

## Proposed Changes to Luxembourg Law on Specialised Investment Funds

The Luxembourg Government on 12 August 2011 submitted to Parliament a bill (the "Bill") to amend the Luxembourg law of 13 February 2007 applicable to specialised investment funds ("SIFs") (the "SIF Law").

The Government's intent, among other things, is to reflect the experience of the Luxembourg regulator, the *Commission de Surveillance du Secteur Financier* (the "CSSF"), and adapt the SIF Law with respect to the AIFM Directive,<sup>1</sup> which must be implemented into national law by 22 July 2013.

If voted, the Bill will bring numerous changes to the current SIF regime.

The Bill provides for changes to the regulatory approval process and includes new provisions with respect to portfolio management, the delegation of certain functions to third parties, risk management and conflicts of interest. Finally, the Bill, if voted, will introduce into the SIF Law additional flexibilities already adopted for UCITS and non-UCITS retail funds by the Law of 17 December 2010 on undertakings for collective investments (the "UCI Law").

### Launch with Prior CSSF Approval

Under the SIF Law, SIFs may be launched before the CSSF has granted its approval, thus allowing them to take up investments immediately. In such cases, the application for approval must be filed with the CSSF within one month of the SIF's creation or constitution.

<sup>1</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

The main risk of such a process is that the CSSF might subsequently require changes to the structuring and documentation of the SIF, which could lead to the SIF's liquidation.

Pursuant to the Bill, neither a SIF nor a sub-fund of an existing SIF may be launched without CSSF approval.

Moreover, the Bill provides that SIFs will have to communicate to the CSSF any substantial changes to documents and/or information which have previously been approved by the CSSF.

### Approval of the Portfolio Manager(s)

The SIF Law currently provides that the directors of SIFs or of their management company, as well as the directors of the custodian bank of the SIF, must be approved by the CSSF, this approval being based on their good reputation and their expertise in light of the SIF's investment policy. The approval by the CSSF of the portfolio manager of a SIF is currently not required.

However, pursuant to the Bill, the CSSF's approval of a SIF is also conditional upon the CSSF approving the persons who will be in charge of the portfolio management. These persons must be of good repute and have adequate experience with respect to the investment policy and strategy of the SIF.

## Delegation to Third Parties

### Delegation of Functions

In order to conduct operations in a more efficient manner, the Bill specifies that SIFs may delegate one or more functions to third parties provided that the following conditions are met:

- the CSSF must be adequately informed;
- the mandate must not prevent the effective supervision of the SIF, and in particular it must not prevent the SIF from acting, or from being managed, in the best interests of investors;
- the directors of the SIF (or its management company) must be able to demonstrate that the delegate is qualified and capable of undertaking the functions in question and was selected with all due care, and that the SIF is in a position to monitor the delegated activity effectively at all times, to give further instructions to the delegate at any time or withdraw the mandate with immediate effect in order to protect the interests of investors;
- the investment management functions are not delegated to the depositary; and
- the offering document of the SIF must list the delegated functions.

### Delegation of the Investment Management Functions

The SIF Law currently does not require that the investment manager of a SIF be approved.

However, upon the adoption of the Bill, SIFs will only be able to delegate the investment management functions to entities or persons authorised or registered for the purpose of asset management and subject to prudential supervision by a supervisory authority. If the investment management function is delegated to a non Luxembourg entity, cooperation between the CSSF and the third country supervisory authority must exist. It is expected that the CSSF will apply the same criteria as for the delegation of the investment management functions by a UCITS.

Nevertheless, should these conditions not be met, the Bill grants some flexibility to the CSSF to decide whether the delegate is acceptable if it can demonstrate that it is of sufficiently good repute and sufficiently experienced. This decision will be taken by the CSSF on a case-by-case basis and it is

expected that the CSSF will grant such exemptions on a very limited basis.

As indicated below, existing SIFs benefit from grandfathering provisions to comply with the above requirements. SIFs that currently do not have compliant delegation arrangements would therefore be forced to appoint a new, compliant asset manager or assume the responsibility themselves. One option in order to achieve the continued involvement of a non-compliant delegate would be to amend the existing delegation agreement to be an investment advisory agreement, pursuant to which the asset manager will provide non-binding investment advice.

### Risk Management and Conflicts of Interest

Under the Bill, SIFs will be required to implement risk management systems to identify, measure, manage and monitor appropriately the risks associated with the investment positions and their contribution to the overall portfolio.

SIFs will also be required to be structured and organised in such a way as to mitigate the risk of any conflict of interest with any person involved in or related directly or indirectly to its activities which would adversely affect the interests of investors. In the case of a potential conflict of interest, the SIF is required to protect the interests of its investors.

The Bill provides that a CSSF Regulation will be adopted to clarify the implementation of the measures on risk management and conflicts of interest.

### Valuation of Contributions in Kind

The Bill stipulates that contributions in kind must be valued by an auditor. Such a valuation was, to some extent, already required by law for certain types of SICAV and this new requirement reflects the administrative practices of the CSSF. The fees of such a valuation are, in principle, to be borne by the subscribing investor.

### Efficiency Measures

The Bill provides for the introduction into the SIF regime of certain measures which were previously introduced for UCITS and non-UCITS retail funds by the UCI Law.

### Cross Investments Between Sub-Funds

SIFs with multiple sub-funds will have the possibility (if permitted by the constitutional documents of the SIF) to invest in other sub-funds of the same SIF provided that:

- the target sub-fund does not invest in the investing sub-fund;
- the voting rights of the target sub-fund are suspended during the period of investment; and
- for as long as the shares/units are held by the SIF, their value will not be taken into account in calculating the SIF's net assets in the context of meeting the minimum net assets requirements.

For existing SIFs, cross investments between sub-funds will only be permitted once their constitutional documents are duly amended.

### Annual Report

The provision of the applicable law which states that the annual report, including the auditor's and the management reports, should be sent to shareholders with the convening notice for the annual general meeting shall not apply to corporate SIFs. This cost-saving measure includes a provision, however, that the convening notice shall indicate the means for providing these documents to shareholders and shall specify that each shareholder may request that the annual report be sent to him or her.

### Record Date

The convening notices for general meetings of shareholders may provide that the quorum and the majority shall be determined according to the shares issued and outstanding at midnight (Luxembourg time) on the fifth day prior to such meeting (the "Record Date"). The Record Date will be an improvement for large funds with a lot of investors, where the drawing up of the meeting attendance list is not always an easy task.

### Articles of Incorporation: Language Requirements

The articles of incorporation of a corporate SIF must be drawn up in English, French or German. If the articles of incorporation of such SIF have been drawn up in English, it will no longer be required to attach a French or German translation.

### Withdrawal of a Sub-fund's Authorisation

The CSSF may withdraw the authorisation of a sub-fund without withdrawing the authorisation of other sub-funds or of the SIF as a whole. This will ensure that not all the investors of a SIF are penalised when only a sub-fund does not comply with the applicable laws and regulations.

### Entry into Force and Transitional Provisions

The Bill is now subject to the Luxembourg legislative approval process and, if voted, will enter into force on the first day of the month following its publication in the official gazette in Luxembourg.

Under the current text, existing SIFs would benefit from the following grandfathering provisions:

- until 30 June 2012 to comply with the provisions on the monitoring of risk management and conflicts of interest; and
- until 30 June 2013 to comply with the provisions in relation to the delegation of functions.

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