Luxembourg

Jacques Elvinger & Xavier Le Sourne
Elvinger, Hoss & Prussen

1. MARKET OVERVIEW

Luxembourg is one of the most experienced and dynamic global investment fund centres. The first Luxembourg investment fund was incorporated in 1959 under the contractual form and Luxembourg counts today more than 3,800 undertakings for collective investments (UCIs). It has been very active in the latest developments of the European UCI industry, in particular during the implementation phase of Directive 2011/61/EU on Alternative Investment Fund Managers (AIFM Directive).

The Luxembourg legal and regulatory system offers sponsors and promoters three different regimes for incorporating their UCIs, namely:

- Part I of the Law of 17 December 2010 on UCIs (2010 Law), which repealed the former Law of 20 December 2002 on UCIs, as amended (2002 Law);
- Part II of the 2010 Law; and
- the Law of 13 February 2007 on specialised investment funds (SIF Law).

The label 'Part II Funds' originates from the 2002 Law, which drew a distinction between the investment funds compliant with the undertakings for collective investment in transferable securities (UCITS) Directives (originally Directive 85/611/EEC, repealed by Directive 2009/65/EC) and the investment funds that were regulated under Part II of the 2002 Law. It is therefore common to define the Part II Funds by comparison with the UCITS (subject to Part I of the 2010 Law), it being noted that only UCITS benefit from the retail European distribution passport throughout the European Economic Area (EEA, ie, the EU and Norway, Iceland and Liechtenstein), whereas other UCIs may under certain conditions set forth in the AIFM Directive benefit from a marketing passport to professional investors.

Investment funds can be subject to different legal regimes as set forth above and be incorporated under numerous legal forms, including public limited liability companies (société anonyme – SA), corporate partnerships by shares (société en commandite par actions – SCA) or private limited liability companies (société à responsabilité limitée – SARL). The implementation of the AIFM Directive has been the occasion for the Luxembourg fund industry to develop a new form of investment vehicle, namely the Special Limited Partnership (the SLP), in French the société en commandite spécial, whose main features are also worth analysing in this outline.

The industry has been growing constantly since 2008. The table below – taken from the Luxembourg Commission for the Supervision of the Financial Sector (Commission de Surveillance du Secteur Financier (CSSF)) Activity

Report (2012) – presents the evolution over the last (full) five years for all three Luxembourg types of UCIs described above:

	Part I		**Part II**		**SIFs**	
	Number	**Net assets (in bn EUR)**	**Number**	**Net assets (in bn EUR)**	**Number**	**Net assets (in bn EUR)**
2008	1,826	1,169.4	708	259.8	837	130.5
2009	1,843	1,465.7	649	221.2	971	154.1
2010	1,846	1,762.7	629	222.2	1,192	214.1
2011	1,870	1,655.5	601	201.7	1,374	239.3
2012	1,801	1,913.1	555	193.8	1,487	276.9

Part I of the 2010 Law deals with UCITS regulated pursuant to Directive 2009/65/EC of 13 July 2009 (UCITS Directive). The exclusive object of UCITS is the investment in transferable securities and/or other eligible liquid financial assets referred to in Article 41(1) of the 2010 Law, namely money market instruments, units of UCITS (including within the same UCITS) and some other UCIs, deposits with credit institutions and financial derivative instruments.

Where the acronym UCITS refers to regulated European branded retail funds, the Commission through the AIFM Directive submits the managers of alternative investment funds (AIFs) to similar organisational and transparency requirements.

The term AIF, as used in the AIFM Directive, refers to collective investment undertakings, which do not qualify as UCITS and, which 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 AIFM Directive introduces a marketing passport to professional investors throughout the EEA subject to compliance with all conditions set forth in the AIFM Directive.

Part II of the 2010 Law deals with UCIs that can be placed with the public but whose principal object may depart from investments in eligible assets within the meaning of Part I, or which are excluded from Part I in the light of either the investment policy (eg, real estate) pursued by them or in the light of the rules applicable to the marketing of their units.

The SIF regime is applicable to UCIs whose securities are restricted to one or several well-informed investors and whose constitutive documents submit them to the SIF regime. They may qualify as AIFs subject to certain criteria listed under section 2. This vehicle offers greater flexibility in terms of corporate structure and investment rules.

With regard to the involvement and contribution of Luxembourg to the private equity industry, the Law of 15 June 2004 regarding investment companies in risk capital (2004 Law) added to the range of Luxembourg products the so-called investment company in risk capital (société d'investissement en capital à risque – SICAR). The SICAR has been conceived as a customised vehicle for sponsors involved in private equity and venture capital. The SICAR offers a favourable tax treatment, which is further

described in section 2.5. and should largely benefit from the creation of the Luxembourg SLP. The SICAR may qualify as an AIF and may also prove to be a dedicated structure for those managers willing to contribute to the development of the European venture capital industry and use the newly created EuVECA label provided for under Regulation (EU) 345/2013 on European venture capital funds (the EuVECA Regulation).

All Luxembourg UCIs and SICARs are subject to the authorisation and ongoing supervision of the CSSF. This is not the case with certain other entities such as the société de participations financières (SOPARFI) which may nevertheless qualify as AIFs and then be regulated at the level of its manager.

2. ALTERNATIVE INVESTMENT FUNDS

Because of their retail distribution features and investment strategies, Part II Funds qualify de jure as AIFs. Other structures, whether regulated or not such as SOPARFIs, SIFs or SICARs, may fall outside the scope of this definition.

2.1. Common structures

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

Non-regulated vehicles

Private investment vehicles can be set up under Luxembourg law in the form of SOPARFIs. The introduction of a marketing passport to EU professional investors makes anachronistic the former disadvantage of this type of company, whose units could not be placed beyond a small circle of investors. The structure itself remains nevertheless outside the scope of supervision of the CSSF and does not benefit from the taxation regime that applies to UCIs or SICARs (see section 2.5. below).

SOPARFIs are most commonly incorporated in Luxembourg as SA, SCA or SARL. Their structuration already benefits from the introduction into the Law of 10 August 1915 on commercial companies (the 1915 Law) of the SLP.

Part II Funds

Part II Funds qualify as AIF under the AIFM Law.

Part II Funds may be set up as FCPs, SICAVs or SICAFs. This section merely focuses on these common forms of investment structures. To some identified extent, they also apply to the other types of AIFs.

The FCP structure is based on three components: the FCP itself, the management company, that may also act as the AIFM and the depositary. It is a contractual-type fund which is, in terms of structure, similar to an English unit trust or a US mutual fund.

The FCP is not a legal entity but is defined as an undivided collection of transferable securities and other assets made up of the collective investments of investors who are entitled to participate equally in the profits and assets by virtue of their investment. Due to the FCP not being organised as a company,

the individual investor is by definition not a shareholder but is commonly referred to as a unitholder. Unlike investors in an investment company (as explained below), unitholders in an FCP are entitled to vote only if and to the extent that the management regulations provide for such a possibility.

If the management company also bears the AIFM licence, it will provide investment management (ie, portfolio and risk management) to the FCP. The management company shall otherwise and where required have to appoint an external AIFM as further analysed under sections 2.2. and 3.1.

The Part II SICAV is set up under the legal form of an SA. Depending on the management structure of the SICAV, its board of directors will have the alternative either to qualify as an internally managed AIFM or appoint an external AIFM as further analysed under section 2.2. The board of directors, appointed from time to time by the shareholders, will in the first instance be in charge of the investment management function or appoint an external AIFM, which will take the responsibility therefor, in both scenarios with the possibil¬ity of delegating portfolio management or advisory functions to local or foreign experts and administration to local service providers. In this structure, the shareholders are convened at least once a year to an annual general meeting to approve the accounts and to appoint or reappoint, as appropriate, the directors of the UCI.

The SICAF is a third route which may be of interest in certain circumstances. A SICAF may be incorporated under the form of an SA but also – as opposed to a SICAV – an SCA. The SCA may prove to ease the control of a promoter on its vehicle. This type of company has indeed two categories of shareholders: the limited shareholders (associés commanditaires) who hold negotiable shares and at least one unlimited shareholder (associé commandité commonly referred to as the general partner) who is indefinitely and jointly liable for all the obligations of the SCA. The general partner is then incorporated in the form of a SARL with a minimal capital (EUR 12,500), thereby in fact limiting the indefinite joint liability of the general partner. It would also be conceivable to incorporate a SICAF in the form of a SARL but the shares in such a company could then neither be publicly offered nor admitted to trading on a stock exchange.

As for the differences between a SICAV and a SICAF, the capital of a SICAF is fixed and does not change automatically with the variations of the net assets as applicable for the SICAV. SIFs and SICARs can also benefit from this feature, as opposed to SOPARFIs. The capital of a SICAF is set forth in the articles of incorporation and the general meeting can increase or reduce the capital or give the board of directors this prerogative within the limits of the authorised capital. It must be noted that the shares in a SICAV must be issued at the net asset value (NAV). This requirement to issue at NAV does not apply to the issue of shares in a SICAF, which can be issued at nominal or par value.

SIFs and SICARs – Preliminary common statement

Whereas units issued by Part II Funds can be placed within the public, other AIFs such as SIFs or SICARs issue securities which may only be held by well-informed investors. Well-informed investors include institutional investors,

professional investors and any other (individual or corporate) investor who: (i) confirms in writing his/its adherence to the status of well-informed investor; and (ii) either invests a minimum of EUR 125,000 or has been subject to assessment by a credit institution, an investment firm or a UCITS management company confirming its knowledge in adequately appraising the considered investment.

SIFs

SIFs, like Part II Funds, are collective investment vehicles subject to the principle of risk-spreading.

SIFs can be incorporated under the form of FCPs or the corporate form, including SICAVs, which may be established under various legal forms (commonly SCA or SA). The new SLP will also be an alternative to these corporate structures.

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

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

SICARs

SICARs commonly adopt the corporate form of SA or SCA. A SICAR will also have the alternative of the SLP for sponsors willing to offer their investors fully tax transparent structures.

A SICAR may be structured with a fixed or a variable capital.

Multiple class structures

Part II Funds, SIFs and SICARs – as opposed to SOPARFIs – can be set up with multiple compartments (umbrella structure).

Each compartment is legally linked to a specific portfolio of investments that is segregated from the portfolio of investments of the other compartments. Pursuant to this 'ring-fencing' principle, although the umbrella structure constitutes one single legal entity, the assets of a compartment are exclusively available to satisfy the rights of investors in relation to that compartment and the rights of creditors whose claims have arisen in connection with the operation of that compartment, unless a clause included in the constitutional documents of the investment entity provides otherwise.

Different classes of securities can be created within such types of AIFs or even within a compartment thereof. Such classes may have different characteristics, notably as regards the fee structure, the type of targeted investors or the distribution policy.

2.2. Regulatory framework

AIFM Regulatory framework

The AIFM is the legal person whose regular business is to manage one or more AIF, and which provides at least portfolio and risk management functions to such AIFs.

Managers who manage AIF assets which do not exceed EUR 100 million or 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 the initial investment in each AIF) are exempt from complying with the full scope of the AIFM Directive and benefit from a lighter registration regime. These managers are required to register with their national regulators and report to them on the AIF they manage on a regular basis. They will not however be allowed to manage AIFs whose total assets are above these thresholds (Full Scope AIFs), which must appoint a fully licensed AIFM.

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

The AIFM Directive makes a distinction between internally managed AIF and externally managed AIF:

- internal AIFMs refers to a structure where the legal form of the AIF permits an internal management (eg, an SA) and where the AIF's governing body (eg, the board of directors) has chosen not to appoint an external AIFM. They are prohibited from engaging in activities other than the internal management of that AIF.
- external AIFMs must engage solely in the investment management of AIF and the performance of additional functions mentioned above (ie, administration, marketing and activities related to the assets of the AIF). External AIFM may however extend their licence to be allowed also to manage UCITS (subject to authorisation under the UCITS Directive). They may also and in addition to the management of the AIF(s), be authorised to provide discretionary management and non-core services (including investment advice).

AIF Regulatory framework

Depending on whether the AIF benefits from an exemption, or from a grandfathering clause, or falls under the registration regime of the AIFM Directive, the authorisation procedure may require the introduction of a file with information on the AIFM (including on the persons conducting the business and the delegation arrangements), and on the AIF(s) itself.

Material shall also have to be produced in relation to a regulated AIF, including a prospectus or any forms of issuing document describing *inter alia* the investment policy and the different service providers. Luxembourg laws already request sponsors of regulated AIFs to provide investors with transparent and adequate information and to keep the essential elements of the document up to date. In this regard and many other disclosure requirements under the AIFM Directive, Luxembourg regulated AIFs already

comply with most of the transparency obligations set forth in the AIFM Directive.

2.3. Operational requirements

Common operational requirements

Many of the ongoing obligations imposed on AIFs under the AIFM Directive are familiar to the Luxembourg fund industry, either because the AIFs already comply therewith under the relevant law or because they derive from the UCITS regime. They include minimum capital requirements, delegation rules or the obligation for any Full Scope AIF or any Luxembourg regulated AIF to have a depositary.

The required share capital of the AIFM varies depending on whether the AIFM is internal or external. Internally managed AIF must have an initial share capital of EUR 300,000. This amount is reduced to EUR 125,000 for an externally appointed AIFM.

Additional own funds may be required, including where the value of the portfolios of an externally appointed AIFM exceeds EUR 250 million.

An independent depositary must be appointed for any regulated or Full Scope AIF. Its functions and liabilities are extensive and include cash monitoring, safe-keeping of assets of the AIF and supervision of transaction and assets of the AIF.

In relation to certain types of funds (essentially private equity, venture capital and real estate funds) which have no redemption rights exercisable during a period of five years from the date of the initial investments, Luxembourg has pragmatically levied the option offered under the AIFM Directive that the depositary can be an entity other than a credit institution or an investment firm which has applied the new licence of 'professional depositary of assets other than financial instruments'.

The 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 letter-box entity. The delegation of portfolio management or risk management: (i) can be given only to authorised and registered firms for the purpose of asset management; and (ii) the cooperation between authorities must be ensured. Where condition under (i) cannot be met, the prior approval of the authorities of the home member state of the AIFM must be obtained. Sub-delegation is permitted subject to similar conditions.

Other rules of conduct apply to AIFM, 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 taken in order to identify, prevent, manage and monitor conflicts of interest as well as structure the risk management function that must be functionally and hierarchically separated from the operating units, including from the portfolio management function.

Additional operational requirements in relation with SICARs

The SICAR benefits from an attractive tax regime described in section 2.5, which can only benefit those vehicles whose purpose is to invest their assets

in securities representing 'risk capital'.

Compliance of the proposed investment policies with the SICAR Law is assessed on a case-by-case basis by the CSSF. The concept of risk capital is defined by the SICAR Law as 'the direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange'. The parliamentary documents of the SICAR Law clearly state that this definition is only indicative. A comprehensive definition was deemed undesirable though so as to avoid the SICAR Law lagging behind the market. As per the SICAR Circular the concept of 'risk capital' generally hinges on two cumulative elements, namely a high risk and an intention to develop the target entities (portfolio companies). The SICAR Circular lists a series of elements that should be considered in order for the sponsor of the SICAR to confirm to the CSSF in a written statement the reasons that make the investment policy acceptable, such as the number and the nature of the target entities, their maturity level, the SICAR's development projects and the envisaged duration of holding.

2.4. Marketing the fund

Passport

The AIFM Directive regulates the marketing of AIF. It introduces a passport for the marketing of AIF to professional investors in the EU. The passport will initially only be available to EU AIFMs managing EU AIFs. The passport will only be available to non-EU AIFMs and non-EU AIFs as from July 2015.

There is no EU passport for the distribution of AIF to retail investors in the AIFM Directive, although the member states may allow AIFM to market to retail investors in their territory units or shares of AIF managed in accordance with the Directive. Luxembourg has opted to introduce this flexibility into the AIFM Law.

Private placement

The AIFM Directive lays down the conditions subject to which AIFMs may market the units of AIFs to professional investors in the EU. The marketing shall only be allowed insofar as the Luxembourg AIFM complies with the AIFM Directive. The marketing occurs with a passport. Private placement rules shall therefore no longer be acceptable, save for the marketing – with a few additional AIFMD requirements – of AIFs by AIFMs that cannot benefit from the passport, such as those established outside the EU or falling below the thresholds as referred to under section 2.2.

The dual regime should nevertheless last until 2018, at which point the EU authorities shall decide on the possible end of national private placement regimes.

Reverse Solicitation

The marketing is defined under the AIFM Directive as a direct or indirect offering or placement, which is made on the initiative of the AIFM or on behalf of the AIFM, of units or shares of an AIF it manages or with investors domiciled or with a registered office in the European Union. Based on this

definition, the solicitation made by an investor to subscribe for units in an AIF received by its AIFM should therefore fall outside the scope of the marketing and not require any notification to be made by the AIFM in order to register the AIF for commercialisation in a different member state. Burden of proof should rely with the AIFM, which would need to show positively that the communications were exclusively initiated by the investor. This may prove to be complicated where the AIF has been notified for marketing to professional investors in the relevant member state.

2.5. Taxation

SOPARFIs

The overall combined rate of corporation taxes is 29.22 per cent in Luxembourg City. Corporation taxes include a: (i) 21 per cent corporate income tax (impôt sur le revenu des collectivités) on which a 7 per cent solidarity surcharge (contribution au fonds pour l'emploi) is added on top, leading to an effective corporate income tax rate of 22.47 per cent; plus (ii) a municipal business tax (impôt commercial communal). The municipal business tax rate varies from one municipality to another. In Luxembourg City, the municipal business tax is 6.75 per cent.

Entities whose assets consist of more than 90 per cent in financial assets, transferable securities and bank deposits, receivables held against related parties or shares or units in tax transparent entities are subject to a minimum flat rate of EUR 3,000 (EUR 3,210 including the 7 per cent solidarity surcharge).

Other entities which have their registered office or their central administration in Luxembourg and which are not subject to the above minimum flat rate are subject to a minimum tax which is determined on the basis of the total assets in the balance sheet of the tax year concerned. This minimum tax ranges from EUR 500 to EUR 20,000 (plus the 7 per cent solidarity surcharge). The EUR 20,000 minimum tax is due for a balance sheet exceeding EUR 20 million. The net value of assets generating or potentially generating income, which is only taxable in a state other than Luxembourg by virtue of a double tax treaty (real estate for example), shall be disregarded for the purpose of computing the minimum tax.

The minimum taxation is not a final tax but an advance tax payment on the corporate tax due in the future. This minimum tax, however, is not refundable.

SOPARFIs are also liable to an annual 0.5 per cent net wealth tax in Luxembourg (impôt sur la fortune) on their unitary value (ie, taxable assets minus liabilities financing such taxable assets) as at 1 January of each year.

Part II Funds

According to Article 174(1) of the 2010 Law, Part II Funds existing under the laws of Luxembourg pay a subscription tax (taxe d'abonnement) at the rate of 0.05 per cent per annum on their total net assets at the end of each quarter except as stated below. According to Article 174(2) of the 2010 Law, a reduced rate of 0.01 per cent per annum is applicable for Luxembourg investment funds whose exclusive object is the collective investment in money market

instruments and the placing of deposits with credit institutions, or in deposits with credit institutions, or whose individual compartments in an umbrella structure or individual classes of units are reserved to one or more institutional investors.

Article 175 of the 2010 Law also provides for tax exemptions applicable under certain conditions to money market instruments, institutions for occupational retirement pensions or similar investment vehicles as well as to microfinance institutions and exchange traded funds (ETFs).

UCIs set up under the 2010 Law are not subject to any Luxembourg ordinary income, capital gain, estate or inheritance taxes payable by the UCI or its non-Luxembourg resident shareholders or beneficiary unitholders in respect of their shares or units in the UCI.

Dividends and interests received by either type of investment fund on its portfolio may be subject to withholding taxes in the countries of origin of those dividends.

SIFs

SIFs are subject to an annual subscription tax (taxe d'abonnement) at a rate of 0.01 per cent based on the basis of the total net assets valued at the end of each calendar quarter. The SIF is not subject to any corporate income tax, municipal business tax or net wealth tax.

Concerning double tax treaties, withholding taxes deducted at source from income received by the SIF on its investments are normally not recoverable. However, SIFs under the corporate form (disregarding whether they qualify as SICAVs or SICAFs) may benefit from certain double taxation treaties. A SIF under the contractual form may also create a subsidiary in order to benefit from a double taxation treaty.

SICARs

The SICAR is liable to corporate income tax and municipal business tax. Any income arising from securities held by a SICAR, as well as any income arising from the sale, contribution or liquidation thereof shall be exempt from its tax base.

However, no corporate income tax and municipal business tax is due on income deriving from the SICAR's investments in risk capital. Debt funding to subsidiaries of the SICAR must, however, be structured as securities as opposed to a simple loan instrument.

The SICAR is not liable to any net worth tax.

With regard to the investors, there is no withholding tax on dividend distributions and interest payments made by a SICAR except, to the extent applicable, under the Savings Directive.

AIFM

Luxembourg offers a tax regime that is comparable in terms of end-tax figure to the other main EU jurisdictions. An AIFM is prima facie subject to the same overall combined rate of corporation tax as a SOPARFI, ie, in Luxembourg City 29.22 per cent.

Taxable profits are calculated by determining the difference between the AIFM's net assets at the beginning and at the end of a given accounting year, adjusted for capital paid in or withdrawn, dividends, and similar distributions of profits. Taxable profits are generally based on the accounting profits. The tax balance sheet generally corresponds to the commercial balance sheet unless tax valuation rules require otherwise. Profits are taxed on an accrual basis.

It is common practice for the AIFM to determine the fees it charges to the AIF it manages on the basis of the costs and expenses it bears to manage the AIF, to which it adds its own profit margin. In practice, the Luxembourg tax authorities accept this 'cost plus method' to determine the profits, and may confirm their approval of the margin determination mechanism. It is however recommended that the profit margin of the AIF be determined on the basis of a transfer pricing report that complies with OECD standards.

2.6. Customary or common terms

SOPARFIs

SOPARFIs are commercial companies that are not subject to any governance rules other than those set forth in the Law of 10 August 1915 on commercial companies (the 1915 Law). SOPARFIs hold financial participations in any type of underlying assets, including one sole underlying, whether listed or non-listed as well as in investment funds, real estate, infrastructure, etc.

Part II Funds

Part II Funds qualify as UCIs, the principle object of which is the investment in securities other than transferable securities and to all investment funds which are excluded from Part I of the 2010 Law. Part II Funds are subject to the risk diversification and investment limits set forth in CSSF Circular 91/75. Part II Funds may not in principle:

- invest more than 10 per cent of their assets in securities which are not listed on a stock exchange or dealt in on another regulated market;
- acquire more than 10 per cent of the securities of the same kind issued by the same issuing body;
- invest more than 10 per cent of their net assets in securities issued by the same issuing body; and
- borrow more than 25 per cent of their net assets.

The CSSF may produce adapted guidelines for particular types of AIFs or investment strategies such as hedge funds (Circular 02/80), real estate or more recently infrastructure investments (which, subject to regulatory confirmation, would be entitled to a 30 per cent diversification calculated on the total assets of the Part II Fund).

SIFs

SIFs must also comply with risk-spreading requirements. Such requirements have been detailed in Circular 07/309 relating to risk-spreading in the context of SIFs (SIF Circular).

As a matter of principle, a SIF may not invest more than 30 per cent of its assets or commitments to subscribe in securities of the same nature issued by

the same issuer (or hold more than 30 per cent thereof in a cash deposit with the same banking institution). This restriction does not apply to sovereign securities and target UCIs that are subject to risk-spreading requirements at least comparable with those applicable to a SIF.

The CSSF may also adapt the diversification rules on a case-by-case basis, depending on a particular project or a type of investment strategy (including infrastructure-related type, which may, subject to the same reserve as outlined above for Part II Funds, may benefit from a 75 per cent diversification limit calculated on the total assets of the SIF).

In light of the virtually unlimited types of assets in which a SIF can invest, including artworks, hedge funds, real estate, infrastructure or private equity, it was considered important to provide for flexible valuation rules. For that reason, the SIF Law provides that, unless otherwise stipulated in the constitutive documents, the assets of a SIF must be valued at 'fair value'.

Furthermore, SIFs are not required to calculate and publish the asset value per share on a regular basis (although some type of determination of total net assets will have to be performed on a quarterly basis for the purpose of assessing the amount of taxe d'abonnement to be payable on a quarterly basis as discussed above).

SICARs

The SICAR Law does not require any risk-spreading (ie, the SICAR may hold only securities of one single issuer) and does not impose any investment rules or restrictions as regards the targeted jurisdictions, industries or currencies. The SICAR Circular provides that, in principle, all financing modes are eligible.

In addition, there is no prohibition on having a majority stake in an entity or being the sole owner.

As regards the functioning rules of a SICAR and its dividend policy, there are no restrictions on repayments and distribution of dividends. The assets of a SICAR must also be valued by reference to the fair value.

3. RETAIL FUNDS

For the purpose of the developments below, retail funds shall be understood as investment funds whose shares or units may be placed with any person, legal or natural, and which do not impose any specific requirements in terms of minimum investments or ongoing shareholding.

3.1. Common structures

Luxembourg investment funds that may be placed with retail investors can be set up under the form of UCITS or Part II Funds. The main legal forms available are described above and include FCPs and SICAV incorporated under the legal form of an SA. Following the entry into force of the AIFM Law, a particular focus should be made on their respective managers.

In combination with these provisions, different regulatory regimes will indeed be available to managers established in Luxembourg and providing collective portfolio management services to retail funds.

- UCITS management companies; UCITS management companies, as regards their authorisation and permitted activities, remain governed by the UCITS laws. No UCITS management company shall engage in activities other than the management of UCITS with the exception of the additional management of other UCIs. The AIFM Law does not have an impact on these, except for the 'super licence' described below.
- AIFM; This is the licence introduced by the AIFM Directive, which must be obtained by a manager managing and/or acting as management company to one or more Part II Funds and which cannot benefit from the registration regime set forth in the AIFM Directive (or other Full Scope AIFs). Managers managing and/or acting as management company to AIFs with assets below the thresholds set out under section 2.2 can opt in to this regime to have the benefit of the marketing passport which the AIFM Directive confers to AIFM.
- UCITS management companies also authorised as AIFM; This is the 'super licence' permitting a manager to manage and act as management company to both types of retail funds, ie, UCITS and Part II Funds (and any other Full Scope AIFs).
- Other management companies; This is to some extent the equivalent of the former non-UCITS management companies under Chapter 16 of the UCI Law but with extended types of activities under the new Article 125-1 of the 2010 Law. These management companies may, in summary: (i) act as manager or management company to any type of investment vehicle which does not qualify as AIF; (ii) act as management company to one or more FCP, SICAV or SICAF that are Full Scope AIF, provided it has designated, on behalf of that Full Scope AIF, a fully authorised AIFM; or (iii) act as manager or management company to AIFs the aggregate assets of which are less than the above thresholds introduced by the AIFM Directive.

These management companies may however not provide the services under (i) without also providing the services under (ii) or (iii), unless the investment vehicles referred to under (i) are eg, SIFs or SICARs that do not qualify as AIFs (ie, not falling within the scope of the AIF definition set forth under section 1). This restriction aims at avoiding that a management company authorised by the CSSF would solely manage non-regulated investment vehicles such as SOPARFIs.

3.2. Regulatory framework

The main duty of the CSSF consists of the supervision of the UCITS and their compliance with the law and their respective constitutive documents, including their contractual documents, such as the offering prospectus. The set-up of a Luxembourg UCITS requires the approval of the CSSF. The same applies to Part II Funds as detailed above.

An application has to be filed with the CSSF for the registration of the fund on the official list of UCI, which shall comprise *inter alia* material attesting to the professional repute of the directors/managers, the risk management process as well as the constitutive documents of the UCI (articles of

incorporation or management regulations, offering prospectus and UCITS Key Investor Information Document).
A UCITS will have the choice between appointing a Luxembourg UCITS management company or being created as a self-managed investment company. In the first case, the application must indicate the name of the management company. In the second case, the application must contain information on the human and technical resources at the disposal of the investment company and describe the manner in which the management, administration and distribution functions will be monitored according to Circular 12/546.

3.3. Operational requirements

There are specific substance requirements in relation to UCITS management companies in particular as regards capital requirements, management and infrastructure as provided for under Circular 12/546, which has also integrated Circular 11/508 regarding applicable organisational requirements, principles to deal with conflicts of interest, applicable rules of conduct, risk management and the right to provide services on a cross-border basis.

A substantial part of Circular 12/546 is therefore dedicated to the arrangements regarding the central administration and internal governance of UCITS management companies and self-managed SICAV. Circular 12/546 reiterates that the central administration must be established in Luxembourg and specifies that it does not only consist of an ‘administrative centre’, but also of a ‘decision-making centre’. As a matter of illustration, it is now required to have at least two conducting officers being permanently based in Luxembourg. The Circular also contains certain interesting precisions regarding premises, operating staff, delegation and incompatibilities affecting the persons in charge of the compliance function, the internal audit and the risk management.

Any change to the constitutive documents and any change of director or main service providers to a Luxembourg UCITS requires prior CSSF approval.

3.4. Marketing the fund

The UCITS Directive provides for specific arrangements in order to ease the cross-border distribution of UCITS-compliant investment funds.
The notification procedure set out in the UCITS Directive has made the European passport for UCITS more effective, by the introduction of an efficient ‘authority-to-authority’ communication procedure for the cross-border marketing of UCITS or sub-funds within the EU.
The CSSF has also enacted Circular 11/509 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 EU and by a UCITS of another member state of the EU wishing to market its units in Luxembourg.

3.5. Taxation

According to Article 174(1) of the 2010 Law, investment funds existing under the laws of Luxembourg pay a subscription tax at the rate of 0.05 per cent per

annum on their total net assets at the end of each quarter except as stated below.

The same reduced rate of 0.01 per cent per annum and exemptions of subscription tax provided for under Article 174 and 175 of the 2010 Law and developed under section 2.5, apply to retail funds covered in this section.

3.6. Customary or common terms

UCITS may only invest in transferable securities, units of other investment funds, deposits with credit institutions, financial derivative instruments and money market instruments. The transferable securities (meaning securities, bonds and similar securities or instruments) and the money market instruments need to be listed on a stock exchange or dealt in on another regulated market, except that up to 10 per cent of the assets of the UCITS may be invested in non-listed transferable securities.

UCITS must comply with specific diversification and concentration limits specified in Part I of the 2010 Law, which reflect the restrictions imposed by the UCITS Directive. A UCITS may indeed not invest more than 10 per cent of its net assets in securities of the same issuer (diversification limit) and may not acquire more than 10 per cent of the securities issued by a single issuer (concentration limit).

4. PROPOSED CHANGES AND DEVELOPMENTS

AIFs

The alternative investment fund industry is entering into a phase of adaptation to the AIFM Directive. The Luxembourg government, in close collaboration with the CSSF, has used the opportunity of implementing the AIFM Directive to introduce some new flexibility such as the SLP or an attractive carried interest regime for certain managers.

Luxembourg is also currently working on the adaptation of the SICAR and SIF Laws to adapt them to the new requirements of the EuVECA Regulation and of Regulation 346/2013 on European social entrepreneurship funds (EuSEF), which introduce a marketing passport to AIFM managing venture capital funds or social entrepreneurship funds and whose assets under management do not exceed the thresholds set forth under section 2.2. above.

UCITS

The UCITS industry is now focused on the proposal for a Directive amending the UCITS Directive (already known as UCITS V) and which aims at addressing discrepancies between member states (and existing European rules such as the AIFM Directive) in respect of depositary duties and liability and remuneration policy.

As for the depositary regime, the current proposal mostly pastes the provisions of the AIFM Directive, although it does not permit any contractual discharge of liability in the case of loss of assets, which remains permitted under certain strict conditions set forth under Article 21 of the AIFM Directive.

It also seems that the remuneration policy regime that has been adopted in the Parliament's report of July 2013 excludes the caps on performance fees and bonuses. Confirmation on this latter issue will have to be closely supervised in light of the upcoming tripartite discussions between the Council, the Commission and the Parliament. This will be another key issue in the future development of the UCITS brand within the European Union and far beyond.