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LUXEMBOURG

Luxembourg Specialised Investment Funds (including certain AIFMD aspects)

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Foreword

Investment funds subject to the law of 13 February 2007 on specialised investment funds (as amended, the **SIF Law**) have proven to be a highly successful alternative investment vehicle. Combining Luxembourg's extensive know-how in fund regulation with the ability to invest in alternative assets, specialised investment funds (**SIFs**) have been at the forefront of regulated alternative investment vehicles globally. Taking an approach similar to the approach later adopted by EU Directive 2011/61/EU on Alternative Investment Fund Managers (the **AIFM Directive**) and the law of 12 July 2013 transposing the AIFM Directive in Luxembourg (the **AIFM Law**), SIFs are the alternative investment vehicles which satisfy the requirements of the AIFM Directive.

Contents

1 Regulatory framework

1.1 Specific applicable laws

Specialised investment funds ("**SIFs**") are undertakings for collective investment ("**UCIs**") governed by the amended Luxembourg law of 13 February 2007 on specialised investment funds ("**SIF Law**").

SIFs qualifiying as *sociétés d'investissement à capital variable* ("**SICAV**") or *sociétés d'investissement à capital fixe* ("**SICAF**") are moreover governed by the amended Luxembourg law of 10 August 1915 on commercial companies ("**Companies Law**").

1.2 Authorisation and supervision

The SIF is a regulated entity subject to the authorisation from and permanent prudential supervision by the Luxembourg supervisory commission of the financial sector (*Commission de Surveillance du Secteur Financier*, the "**CSSF**").

However, SIFs are subject to a less stringent regulatory regime than UCIs governed by the amended Luxembourg law of 17 December 2010 relating to undertakings for collective investment ("**UCI Law**").

SIFs may only start their operations upon the prior CSSF approval. Moreover, an FCP-SIF cannot be launched without the prior regulatory approval of its management company. The CSSF has comprehensive supervision powers and *inter alia* the right to:

- access any document in any form and receive a copy thereof;
- require any person to provide information and, if necessary, to summon and question any person with a view to obtaining information;
- carry out on-site inspections or investigations, by itself or by its delegates, of the persons subject to its supervision under this law;
- require communication of recordings of telephone exchanges and existing data;
- require the cessation of any practice that is contrary to the provisions adopted for the implementation of the SIF Law;
- request the freezing or the sequestration of the assets by the president of the District Court of and in Luxembourg (*Tribunal d'Arrondissement de et à Luxembourg*) acting on request;
- pronounce the temporary prohibition of exercising professional activities against the persons subject to its prudential supervision, as well as the members of administrative, governing and management bodies, employees and agents linked to these persons;
- require authorised investment companies, management companies and depositaries to provide information;
- adopt any type of measure to ensure that investment companies, management companies and depositaries continue to comply with the requirements of the SIF Law;
- require, in the interests of the shareholders or of the public, the suspension of the issue, repurchase or redemption of shares or units;

- withdraw the authorisation granted to a SIF, a management company or a depositary;
- transmit information to the public prosecutor (*Procureur d'Etat*) for criminal proceedings;
- instruct approved statutory auditors or experts to carry out verifications or investigations;
- require the dissolution and the liquidation of one or several sub-funds of a SIF whose entry on the official list has finally been refused or withdrawn; and
- make public any administrative fine imposed under article 51 of the SIF Law, unless such a disclosure would seriously jeopardise the financial markets, be detrimental to the interests of investors or cause disproportionate damage to the parties concerned.

The directors[1] of the SIF must be of good repute and have sufficient experience in relation to the type of SIF that is being created. To that end, the identity of both the initial directors and their successors must be communicated to and approved by the CSSF.

The SIF must draw up an issuing document that includes all the information necessary for investors to be in the position to make an informed judgment on the proposed investment and the corresponding risks. Once drafted, the issuing document may need to be further updated, whereas the updates have to be made within a certain time period, as the case may be. Currently, an obligation to update the issuing document exists (i) once new securities are issued to new investors as well as (ii) in regard of a sub-fund in liquidation and (iii) in regard of sub-funds once contained in the issuing document but non-launched or awaiting reactivation after the expiry of an 18 months period.[2]

Authorised SIFs are then recorded by the CSSF on an official list. This entry is tantamount to the authorisation and is notified by the CSSF to the SIF.

The authorisation process is limited to the approval of the issuing document, the management regulations (for FCPs) or the articles of incorporation (for SICAVs/SICAFs), the SIF's directors,[3] the depositary, the auditor and the place of central administration which has to be located in Luxembourg.

1.3 Object

UCIs situated in Luxembourg shall be considered as SIFs if:

- their exclusive object is the collective investment of their assets in values in order to spread the investment risks and to provide their investors with the benefit of the result of the management of their assets;
- their securities or interests (*parts d'intérêts*) are restricted to one or more well-informed investor(s); and
- their constitutive or issuing documents provide that they are subject to the provisions of the SIF Law.

1 "Director(s)" shall mean, in the case of public limited liability companies (*société anonyme* or SA) and in the case of cooperatives in the form of a public limited liability company (*société coopérative organisée sous forme de société anonyme* or SCoSA), the members of the board of directors; in the case of partnerships limited by shares (*société en commandite par actions* or SCA), common limited partnerships (société en commandite simple or SCS) and special limited partnerships (société en commandite spéciale or SCSp), the general partner(s); in the case of private limited liability companies (*société à responsabilité limitée* or Sarl), the manager(s) and in the case of mutual funds in the contractual form (*fonds commun de placement* or FCP), the members of the board of directors/managers of the management company.

2 Whereas in the two latter cases, the update has to be made within 6 months.

3 For the purpose of authorisation each potential director must provide the CSSF with *inter alia* a criminal register excerpt and inform the CSSF of each criminal sanction, even if older than ten years and not mentioned in the excerpt (CSSF's 2011 annual report, page 230).

1.4 Investment policies, borrowing rules and investment restrictions

The SIF Law does not provide for specific investment policies, borrowing rules or investment restrictions.

This allows for significant flexibility with regard to the eligible assets.

The general rules are as follows:

- the assets must be able to be legally acquired by the SIF;
- they must be able to be held in custody; and
- they must be properly valued.

The Luxembourg market has hence seen SIFs investing for instance in transferable securities, money market and financial derivative instruments, real estate, microfinance, carbon credits and private equity.

Like other Luxembourg UCIs, SIFs are however subject to the principle of risk diversification. The CSSF stated in its circular 07/309 relating to risk spreading in the context of SIFs that the SIFs' issuing document must include quantifiable restrictions evidencing the fulfilment of the principle of risk-spreading.

Generally, the CSSF considers that the risk-spreading principle is complied with by SIFs if the following investment restrictions are met:

(i) In principle, a SIF may not invest more than 30% of its assets or commitments in securities of the same type issued by the same issuer. This restriction does not apply to:

- investments in securities issued or guaranteed by a OECD member state or by its regional or local authorities or by EU, regional or worldwide supranational institutions and bodies; and
- investments in target UCIs which are subject to risk-spreading requirements at least comparable to those applicable to SIFs, it being understood that every sub-fund of a target umbrella UCI is to be considered as a separate issuer provided that the principle of segregation of liabilities among the various sub-funds vis-à-vis third parties is ensured.

(ii) Short sales may not, in principle, 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.

(iii) While using financial derivative instruments, the SIF must ensure a similar risk spreading by an appropriate diversification of the underlying assets. With the same objective, the counterparty risk in an over-the-counter operation must be limited in respect of the quality and qualification of the relevant counterparty.

These guidelines shall, in principle, apply to all SIFs, although the CSSF may grant derogations on a case-by-case basis upon adequate justification, or impose additional investment restrictions in view of a specific investment policy.

1.5 Eligible investors

The SIF Law requires investors to qualify as "*well-informed investors*", which are institutional investors, professional investors as well as any other investor who:

(i) has declared in writing its status as a well-informed investor; and

(ii) (a) invests a minimum of EUR 125,000.- in a SIF; or

(b) has obtained an assessment from (i) a credit institution as defined in Directive 2006/48/CE, (ii) an investment firm as defined in the amended Directive 2004/39/CE ("**MiFID**"), or (iii) a management company as defined in Directive 2009/65/EC, certifying his expertise, experience and knowledge to adequately appraise an investment in a SIF.

These requirements do not apply to the directors and other persons involved in the management of the SIF.

The SIF Law does not contain any definition of the concepts of institutional investor and professional investor.

In practice, the concept of "*institutional investor*" usually refers to entities managing important assets such as, for example, credit institutions, professionals of the financial sector, undertakings for collective investment, insurance and reinsurance companies, social security institutions, pension funds, etc.

The concept of "*professional investor*" is inspired by MiFID and generally refers to those investors who are deemed to have the experience, knowledge and expertise to make their own investment decisions and properly assess the risk they incur. Traditionally, this includes credit institutions, investment firms, other authorised or regulated financial institutions and other institutional investors.

In its 2007 annual report, the CSSF specified that SIFs (i) are responsible for ensuring that their investors qualify as well-informed investors and (ii) must put in place procedures ensuring that their ultimate investors comply with all applicable requirements.

The SIFs have to implement measures to ensure that the securities they issue are held by well-informed investors.

2 Structural and legal aspects

2.1 Legal form

SIFs may be organised in several legal forms:

2.1.1 SIFs of the contractual type (FCP-SIF)

A *fonds commun* de placement ("**FCP**") is a mutual fund established by contract. It is not a corporate entity but an undivided co-ownership of assets, which is managed by a management company (*société de gestion*) located in Luxembourg which complies with the conditions set out either in chapter 15, 16 or 18 of the UCI Law. Such management company is a corporate entity which has a legal personality and is the legal management body of the FCP.

The FCP-SIF will be managed by either:

- a management company governed by Chapter 15 of the UCI Law ("**Chapter 15 Management Company**"), provided that it manages at least one additional undertakings for collective investment in transferable securities ("**UCITS**") set-up in accordance with the UCITS Directive (Directive 2009/65/EC); or

- a management company governed by Chapter 16 of the UCI Law ("**Chapter 16 Management Company**"), provided that it exclusively manages SIFs or UCIs subject to Part II of the UCI Law; or

- a management company governed by Chapter 18 of the UCI Law ("**Chapter 18 Management Company**"), which is permitted by its statute to manage UCIs for the purposes of Chapter 16 of the UCI Law.

The main differences between a Chapter 15, a Chapter 16 and a Chapter 18 Management Companies relate to:

- the scope of functions;

- human resources and capital requirements;

- corporate governance; and

- passporting of certain services.

According to the SIF Law, the management company (be it a Chapter 15, a Chapter 16 or a Chapter 18 Management Company) acts in its own name, but has to indicate that it acts on behalf of the relevant FCP-SIF. It manages the FCP-SIF in accordance with its management regulations and issuing document.

Furthermore, it must act in the exclusive interest of the unitholders. The management company of an FCP-SIF must be approved by the CSSF and is incorporated with a minimum paid-in capital of EUR 125,000. Chapter 15 Management Companies are subject to additional own funds requirements depending on the amount of the assets under management.

The FCP-SIF's net assets must amount to at least EUR 1,250,000. This minimum must be reached within twelve months from its authorisation by the CSSF. FCP-SIFs are not liable for the obligations of the management company or the unitholders.

Investors in FCP-SIF receive, in consideration for their investment, units of the FCP-SIF, which may be issued in either registered or bearer[4] form and can be paid-in either fully or partially. Unlike shares of SICAVs (please see below), units of FCP-SIFs do not grant voting rights unless expressly provided for otherwise.

2.1.2 SIFs of the corporate type ("SICAV-SIF" and "SICAF-SIF")

There are two kinds of corporate type SIFs:

- the *société d'investissement à capital variable* ("**SICAV**"), which is an investment company with variable capital; and

- the *société d'investissement à capital fixe* ("**SICAF**"), which is an investment company with fixed capital. A notarial deed is hence required each time the company's share capital is modified. The SICAF is of relatively minor importance in practice and will not be further addressed herein.

A SICAV-SIF is managed by a management body which varies depending on its legal form. Although not mandatory, a management company may be appointed by a SICAV-SIF; it may be either a Chapter 15 Management Company if it already manages at least one UCITS, a Chapter 16 Management Company or a Chapter 18 Management Company.

4 They however need to be immobilised in accordance with the law of 28 July 2014 concerning the compulsory deposit and immobilisation of shares and units in bearer form.

The SICAV-SIF's minimum subscribed share capital, increased by any share premium (*primes d'émission*) is EUR 1,250,000., which must be reached within a period of twelve months from its authorisation by the CSSF. On the incorporation date of the SICAV-SIF, however, an initial share capital in the amount, which corresponds to minimum amount of the share capital of the chosen corporate form, must be paid in.

An investor subscribing for shares or interests in a SICAV-SIF becomes a shareholder[5] of the company[6] and can therefore in principle participate in and vote at general meetings of shareholders. Therefore, shareholders can decide a variety of matters, including the granting of discharge to the directors, the appointment or revocation of the members of the board of directors, the approval of the annual accounts and the liquidation of the SICAV-SIF.

The share capital of a SICAV-SIF is variable, meaning that its share capital is equal to the total net asset value of the SICAV-SIF. The benefit of this corporate form is that permanent changes to the SICAV-SIF's share capital may be made without the intervention of a Luxembourg notary.

The share capital is represented by either registered or bearer shares[7] which may be paid-in either fully or partially (minimum 5%). Shares of the SICAV-SIF are issued without mention of nominal value. The SICAV-SIF is not obliged to create a legal reserve.
The SIF Law does not contain any provision limiting the categories of shares and other securities that a SICAV-SIF may issue. As a consequence, a SICAV-SIF can issue shares, bonds, founder shares (*parts bénéficiaires*) and any other securities within the limits of the Companies Law.

SIFs organised as a commercial company do no longer need to send the annual report, the management report and the auditor report to the shareholders at the same time as the convening notice is being sent to general meetings of shareholders.

The convening notice must:

- indicate the place and practical arrangements where these documents will be made available to the shareholders; and
- specify that the shareholders may request to obtain those.

The convening notice can further indicate that the quorum will be fixed according to the number of issued shares on the 5th day prior to the general meeting, i.e. the record date.

The respective shareholder's voting and participation rights will be fixed according to the shares held at the record date.

The translation of the English worded articles of incorporation into either French or German is not required; the same applies to any other notarial act (such as e.g. the extraordinary general meeting minutes or the merger project regarding a SICAV).

2.1.3 SIFs incorporated in a form other than FCP or SICAV

SIFs may be established in any corporate form, but also in the form of an association or foundation as well as under fiduciary contract, provided that their exclusive object is the collective investment of their funds in values in order to spread investment risks.

5 "Shareholder(s)" shall refer to the holder of interests in the case of a partnership.
6 "Company(s)" shall refer to the partnership in the case of a partnership (SCA, SCS or SCSp).
7 "Share(s)" shall refer to the interests of the partnership in the case of a partnership.

2.2 Umbrella SIFs and multiple class structures

A SIF may be organised as an umbrella fund, whereby the entire SIF consists of one or more sub-funds. This possibility and its modalities must be expressly provided for by the constitutive documents. The issuing document must further describe each sub-fund's specific investment policy and other distinguishing features.

These sub-funds must differ in their investment policy, fee structure, distribution policy, type of target investors and/or shares/units of different values. To some extent, the corporate governance structure may also vary from one sub-fund to the other (e.g. use of specific committees, investment managers or advisers). There may however be only one management body and one depositary for the entire SIF.

The SIF Law provides for the so-called "*ring-fencing*" principle according to which each sub-fund corresponds to a separate part of the assets and liabilities of the SIF, which implies the following consequences:

- the rights of investors and creditors relating to a particular sub-fund or raised by the creation, operation or liquidation of that sub-fund are limited to the assets of that sub-fund;
- the assets of a sub-fund are exclusively available to satisfy the rights of the investors relating to such sub-fund and the rights of the creditors whose claim arose in relation to the creation, operation or liquidation of such sub-fund;
- for the purpose of relations between investors, each sub-fund will be deemed to be a separate entity; unless a clause included in the constitutive documents provides otherwise; and
- each sub-fund may be liquidated separately and the liquidation of a sub-fund shall not involve the liquidation of another sub-fund. Only the liquidation of the last remaining sub-fund involves the liquidation of the SIF.

Cross sub-fund investments are subject to the following conditions:

(i) the target sub-fund may not make circle investments in the investing sub-fund;

(ii) the voting right(s), if any, attached to those securities will be suspended for the time being held by that sub-fund; and

(iii) during this period, the value of those securities will not be considered for the verification of the minimum threshold of net assets.

The difference to UCITS is that:

- management, subscription and repurchase fees may be charged; and
- the target sub-fund may, i.e., invest its monies in the other sub-fund of the same SIF (except in the investing sub-fund).

Cross sub-fund investments must only be provided for in the issuing document.
As an alternative or in addition to the umbrella structure, it is possible to create various classes or categories of shares/units within each sub-fund. These classes must differ in their fee structure, distribution policy and/or target investors.

2.3 Contribution of funds to the SIF

The SIF can be established by contribution in cash, contribution in kind or by a combination of both. Funds can also be contributed to the SIF in the form of debt (bonds). Any contribution in kind to a SIF will be subject to a report issued by an external and independent auditor (*réviseur d'entreprises agréé*). The nature of the contributions (equity or debt) depends largely on tax considerations and investor preferences.

Generally, the funding depends on the following criteria:

- variable or fixed capital;
- the form of shares, units or other securities (so called *titres*) that will be issued; and
- the structure of capital calls and closings.

2.4 Issue and redemption of shares or units

The SIF Law does not contain any provisions regarding the issue and redemption of shares/units. Specific rules must hence be disclosed in the articles of incorporation (in the case of a SICAV-SIF) or the management regulations (in the case of an FCP-SIF) and the issuing document of the SIF.

As a consequence, the issue and redemption prices do not necessarily need to be based on the net asset value, but rather on a predetermined fixed price or can comprise a portion of par value and issue premium.

A SIF may be closed-ended, meaning that it does not redeem its shares/units upon request of its investors, or open-ended, in which case its shares/units are repurchased at the request of its investors.

2.5 Valuation of assets

Except if otherwise provided for by the SIF's constitutive documents, SIF's assets must be valued at fair value. The valuation must be made in accordance with the rules provided for in the articles of incorporation of a SICAV-SIF or the management regulations of an FCP-SIF.

The net asset value of the SIF must be determined at least on a yearly basis, at the end of the financial year.

2.6 Dividend policy

The SIF Law does not contain any restriction on the distribution of dividends, as long as the subscribed share capital of a SICAV-SIF, increased by the share premium, or the net assets of an FCP-SIF does not fall below the legal minimum, currently set at EUR 1,250,000.

The distributions and repayments must be made in accordance with the rules provided for in the constitutive documents.

2.7 Financial statements

The SICAV-SIF and, in the case of an FCP-SIF, the management company, must establish an annual report for each financial year which must be made available to investors within 6 months after the period to which it refers has ended.

The SIF's annual report must notably include the following elements:

- a balance sheet or a statement of assets and liabilities;
- a detailed income and expenditure account for the financial year concerned;
- a report on the activities of the relevant financial year; and
- any significant information which will enable investors to make an informed judgment on the development of the activities and the results of the SIF.

SIFs are not required to produce either semi-annual reports or consolidated accounts.

3 Management and service providers

3.1 Management body

The management body depends on the legal form of the SIF.

Irrespective of the legal form, the directors must be of good repute and be sufficiently experienced in relation to the type of SIF concerned. They must hence submit supporting documentation to the CSSF evidencing their specific experience in relation to the relevant assets.

There is no condition of nationality or residence. However, from a foreign tax law perspective, it may be recommended that the management body holds regular meetings in Luxembourg to ensure that the SIF has appropriate tax substance.

SIFs have to implement:

(i) appropriate risk management systems in order to detect, measure, manage and monitor the risk associated and the contribution thereof to the general risk profile of their portfolios; and

(ii) appropriate conflicts of interest provisions.

CSSF Regulation No. 15-07, which lays down the requirements of the AIFMD, provides guidance on the new risk management and conflict of interest requirements introduced by the SIF Law.

3.2 Delegation to third parties

The delegation of specific tasks and functions to third parties is, *inter alia*, subject to:

(i) the relevant disclosure in the issuing document;

(ii) the fact that the delegate has the necessary honorability and experience; and

(iii) the fact that the delegation of investment management functions, if applicable, can in principle only be given to individuals or legal persons being subject to prudential supervision; the CSSF may however grant exemptions.

3.3 Promoter, initiator, investment manager and/or adviser

The creation of a SIF does not require the intervention of a promoter. However, the CSSF needs to be informed of the name of the person/entity initiating the creation of the SIF.

The appointment of investment manager and every person succeeding it in office is subject to the approval by the CSSF. Generally, the appointment of an investment adviser will not require a prior CSSF approval.

3.4 Depositary

The custody of the assets of a SIF must be entrusted to a depositary. The depositary must either have its registered office in Luxembourg or be the Luxembourg branch of a credit institution having its registered office in another member state of the European Union. Their appointment is subject to CSSF approval.

The concept of custody should not be understood in the sense of "*safekeeping*" but only in the sense of "*supervision*". This implies that the depositary must have knowledge at any time of how the assets of the SIF have been invested and where and how these assets are available. This does however not prevent the physical safekeeping of the SIF's assets by third parties designated by the SIF with the approval of the depositary.

The depositary of an FCP-SIF shall in addition carry out all operations concerning the day-to-day administration of the assets of the FCP-SIF (e.g. collection of dividends, interest and proceeds of matured securities, exercise of options, etc.).

The depositary must, while carrying out its duties, act independently and solely in the interest of the SIF's investors.

The depositary, whose duties are subject to an obligation of means, is liable to: (i) the management company of the FCP-SIF; and (ii) the investors of the SIF for any losses suffered by them as a result of its failure to perform its obligations or its wrongful improper performance thereof. Moreover, the depositary's liability is not affected by the fact that it has entrusted some or all of the assets in its custody to a third party.

3.5 Prime Broker

SIFs can use the services of a prime broker. CSSF Circular 08/372 sets out the guidelines of the depositary of those SIFs which use derivatives or adopt alternative investment strategies and have appointed a prime broker.

The Circular indicates examples of services generally rendered by prime brokers:

- safe-guarding of the SIF's assets;
- execution of transactions and netting operations on behalf of the SIF;
- actions relating to margin deposits;
- setting up credit facilities to finance overdrafts; and/or
- securities lending, borrowing or share repurchase transactions.

Due to the role of the prime broker in the custody of the SIF's assets and given the interaction between the prime broker and the depositary in the context of the provision of services by the prime broker, the depositary has to approve the prime broker chosen by the SIF and has to make sure that it is in a position to fulfil its task of supervising the SIF's assets.

It is either the management board of a SIF (in the case the SIF is a legal entity) or the management company (if the SIF is an FCP) which has the responsibility of selecting a prime broker. The appointment is formalised by way of contract which sets forth the duties and responsibilities of the prime broker.

In order to be approved by the depositary, the prime broker has to fulfil the following conditions:

(i) the prime broker has to be a financial institution regulated by a supervisory authority in a state in which the supervisory regime is recognised as being equivalent to the regime provided by EU law;

(ii) the prime broker has also to be a financial institution which is recognised and which specialises in this type of transactions;

(iii) the Circular further provides for the organisation of the relationship between the depositary and the prime broker and for additional tasks of the depositary in case of an FCP-SIF.

The issuing document must include an adequate description of the involvement of the prime broker and disclose any potential related risks, including the counterparty risk.

3.6 Central administration

Both the central administration (i.e. head office) of a SIF and the registered office of a SICAV-SIF and of the management company of an FCP-SIF must be located in Luxembourg.

The function of central administration includes:

- accounting and administrative functions;
- ensuring that the issuing document, the register of units or shares as well as the accounting and other documents intended for investors are kept in Luxembourg;
- the calculation of the net asset value of the shares or units as well as the issue and redemption of the shares or units must be either made in Luxembourg or initiated from Luxembourg; and
- ensuring that the correspondence to investors must be dispatched from Luxembourg.

SIFs may appoint, subject to CSSF approval, one or more central administration agent(s) in Luxembourg in charge of the day-to-day book-keeping operations, the calculation of the net asset value and other administrative tasks.

The CSSF may authorise the outsourcing of certain tasks to a foreign entity on a case-by-case basis and subject to specific requirements.

The central administration agent is usually responsible for anti-money laundering compliance. It also usually provides the SIFs financial information to the CSSF on a monthly and annual basis. They consist of the:

- global net asset value and the net asset value per share/unit;
- number of shares/units issued or redeemed; and
- incomes and dividends distributed globally and per share/unit.

3.7 Auditor

Each SIF must appoint a Luxembourg-based independent auditor (*réviseur d'entreprises agréé*) which must have the appropriate professional experience and be approved by the CSSF.

In carrying out its audit function, the auditor must promptly report to the CSSF any fact or decision which it becomes aware of which:

- is likely to constitute a material breach of the SIF Law or the regulations adopted for its execution;
- affects the continuous functioning of the SIF; or
- leads to a refusal to certify the accounts or to the expression of qualifications thereon.

4 Setting-up a SIF and admission to the official CSSF list

4.1 Setting-up a SIF

The procedure for setting-up a SIF differs for FCPs and SICAVs.

4.1.1 FCP-SIF

An FCP-SIF is established by contract established by its management company. This contract is represented by the FCP-SIF's management regulations and must be filed with the Luxembourg Trade and Companies Register (*Registre de Commerce et des Sociétés*, the "**RCS**"). Notice of the filing must be published in the Luxembourg electronic central platform of official publications (*Recueil électronique des sociétés et associations*, the "**RESA"**).

The provisions of the management regulations are considered to be accepted by the unitholders as soon as they acquire units in the FCP-SIF. The SIF Law sets out the basic provisions that must be included in the management regulations (e.g. the investment policy, distribution policy, procedure for issue and repurchase of units, etc.).

The management company (be it a Chapter 15, a Chapter 16 or a Chapter 18 Management Company) must be approved by the CSSF. It is generally created by notarial deed in the form of a public limited liability company (*société anonyme*) or a private limited liability company (*société à responsabilité limitée*) with a minimum paid-in capital of EUR 125,000. The articles of incorporation of the management company are filed with the RCS and published *in extenso* in the RESA.

4.1.2 SICAV-SIF

A SICAV-SIF may be established as an SA, SCA, SCS, SCSp, Sarl, or SCoSA. The subscribed capital of the SICAV, increased by the issue premiums or the original value of the interests, may not be less than EUR 1,250,000.

SA is the most frequent legal form as it offers the advantages of limited liability and free transferability. However, the SCA is tax transparent for certain jurisdictions and may hence be more appropriate in certain circumstances.

Depending on the legal form, the SICAV-SIF must be incorporated by notarial deed (SA, S.à r.l. and SCA) or by private agreement (SCS and SCSp). If the articles of association or the social contract of a SICAV, and any amendment thereto, are recorded in a notarial act, the latter may be executed, at the parties' choice, in either French, German or English language.

The notarial deed must be filed with the RCS and is published *in extenso* in the RESA.

4.2 Procedure for the admission to the official list

Each SIF must apply to the CSSF for authorisation to be recorded on the official list of SIFs. The application must be filed with the CSSF within one month of establishment.[8]

To CSSF authorization requires first of all the filing of an extensive CSSF application questionnaire which contains a number of working sheets with mandatory fields, mainly relating to the specifics of the SIF and its sub-funds, if any, and information regarding the services providers of the SIF. The questionnaire further indicates the documents to be filed with the CSSF, being i.a.:

- draft issuing document, which must include the information necessary for investors to be able to make an informed judgement on the investment proposed to them and of the risks associated;
- draft articles of incorporation (for a SICAV or other company) or draft management regulations and articles of incorporation of the management company (for an FCP);
- draft agreements with the service providers: depositary, central administration, investment manager/adviser, registrar and transfer agents, etc;
- acceptance letter from the auditor;
- the identity of the initiator(s), their respective structure charts and last annual accounts;
- for each of the director or manager of the SIF and/or of its management company (if any): a copy of their identity card or passport, an extract of the criminal register (if available), a declaration of honour and a dated and signed *curriculum vitae* evidencing good repute and experience in relation to the management of the SIF. Directors/managers already approved by the CSSF in relation to similar SIFs are in principle not required to re-file these documents but the CSSF may request updated version thereof;
- information on the marketing of the shares/units of the SIF;
- a business plan, a sample portfolio and other information regarding the investment policy of the SIF; and
- the conflict of interest and the risk management policies of the SIF or, for FCP-SIF, of the management company.

In the framework of its supervisory function, the CSSF may at any time request any other information or document it deems fit.

These documents may be submitted in French, English or German.

8 For the avoidance of any doubt, it shall be clarified that this information only refers to the recording on the official CSSF list of SIFs (s. Art. 43 SIF Law). However, it does not apply to the launch of the SIF, which is subject to the prior approval of the CSSF (s. Art. 42 I, II SIF Law).

4.3 Registration on the official CSSF list and ongoing supervision

Once all the documents have been approved by the CSSF and executed by the relevant parties, the SIF will be recorded on the relevant official CSSF list. The regulator will also visa-stamp the issuing document.

In its ongoing supervisory function, the CSSF will *inter alia* verify whether the SIF complies with all applicable laws and regulations, its articles of incorporation or management regulations and issuing document. The CSSF is assisted in this respect by the relevant central administration agent and auditor.

Non-compliance with those documents may lead to fines, the suspension of payments and/or the deregistration from the official CSSF list.

5 Tax framework

A SIF is not liable to Luxembourg taxes on its profits or net wealth. Nor do distributions of profits by a SIF in whatever name or form give rise to Luxembourg withholding tax. Distributions and capital gains realised in respect of SIFs by non-residents (not having a Luxembourg permanent establishment to which its interest in the SIF is allocable) are not subject to Luxembourg taxation. A SIF is however subject to an annual subscription tax (*taxe d'abonnement*) of 0.01%, assessed on its total net assets, certain exemptions apply.

Luxembourg holds the view that a SIF which is organised as a corporate entity (e.g. an SARL, an SA or an SCA) should in principle be eligible to the benefits of the tax treaties concluded by Luxembourg, unless the treaty provides otherwise. A SIF which is organised as a common fund (FCP) or a limited partnership (SCS or SCSp) typically cannot claim treaty benefits itself.

Fund management services rendered to a SIF are not subject to Luxembourg VAT.

6 Certain AIFMD aspects

6.1 Introduction

The implementation of the directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (the "**AIFMD**") into national law entailed some important amendments to the Luxembourg SIF regime. Whilst the first part of the SIF Law contains the general provisions applicable to all SIFs, the second part of the SIF Law applies to SIFs qualifying as alternative investment funds (the "**SIF-AIFs**") which are required to be managed by authorised alternative investment fund manager (the "**AIFM**").

The most salient updates could be summarised as follows:

6.2 Management of a SIF-AIF

Article 80 of the SIF Law states that a SIF-AIF has to be managed by an AIFM, which can be established in Luxembourg, in another EU member state or in a third country. The SIF-AIF can choose to be managed either by an external manager or to be self-managed if it is organised in any form other than FCP or SCSp (internally managed SIF-AIF).

An internally managed SIF-AIF, in addition to the requirements of the SIF Law, is also subject to the obligations applicable to an AIFM, in accordance with the AIFM Law, which can be summarised as follows:

- to obtain a CSSF approval as an AIFM (in addition to the CSSF approval as a SIF);
- to have a minimum initial share capital of EUR 300,000;
- to hold additional own funds or professional indemnity insurance as a coverage for potential professional liability risks;
- to draw up remuneration policies that are consistent with effective risk management and do not encourage inconsistent risk taking;
- to draw up special procedures for identifying, preventing, managing and monitoring conflicts of interest;
- to establish an adequate risk management system for identifying, measurement, managing and monitoring all risks relevant to the investment strategy;
- to establish an appropriate liquidity management system for monitoring the liquidity risks and ensuring its compliance with the obligations of the internally managed SIF-AIF;
- to report to CSSF on main traded instruments, used markets, its principal exposure and its most important concentrations;
- to provide the CSSF with information on the risk profile, risk management system and the results of the stress tests performed;
- to comply with specific disclosure obligations and anti-asset stripping measures; and
- to control and to supervise the delegates.

Internally managed SIF-AIFs and SIF-AIFs managed by an EU authorised AIFM benefit from the European passport, which allows the marketing of their shares, units or partnership interests to professional investors in accordance with the AIFMD within the EU via a regulator-to-regulator notification procedure. Marketing to investors, which do not qualify as professional investors within the meaning of the AIFM Law, has to be carried out in compliance with the national private placement regime of each country.

6.3 Depositary of a SIF-AIF

In addition to the requirements set out in Section 3.4, the depositary of SIF-AIF is also obliged to keep the SIF-AIF's assets safe, to monitor the SIF-AIF's cash flow and to carry out some specific oversight duties in accordance with the SIF Law.

In case of loss of a financial instrument held on behalf of the SIF-AIF by its depositary, the depositary bears the full responsibility for that lost and must return financial instruments of the identical type or the corresponding amount to the SIF-AIF or to the AIFM in case an external AIFM has been appointed. The depositary shall not be liable if it can prove that the loss has arisen as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary.

The depositary shall further be liable to the SIF-AIF or its investors for any other losses arising from negligence or intentional failure of the depositary to properly fulfil its obligations under the AIFM Law.

Subject to provisions of the AIFM Law, a depositary may delegate its functions to a prime broker if it has functionally and hierarchically separated the performance of its functions as a delegate from its functions as prime broker.

6.4 Valuation of SIF-AIF's assets

The valuation of the SIF-AIF's assets and a calculation of net asset value per SIF-AIF's share or unit have to be performed at least once a year (if no special provisions apply) either by the AIFM itself or by an independent external valuer (with no discharge of liability) that is subject to a mandatory professional registration.

6.5 Remuneration and Transparency requirements

The annual reports of the SIF-AIFs need to disclose the information about the total remuneration amount for the considered financial year. In that report should be indicated, which amount relates to the fixed part and which amount relates to the variable part of the remuneration of the AIFM's staff as well as the aggregate amount of remuneration for the senior management and such staff members of the AIFM whose actions have material impact on the risk profile of the SIF-AIF. Furthermore, the number of beneficiaries and, where relevant, carried interest paid by the SIF-AIF, must be disclosed.

In addition to the annual reports, the AIFM or the internally managed SIF-AIF is obliged to provide to the investors of the SIF-AIF before they invest therein, a certain number of information, being further specified in the AIFM Law as well as any material changes thereof.

The issuing document of the SIF-AIF also needs to list the product requirements provided for in article 21 of the AIFM Law.

6.6 Taxation of Carried interest

The Luxembourg taxation rules define carried interest (*l'intéressement aux plus-values*) as a share in the profit of an AIF paid to employees of AIFMs or employees of management companies of an AIF. The carried interest must be paid on the basis of an incentive right which is granted based on the employees' status and the AIF's performance.

The tax law distinguishes between two categories of carried interest income earned by the employees of AIFMs or employees of management companies of AIFs:

(i) Carried interest not structured as units, shares or securities issued by an AIF; and

(ii) Carried interest structured as units, shares or securities issued by an AIF.

The return on the first type of carried interest arrangement is taxed at the progressive income tax rate up to 45.78 percent. Capital gains on the second type of carried interest realised are subject to the same progressive income tax rate. However, if the gain is realised after a period of six months it is not subject to taxation, unless the carried interest represents a substantial shareholding in a tax-opaque AIF. Such a substantial shareholding is generally present if the carried interest directly or indirectly represents more than 10 percent of the AIF's capital. In this case, gains are taxed at half the progressive income tax rate. To ensure that the income paid under the second type of carried interest arrangement benefits from this exemption, the carried interest holder should dispose of its carried interest, which would generally entail a buy-back of carried units by the AIF.

For employees who migrate to Luxembourg, the new rules provide for a substantially reduced tax for the first type of carried interest arrangements. The conditions for such individuals benefiting from the reduced tax rate are the following:

(i) The employee became resident in Luxembourg in 2013 or within the five years after 22 July 2013;

(ii) The employee in question has not, before migrating to Luxembourg, been resident for tax purposes in Luxembourg or been subject to Luxembourg individual income tax with respect to professional income in the five years prior to 22 July 2013;

(iii) No advance payments for carried interest have been paid to the employee; and

(iv) The remuneration is paid within 10 tax years after the year when the employee began to perform the functions for which the carried interest is paid.

If all these conditions are fulfilled, employees of an AIFM or employees of management companies of AIFs may benefit from a reduced rate corresponding to 25 percent of the personal income tax rate, leading to a maximum tax rate of circa 11 percent.

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July 2018