end of a five-year (extendable) transitional period.

Appendix 1

ABOUT THE AUTHORS

JACQUES ELVINGER

Elvinger, Hoss & Prussen

Jacques Elvinger gained a master's degree in law (University of Strasbourg) in 1983 and became a partner with Elvinger, Hoss & Prussen in 1986.

Mr Elvinger practises commercial, company, banking and finance law. He specialises in the field of undertakings for collective investment, pension funds and other investment vehicles, and is head of the investment fund department at Elvinger, Hoss & Prussen.

He is a member of the Board of Directors of the Association of the Luxembourg Fund Industry (ALFI), chair of ALFI's Regulatory Board and co-chair of ALFI's Legal Commission. He is a member of several advisory committees of the Commission for the Supervision of the Financial Sector in the area of investment funds. He is also a member of the High Committee for the Development of the Financial Centre led by the Luxembourg Ministry of Finance and a member of the Working Group of the European Fund and Asset Management Association on the development of UCITS. He is a member of the Committee I (Investment Funds) of the International Bar Association.

He is a lecturer at the University of Luxembourg and holds courses on the examinations for admission to the Luxembourg Bar.

OLIVIER GASTON-BRAUD

Elvinger, Hoss & Prussen

Olivier Gaston-Braud has specialised for more than 10 years in corporate tax, transactional and investment-related tax matters including international tax planning, M&A, private wealth planning, both in direct and indirect taxes, as well as in transactional corporate aspects and regulatory matters.

He holds a *Diplôme d'Etudes Supérieures Spécialisées* in tax law from the University of Toulouse, and a *Diplôme d'Etudes Approfondies* in private international law and international business law from the University of Paris I Panthéon Sorbonne.

Before joining Elvinger, Hoss & Prussen, he worked with another Luxembourg law firm for four years, and prior to that was the head of corporate and tax structuring within a Luxembourg bank active in the Nordic market.

He is a founder and former president of the Young IFA Luxembourg. He is also a member of the International Fiscal Association and the International Bar Association.

He is fluent in French and English.

JOACHIM KUSKE

Elvinger, Hoss & Prussen

Joachim Kuske's principal fields of activity are investment funds, management and investment companies. He is a Master of Law of the Université Robert Schuman (Strasbourg) and holds a *Diplôme d'Etudes Européennes Approfondies* in EC Law from the College of Europe in Bruges.

He first worked for a subsidiary of a French bank in Luxembourg in the investment funds department, and became a member of the Luxembourg Bar in 2004 as an associate with Delwaide Avocats before joining Elvinger, Hoss & Prussen in 2005.

From 2009 until 2014, he worked with VPB Finance SA, a Luxembourg UCITS management company, and from 2011 until 2014 acted as a conducting officer and member of the board of directors in this company. In 2014, he returned to Elvinger, Hoss & Prussen as counsel in the asset management and investment funds practice.

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