

Luxembourg Investment Fund Handbook

Investing via Luxembourg

keys for selecting the appropriate vehicle

We have come a long way from times where funds used to be designed to ensure regular income and minimum risks to investors, and, to this effect operated in a similar way, taking long positions on securities listed in developed markets and benefiting from high credit-rating.

The stock market's fluctuation in the 2000's made traditional asset classes less attractive to investors, who began turning to alternative strategies and more aggressive tools such as short sales, financing leverage, arbitrage, over the counter, and investment in emerging markets derivatives, venture capital, high yield and junk bonds...

Since then, the panel of funds has increasingly branched out into **multiple types of schemes with diverging investment strategies:** such as private equity funds, real estate funds, hedge funds, multiple tier structures (funds of funds)...

The uniform set of rules edified until then needed be adapted to this revolution. To this end, many countries, including Luxembourg, conceived diversified set of rules designed to keep pace with the new investment scenario and emerge as an economy with various investment options that would yield optimum benefits.

To avoid getting lost in this booming legal environment, follow this guide...

This handbook has been prepared by Noble & Scheidecker for general guidance only and is based on Luxembourg regulation as on September 2009. Although the greatest care has been taken to ensure that the information contained therein are accurate on the date of publication, Noble & Scheidecker does not accept any liability to any person for the information (or the use or reliance upon such information) which is provided in this handbook or incorporated into it by reference. On any specific matter, please contact us for appropriate advice.

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Choosing Luxembourg

Luxembourg, Leader of European Fund Business

Luxembourg is the **second place worldwide for domiciled funds** just behind **the United States**.

By the end of August 2009 there were as many as 3,449 undertakings for collective investment (“UCIs” including SIFs) and 232 SICARs in Luxembourg. When taking into account the sub-funds of UCIs’ umbrella structures, a total of 10,818 collective investment schemes are active with more than 1,739 billion EUR assets under management.

Approaching 10 % of hedge funds and 20 % of all funds of hedge funds worldwide are domiciled in Luxembourg. Luxembourg is a favored domicile for European real estate vehicles.

Luxembourg is European leader in terms of cross-border distribution of funds and is prime location for retail funds in transferable securities dedicated for cross-border distribution (above 76% of cross-border European funds are domiciled in Luxembourg). Promoters from all over the world (mainly from the United States, Switzerland, Germany and Italy) have domiciled funds in Luxembourg, for marketing throughout more than 140 countries.

4 good reasons for choosing Luxembourg

The success of Luxembourg as an investment destination can be attributed to the country’s business-friendly regulation, combined with a favorable tax environment and expert professional services.

Flexible onshore regulation

Luxembourg’s success in the fund industry can be traced to a strong collective will of the successive Luxembourg governments to build **efficient legislative framework** that supports the development of the

financial centre. It was one of the first countries to issue specific tax and legal rules adapted to funds and was the **first country to implement** the European directive related to UCITS of 1985.

As a Member State of the European Union, Luxembourg is an onshore financial place fully compliant with EU regulation, and attracts investors and promoters seeking investment vehicles subject to a higher degree of regulation than that applied in the offshore islands.

One of Luxembourg's key challenges has been to enact laws which keep pace with the **constantly evolving** fund market. The creation of flexible vehicles such as SICARs for the private equity industry and the SIF for qualified investors are recent examples.

The Luxembourg supervision authority (*Commission de Surveillance du Secteur Financier – CSSF*) is well-known for its **pragmatic and efficient supervision** of the Luxembourg fund industry, and its openness to innovation.

Favorable tax framework

Luxembourg offers a favorable tax framework. Most of collective saving schemes in Luxembourg are exempt from corporate taxes and are subject to very low ancillary taxes. In addition, Luxembourg is part of a great network of bilateral treaties avoiding the burden of double taxation.

International expertise

Luxembourg is centrally located in Europe, which makes it an ideal gateway to access the newly enlarged European markets. Luxembourg is renowned for its multiculturalism and multilingualism, with the workforce coming from many European countries.

Luxembourg provides all the necessary services for the fund industry: custodians, asset managers, fund accountants and administrators, transfer agents, distributors, auditors, legal and tax advisers, information technology specialists...

Strong economy and stable policy

Luxembourg enjoys a reputation of a politically stable and economically prosperous country, with **consistent growth, low inflation and low unemployment levels**.

Apart from the fund industry, Luxembourg is one of the ten largest financial centers in the world, with a highly developed banking and insurance sectors. The **iron and steel industry** plays a key role in the country's economy, followed by **a wide range of business interests**, like chemical and synthetic materials, mechanical construction, electronic supplies, glass industry, wood processing, logistic and airfreight activities. Telecommunications, e-commerce and audiovisual have grown dynamically in recent years. Many major multinational groups from various business sectors are headquartered in Luxembourg.

Luxembourg's gross domestic product (GDP) per capita is the highest in the world¹.

Luxembourg's **political system** shows great stability. Since 1995, the Prime minister has been in power without interruption. This has ensured the continuity of policy implementation. Luxembourg plays a key role in the European Union (twice president of the European Commission). Luxembourg is one of the EU capital cities and hosts a number of EU institutions.

¹ More than 87,955 \$ according to the International Monetary Fund (45,490 for USA).

Choosing a Luxembourg vehicle

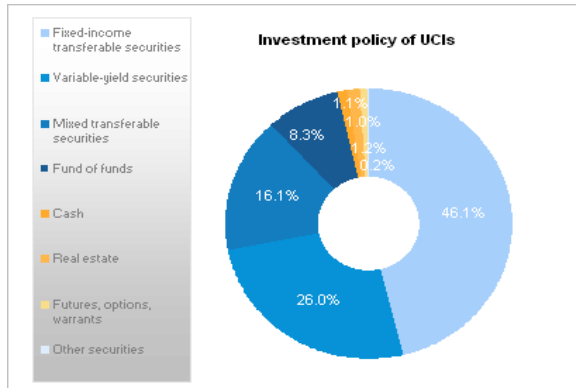
Panel of funds established in Luxembourg

Owing notably to a favourable legal and tax framework, Luxembourg has attracted all types of funds.

The major part of the nets assets is made of **retail funds** (75 % of the net assets). Luxembourg is also home to **hedge funds, funds of funds, real estate funds** and **private equity/venture capital**.

Investment policy of UCIs

Situation as at 30.06.09 (CSSF website)



Investment policy of UCIs	Net assets (in bn EUR)
Fixed-income transferable securities (*)	751.318
Variable-yield fixed income securities (**)	424.300
Mixed transferable securities (***)	262.036
Fund of funds (****)	135.817
Cash	18.644
Real estate	20.064
Futures, options, warrants	15.744
Other securities (*****)	3.333
TOTAL	1,631.256

(*) including EUR 326.792 billion in money market instruments and other short-term securities
 (**) including EUR 3.927 billion in non listed securities and EUR 0.276 billion in venture capital
 (***) including EUR 1.462 billion in non listed securities and EUR 0.324 billion in venture capital
 (****) including EUR 0.186 billion in non listed securities
 (*****) including EUR 0.057 billion in venture capital

What type of fund are you willing to set up?

As a matter of fact, investors choose at first stage the type of assets classes and investment strategy they want to stake on. Below are summarized the main types of funds existing:

Transferable Securities Funds invest primarily in **listed shares, bonds, and other negotiable securities, as well as money market instruments and derivatives**. Their performance is closely linked to that of financial markets.

In Luxembourg, funds investing in transferable securities are referred to as **Undertaking for Collective Investments in Transferable Securities** or UCITS.

↳ UCITS include several sub-types of funds, among which: **Bond Funds** (primarily investing in bonds and debt instruments), **Stock Funds** (investing in equity), **Balanced funds** (or "hybrid funds", investing in both stocks and bonds) and **Income funds** (investing in bonds and preferred stocks that pay regular dividends).

Money Market Funds invest in **short term (one day to one year) debt obligations** such as treasury bills, certificates of deposit, commercial paper and liquidities.

Private equity funds target **illiquid assets such as non listed companies**, usually with the aim of controlling the target; investors in private equity may not enter or leave the fund easily and assume substantial risk from which they expect a long-term higher financial return.

↳ **Venture capital funds** are private equity funds investing in companies which have been recently constituted (start-up), are still in the early development age or are acting in sectors with high development potential (early stage).

Real estate funds (Reif)

focus either on direct real estate assets or real estate-related assets (transferable securities, funds and derivatives whose underlying assets are real estate).

Funds of Funds (FoF)

invest in other funds (UCITS or other funds). Ensure a greater diversification and stability; F3s (fund of fund of fund) structures are also used.

↳ The master / feeder structure is available in Luxembourg. A Luxembourg fund may invest 100% of its assets (the feeder fund) in a foreign fund (the master fund) if the following requirements are met:

- the master fund must be open-ended
- the custodian of the feeder fund must have a transparent right of regard on the assets of the master fund
- the prospectus of the feeder fund must contain specific provisions (notably, in case the promoter of the feeder fund is the promoter of the master fund, the nature of the fees that may arise)
- other conditions on a case-by-case basis

Hedge funds

A hedge fund is a speculative fund seeking high returns and relying heavily on derivatives, and in particular options or futures. Hedge funds use leverage and commit capital in excess of their equity

Sophisticated funds:

Those funds are reserved to institutionals, professional investors and high-net-worth individuals. They benefit from a more flexible regulation compared to retail funds.

Retail funds:

Those funds are open to retail investors

Many other reasons may support the creation of a specific fund such as the geographical allocation of assets classes (Europe, USA, emerging markets...), the type of management (value, growth..²), the market value of the issuing companies (large-caps, mid-caps, etc³), and the investment criteria (**sector funds** invest in companies in a specific sector like automotive, technology, ..., **socially responsible funds** aim to invest in companies that adhere to certain principles: "green funds", funds supporting workplace diversity,...)

The Luxembourg legislation offers a wide range of solutions that allow to set-up any types of funds and provide promoters with tailor-made business models.

² **Growth Funds** invest in stocks believed to be the fastest growing companies in the market, **Value Funds** invest in large and mid-sized companies that appear to be overlooked or out of favor and **Blend Funds** are a "blend" of both growth and value stocks.

³ **Large-Cap Funds** - These funds invest in companies whose market value is large. These funds tend to be well-established corporations and tend to pay dividends, **Mid-Cap Funds** - These funds invest in mid-sized companies whose market value is more in the range of \$1 billion to \$9 billion., **Small-Cap Funds** - These funds invest in emerging companies whose market value, is less than \$1 billion. These companies tend to use profits to grow rather than pay dividends.

Legal structures available – overview

Luxembourg offers a wide range of vehicles adapted for each type of investments.

SIF ⁴	flexible vehicle for sophisticated investors , suited for any kind of fund policy: hedge funds, private equity, real estate, transferable securities, bonds, debts instruments... with light constraints in terms of risk-spreading
SICAR ⁵	flexible vehicle dedicated to high-risk investments of sophisticated investors such as private equity/venture capital investments ⁶ with no risk-diversification rules applying
UCI ⁷	investment vehicle that may be offered to all type of investors and invest in all type of assets with a more regulated environment than SIFs and SICARs.
European UCITS ⁸	open-ended UCI investing solely in listed transferable securities, units of other open-ended UCIs, money market instruments, deposits (< 12 months) and/or derivatives (eligible assets) , benefiting from the European Distribution Passport but subject to high investments restrictions (e.g. diversification and borrowing policy)

Key elements for choosing a vehicle - FAQs

The choice of a legal vehicle will depend on the combination of several factors. Preliminary questions during initial thinking phase:

Investors targeted **Retail investors:** European UCITS or UCIs may be offered to retail investors whereas the shares/units of SIF or SICAR are marketed for well-informed investors.

⁴ Specialised Investments Fund, introduced in Luxembourg in February 2007

⁵ *Société d'investissement à capital risque*, created by the law of June 15, 2004 concerning venture capital and private equity investment companies

⁶ However not hedge funds

⁷ Undertaking for Collective Investment, regulated by part II of the law of 20 December 2002

⁸ Undertaking for Collective Investment in Transferable Securities, regulated by the European Directive 85/611/EEC Directive and Part I of the UCI law

Cross-border distribution in Europe: The European UCITS will be the ideal vehicle for cross-border distribution to retail investors within Europe as it benefits from European Distribution Passport. Closed-ended UCIs benefit from Prospectus Passport.

Institutionals professional investors and high net worth individuals: SIFs and SICARs are dedicated to those sophisticated investors. They benefit from a lighter supervision compared to European UCITS and UCI.

Investment policy

Investment in private equity / venture capital: SIFs, UCIs and SICARs may be appropriate vehicles:

The SICAR offers advantages for this kind of investment policy:

- No risk diversification rules
- Private equity and venture capital assets are eligible for a SICAR
- All types of financing are accepted (bonds, loans, mezzanine loans...)

SIF structured as umbrella funds often have a compartment dedicated to private equity. This vehicle is attractive for this investment policy because:

- May invest in non-listed securities;
- Is submitted to light diversification rules;
- May be shaped for a large panel of different fund raising models
- Grants loans to third parties

Investment in real estate or in derivatives SIFs, UCIs and SICARs under certain conditions are eligible vehicles for this kind of investment policy

The SIF is especially designed for these kind of investment policy because of the following key advantages:

- No « fiduciary duties » for the custodian
- Possibility to appoint a sub-custodian or a prime broker
- Level of leverage up-to 400% of its net assets
- Valuation of the assets at fair value or based on professional methods of a specific industry

Investment in listed transferable securities European UCITS UCIs SIFs and SICARs under certain conditions may opt for this investment policy. The choice will notably depend of the other factors detailed below.

Level of diversification for the investment

Investment vehicle with no diversification rules: The SICAR may invest 100% of its net assets in a single target.

Low level of diversification: The SIF may invest up to 30% of its net assets in the same instrument issued by the same issuer.

High level of diversification: The European UCITS may only invests up to 10% of its net assets in security issued by the same issuer.

Structure

Umbrella fund: European UCITS, UCIs, SIFs and SICARs may be structured as an umbrella fund.

Master / feeder structure: UCIs, SIFs and SICARs may be structured as master/feeder structure.

Level of supervision

Regulated vehicles: European UCITS, UCIs SIFs and SICARs fall under the supervision of the CSSF.

High level of supervision: European UCITS and UCIs are regulated vehicles which comply with the European standards.

Flexible supervision: SIFs and SICARs benefit from a light regulation which responds to the need of the sophisticated investors.

Fund raising

Capital calls: SIFs and SICARs may issue partly paid-up shares which need only to be paid up at 5%. Only 5% of the subscription per share needs to be paid up, making it easier to make capital calls.

Marketing strategy

All vehicles, except European UCITS may make private offering.

Listing: All vehicles (including SIFs and SICARs, which are merely offered to well-informed investors) may be listed.

Valuation of the assets

Valuation at probable disposal: Shares/units of UCIs and European UCITS must be valued at last quotation value (where listed), otherwise at probable disposal value.

Valuation at fair value or based on valuation methods established by professionals: The valuation of the assets of the SIFs and the SICARs may be at fair value or based on the valuation methods established by professionals association like Royal Institution of Chartered Surveyors guidelines for real estate funds.

Granting of loans and/or financial guaranties

All vehicles except European UCITS may grant loans and act as guarantors for third parties.⁹

European UCITS are nevertheless entitled to invest in debt instruments, acquire partly paid instruments and enter into securities lending transactions (under specific conditions).

Legal personality and transparency

Legal personality: depending on the most efficient tax planning built up:

- funds may be set-up under the corporate form. SIF, European UCITS and UCIs set-up in a corporate form so called “SICAV” if with variable capital or so called “SICAF” if with fixed share capital. This type of fund will benefit from the legal personality.
- All vehicles, except SICARs, may be set-up under the contractual form. Those funds are so called “FCP” or common fund. They have no legal personality and are acting through their management company.

Tax transparency:

- All vehicle may be considered as opaque if set-up under the corporate form (except if a limited corporate partnership SCS)
- The SICAR if incorporated as a SCS and the other vehicles if set-up as a FCP will be considered in Luxembourg as

⁹ However, UCIs and SIFs organized as FCP are not authorized to grant loans to unitholders.

tax transparent thus a look-through entity at the fund level:

- no capital gain tax or income tax
- no withholding tax on the distribution made by the FCP
- no transfer tax applies to the issue of the units
- investors might benefit from home country treaty

The investors may therefore analyse their tax position for the returns received from the underlying assets and their own country of residency.

Retail investors ?	UCI Part II/ European UCITS
No eligible promoter ?	SIF / SICAR
No risk-spreading ?	SICAR
Closed-ended ?	SIF, SICAR, UCI Part II
Need for leverage ?	SIF, SICAR, UCI Part II
Need for flexibility in calculation of issue/redemption prices?	SIF / SICAR
Need for European Passport for your fund?	European UCITS
Need for a European Passport for your prospectus?	closed-ended SIF/ closed-ended SICAR / closed-ended UCI
Master / feeder structure ?	SIF / SICAR / UCI Part II
Umbrella funds?	European UCITS / UCI Part II / SIF / SICAR

Implementation process

Investing in Luxembourg entails going through the following steps:

- step 1 **Select a type of vehicle adapted to project:** travel through the guiding grid of criteria above and have positive returns (commitment letters) from potential investors
- step 2 **Customize vehicle selected**
- choose a **contractual form** (FCP¹⁰) or **corporate form**
 - if corporate form, also choose
 - **whether a fixed capital or variable capital is needed** (SICAF or SICAV) in a structure with variable capital, the amount of share capital automatically increases or decreases when shares are issued or redeemed, whereas the modification of the share capital of a SICAF requires a decision of the general meeting¹¹ and a notarial deed¹²
 - **a legal corporate form:** depending on the type of fund, several types of corporate companies may be offered, among which:
 - public limited companies (*société anonyme* or *SA*);
 - partnerships limited by shares (*société en commandite par actions* or *SCA*);
 - private limited companies (*société à responsabilité limitée* or *SARL*).
- step 3 **Involve professionals**
- promoter (not required for SIFs, SICARs)
 - management company (mandatory for a FCP)
 - custodian
 - independent auditor

¹⁰ similar to unit trusts

¹¹ or of the board of directors in case of authorized capital

¹² In addition, the shares of a SICAV must be (i) fully paid up and (ii) issued and redeemed at a price based on net asset value, whereas the shares of a SICAF may be partly paid up and may be issued and redeemed at another price.

- other service providers, e.g. investment advisor, transfer agent, listing agent, prime broker...

↳ A standard way to proceed is to appoint a Luxembourg bank specialized in private banking which will offer a complete panel of fund management services (custody, transfer agency, paying agency, registry agency, book keeping etc...). Via its network of affiliated companies, this bank will recommend or provide some management companies and agents to carry out the administration of the fund.

step 4 **Start of drafting of the documentation**

constituent documentation of the fund:

- offering document / prospectus
- where the fund is under corporate form: articles of incorporation, shareholders' agreement where necessary, other documentation (first general meeting of shareholders, ...);
- where the fund is under contractual form : management regulation agreement with the management company.

agreements with professionals : custodian agreement, investment management agreement (between the fund and the management company), investment advisory agreement, transfer agency agreement, paying agency agreement...

subscription agreement with investors

step 5 **Start compiling the application file for the CSSF**

The file notably includes the draft constituent documents and agreements with main professionals (custodian, management company, central administration, listing agent agreement...).

(Where applicable) preparation of application file for IPO on the Luxembourg Stock Exchange (if listing contemplated)

step 6 **Hold initial informal meeting with the CSSF**

hold also an informal meeting with the Luxembourg stock exchange (if listing contemplated)

- step 7 **Check compliance with marketing restrictions in jurisdictions where investors are to be targeted**
- step 8 **Apply before the CSSF** in principle within one month following the setting up of the scheme and in any case before starting the activity (except in the case of SIFs)
- step 9 **Set up the fund**
- the constitution of a corporate entity need to be enacted in front of a Luxembourg notary public, registered in the Luxembourg trade register and published with the Luxembourg official legal Gazette (Memorial C)
 - the management regulations of the FCP must be registered in the Luxembourg trade register and published
- step 10 **Execute the agreements with professionals**
- step 11 **Launching**
- the CSSF will grant its approval to the fund and inscribe it on the official list of Luxembourg funds.

Involving professionals

Launching a regulated fund in Luxembourg will require the involvement of multiple players, under the supervision of the regulatory authorities.

Promoter

While approving a **UCI or European UCITS**, the CSSF will consider the reputation, experience and financial standing of its promoter, i.e. the entity having originated the constitution of the fund and which effectively determines the policy and course of action of the fund.

The CSSF often also requires that a majority or at least a part of the directors of the SICAV or of the management company of the FCP be provided by the promoter.

The name of the promoter must as well be disclosed to the investors in the **prospectus**.

The promoter is held liable towards the investors for any default or misconduct in the management and administration of the fund.

↳ SIFs and SICARs need not be promoted by an entity with significant financial resources (and the name of the promoter, if any, need not be disclosed). This is of great advantage especially in the hedge fund sector.

Management

Management tasks

The management of a fund covers three main sets of activities:

- Central administration**
 - keeping of **accounts** and accounting documents
 - calculation of net asset value
 - issuance and redemption of shares/units: determination of the price, preparation of subscription and repurchase contract notes and shares/units certificate, dispatch of such notes and certificates;
 - maintaining of the register of shareholders/units holders
 - financial reports and all documentation intended for investors
 - printing / mailing marketing documents for investors
 - storage of main legal documentation of the fund
 - fund domiciliation

- Investment management**
 - managing of the investment portfolio of the fund
 - decision-maker usually on a discretionally basis for acquiring / disposing of the assets

- Marketing of the shares/units** - distribution of shares/units

Responsibility for the management

Legal corporate officers

in case a Luxembourg fund is structured as a **corporate entity** (SICAV, SICAF,) (e.g. for a *société anonyme*: directors or for a *société en commandite par actions* : *general partner*), the legal officers¹³ are scrutinized by the CSSF at the time of setting-up of the fund. The CSSF will have to assess their good repute and expertise in the type of fund concerned (especially for hedge funds, venture capital/private equity funds, real estate funds).

Management company where the Luxembourg fund is organized as a FCP. The management company must be a regulated entity submitted to the supervision of the CSSF.

If the management company manages at least one European UCITS, it will be subject to a heavier supervision but will benefit from the European Passport for its activities.

↳ The management of a fund, though organized as a corporate entity (SICAV, SICAF), may also be delegated to a **management company**¹⁴.

¹³ For European UCITS and UCIs: not only legal officers but also any person which effectively determines the conduct of the activities of the vehicle shall be approved by the CSSF.

¹⁴ A European SICAV or SICAF must either appoint a management company or "perform itself all the central administration tasks

Outsourcing

Central administration may be outsourced to one or several service providers. Depending on their activities, services providers are (or not) regulated companies and may under certain conditions be located abroad.

Nature:

Central administration:

- **administrative agents** : provide administrative services forming an integral part of the business activities of the fund.
- **client communication agents**: confidential documents for clients
- **registrar agents** : keep the shareholder's register registry, including receipt and execution of transfer orders

Distribution

- **distributors** : collect subscriptions and redemption orders and/or make payments in this respect
- **nominees** : subscribe to shares/units of the fund in their own name but for the account of the investors
- **market makers**: subscribe to shares/units of the fund in their own name and at their own risk and re-sell them to investors

Investment management

- **investment managers**: manage investment portfolio
- **investment advisors**: advise the investment manager in the choice of the investment.

Other

- **primary and secondary IT systems operator¹⁵**: run IT systems and communication networks
- **prime broker**: are usually involved in hedge funds schemes for a panel of services including the performance of transactions on the assets of the fund, financing of the fund against collaterals taken over the assets of the hedge funds.(margin trading and securities lending).
- **paying agents, brokers, placement agent etc....**

¹⁵ operators of financial sector information technology systems and communication networks

Limits

The CSSF requires that services relating to the same task be carried out by the same service provider (e.g. the execution of issues and repurchases and the keeping of the participant register must be entrusted to the same service provider).

Outsourcing abroad

The following tasks may be carried out from abroad:

Investment management: investment and disinvestments decisions may be made abroad, and foreign investment advisers may be involved (in particular, where assets are located).

Distribution of shares/units : foreign intermediaries may be appointed for the placing and repurchase of shares and participate in issue and repurchase operations as distributors, nominees or market makers, provided notably that the investors are able to deal directly with the fund.

Specific tasks of the central administration (under specific conditions):

- the IT processing unit used for the accounting, the calculation of the net asset value and the holding of participants' register may be located abroad
- Financial information may be entered in the remote-access computing network by portfolio managers or other service provider located abroad, however, the allocations, apportionment and provision necessary for finalizing the calculation of the NAV must be performed in Luxembourg.
- technical and physical aspects of preparation of prospectus, financial reports and other documents intended for investors, such as printers or other service providers in relation to the physical delivery of such documents may be established abroad.
- dispatching of prospectus, financial reports and other documentation to investors may be carried out from abroad provided such tasks are performed under the continuing supervision of the central administration of the fund in Luxembourg, which is responsible for the strict compliance with confidentiality of the data.

Custodian

The custodian of a Luxembourg fund must be a **Luxembourg credit institution or a Luxembourg branch of a credit institution domiciled in any European Union Member State.**

The custodian has to be approved by the CSSF while approving the scheme. Generally, the CSSF license is kept by the depositary after the approval given by the CSSF for the first fund.

The custodian and the fund must ever be two separate entities. In practice however, it is admitted that the legal officers of the fund (or of the management company) be located with the custodian. Usually the management company and the investment managers belong also to the group of the custodian except for private equity / hedge funds for which the investment management is granted to the sponsor.

Responsibilities

Custody of assets

This role includes:

safekeeping of the assets: the custodian of the fund is in charge of the material custody of the assets. However, under Luxembourg regulatory provisions, safekeeping shall be understood as the supervision of the assets, which means that the custodian must know at all time how the assets of the fund are invested in and where the assets are located. As a result the custodian may recourse to sub-custodians which will keep the assets.

Monitoring of operations

Except in cases where the fund assumes the form of a SIF or SICAR (unless otherwise stated in the constituent documents), the depositary must control that

- the issuing and repurchase of units comply with the constituent documents and the regulatory rules

- the counterparts of the operations made by the fund are well remitted within the usual time limit
- the fund uses its returns according to its constituent documents
- the instructions of the management company comply with laws and management regulation (for FCP only)
- NAV calculation complies with laws and management regulation (for FCP only)

↳ In a FCP, the depositary carries out the day-to-day management of the assets (collection of dividends...)

A lighter role is conferred to the custodian of SIFs and SICARs.

Use of Prime Broker by a SIF

A SIF adopting alternative investment strategies (hedge funds) may use the services of a prime broker.

Such a prime broker designated by the SIF must be accepted by the custodian of the SIF who organizes its relationships with the prime broker.

In this respect, the custodian ensures only that the prime broker is:

- a financial institution under the control of a supervision authority of a State having a supervision regime recognized as equivalent to that provided by the EU legislation.
- a Financial institution recognized and specialized in this type of operation.

In its relationships with the prime broker the custodian has a right of information (he must be able to obtain from the prime broker, at any time, the information on the composition and the value of the assets) and a right of intervention on the assets entrusted to a prime broker.

However, the custodian is not entitled to know which correspondents of the prime broker hold ultimately the assets of the SIF.

For the sake of information to investors, the marketing documentation of the SIF (including the issuing document) using a prime broker must describe adequately the involvement of the prime broker and the related risks such as the counterparty risk.

Independent fund auditor

Who A member of the Luxembourg “Institut des Reviseurs d’Entreprise” (independent auditor) must be appointed at the incorporation / creation of the fund. The choice of the independent auditor needs to be approved by the CSSF.

Liabilities The independent auditor plays a key role in the supervision of the investment policies and organization of the fund not only upon the audit of the accounting aspects, but also on the operational aspects that must comply with all the Luxembourg regulatory provisions.

Functions:

- to **review the annual accounts**
- to review the **activities and the compliance with the domestic rules** (banking secrecy, anti money laundering, etc)
- to carry out **specific reporting duties to the CSSF** : the auditor must report promptly to the CSSF any fact or decision of which it has become aware and which is likely to constitute a material breach of law or of the regulations; lead to a refusal to certify the accounts or to the expression of qualifications thereon, etc.

↳ In real estate funds organized as UCI, an independent appraiser must be appointed for the valuation of the properties (once a year + at each new acquisition/sale of property).

Fixing figures: capital and portfolio

Capitalization

UCI and European UCITS	Net assets / share capital = EUR 1,250,000 to be reached within six months as of approval EUR 300,000 to be reached at the date of approval for European UCITS under the form of a SICAV or SICAF which has not appointed a management company SICAV: shares must be fully paid up at incorporation; SICAF: may issue partly paid up shares
SIF	FCP: net assets = EUR 1,250,000 or SICAV/SICAF : share capital + share premium: EUR 1,250,000 to be reached within 12 months as of approval (only 5 % of each share must be paid up in cash or kind)
SICAR	Share capital EUR 1,000,000 to be reached within 12 months as of incorporation (only 5 % of each share must be paid up in cash or kind , making it easier for private equity funds, for example, to make capital calls)

↳ Whatever the type of the fund, the capital may be denominated in any currency

Valuation : NAV calculation

Definition	The NAV is defined as being the value per share resulting from the total net asset value of the undertaking divided by all outstanding units/shares (including any additional costs).
Calculation frequency	<p>Shares/units of UCIs and European UCITS must be issued (and redeemed, where applicable) at NAV (+ commissions/fees)¹⁶.</p> <p>NAV of UCIs must be determined and published at least once a month¹⁷; NAV of European UCITS must be calculated and published at least twice a month.</p> <p>There is neither a mandatory requirement to subscribe and redeem at NAV for SIFs and SICARs, nor to publish it (except in the annual report). Valuation of the assets of a SIF needs only to be performed once a year to support the annual financial statement processes. Valuation of the assets of a SICAR must be published twice a year if requested by investors.</p>
Methods	<p>UCIs and European UCITS: listed securities: last known stock exchange quotation; otherwise: probable realization value</p> <p>SIFs: method detailed in constituent documentation, which allows the reference to some alternative valuation methods published by recognized professional association such as EVCA RICS or TEGOVA.</p> <p>SICARs: foreseeable sales price estimated in good faith</p>

¹⁶ Except for UCIs with fixed capital (SICAF)

¹⁷ However once a year for real estate funds + at each acquisition/sale of property

↳ A specific set of rules becomes applicable in case of NAV calculation errors, which aim at (i) informing the custodian, promoter, investors and CSSF (ii) correcting the error and (iii) indemnifying the investors and/or UCI. Other rules aim at protecting funds and investors against late trading and market timing practice, which may include valuation of securities at fair value.

Diversification rules

SIFs, UCIs and European UCITS must comply with quantitative risk-spreading rules, described below. However, more flexibility may be left to SIFs and UCIs (with regards notably to the quality of the investors and promoter) and to a certain extent to European UCITS.

SICARs need not to diversify their investments.

European UCITS

- *transferable securities - money market instruments:*

- only listed securities (or in the process of being listed); money market instruments need not be listed if specific conditions are met

- up to 10% in securities of the same type issued by the same issuer (this limit may be increased in specific cases, e.g. to 35 % for securities issued or guaranteed by a European Member State); the total amount of securities in which the fund invest more than 5% of its net assets may not exceed 40% of the net assets)

↳ other thresholds have to be applied

- *shares/units of other open-ended funds:*

- up to 20% of net assets in the same fund and no more than 25% of the shares/units issued by the same fund

- up to 30 % of net assets in funds other than European UCITS

- investments in funds of funds (i.e. funds investing more than 10% of their net assets in other funds) are not authorized

- *deposits*

- only deposits < 12 months and redeemable on demand

- up to 20% in deposits kept by the same credit institution

- *derivatives*

- only derivatives listed or negotiated on a regulated market, OTC (under specific conditions) or embedded derivatives
- underlying assets must be transferable securities (listed or in process of being listed) and money market instruments, shares/units of other open-ended funds, deposits, financial indices, interest rates, foreign exchange rates
- the same limitation as for direct investment apply. In addition, the global exposure may not exceed the total net value of the portfolio (the calculation of the global exposure must comply with specific requirements, notably with regard to the counterparty risk)

↳ up to 20 % of net assets in transferable securities + money market instruments + deposits + counterparty risk in the same entity/group ; up to 50 % in liquid assets (money market instruments + deposits)

↳ up to 10 % in other asset classes, but no investment in precious metals

UCI

- *investing in transferable securities (but not European UCITS)*

Up to 10 % of net assets invested in non listed securities

+ up to 10 % of net assets invested in securities issued by the same issuer

+ up to 10% of the securities of same type issued by the same entity

- *investing in other open-ended funds (FoF)*

the triple limitation of 10% is not applicable if the target funds are subject to risk spreading rules similar to that required for Luxembourg funds.

- *private equity / venture capital*

i.e funds with up to 20 % of net assets invested in venture capital/private equity:

< 20 % of net assets in the same issuer

- *real estate*

up to 20 % of net assets in the same real estate asset

- *hedge funds organized as UCI*

transferable securities and money market instruments:

- no more than 10 % of global assets in non listed transferable securities and money market instruments
- no more than 20 % of global assets of same type in securities of the same entity
- no more than 20 % of securities of same type issued by same entity

derivatives (including OTC)

- no more than 5% of global assets in the same instrument
- not more than 20 % of global assets in the same type of instruments
- globally no more than 50 % of global assets

SIFs

On a case-by-case basis but generally up to 30 % per issuer (or the aggregate value of commitments) in securities of the same type of the same issuer or in the same asset.

Short sales may in principle not result in the SIF holding a short position on securities of the same type issued by the same issuer representing more than 30 % of its assets. A similar level of risk spreading as that applicable in case of directive investment must be ensured through diversification of underlying assets.

Borrowing rules and leverage

Luxembourg funds may have recourse to borrowing, below are specified some specific guidance issued by the CSSF.

European UCITS	In principle: no borrowing. European UCITS may temporary borrow until 10 % of their net asset for the redemption of their shares or for the acquisition of real estate necessary to their activities and acquire foreign currencies by means of back-to-back loans
UCI – general rules	up to 25 % of net assets authorized without specific authorization of CSSF (including for the purpose of investment); upon authorization of CSSF when exceeding 25 % of net assets (debt funds)
UCI- real estate funds	Up to 50 % of the valuation of all the properties
UCI- hedge funds	only with specialized lenders up to 200% of net assets (up to 400% in specific cases)
SIF and SICAR	No specific guidelines, but subject to the control of the CSSF.

Registrating and reporting

CSSF supervision

Initial authorization

Funds established in Luxembourg have to be **previously authorized** by the CSSF and registered on an official list. The granting of the license is published in the Luxembourg Official Gazette.

The CSSF scrutinizes notably the curriculum vitae of the directors and officers, the choice of custodian, independent auditor, and agents, the constituent documents and agreements and the financial resources of promoter.

In addition, open-ended UCIs must submit to the CSSF and publish a **prospectus** at their setting up with mandatory format. European UCITS must in addition publish a **simplified prospectus**.

On-going supervision

Investment funds are basically submitted to the continuous supervision of the CSSF

Regular information has to be provided to the CSSF as well as any changes to the documents and information contained in the application file.

The CSSF has the right, at any time either directly or through an intermediary to examine the books and records.

Accounting requirements and financial reports

Funds are required to prepare periodically the following reports:

Annual report

An annual report (also known as short form report) audited by the external auditor must be published within four months (six months for a SIF) as of the end of the financial year and sent to the CSSF.

The annual report must notably include details on the fund's activities, a statement of assets and liabilities in accordance with International Standards on Auditing (ISA no700), a detailed income and expenditure account, and information on NAV per share/unit, portfolio, etc. In case the fund is under a corporate form, the annual report has to be registered at the Luxembourg Trade and Companies Register.

Semi-annual report

A non-audited semi-annual report must be published within two months following the financial year end and sent to the CSSF.

The content is lighter than the annual report.

SIFs and SICARs are not required to prepare a semi-annual report

Long form report

The fund auditor must deliver to the directors and CSSF his report highlighting the auditors' findings during the course of the audit relating to the financial and organizational aspects (central administration, custodian relationship and other intermediaries such as the investment managers etc.). The report is not intended to be disclosed to the investors.

Here again SIFs are not required to prepare a long form report which is a very appreciated flexibility of the rule.

Professional rules and KYC

Funds and professionals involved in an investment fund scheme are subject to general professional rules.

Internal procedures and organisation

Funds and other professionals shall evidence sound administrative and accounting internal procedures, control and safeguard arrangements for electronic data processing, logistics for safeguarding of funds and instruments belonging to investors.

Relations with Investors

Funds and other professionals must act in the best interest of the investors and preserve the integrity of market, make adequate disclosure of relevant information in dealings with investors, minimise conflicts of interests, etc.

KYC and cooperation with authorities

Funds and professionals are required to identify their investors and, as the case may be, the individuals benefiting from the transaction (so-called Know Your Customer procedure). They have a cooperation duty with the authorities regarding anti-money laundering. However, identification is not required from funds investors or distributors which are national or foreign institutions subject to at least equivalent money laundering regulation and supervision.

Secrecy

Funds and other professionals are required to keep secret any information transmitted to them. Disclosure of such information is punishable by penalties/imprisonment. The obligation to maintain secrecy ceases however where disclosure is required by law.

Marketing

Prospectus

Luxembourg funds are basically required to have a prospectus or an offering document duly approved by the CSSF for the marketing of their units/shares in Luxembourg. The type and the content of prospectus vary depending on the type of fund or of the redemption possibilities of the fund (open-ended/closed-ended).

Prospectus

UCITS and UCIs as well as closed-ended SIFs and SICARs (under certain conditions) must issue a prospectus. UCITS must in addition issue a simplified prospectus.

The prospectus must notably contain detailed information on the investment policy, restrictions and the risks related to the fund. The prospectus must also contain information regarding the management company and any delegation possibilities. The content of the prospectus draws-up an executive summary and then a comprehensive description of the fund.

Under certain conditions UCIs may be exempted from issuing a prospectus. For example UCIs are not obliged to issue a prospectus if:

- the offer is addressed to less than 100 investors or to sophisticated investors only; or
- the global value of the offer does not exceed EUR 100,000 over 12 months; or
- the UCI is closed-ended and does not market its shares/units in any manner.

Offering document

SIFs (if they do not issue a prospectus) and SICARs must issue an offering document. This document must include the information necessary for the investors to make an **informed**

judgment of the investment offered and, in particular, of the risks attached thereto. Compared to the prospectus, the description of the investment policy, the investment restrictions and the risk factors may be less detailed. There is no mandatory content required by law but it is market practice to use the quite same form as for the other funds which also facilitates the examination of the CSSF examiner in charge to approve the document.

European Passport

Cross-border marketing of funds established in Luxembourg is facilitated by (i) the European Distribution Passport (for European UCITS only) and (ii) the European Prospectus Passport (for all closed-ended vehicles).

European Distribution Passport

Marketing units of **European UCITS in** other EEA countries¹⁸ is rather straightforward:

- information to the CSSF
- notification to the foreign supervision authority¹⁹
- arrangements in the host country for redemption orders, payments and information to investors
- translation of documents intended for public (prospectus and reports) into a language authorized under local jurisdiction

Marketing may begin after two months:, unless local authorities contest marketing arrangement in the meantime (they may however not challenge prospectus or constituent documentation).

European Prospectus Passport

Since the Prospectus Directive units of **closed-ended UCIs, SIFs and SICARs** may be marketed in other EEA countries on the basis of the prospectus initially approved in the home member state country of the fund.

However, each host member state jurisdictions may provide for additional requirements depending on certain local fund industry specificities.

¹⁸ EU Member State and Island, Lichtenstein and Norway

¹⁹ including an attestation of the CSSF of its quality of European UCITS, constituent documentation, prospectus and simplified prospectus, last annual and semi-annual report, details of the arrangements made for marketing in the relevant Member State

Marketing of foreign fund in Luxembourg

European UCITS

European UCITS domiciled in other EEA countries may market their shares in Luxembourg by following a simple set of formalities:

- information to domestic authorities and notification to the CSSF (idem as above)
- appointment of a credit institution established in Luxembourg to ensure that facilities are available for payments and repurchases
- publication in Luxembourg of the documents and information published in the home country; if not prepared in English, French or German: translation into one of these languages

↳ European UCITS must comply with Luxembourg requirements with respect to consumer protection.

Other open-ended funds: Open-ended funds, whatever their country of origin, may be marketed in or from Luxembourg if:

- they are subject to permanent supervision in their home country
- they are authorized by the CSSF
- they appoint a credit institution established in Luxembourg to ensure that facilities are available for redemptions and payments upon shares/units

↳ Open-ended foreign funds may however be offered in Luxembourg through private offer without respecting the above requirements.

Closed-ended funds

Closed-ended funds, whatever their country of origin, may market their shares in Luxembourg with the only condition that they have a prospectus approved by the CSSF and published, unless:

- the offer is addressed to less than 100 investors or to accredited investors only, or the global amount of the offer does not exceed EUR 100,000
- the fund benefits from a European Prospectus passport delivered in another EEA countries.

Listing in Luxembourg

Luxembourg has established a flexible framework of financing opportunities through two main types of capital markets:.

Two markets

The **Luxembourg Stock Exchange main market** is mentioned on the list of EU regulated markets; the procedure for cross-border offer of securities is made very simple with the added advantage of the European Prospectus Passport.

The **Euro MTF market** allows more flexibility for accounting standards adopted by the issuer, since there is no obligation to comply with IFRS or equivalent accounting standards and the financial reporting obligations are less stringent.

Application to main market

The listing is subject to **CSSF's approval** of the prospectus and the publication thereof, and admission by the **Luxembourg Stock Exchange (LSE)**.

The application for a listing on the LSE and the application for approval of the scheme by the CSSF can be made simultaneously. The format of a prospectus varies according to the market chosen and the vehicle.

↳ Units/shares of open-ended foreign funds may be listed whatever the domicile country of the fund. However, the offering of such shares/units must comply with the rules applicable for marketing.

Optimizing tax

The tax treatment of Luxembourg fund mainly depends on the legal structure chosen.

UCIs, UCITS and SIFs

Taxation of vehicle:

UCIs, European UCITS and SIFs are subject to an annual **subscription tax equal to 0.05 %** of their net assets (0.01 % for SIF and institutional investors in UCI and European UCITS). Shares of other funds are excluded from the tax basis. The tax is quarterly payable based on the NAV.

Benefit of Double Tax treaties

Funds incorporated under the contractual form (FCP) in general terms do not benefit from the tax treaties concluded by and between Luxembourg and other countries, whereas treaty protection may be available in some limited cases for funds incorporated under the corporate form (SICAV/SICAF).

Withholding taxes on dividends – capital gains

Dividend and capital gains are not subject to withholding taxes in Luxembourg, except in specific cases²⁰.

VAT

Management services are VAT exempt

Tax Planning

As the UCI, European UCIT or SIF are basically in a Luxembourg tax - free environment, there would be at first sight no need to apply further tax planning. Nevertheless, if the underlying investments would generate income which would be subject to withholding tax one may wish to interpose a fully taxable subsidiary company in an appropriate jurisdiction and so as to be able possibly to reduce or even avoid withholding taxes becoming due. Further tax optimisation may be achieved by having the UCI, European UCIT or SIF making investments through fully taxable subsidiaries benefiting from tax treaties and/or from the EU Parent Subsidiary Directive (CE 1990/435), as amended.

²⁰ i.e when the European Savings Directive applies, i.e. for dividends and interests paid by European UCITS or FCP investing in transferable securities to investors in the EU

Likewise, if there would be tax constraints at the level of the investors who are investing in UCI, European UCIT or SIF, one may consider interposing an appropriate vehicle in between the UCI, European UCIT or SIF on one end and the investors on the other hand and so as to try to lower the tax burden at the level of the investors and / or to be able to convert the nature of the income in a type of income which would be relatively low taxed in the country of residence of the investors (e.g. conversion of recurrent income into capital gains).

SICAR

Taxation of vehicle:

In principle, SICARs are subject to **corporate income tax and municipal business tax** (in principle at an aggregate rate of 28.59%). Income and capital gains derived from securities assets, as well as income from temporary liquid assets pending investment in risk capital²¹ are not included in the taxable basis. Income received from Luxembourg fully taxable companies are in principle subject to a withholding tax of 15 % but exemptions are set forth if at least 10 % or more than EUR 1,200,000 of the issuing company is held during 12 months or more by the SICAR.²²

Where the SICAR assumes the form of a limited partnership, the taxation fundamentally rests at the level of the investor (transparency).

Fixed contributions (not exceeding 5,000 Euros per year) are due to the CSSF

SICAR is exempt from Net Wealth Tax

Benefit of Double Tax Treaties

SICAR may in principle benefit from tax treaties.

However to secure the Double Tax Treaties eligibility of the SICAR it might be helpful to interpose an intermediate holding company between the SICAR company and the target company. Such intermediate holding company should be located in a jurisdiction with a flexible participation exemption regime and where dividend withholding tax on dividends distributed to the SICAR company is absent based on domestic tax provisions or the provisions of the EU Parent Subsidiary Directive (CE 1990/435), as amended.

²¹ For a maximum of 12 months

²² For SICAR assuming the form of an SA, SCA or Sarl.

Withholding taxes on dividends – capital gains

Withholding tax on distributions neither applies to distributions carried out by SICAR²³, nor to capital gains upon disposal of shares.

VAT

Management services are VAT exempt

Tax Planning

If there would be tax constraints at the level of the investors who are investing in the SICAR company, one may consider interposing an appropriate vehicle in between the SICAR company on one hand and the investors on the other hand and so as to try to lower the tax burden at the level of the investors and / or to be able to convert the nature of the income in a type of income which would be relatively low taxed in the country of residence of the investors.

²³ Exemption from corporate income tax and municipal business tax possible on dividends received by Luxembourg parent company

In two words...

	Main benefits	Main constraints
European UCITS	<ul style="list-style-type: none"> - availability of European Distribution Passport - low taxation - easy compartmentalization 	<ul style="list-style-type: none"> - highly regulated to ensure efficient protection to investors - limited to a specific range of financial assets - strong diversification rules - restrictions for borrowing, leveraging or hedging their investments
UCI	<ul style="list-style-type: none"> - flexible in terms of eligible assets - relative flexibility of rules – possibility of derogations - prospectus passportable if closed-ended - low taxation - easy compartmentalization 	<ul style="list-style-type: none"> - investment restrictions - restrictions for borrowing, leveraging or hedging their investments - non availability of European Distribution Passport
SIFs	<ul style="list-style-type: none"> - flexible in terms of eligible assets: suited for both traditional and alternative investment vehicles - flexibility in term of investment, leverage and governance - reduced scope of scrutiny of CSSF upon approval 	<ul style="list-style-type: none"> - non availability of European Distribution Passport - not suited for retail funds

	<p>and reporting</p> <ul style="list-style-type: none"> - low taxation - offering document passportable if closed-ended - easy compartmentalization - time to market 	
SICAR	<ul style="list-style-type: none"> - flexibility in terms of governance, lending and leverage - no diversification requirements. - reduced scope of scrutiny by CSSF upon approval and reporting - easy compartmentalization 	<ul style="list-style-type: none"> - not suited for all asset classes (only private equity, venture capital, and certain real estate investments) - non availability of European Distribution Passport