

AMENDMENT TO THE DEPOSITARY REGIME OF LUXEMBOURG PART II UCIS

The Luxembourg law of 27 February 2018 (2018 Law) has been published in the Luxembourg official journal, the *Mémorial A*, on 1 March 2018 and will enter into force on 5 March 2018.

The main purpose of the 2018 Law is to implement certain provisions of Regulation (EU) 2015/751 of 29 April 2015 on interchange fees for card-based payment transactions and to modify various Luxembourg laws on financial services. Moreover, it also amends the Luxembourg law of 17 December 2010 on undertakings for collective investment (UCI Law) and the Luxembourg law of 12 July 2013 on alternative investment fund managers (AIFM Law) to clarify the depositary regime of Luxembourg undertakings for collective investment governed by Part II of the UCI Law (Part II UCIs).

BACKGROUND

Further to the implementation of Directive 2014/91/EU amending the so-called "UCITS Directive" as regards depositary functions, remuneration policies and sanctions (UCITS V Directive) in Luxembourg, the UCI Law had been amended with effect as of 1 June 2016 to impose the new UCITS V Directive depositary regime to Luxembourg UCITS.

At that time, the Luxembourg legislator also decided to extend the application of the UCITS V Directive depositary regime to all Part II UCIs, which by definition qualify as alternative investment funds (AIF) within the meaning of the AIFMD, and this without making any distinction according to the type of investors to whom these Part II UCIs are distributed (i.e. retail investors or professional investors), and also regardless of whether the alternative investment fund manager (AIFM) of these Part II UCIs is a fully authorised and licensed AIFM (Authorised AIFM) or is a registered AIFM that manages portfolios of AIFs whose assets under management in total do not exceed the EUR 100/500 million thresholds laid down in the AIFMD (Registered AIFM).

Key issues

- Depositary regime of Part II UCIs marketed to retail investors in Luxembourg is aligned with UCITS V Directive depositary regime
- Depositary regime of Part II UCIs marketed to professional investors only is aligned with AIFMD depositary regime or SIF Law depositary regime
- Application of AIFMD or SIF Law depositary regime to Part II UCIs marketed to professional investors only will depend on the status of the AIFM of these Part II UCIs, i.e. a fully authorised and licensed AIFM respectively a registered sub-threshold AIFM or a non-EU AIFM
- To be subject to AIFMD or SIF Law depositary regime, Part II UCIs must make clear in their offering documents that the marketing of their shares/units is only allowed to professional investors to the exclusion of retail investors in Luxembourg

NEW DEPOSITARY REGIME OF PART II UCIS

The modifications introduced by the 2018 Law to the UCI Law and the AIFM Law intend to ensure the same high level of protection to all retail investors in Luxembourg, and therefore limit the scope of application of the UCITS V Directive depositary regime - in addition to Luxembourg UCITS (as required by the UCITS V Directive) - to those Part II UCIs with offering documents which allow the marketing of their shares or units to retail investors in Luxembourg.

According to the revised provisions of the UCI Law, the depositary regime of Part II UCIs may be summarised as follows:

- Part II UCIs that are or may be **marketed to retail investors in Luxembourg** according to their offering documents will be subject to the **UCITS V Directive depositary regime**, as implemented by articles 17 and following, 33 and following or 39 of the UCI Law depending on the legal form of the relevant Part II UCI. For the avoidance of doubt, these Part II UCIs allowing the marketing of their shares or units to retail investors in Luxembourg will fall within the scope of the UCITS V Directive depositary regime irrespective of whether they are managed by an Authorised or Registered AIFM (both established either in Luxembourg or in another Member State) or by a non-EU AIFM;
- Part II UCIs with offering documents which **do not allow the marketing to retail investors in Luxembourg** and which are **managed by an Authorised AIFM** will be subject to the AIFMD depositary regime, as implemented by articles 19 of the AIFM Law;
- Part II UCIs with offering documents which **do not allow the marketing to retail investors in Luxembourg** and which are **managed by a Registered AIFM** or by a **non-EU AIFM** will be subject to the **SIF Law depositary regime**, i.e. the one set out in articles 16 and following, 33 and following or 40, paragraph 2 of the law of 13 February 2007 on specialised investment funds (SIF Law) depending on the legal form of the relevant Part II UCI.

In order to ensure that Part II UCIs are subject to the AIFMD respectively the SIF Law depositary regime as per the above, the preparatory documents of the 2018 Law provide that the offering documents of these Part II UCIs must expressly state that their shares/units will be marketed exclusively to professional investors within the meaning of article 4, paragraph 1, point ag) of the AIFMD (i.e. investors considered as professional clients or that can be considered, upon request, as professional clients in accordance with MiFID2).

ACTIONS TO BE TAKEN

The 2018 Law does not provide for any specific transitional provisions in relation to the amendments made to the depositary regime of Part II UCIs.

Therefore, as from 5 March 2018, Part II UCIs must ensure that they have appointed a depositary in accordance with the UCITS V, AIFMD or SIF Law depositary regime as applicable to them. They will also have to consider amending their offering documents as appropriate, and the case being their depositary agreement, should they want to ensure to remain subject to the AIFMD respectively the SIF Law depositary regime in case they are not marketed to retail investors in Luxembourg.

Luxembourg Part II UCI Depositary Regime Comparison of Luxembourg requirements under UCITS V, AIFMD & SIF Law			
	UCITS V as implemented by Lux UCI Law	AIFMD as implemented by Lux AIFM Law	SIF Law
Single Depositary Requirement	Yes	Yes	Yes
Depositary Eligibility Criteria	Lux credit institution or Lux branch of EU credit institution	Lux credit institution or Lux branch of EU credit institution + some other eligible entities subject to specific requirements	Similar to AIFMD
CSSF Approval	Yes	Yes	Yes
Written Contract with Depositary	Yes	Yes	Yes
Safekeeping Functions	Yes Similar to AIFMD	Yes Similar to UCITS V	Yes Less detailed than UCITS V and AIFMD that have different requirements for financial instruments capable of being held in custody and "other assets"
Cash Monitoring Functions	Yes Similar to AIFMD	Yes Similar to UCITS V	No specific requirement
Oversight Functions	Yes Similar to AIFMD	Yes Similar to UCITS V	No specific requirement
Re-Use of Assets by Depositary	Only permitted if executed for the account of the fund and subject to strict conditions	Permitted with prior consent of the fund/AIFM	No specific requirement, but depositary must exercise its functions in the exclusive interest of the investors
Delegation	Only safekeeping functions may be delegated to third parties subject to strict conditions	Similar to UCITS V	Not explicitly addressed by SIF Law, but delegation of safekeeping functions is accepted under certain conditions
Sub-Delegation	Permitted under the same conditions as delegation	Similar to UCITS V	Not explicitly addressed by SIF Law, but permitted under the same conditions as delegation
Depositary Liability	<p>UCITS V and AIFMD provide for a more rigorous liability regime than SIF Law, which provides that depositary is liable for any losses resulting of its wrongful failure to perform its obligations or its wrongful improper performance thereof</p> <p>Under UCITS V and AIFMD, the depositary is liable for any of loss of financial instruments held in custody by the depositary or its delegate unless it can prove that the loss is due to an unavoidable external event beyond its reasonable control and the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. As regards "other assets", the depositary is liable for its negligence or intentional failure to properly fulfil its obligations. Moreover, no limitation and/or discharge of the depositary's liability is possible, <u>except</u> under AIFMD that allows the contractual transfer of the depositary's liability to the sub-custodian/delegate in certain circumstances and pursuant to certain conditions</p>		
Incompatibilities	<p>Similar general requirements under UCITS V, AIFMD and SIF Law, which provide that (i) the depositary must act independently and solely in the interest of the investors, (ii) no entity may act at the same time as investment fund, AIFM/management company and depositary, and (iii) no delegation of the investment management function may be conferred on the depositary</p> <p>However, UCITS V imposes additional and more stringent independency requirements on depositary and management company/self-managed investment fund (i.e. prohibition of common management, cross-shareholding and group link allowed under certain conditions, and independent board members required where there is a group link between the management company/self-managed investment fund and the depositary)</p>		

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