

Retail investment funds in Luxembourg: regulatory overview

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RETAIL FUNDS

1. What is the structure of the retail funds market? What have been the main trends over the last year?

Open-ended retail funds

Over the last year, Luxembourg has maintained its position as a premier financial centre for the structuring and the distribution of retail investment funds.

Under the Law of 17 December 2010 on undertakings for collective investment (Collective Investment Law), retail investment funds in Luxembourg can be set up as either:

- Undertakings for collective investment in transferable securities (UCITS) subject to Part I of the Collective Investment Law.
- Undertakings for collective investment (UCIs) subject to Part II of the Collective Investment Law.

The most recent landmark development for retail funds in Luxembourg has been the implementation of Directive 2014/91/EU on UCITS depositary functions, remuneration policies and sanctions (UCITS V). The Law of 10 May 2016, transposing UCITS V, entered into force on 1 June 2016 (UCITS V Law) and introduced new amendments to the Collective Investment Law.

Closed-ended retail funds

Closed-ended retail funds can be set up as UCIs and will be subject to Part II of the Collective Investment Law (see above, *Open-ended retail funds*).

Regulatory framework and bodies

2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

Open-ended retail funds

Regulatory framework. In addition to the Collective Investment Law, UCITS must comply with specific regulations issued by the Luxembourg financial supervisory authority, the *Commission de Surveillance du Secteur Financier* (CSSF) (see below, *Regulatory bodies*), including:

- CSSF Regulation N° 10-04 relating to UCITS organisational and procedural requirements (CSSF Regulation N° 10-04).
- CSSF Circular 16/644 on provisions applicable to UCITS depositaries (repealing and replacing CSSF Circular 14/587 from 13 October 2016) (Circular 16/644).
- CSSF Circular 12/546 on authorisation and organisation of Luxembourg UCITS management companies as well as self-

managed UCITS, as amended by CSSF Circular 15/633 (Circular 12/546).

- CSSF Circular 11/512 clarifying risk management rules and procedures.
- CSSF Circular 04/146 regarding protection against late trading and market timing practices (Circular 04/146).
- CSSF Circular 02/77 relating to NAV calculation errors and non-compliance with investment rules applicable to collective investment undertakings (Circular 02/77).
- IML Circular 91/75 on the revision and remodelling of rules applicable to Luxembourg collective investment undertakings, as amended by CSSF Circular 05/177 (Circular 91/75).

Furthermore, the following government regulations are applicable to UCITS:

- Grand-Ducal Regulation of 28 October 2013 relating to the fees to be levied by the CSSF.
- Grand-Ducal Regulation of 8 February 2008 clarifying certain definitions relating to UCITS.

UCIs are subject to:

- Part II of the Collective Investment Law.
- Certain regulations applicable to UCITS (such as Circular 04/146, Circular 02/77, and Circular 91/75).
- Specific regulations, such as CSSF Circular 02/80 relating to rules applicable to UCIs pursuing alternative investment strategies (Circular 02/80).

Regulatory bodies. The CSSF is responsible for the initial authorisation and ongoing supervision of UCITS and UCIs, as well as their management companies. The CSSF carries out its duties exclusively in the interest of the public and has all supervisory and investigative powers necessary for the exercise of its functions.

Closed-ended retail funds

See above, *Open-ended retail funds*.

3. Do retail funds themselves have to be authorised or licensed?

Open-ended retail funds

UCITS. A Luxembourg UCITS must obtain prior authorisation from the CSSF to carry out its activities. As part of the authorisation procedure, the following elements must be submitted to the CSSF:

- The relevant application questionnaire(s).
- The draft constitutive documents or management regulations.

- The draft prospectus and related Key Investor Information Document(s) (KIID).
- The draft agreements to be entered into by the UCITS and its service providers (including most notably the depositary).
- Application documents relating to the board of directors.
- Information relating to the management company (if any).
- The risk management process and other relevant operational procedures.

The CSSF keeps an official list of UCITS which are authorised in Luxembourg and subject to its supervision. Entry on the official list will mean that a UCITS has been authorised by the CSSF.

Furthermore, a foreign UCITS may be marketed in Luxembourg subject to prior notification to the regulator of its home Member State and transmission of such notification by the latter to the CSSF.

UCIs. The procedure for authorisation of UCIs is quite similar to that of UCITS (except for the KIID and certain substance or procedural requirements). If a UCI qualifies as an alternative investment fund (AIF) under the Law of 12 July 2013 on alternative investment fund managers, further specific requirements may apply.

Closed-ended retail funds

See above, *Open-ended retail funds*: UCIs.

Marketing

4. Who can market retail funds?

Open-ended retail funds

UCITS. Shares or units of a Luxembourg UCITS can be marketed by the fund itself or by its designated management company (if any) as part of its collective portfolio management function.

The appointed management company can delegate the marketing activities to third parties. These include:

- Local distributors subject primarily to the Law of 5 April 1993 on the financial sector.
- Foreign distributors with adequate financial resources and capabilities. A UCITS can also appoint such entities directly.

UCIs. See above, *Open-ended retail funds*: UCITS. If a UCI qualifying as an AIF appoints an authorised AIF manager (AIFM), the AIFM will be in charge of marketing the UCI (but can also delegate this function).

Closed-ended retail funds

See above, *Open-ended retail funds*.

5. To whom can retail funds be marketed?

Open-ended retail funds

UCITS. A Luxembourg UCITS can be marketed to all types of investors, including retail and institutional investors. However, a UCITS can also choose to create sub-funds or share/unit classes that are reserved for certain investors only.

UCIs. In principle, the marketing rules for UCITS are applicable to open-ended UCIs.

Closed-ended retail funds

See above, *Open-ended retail funds*.

Managers and operators

6. What are the key requirements that apply to managers or operators of retail funds?

Open-ended retail funds

UCITS. A UCITS management company acting on behalf of a common investment fund (*fonds commun de placement*) (FCP) or as a designated management company for an investment company with variable capital (*société d'investissement à capital variable*) (SICAV) can only commence its business activities once authorisation from the CSSF is obtained. For details of legal fund vehicles, see *Question 8*.

Applications for authorisation must comprise all relevant information and documents allowing the CSSF to identify and assess the applicant, including:

- A programme of activities.
- Information on the organisation and infrastructure, management and shareholding structure.
- The policies and procedures.

A UCITS management company must comply with the general requirements set out in Chapter 15 of the Collective Investment Law, especially in relation to:

- Initial capital and own funds.
- Substance (for example, the head office and registered office must be located in Luxembourg).
- Governance (for example, the persons who effectively conduct the business of the management company must be of sufficiently good repute and be sufficiently experienced in relation to the type of funds managed).

A UCITS management company must (among other things) maintain permanent compliance, internal audit and risk management functions, and ensure adequate supervision of any delegated activities (*CSSF Regulation N° 10-04; Circular 12/546*).

Under the UCITS management company passport regime, a UCITS management company established and duly authorised in another EU member state can manage Luxembourg UCITS.

UCIs. A UCI management company must seek CSSF authorisation prior to commencing its activities. A UCI management company must comply with the provisions of Chapter 16 of the Collective Investment Law (unless it also manages UCITS). These provisions are generally less strict than the provisions applicable to UCITS management companies. If a UCI qualifies as an AIF, further organisational and procedural requirements may apply with respect to its AIF manager (if any).

Closed-ended retail funds

See above, *Open-ended retail funds*: UCIs.

Assets portfolio

7. Who holds the portfolio of assets? What regulations are in place for its protection?

Open-ended retail funds

UCITS. A UCITS must appoint a depositary bank to ensure the safekeeping and monitoring of its portfolio assets. This bank must be a Luxembourg credit institution supervised by the CSSF.

UCITS depositaries are subject to the organisational, operational and other requirements set out in the:

- Collective Investment Law (as amended by the UCITS V Law).
- Regulation (EU) 2016/438 on the obligations of depositaries (UCITS V Delegated Regulation).
- Circular 16/644.

UCIs. The UCITS V Law introduced a single depositary regime by aligning the requirements applicable to UCI depositaries with the requirements applicable to UCITS depositaries (see above, *Open-ended retail funds: UCITS*).

Closed-ended retail funds

See above, *Open-ended retail funds: UCITS*.

Legal fund vehicles

8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

Open-ended retail funds

Legal vehicles. In principle, both UCITS and UCIs can be set up as any of the following types of legal vehicle:

- **Investment company with variable capital (*société d'investissement à capital variable*) (SICAV).** A SICAV can be self-managed or can appoint a management company. SICAVs issue shares.
- **Common investment fund (*fonds commun de placement*) (FCP).** This is an undivided co-ownership of assets without legal personality that issues units. An FCP must appoint a management company.
- **Investment company with fixed capital (*société d'investissement à capital fixe*) (SICAF).** A SICAF can be self-managed or can appoint a management company.

Advantages. The comparative advantages of these legal vehicles are as follows:

- **SICAV.** The share capital of a SICAV is equal to its total net asset value (NAV), which facilitates the subscription and redemption procedures.
- **FCP.** Due to its contractual form, an FCP is not subject to company law requirements, and therefore provides its participants with more organisational flexibility than a SICAV.

Disadvantages. A SICAF must hold a general meeting before a notary to modify its capital at each subscription or redemption of shares.

Closed-ended retail funds

Legal vehicles. The legal structures used for closed-ended UCIs are the same as for open-ended UCIs (see above, *Open-ended retail funds: Legal vehicles*).

Advantages. See above, *Open-ended retail funds: Advantages*.

Disadvantages. See above, *Open-ended retail funds: Disadvantages*.

Investment and borrowing restrictions

9. What are the investment and borrowing restrictions on retail funds?

Open-ended retail funds

UCITS. A UCITS can invest in the following types of assets, subject to certain eligibility criteria and concentration limits being met:

- Transferable securities and structured financial instruments.

- Money market instruments.
- Units of UCITS and other collective investment undertakings.
- Deposits with credit institutions.
- Financial derivative instruments.

Among the applicable risk diversification requirements, a UCITS must comply with the "5/10/40" rule. This rule requires that both:

- A maximum 10% of the fund's net assets must be invested in transferable securities and money market instruments issued by a single issuer.
- The aggregate value of transferable securities and money market instruments held by the relevant UCITS in the issuers in which it invests more than 5% must be limited to 40% of its net assets.

A UCITS can borrow up to 10% of its net assets on a temporary basis and/or to acquire immovable property essential for the direct pursuit of its business. However, this must not exceed 15% of its net assets cumulatively.

UCIs. Unless it is granted specific derogation from the CSSF or is pursuing a specific investment strategy (for example, in relation to venture capital, futures contracts/options, and/or real estate), an open-ended UCI must not:

- Invest more than 10% of its net assets in unlisted securities (that is, securities that are not listed on a stock exchange or dealt in on another regulated market that operates regularly and is recognised and open to the public).
- Invest more than 10% of its net assets in securities issued by a single issuer.
- Acquire more than 10% of the same type of securities issued by a single issuer.
- Borrow more than an amount corresponding to 25% of its net assets.

Closed-ended retail funds

See above, *Open-ended retail funds: UCIs*.

10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

Open-ended retail funds

UCITS. Within a UCITS, it is possible to create sub-funds and share/unit classes that are restricted to certain investors (see *Question 5, Open-ended retail funds*).

In addition, a UCITS sub-fund can be closed to further subscriptions (on either a temporary or permanent basis) when reaching the end of the initial subscription period or achieving an economically efficient size.

Conversely, a UCITS can foresee special circumstances (such as a temporary liquidity shortage) allowing for a delayed settlement of redemptions and a prorated reduction of redemption requests.

UCIs. Open-ended UCIs can establish more flexible rules for the issuance and redemption of shares/units.

Closed-ended retail funds

See above, *Open-ended retail funds: UCIs*. Closed-ended funds do not offer any redemption rights.

11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

Open-ended retail funds

UCITS. Under the Collective Investment Law, there are no restrictions on the transfer of rights held in a UCITS to third parties.

UCIs. There are no specific legal restrictions to transfer rights held in a UCI to third parties. Any contractual restrictions should be provided for in the fund documents.

Closed-ended retail funds

See above, *Open-ended retail funds: UCIs*.

Reporting requirements

12. What are the general periodic reporting requirements for retail funds?

Open-ended retail funds

Investors. UCITS must publish a prospectus, an audited annual report within four months from the end of each financial year, and a semi-annual (unaudited) report within two months from the end of the relevant financial period. UCIs must also publish a prospectus and similar financial reports (but within six and three months respectively from the end of the relevant financial period).

Regulators. UCITS and UCIs must submit monthly, semi-annual and annual financial information to the CSSF. Self-managed UCITS and UCITS management companies must submit additional periodic reports to the CSSF in accordance with Circular 12/546.

Closed-ended retail funds

See above, *Open-ended retail funds*. If a UCI qualifies as an AIF, further specific reporting requirements may apply.

Tax treatment

13. What is the tax treatment for retail funds?

Open-ended retail funds

Funds. UCITS and UCIs must pay an annual subscription tax of 0.05% on their NAV. This rate is reduced to 0.01% for certain money market funds/cash funds and sub-funds or classes reserved for institutional investors.

Exemptions apply to:

- The value of the assets represented by shares/units held in other collective investment undertakings, provided these are already subject to subscription tax.
- Special institutional money market funds.
- Pension funds.

- Collective investment undertakings investing in microfinance.
- Exchange traded funds.

Resident investors. No withholding tax applies on dividend and capital gains distributions to resident investors. Any distributions received will be subject to Luxembourg income tax.

Non-resident investors. No withholding tax applies on dividend and capital gains distributions to non-resident investors. Furthermore, non-resident investors are not subject to Luxembourg income tax when investing in Luxembourg UCITS and UCIs.

Tax reporting. UCITS and UCIs are subject to tax reporting requirements imposed under the US Foreign Account Tax Compliance Act (FATCA) and the OECD Common Reporting Standard (CRS) rules.

VAT. Management services rendered to UCITS and UCIs are exempt from VAT.

Closed-ended retail funds

See above, *Open-ended retail funds*.

Quasi-retail funds

14. Is there a market for quasi-retail funds in your jurisdiction?

There is no distinct market for quasi-retail funds in Luxembourg. However, Regulation (EU) 2015/760 on European long-term investment funds (ELTIF Regulation) allows EU alternative investment funds (see *Question 16*) investing mainly in eligible long-term assets to be marketed to retail investors under certain conditions (such as providing a key information document specifying the product features and risks).

Reform

15. What proposals (if any) are there for the reform of retail fund regulation?

Regulation (EU) 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs Regulation) introduces the requirement to provide a key information document (KID) for a wide range of investment products from 1 January 2018. However, UCITS will not need to produce a PRIIPs Regulation-compliant KID until 31 December 2019, at which point a review will be carried out to assess whether the transitional period should be extended.

Furthermore, Directive 2014/65/EU on markets in financial instruments (MiFID II) will have a significant impact on UCITS distribution models when it enters into force on 3 January 2018. Under MiFID II, the classification of "complex" financial instruments has been extended to include structured UCITS. Consequently, UCITS distributors will no longer be able to market such funds on an execution-only basis, without performing an appropriateness test.

ONLINE RESOURCES

Commission de Surveillance du Secteur Financier (CSSF)

W www.cssf.lu

Description. Official website of the Luxembourg financial supervisory authority. The website contains electronic versions of the applicable laws and regulations. The website also contains relevant information and documents relating to authorisation procedures.

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