C L I F F O R D
C H A N C E

Client briefing
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Luxembourg Law of 17 December 2010 on Undertakings for Collective Investment

The Luxembourg law of 17 December 2010 on undertakings for collective investment was voted by the Luxembourg Parliament on 16 December 2010 and entered into force on 1 January 2011. It implements the UCITS IV Directive and introduces a number of other changes to the Luxembourg legislation applicable to investment funds. As was the case in 1985 and 2002 with respect to the first UCITS Directive and the so-called UCITS III Directive, Luxembourg is the first country within the European Union to pass the UCITS IV Directive into national law.

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Introduction

The Luxembourg law of 17 December 2010 (2010 Law) on undertakings for collective investment (UCIs) was published in the Official Journal of the Grand Duchy of Luxembourg, *Mémorial A* n° 239, on 24 December 2010 and entered into force on 1 January 2011. The new law implements Directive 2009/65/EC (UCITS IV Directive) and will repeal the Luxembourg Law of 20 December 2002 on UCIs, as amended (the 2002 Law), with effect on 1 July 2012.

Two separate regulations (n°10-04 and n°10-05) have also been adopted by the Luxembourg supervisory authority of the financial sector (CSSF) in view of the implementation of the Level 2 legislation adopted by the European Commission on 1 July 2010 (i.e. Directive 2010/42/EU and Directive 2010/43/EU). The CSSF regulations were published along with the 2010 Law in the *Mémorial A* on 24 December 2010 and entered into force on 1 January 2011.

This briefing provides an overview of (i) the structure and scope of the 2010 Law; (ii) the main changes relating to UCITS vehicles; (iii) the main changes relating to non-UCITS vehicles; (iv) the principal amendments to the taxation regime of UCIs; and (v) the transitional provisions of the 2010 Law.

Structure and Scope of the 2010 Law

The UCITS IV Directive introduces a number of significant changes in relation to funds structured as UCITS and requires the respective national laws in Europe to be amended accordingly by 30 June 2011.

In considering how to implement these changes, the Luxembourg government decided that the 2002 Law should be abolished and replaced by an entirely new law. This decision was based on the fact that the 2002 Law had already been subject to a significant number of amendments and, therefore, it seemed more appropriate to produce an entirely new law governing UCIs.

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The adoption of an entirely new law was also considered as an opportunity to introduce some other changes which are not related to the UCITS IV package in order to make the Luxembourg investment fund regime more attractive. Nevertheless, the majority of the provisions of the 2002 Law have been retained in the 2010 Law, particularly those not affected by the UCITS IV Directive (in particular, the current Part II of the 2002 Law).

As expected, the 2010 Law replicates almost all the provisions of the UCITS IV Directive and is formatted in the following structure which is, to a large extent, the same as the 2002 Law.

Part I - Chapter 1 to Chapter 9

These provisions continue to govern UCITS. Additional provisions have been added to take account of the new cross-border notification procedure, mergers of UCITS and the rules applicable to master-feeder structures. In relation to the provisions of the 2002 Law which are not affected by the UCITS IV Directive, the 2010 Law retains those provisions as they were under the 2002 Law.

Parts II and III - Chapter 10 to Chapter 14

These provisions continue to govern UCIs subject to Part II of the 2002 Law (Part II UCIs) and foreign UCIs to a large extent. To a large extent, the 2010 Law comprises the same provisions as the 2002 Law.

Part IV - Chapter 15 to Chapter 18

These provisions govern management companies. As with the 2002 Law, a distinction is drawn between management companies managing UCITS (Chapter 13 Management Companies under the 2002 Law, or Chapter 15 Management Companies under the 2010 Law) and those managing other UCIs (Chapter 14 Management Companies under the 2002 Law, or Chapter 16 Management Companies under the 2010 Law). The most significant change to the UCITS regime arises from the possibility for Chapter 15 Management Companies to benefit from the European passport regime.

Part V - Chapter 19 to Chapter 26

These provisions govern, amongst others, the authorisation, organisation of supervision and obligations concerning information to be supplied to investors. They remain largely the same as under the 2002 Law. The main substantial amendments concern the new key investor information document (KID) (which will replace the simplified prospectus) and the provisions governing cooperation between supervisory authorities. The 2010 Law also takes into account the enhanced sanctions available to the CSSF and its supervisory powers.

Except for the points described below, provisions concerning tax, criminal sanctions, liquidation of UCIs, and umbrella UCIs are largely the same as under the 2002 Law.

UCITS and the 2010 Law

UCITS IV will have the effect of streamlining the process of cross-border sales of UCITS funds across the European Union whilst also giving UCITS managers a passport. It will also facilitate UCITS master-feeder structures and cross-border mergers of UCITS. Below is an overview of the key changes implemented by the 2010 Law.

Management Company Passport and Organisation Requirements

In line with the UCITS IV Directive, the 2010 Law provides that Luxembourg management companies authorised under Chapter 15 of the 2010 Law (Chapter 15 Management Companies) can benefit from a true European passport, pursuant to which they can pursue the activity of collective portfolio management, not only to UCITS established in Luxembourg, but also to UCITS established in other member states of the European Union and of the European Economic Area (Member States). To the same extent, the 2010 Law provides that management companies authorised under the UCITS IV Directive in another Member State can provide the services for which they have been authorised not only to UCITS established and managed in their home Member State, but also to UCITS established in other Member States such as Luxembourg. The consequence of these changes is that the competent authority of the management company may not necessarily be the authority competent to supervise the UCITS under management.

When carrying out their activities on a cross-border basis, Chapter 15 Management Companies, as well as management companies authorised under the UCITS IV Directive in another Member State, have the choice of either setting-up a branch or providing services under the freedom to provide services. The passport will offer more flexibility for

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management companies to provide collective portfolio management services cross-border without being obliged to be established in the UCITS' home Member State. Management companies will also potentially benefit from reduced costs and economies of scale due to the fact that they can sell UCITS across the European Union without establishing a full suite of administrative functions in each jurisdiction and through the possibility for consolidation of existing management companies.

The core activities covered by the management company passport are investment management, administration and marketing. Additional and non-core functions, such as investment advice on certain MiFID instruments, and safekeeping and administration in relation to units of UCIs, are also included. However, the management of UCITS' and other UCIs' investment should remain the principal function of management companies.

The allocation of supervisory responsibility between the CSSF and the host Member States' competent authorities is aimed to ensure the smooth operation of the management company passport. In the case of a Chapter 15 Management Company providing its services in another Member State, the CSSF will be responsible, *inter alia*, for supervising the adequacy of the arrangements and organisation of the Chapter 15 Management Company whereas the competent authorities of the UCITS will be responsible, *inter alia*, for the creation and authorisation of the UCITS. If the management company's home Member State is not the UCITS' home Member State, the UCITS depositary will have to enter into a written agreement with the management company regulating the flow of information deemed necessary to allow the depositary to perform its supervisory functions and monitoring duties.

As under the 2002 Law, Chapter 15 Management Companies are subject to specific organisational and conflicts of interest requirements as well as precise rules of conduct and provisions on risk management. The detailed rules in this respect have been laid down in CSSF Regulation n°10-04, which entered into force on 1 January 2011. The content of the written agreement and the measures to be taken by the depositary in order to fulfil its duties regarding a UCITS managed by a management company established in another Member State is also clarified in this CSSF regulation. Moreover, new organisational requirements have been added, such as the need to establish appropriate procedures and arrangements to ensure that Chapter 15 Management Companies deal properly with investor complaints and that there are no restrictions on investors exercising their rights in the event that the Chapter 15 Management Company manages UCITS established in another Member State.

Notification Procedure

The management company passport facilitates cross-border marketing and distribution of UCITS in other host Member States following appropriate notification to the respective competent authorities. An important development under the UCITS IV Directive is that the *ex ante* control of the host Member State competent authorities is removed and replaced by a "regulator-to-regulator" system.

Chapter 6 of the 2010 Law deals with UCITS established in Luxembourg which market their units in other Member States and Chapter 7 relates to UCITS established in other Member States which market their units in Luxembourg.

In short, a UCITS established in Luxembourg which proposes to market its units in another Member State must notify the CSSF of its intention to be distributed in such host Member State. The notification letter shall include information on arrangements made for marketing units of the UCITS in the host Member State, including, where relevant, in respect of unit classes. The CSSF will then transmit the notification letter and accompanying documentation as well as an attestation certifying that the UCITS fulfils the conditions imposed by the UCITS IV Directive to the competent authorities of the host Member State no later than 10 working days following the date of receipt of the complete notification file. Upon transmission of the notification file, the CSSF will immediately notify the UCITS, at which point the marketing of the units of the UCITS in the host Member State can begin. The UCITS will, however, still be subject to the laws of the host Member State applicable to marketing arrangements and to ongoing supervision by the host Member State competent authorities.

The same rules apply *mutatis mutandis* in case of a foreign UCITS wishing to market its units in Luxembourg.

Level 2 implementing measures with respect to the form and content of the standard notification letter and UCITS attestation, and the use of electronic communication between competent authorities for the purpose of notification, have been specified in Commission Regulation n° 584/2010 of 1 July 2010 which will apply from 1 July 2011. The success of this new notification procedure will be closely linked to the ongoing work in relation to the implementation measures for the management company passport and the KID.

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UCITS Mergers

UCITS IV introduces a legal framework for the national and cross-border merger of UCITS, which is implemented in the new Chapter 8 of the 2010 Law. This development is particularly welcomed as it is widely believed that the European UCITS market is characterised by funds of sub-optimal size. An effective merger regime should provide for the capability to rationalise the fund landscape whilst at the same time ensuring the highest level of investor protection and is intended to result in significant savings for the fund industry.

The 2010 Law provides for three different merger techniques: merger by absorption, merger by creation of a new entity and scheme of amalgamation. The proposed merger regime only covers mergers of UCITS, including investment compartments thereof. It applies to cross-border mergers and domestic mergers even in the case of a pure domestic merger between UCITS established in Luxembourg where none of the UCITS concerned have been notified for cross-border marketing of its units in another Member State[1]. For the avoidance of doubt, the provisions of Chapter XIV of the Luxembourg Law of 10 August 1915 on commercial companies, as amended (Company Law), on mergers are not applicable to mergers of UCITS.

Where the merging UCITS is established in Luxembourg, a merger is subject to prior authorisation by the CSSF. The CSSF shall inform the merging UCITS within 20 working days of submission of the complete application whether or not the merger has been authorised. The merging UCITS must provide the CSSF with the following documentation in either Luxembourgish, French, German or English:

- The common draft terms of the proposed merger approved by the merging UCITS and the receiving UCITS;
- An up-to-date version of the prospectus and the KID of the receiving UCITS, if it is established in another Member State;
- A statement by each of the depositaries of the merging and the receiving UCITS stating that certain provisions of the common draft terms of the merger are in accordance with the constitutional documents of the merging and the receiving UCITS and the 2010 Law. In the case where the receiving UCITS is established in another Member State, this statement by the depositary of the receiving UCITS shall confirm that the relevant provisions of the common draft terms of the merger are in accordance with the constitutional documents of the receiving UCITS and the UCITS IV Directive; and
- The information on the proposed merger that the merging and the receiving UCITS intend to provide to their respective unitholders.

In addition, an authorised auditor or, as the case may be, an independent auditor must validate: (i) the criteria used for valuing the assets and, as the case may be, the liabilities of the UCITS on the date for calculating the exchange ratio; (ii) where applicable the cash payment per unit; and (iii) the calculation method of the exchange ratio as well as the actual exchange ratio determined at the date for calculating that ratio.

The 2010 Law provides for specific rules for determining the effective date of the merger. Where the management regulations or the instruments of incorporation provide for the approval of the merger by a meeting of unitholders, these documents must provide for the quorum and majority requirements applicable save that with respect to the approval of the common draft terms of the merger by the unitholders, such an approval must be adopted by simple majority, without however requiring more than 75% of the votes cast by the unitholders present or represented at the meeting. In the absence of specific provisions in the management regulations or the instruments of incorporation, any merger must be approved either (i) by the management company for any merging UCITS having the legal form of a mutual fund (FCP), or (ii) by the general meeting of unitholders deciding by simple majority of the votes cast by unitholders present or represented at the meeting for any merging UCITS having a corporate form.

Insofar as a merger requires the approval of the unitholders, only the approval of the unitholders of the compartment(s) concerned by the merger shall be required, unless otherwise provided in the management regulations or the instruments of incorporation of the UCITS.

The practical terms of merger procedures for Luxembourg UCITS concerned by a merger are laid down in CSSF Regulation n°10-05, which entered into force on 1 January 2011. This CSSF regulation focuses on the information to be

[1] Article 66(2) of the 2010 Law. The 2010 Law is more extensive than the UCITS IV Directive since the latter covers domestic mergers only where at least one of the UCITS involved has been notified for cross-border marketing of its units in another Member State.

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provided to the unitholders of both the merging UCITS and the receiving UCITS, tailoring the information to meet the different needs of the two groups of unitholders.

It is hoped that the new merger regime will result in a less onerous filing procedure with the competent authorities of both the merging UCITS and the receiving UCITS, a simplified and more efficient (and therefore less costly) process for mergers and less delay in the merger process. However, the merger regime under UCITS IV will require a high level of cooperation and trust between national competent authorities to be effective. Tax neutrality of UCITS and unitholders is also an important issue that still needs to be addressed, as it ensures that investors in cross-border UCITS enjoy equal benefits regardless of the Member State in which they or the UCITS reside.

Master-Feeder Structures

UCITS IV introduces a form of asset pooling to the UCITS landscape in the form of "master-feeder" structures which should create opportunities to enable UCITS' promoters and asset managers, improving the efficiency of the UCITS framework through economies of scale and greater adaptability to investors' preferences. Such asset pooling allows simultaneous management by the master UCITS of assets gathered by several feeder UCITS, each of which can still maintain a local fund presence in a range of target European markets.

The 2010 Law includes a new Chapter 9 which allows a feeder UCITS to invest at least 85% of its assets in units of another UCITS (the master UCITS) or a compartment thereof, subject to several requirements including:

- The master UCITS must be established in Luxembourg or in another Member State, it may not be a feeder UCITS itself and may not hold units in a feeder UCITS;
- The prospectus of the feeder UCITS must contain certain information including a brief description of the master UCITS, its organisation, investment objective and policy, and risk profile. The feeder UCITS shall, *inter alia*, enter into an agreement with the master UCITS which shall be made available, on request and free of charge, to all unitholders. However, if both the master and the feeder UCITS are managed by the same management company, the agreement may be replaced by internal conduct of business rules. In addition, if the master and the feeder UCITS have different depositaries or auditors, those depositaries or auditors must enter into an information-sharing agreement in order to ensure the fulfilment of the duties of both depositaries and auditors.
- The master and the feeder UCITS shall also take appropriate measures to coordinate the timing of their net asset value calculation and publication in order to avoid market timing in their units and prevent arbitrage opportunities.

The investment of a feeder UCITS which is established in Luxembourg into a given master UCITS shall be subject to the prior approval of the CSSF. The feeder UCITS shall be informed by the CSSF within 15 working days following the submission of a complete file, whether or not the CSSF has approved the feeder UCITS investment into the master UCITS. Any master UCITS established in Luxembourg shall immediately inform the CSSF of the identity of each feeder UCITS which invests in its units. If the feeder UCITS is established in another Member State, the CSSF shall immediately inform the competent authorities of the feeder UCITS home Member State.

The practical terms for Luxembourg UCITS concerned by master-feeder structures, including provisions on the agreement and internal conduct of business rules between feeder UCITS and master UCITS, on liquidation, merger or division of the master UCITS and on auditors and depositaries are laid down in CSSF Regulation n°10-05, which entered into force on 1 January 2011.

Key Information Document

UCITS IV replaces the simplified prospectus with a key investor information document known as the "KID". Where the UCITS is established in Luxembourg or markets its units in Luxembourg pursuant to Chapter 7 of the 2010 Law, the words "key investor information" shall be clearly stated in that document in Luxembourgish, French, German or English.

The KID is an extremely short and concise document (in principle no longer than two pages) written in non-technical language which aims to help potential investors understand the essential characteristics of the UCITS concerned and to select the UCITS investments that best corresponds to their needs and expectations. The essential elements of the KID must be kept up to date and the UCITS must provide the CSSF with any amendment thereto.

The KID shall include a short description of the objectives and investment policy of the UCITS, a risk and reward profile, past performance data or, where relevant, performance scenarios, and details on costs and associated charges.

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Additional information will need to be included in specific circumstances, for example in the case of an umbrella fund, a fund of funds or master-feeder structures, or where the UCITS has more than one class of units. The KID may be delivered in a durable medium other than paper, including on a website, provided that appropriate precautionary measures are taken.

The KID constitutes pre-contractual information. It shall be fair, clear, not misleading and shall also be consistent with the prospectus. No person shall be held liable solely on the basis of the KID, including any translation thereof, unless it is misleading, inaccurate or inconsistent with the prospectus.

Much of the detail of the KID is determined at Level 2 in Commission Regulation n° 583/2010 that will apply from 1 July 2011. As indicated by the European Commission, this Regulation should be read alongside the guidelines published by the Committee of European Securities Regulators (CESR)[2] on 1 July 2010 in relation to the KID.

Cooperation between Supervisory Authorities

The 2010 Law includes new provisions on the CSSF's cooperation with the competent authorities of the other Member States, which require a higher level of cooperation between competent authorities than before in order to realise their true potential. The management company passport, master-feeder structures and merger provisions all require that the respective responsibilities of the relevant competent authorities are clearly defined. This avoids duplication of resources and limits unnecessary operational risk. In respect of merging UCITS, it is understood that effective cooperation is essential in order to provide adequate investor protection, which is a key aim of the UCITS IV revision. Furthermore, the success of the new streamlined notification procedure, and the desired reduced regulatory and cost burden of such changes, will depend largely on the level of confidence between European regulators.

The general collaboration duty and professional secrecy obligations under the 2002 Law are retained by the 2010 Law and even somewhat strengthened. The CSSF shall provide the competent authorities of other Member States with all information necessary in conducting their supervisory role without delay. This is clearly more demanding than the close collaboration and information-sharing requirements prevailing before. The CSSF shall cooperate with the competent authorities of other Member States even in cases where the conduct under investigation does not constitute an infringement of any regulation in force in Luxembourg.

Furthermore, specific cooperation requirements allow for on-the-spot verifications of information and investigations to be conducted by the competent authorities of other Member States in Luxembourg. The CSSF is further empowered to take actions against a UCITS, the units of which are marketed in Luxembourg, if it has clear and demonstrable grounds for believing that such a UCITS is in breach of the obligations arising from the UCITS IV Directive which do not confer powers on it, and if, despite the measures taken by the competent authorities of the UCITS' home Member State, the UCITS persists in acting in a manner that is clearly prejudicial to the interests of investors in Luxembourg.

The CSSF is granted wide-ranging and detailed supervisory and investigatory powers. The fine which may be imposed upon directors or members of the management board or, as the case may be, upon managers and officers of UCIs, as well as upon the liquidators in the case of voluntary liquidation of a UCI, in the event of their refusal to provide the financial reports and the requested information or where such documents prove to be incomplete, inaccurate or false, and in the event of any violation of the provisions of Chapter 19 "Authorisation" of the 2010 Law or in the event of any other serious irregularity being recorded, was (i) extended to managers and officers of management companies, depositaries and any other undertaking contributing towards the business activity of UCIs subject to supervision by the

[2] CESR has been replaced by the European Securities and Markets Authority (ESMA) on 1 January 2011.

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CSSF, and (ii) increased from EUR 15-50 to EUR 125-12,500. In addition, the CSSF may make public any such fine, 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.

Level 2 implementing measures relating to the procedures for on-the-spot verifications and investigations, and the exchange of information between Member States' competent authorities are specified in Commission Regulation n° 584/2010 which will apply from 1 July 2011.

Non-UCITS and the 2010 Law

In addition to the implementation of the UCITS IV Directive, the 2010 Law introduces some other changes to the 2002 Law, the Luxembourg Law of 13 February 2007 relating to specialised investment funds (SIFs), as amended (the SIF Law), and the Law of 4 December 1967 on income tax. The most important changes are outlined below.

Cross-Investments within Umbrella UCIs

While this possibility was not initially provided for in the 2002 Law, a compartment of an umbrella UCI (whether set up as a UCITS or a Part II UCI) may now subscribe, acquire and/or hold securities to be issued or issued by one or more compartments of the same UCI subject to the following conditions:

- Disclosure - Such possibility must be specifically provided for in the management regulations or the instruments of incorporation as well as in the prospectus of the UCI. Consequently, existing umbrella UCIs wishing to use this possibility must first amend their management regulations or instruments of incorporation as well as their prospectus;
- No circle investments - The target compartment cannot, in turn, invest in the investing compartment;
- No investment cascades - With a view to preventing cascade investments, no more than 10% of the assets of the target compartments whose acquisition is contemplated may, pursuant to their management regulations or their instruments of incorporation, be invested in aggregate in units of other UCIs;
- Voting rights - Voting rights, if any, attached to the securities of the target compartment are suspended for the duration of the investment and without prejudice to the appropriate processing of the accounts and periodic reports;
- Net asset value - For as long as the securities of the target compartment are held by the UCI, their value will not be taken into consideration for the calculation of the net assets of the UCI for the purposes of verifying that the minimum threshold of the net assets imposed by the 2010 Law (i.e. EUR 1,250,000) is complied with; and
- No duplication of fees - There is no duplication of management/subscription or repurchase fees between those at the level of the investing compartment and the target compartment.

In addition, the investing compartment of an umbrella UCITS must comply with the existing investment limits applicable to investments in UCITS and other UCIs. Consequently, a compartment of a UCITS may not invest more than 20% of its net assets in the units of another compartment of the same UCITS[3].

The investing compartment shall also respect the acquisition limits applicable to investments in UCITS and other UCIs. Therefore, a compartment of a UCITS may not acquire more than 25% of the units issued by another compartment of the same UCITS[4].

For the sake of completeness, cross-investments between compartments of the same umbrella UCI are permitted from 1 January 2011 to both UCIs subject to the 2010 Law and for UCIs that have opted to remain subject to the 2002 Law until 30 June 2011 provided, however, that such possibility is authorised by the UCITS' or Part II UCI's constitutive documents.

[3] Article 46 (1) of the 2010 Law.

[4] Article 40 of the 2010 Law seems to indicate that the 25% limit referred to in Article 48(2) should be calculated at the level of the target compartment individually. Under the 2002 Law regime, however, this 25 % limit is calculated at the level of the target UCITS as a whole (i.e. on the basis of the units issued by all of the UCITS' compartments).

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Withdrawal of CSSF Authorisation of One Compartment

The 2010 Law clarifies that the CSSF may withdraw authorisation of one compartment of an umbrella UCI (either a UCITS or a Part II UCI) without impacting the whole umbrella structure (i.e. withdrawal of authorisation of one compartment does not give rise to the removal of the umbrella UCI itself from the official list)[5]. This change aims at avoiding a negative impact on investors in the other existing compartments and is effective from 1 January 2011.

Delegation of Functions in Part II UCIs

In order to protect investors of Part II UCIs, the following new rules (which are similar to those applicable to UCITS) must be complied with in case of delegation of one or several functions by a Part II UCI (or its management company)[6]:

- The CSSF must be informed in an appropriate manner;
- The mandate shall not prevent the effectiveness of supervision over the Part II UCI, and in particular it must not prevent the Part II UCI from acting, or from being managed, in the best interest of the investors;
- When the delegation concerns investment management, the mandate may be given only to undertakings which are authorised or registered for the purpose of asset management and subject to prudential supervision;
- Where the mandate concerns investment management and is given to a third-country undertaking, cooperation between the CSSF and the competent authorities of this country must be ensured; and
- A mandate with respect to the core function of investment management shall not be given to the depositary.

Part II UCIs existing before 1 January 2011 benefit from a grandfathering provision and will have until 1 July 2012 to comply with the above requirements[7].

Specific Changes Applicable to Management Companies

Official List for All Luxembourg Management Companies

The 2010 Law expressly provides for the registration, as from 1 January 2011, of all Luxembourg management companies authorised by the CSSF on an official list held by the CSSF[8]. The 2002 Law did not provide for the existence of such a list, while practice has shown the importance of having an official list, which was set up by the CSSF for Chapter 13 Management Companies only.

The entry of all Luxembourg management companies on the official list is tantamount to authorisation and is notified by the CSSF to the Luxembourg management company concerned. Applications for entry on the list must be filed with the CSSF before the incorporation of the management company. The incorporation of the management company can only be undertaken after notification of the authorisation by the CSSF. Finally, this list and modifications made thereto are published in the *Mémorial* by the CSSF.

Exercise of the Activity of Management Companies by Multilateral development Banks

A new Chapter 18 of the 2010 Law ensures that multilateral development banks listed in point 20 of Annex VI of Directive 2006/48/EC (as amended), which are permitted by their statutes to perform collective portfolio management services, are authorised to act as Chapter 16 Management Companies (formerly Chapter 14 Management Companies). These multilateral development banks include, *inter alia*, the European Investment Bank, the European Bank for Reconstruction and Development and the European Investment Fund. Such institutions are required to provide the CSSF, in relation to UCIs under their supervision, with the information required by the CSSF for the purposes of prudential supervision of the UCIs managed. In case of UCIs which have the form of an FCP, the provisions of this chapter shall only apply if the management regulations of the FCPs concerned are subject to Luxembourg law.

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[5] Article 181(7) of the 2010 Law.

[6] Articles 95 indent 2, 99(6) and 125(1) indent 6 of the 2010 Law.

[7] Article 183(4) indent 2 of the 2010 Law.

[8] Article 101 indent 3 of the 2010 Law.

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The SIF Law was also amended to allow the aforementioned multilateral developments banks to act as management companies of SIFs under the form of an FCP.

The above changes entered into force on 1 January 2011.

Specific Changes Applicable to SICAV/SICAF

As detailed below, the 2010 Law includes changes specific to UCIs (whether set up as UCITS or Part II UCIs) having adopted the form of an investment company with variable capital (SICAV) or investment company with fixed capital (SICAF), which are effective from 1 January 2011.

Language of the Articles of Incorporation

The articles of incorporation of a Luxembourg SICAV/SICAF and any amendment thereto must be recorded in a special notarial deed drawn up in French, German or English, as the appearing parties may decide[9].

According to the 2010 Law, where this deed is drawn up in English, the requirement to attach a French or German translation to the deed when it is filed with the Luxembourg Register of Trade and Companies is no longer required. For the avoidance of doubt, no similar provision is provided for in respect of the articles of incorporation of management companies.

Convening Notice to the Annual General Meeting of the Unitholders

By derogation to the provisions of Article 73, paragraph 2 of the Company Law, UCIs having adopted the form of a SICAV/SICAF are no longer required to send annual accounts, as well as the report of the authorised auditor, management report and, where relevant, comments made by the supervisory board to the registered unitholders at the same time as the convening notice to the annual general meeting of the unitholders[10].

The convening notice to the annual general meeting of the unitholders shall indicate the place and the practical arrangements for providing these documents to the unitholders (e.g. on a website or by e-mail) and shall specify that each unitholder may request that annual accounts, as well as the report of the authorised auditor, management report and, where applicable, comments made by the supervisory board are sent to the requested unitholder.

Cut-off Time for General Meetings - Calculation of Applicable Majority and Quorum Requirements

Calculation of applicable quorum and majority requirements at a general meeting of unitholders shall in principle be made on the basis of the units issued and outstanding at the time such general meeting is held. Article 67 (4) of the Company Law provides that "*Every shareholder may, notwithstanding any clause to the contrary in the constitutive instrument, take part in the deliberations, with a number of votes equal to the number of shares held by him, without limitation*". This rule may be practically very difficult – or even impossible – for UCIs having adopted the form of a SICAV/SICAF with a large number of investors, notably where units are issued and redeemed on a daily basis. Considering the large number of daily subscription and redemption requests, and therefore, the number of changes to the register of unitholders which such SICAV/SICAF may be subject to, the setting up of the attendance list and the vote cast check of each unitholder may be quite time consuming. In most cases, it is not possible to set up the attendance list in one day.

In order to remedy these difficulties, the 2010 Law provides that the convening notices to the general meetings of unitholders of a SICAV/SICAF may provide that the quorum and the majority at the general meeting shall be determined according to the units issued and outstanding at midnight (Luxembourg time) on the fifth day prior to the general meeting (referred to as the record date). The rights of a unitholder to attend a general meeting and to exercise the voting rights attaching to his units are determined in accordance with the units held by this unitholder at the record date.

Changes to the Taxation Regime of UCIs

New tax measures for UCIs (whether set up in the form of UCITS or Part II UCIs) are outlined in the 2010 Law and applicable as of 1 January 2011. The main changes to the 2002 Law regime are briefly summarised below.

[9] Articles 26(2), 39, 95(1) and 99(7) of the 2010 Law.

[10] Articles 26(3), 39, 95(1) and 99(8) of the 2010 Law.

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ETFs Exempt from Subscription Tax

Up until 1 January 2011, exchange traded funds (ETFs) were subject to an annual subscription tax at the reduced rate of 0.01% on their net assets. The tax provisions of the 2002 Law were supplemented by a new paragraph on ETFs to allow UCIs as well as individual compartments of UCIs with multiple compartments, (i) the securities of which are listed or traded on at least one stock exchange or another regulated market operating regularly, recognised and open to the public, and (ii) the exclusive object of which is to replicate the performance of one or more indices, to be exempted from the payment of the annual subscription tax, as is the case in other jurisdictions for such ETFs[11].

This new provision should be read in conjunction with the new sub-section (4) of article 176 of the 2010 Law which specifies that without prejudice to additional or alternative criteria that may be determined by Grand Ducal regulation, such index must represent an adequate benchmark for the market to which it refers and must be published in an appropriate manner.

Multi-Employer Pension Funds Exempt from Subscription Tax

Pursuant to the 2002 Law, UCIs, the securities of which are reserved for institutions for occupational retirement provision or similar investment vehicles, are exempted from the annual subscription tax. This exemption was however limited to pension funds created at the initiative of a same group for the benefit of their employees, i.e. UCIs used as group pension pooling vehicles. Conversely, the SIF Law provides for the exemption of the annual subscription tax where the securities of the SIF concerned are reserved for institutions for occupational retirement provision, or similar investment vehicles, set up on one or several employers' initiative for the benefit of their employees.

The 2010 Law amends the 2002 Law to put it in line with the recently amended text of the SIF Law and states that UCIs are exempt from subscription tax where the securities of such UCIs are reserved for (i) institutions for occupational retirement provision or similar investment vehicles, set up on one or more employers' initiative for the benefit of their employees and (ii) companies of one or more employers investing funds they hold, to provide retirement benefits to their employees [12].

As a general rule, if several classes of securities exist within the UCI or the compartment, the exemption from the subscription tax to the benefit of ETFs and multi-employer pension funds only applies to classes fulfilling the conditions mentioned above.

Non-Resident Investors Exempt from Taxation on Capital Gains

Up until 1 January 2011, capital gains realised by non-resident investors upon the disposal of shares of Luxembourg SICAVs, SICAFs and other corporate UCIs could have been subject to Luxembourg taxation in the event of a sale of at least a 10% shareholding within 6 months following acquisition of the shares to the extent that there was no treaty granting the exclusive taxation right to the country of the investor. Such taxation applied, *inter alia*, to foreign feeder funds investing into a Luxembourg master fund.

In order to respond to the needs of non-resident investors (and notably of feeder funds) willing to invest in corporate UCIs, the 2010 Law amends article 156 (8) (c) of the Luxembourg income tax law in order to exempt income realised by non-resident investors from the sale of a holding in a Luxembourg SICAV, SICAF and other corporate UCI[13].

Non-Resident UCIs Exempt from Taxation on Profits and Net Assets

As part of the transposition of the UCITS IV Directive, it appeared important to the Luxembourg legislator to explicitly exclude from the scope of Luxembourg corporate income tax, municipal business tax and net wealth tax, UCIs which are established outside the territory of Luxembourg even if they have established their effective centre of management or their central administration in Luxembourg.

This measure mainly aims at ensuring that foreign investment funds are not subject to taxation in Luxembourg when they are managed or administered from Luxembourg[14]. This provision was crucial to clarify the tax treatment of foreign UCIs managed by a Luxembourg management company.

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[11] Article 175 e) of the 2010 Law.

[12] Article 175 c) of the 2010 Law.

[13] Article 178 of the 2010 Law.

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Transitional Provisions

The 2010 Law entered into force on 1 January 2011. Chapter 25 and 26 of the 2010 Law contain transitional, amending and repealing provisions which entail the following consequences in respect of the entry into force of the different provisions of the 2010 Law.

Transitional Period for UCITS and Part II UCIs

- UCITS created before 1 January 2011, as well as UCITS created between 1 January 2011 and 1 July 2011, will have the choice, until 1 July 2011, to either remain subject to the 2002 Law or to be governed by the 2010 Law. As from 1 July 2011, they shall be *ipso jure* governed by the 2010 Law, but they will have until 1 July 2012 to replace their simplified prospectus by the KID if they have not submitted themselves to the 2010 Law before 1 July 2011. In principle, a new compartment shall not co-exist in the same umbrella UCITS with compartments still subject to the 2002 Law, i.e. the option referred to in the preceding bullet point must be exercised in respect of the whole UCITS, so that all the compartments of a UCITS are governed by the same set of rules[15].
- UCITS created as from 1 July 2011 shall be *ipso jure* governed by the 2010 Law.
- Part II UCIs created before 1 January 2011 shall be *ipso jure* governed by the 2010 Law, but they will have until 1 July 2012 to comply with the new legal provisions applying to the delegation of their functions.
- Part II UCIs created after 1 January 2010 shall be *ipso jure* governed by the 2010 Law.
- For those UCIs existing on 1 July 2011 and that have been subject until that date to the 2002 Law, all references in the management regulations or the instruments of incorporation to the 2002 Law will be deemed to be replaced by references to the 2010 Law.

The 2010 Law also provides that, between 1 January 2011 and 1 July 2011, UCITS and management companies authorised in other Member States may rely on the provisions of the 2010 Law in a cross-border situation only if the provisions of the UCITS IV Directive have been implemented in their home State.

Transitional Period for Management Companies

- Chapter 13 Management Companies created before 1 January 2011, as well as Chapter 13 Management Companies created between 1 January 2011 and 1 July 2011, will have the choice until 1 July 2011 to either remain subject to the 2002 Law or to be governed by Chapter 15 of the 2010 Law. As from 1 July 2011, they shall be *ipso jure* governed by the 2010 Law.
- Chapter 13 Management Companies created as from 1 July 2011 shall be ipso jure governed by the 2010 Law.
- Chapter 14 Management Companies created before 1 January 2011 shall be ipso jure governed by Chapter 16 of the 2010 Law, but will have until 1 July 2012 to comply with the new legal provisions applying to the delegation of their functions.
- New Chapter 14 Management Companies shall not be created after 1 January 2011.
- For those management companies existing on 1 July 2011 and that have been subject until that date to the 2002, all references in their instruments of incorporation to the 2002 Law will be deemed to be replaced by references to the 2010 Law.

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[14] Article 179 of the 2010 Law.

[15] According to CESR' guidelines on transition for the simplified prospectus to the KID (CESR/10-1319), for any new compartment added to an umbrella UCITS existing at 30 June 2011, the management company may choose whether to provide a simplified prospectus or a KID for that new compartment. Consequently, investors could be offered both a simplified prospectus and a KID for different compartments of the same UCITS. However, in respect of new classes of units approved during the transitional period, CESR would expect that a consistent approach is taken, i.e. either use a simplified prospectus or a KID for all unit classes. The CSSF has not communicated any official position in this respect yet.

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Conclusion

The 2010 Law has great potential and brings many benefits to the Luxembourg and European funds industry. A functioning management company passport, cross-border merger and master-feeder structure provisions alongside a streamlined notification procedure are changes which are hoped to save the industry substantial time and costs. The management company passport and streamlined notification should result in a simplified regulatory framework, whereas cross-border mergers and master-feeder structures will encourage economies of scale and cost savings through the pooling of fund assets.

Clifford Chance can provide you with an integrated service and dedicated team who will be happy to answer your questions, to structure investment funds (including UCITS), draft their documentation in accordance with the Luxembourg fund legislation and advise on their tax regime.

Please note that an English translation of the 2010 Law may be obtained upon request.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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