

Luxembourg Bill of Law Transposing the AIFM Directive

On 24 August 2012, Bill of law N°6471 (Bill 6471) relating to the transposition of the Alternative Investment Fund Managers Directive (AIFMD) was deposited with the Luxembourg Parliament. It is anticipated that Bill 6471 will be adopted before end 2012, six months before the deadline for implementation provided for in the AIFMD.

This client briefing explains the key changes to be introduced by Bill 6471 to the current legal framework of Luxembourg regulated investment vehicles (i.e. Part II UCIs, SIFs and SICARs) and their management companies (where applicable). It also outlines the expected timeline and grandfathering provisions.

Introduction

The scope of Bill 6471 exceeds the mere implementation of the AIFMD. Indeed, Luxembourg authorities have taken this as an opportunity to further improve the attractiveness of Luxembourg as an alternative investment fund domicile as a whole.

Besides one specific new law on AIFMs (AIFM Law)¹, Bill 6471 provides for a legal efficiency package including:

- amendments to several product laws (e.g. UCI Law², SIF Law³, SICAR Law⁴, Financial Sector Law⁵, etc.) and some tax laws;
- non-directly AIFMD related changes to existing fund laws and company law, including essentially the modernisation of the existing Luxembourg common limited partnership (*société en commandite simple*),

the introduction of improvements to the existing Luxembourg partnership limited by shares (*société en commandite par actions*) and the introduction of the Luxembourg special limited partnership (*société en commandite spéciale*) without legal personality.

As of today, there is still some uncertainty as to the full extent of some aspects of the AIFM Law and the proposed amendments to the UCI Law, SIF Law and SICAR Law. Indeed, Bill 6471 has still to be discussed by the Luxembourg Parliament and some modifications may be introduced before it is finally passed into law. Moreover, the below information will also be subject to clarifications upon adoption by the European Commission of Level 2 measures providing for additional details and further guidance on the implementation of the AIFMD.

Key issues

- Introduction
- The AIFM Law in a Nutshell
- Impact on Management Companies
- Impact on Part II UCIs, SIFs and SICARs
- Impact on Services Providers
- Expected Timeline
- Conclusion

1. The AIFM Law in a Nutshell

In line with the AIFMD, the AIFM Law lays down the rules applicable to the authorisation, the scope of activities and the transparency requirements relating to Luxembourg alternative investment fund managers (AIFMs) managing and/or marketing alternative investment funds (AIFs) within the EU.

1.1 Scope

Subject to the exceptions and grandfathering provisions set forth under 1.2 and 1.3 below, the AIFM Law will apply to all Luxembourg AIFMs, which manage one or more AIFs, irrespective of whether the AIF is a Luxembourg, EU or, to a certain extent, non-EU AIF and regardless of its legal form and/or regulatory regime⁶.

1.1.1 AIFM Concept

Definition

The AIFM Law defines the "AIFM" as any legal person whose regular business is managing, i.e. providing at least the key function of portfolio management and/or risk management to, one or more AIFs.

According to the AIFM Law, the AIFM can either be:

- an **external manager**, which is the legal person appointed by the AIF or on behalf of the AIF and which through this appointment is responsible for managing the AIF; or
- the AIF itself (which shall then qualify and be authorised as the AIFM), where the legal form of the AIF permits an **internal management** and where the

AIF's governing body chooses not to appoint an external AIFM.

Authorisation

Under the AIFM Law, any Luxembourg AIFM will need to apply for authorisation with the CSSF prior to starting its business, unless (but only within the limits) it is excluded, exempted or grandfathered (see 1.2 and 1.3 below).

Potential Luxembourg AIFMs

The following regulated entities may potentially qualify as AIFM under the AIFM Law:

- management companies governed by Chapter 15 of the UCI Law to the extent they manage AIFs in addition to UCITS (see 2.1 below);
- management companies governed by Chapter 16 of the UCI Law to the extent they perform AIFM activities in relation to AIFs (see 2.2.2 below);
- internally managed SICAVs and SICAFs governed by Part II of the UCI Law, respectively the new Part II introduced in the SIF Law (see 3.1.1 and 3.2.1 below);
- internally managed SICARs governed by the new Part II introduced in the SICAR Law (see 3.2.1 below).

Scope of Activities

According to the AIFM Law, any authorised AIFM will perform the following **internal management functions**:

- Investment management function, which is the key function to be performed at a minimum by every AIFM and which includes at least:
 - portfolio management;
 - risk management.

- Other functions (that may be provided by an AIFM only if the key function of portfolio management and/or risk management is also provided):
 - administrative services (e.g. legal and fund management accounting services, customer inquiries, valuation and pricing, regulatory compliance monitoring, maintenance of unit-/shareholder register, distribution of income, unit/shares issues and redemptions, contract settlements, and record keeping);
 - marketing services;
 - activities related to the assets of the AIFs (namely services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters, advice and services relating to mergers and the purchase of undertakings and other services connected to the management of the AIF and the companies and other assets in which it has invested).

In line with the AIFMD, the AIFM Law also allows external AIFMs (but not internally managed AIFs) to provide the following **additional and non-core services** (only if the key function of portfolio management and/or risk management is also provided by these external AIFMs):

- management of portfolios of investments, including those owned by pension funds and institutions for occupational retirement, in accordance with mandates given by investors on a discretionary, client-by-client basis;
- non-core services (only if the additional management of portfolios of investments is provided) comprising:
 - investment advice;
 - safe-keeping and administration in relation to shares or units of collective investment undertakings;
 - reception and transmission of orders in relation to financial instruments.

Delegation of functions

Subject to strict conditions laid down in the AIFM Law, some of the functions of an AIFM may be delegated (and sub-delegated) to third party service providers with the requisite resources and expertise.

As a general principle, the AIFM must remain in charge of some of its basic functions (i.e., the AIFM must not delegate so many of its functions that it is no longer considered, in substance, as the AIFM or it is reduced to a "letter-box entity"). Moreover, the delegation of functions must not serve as a means to bypass the requirements of the AIFM Law. As a result, sub-delegation is permitted subject to similar conditions. Finally, the AIFM will remain liable towards the AIF and its investors with respect to the delegated (and sub-delegated) functions, and it is obliged to supervise the third party service providers on an ongoing basis.

According to the AIFM Law, the following conditions must, in addition

to prior notification and disclosure requirements, be complied with in respect of any delegation by the AIFM:

- the AIFM must be able to justify its entire delegation structure with objective reasons;
- the delegate must have sufficient resources to perform the relevant tasks and the persons who effectively conduct the delegated activities must be of sufficiently good repute and sufficiently experienced;
- where the delegation relates to portfolio management or risk management, delegation may only be made to undertakings which are authorised or registered for the purpose of asset management and subject to supervision. Where this condition cannot be satisfied, delegation may only be given after prior approval of the CSSF;
- where the delegation concerns the portfolio management or the risk management and is given to a third-country undertaking, in addition to the above, there must be a co-operation agreement in place between the CSSF and the supervisory authority of that undertaking;
- the delegation must not prevent the effectiveness of supervision of the AIFM, and in particular, it must not prevent the AIFM from acting, or the AIF from being managed, in the best interests of its investors;
- the AIFM must be able to demonstrate that the delegate is qualified and capable of undertaking the functions in question and that it has been selected with all due care, and the AIFM must be able to effectively monitor at any time the

delegated activity, to give at any time further instructions to the delegate and to withdraw the delegation with immediate effect when this is in the interests of investors;

- in order to avoid conflicts of interests, the AIFM may not delegate portfolio or risk management functions to the depositary or to a delegate of the depositary, or to any other entity whose interests may conflict with those of the AIFM or the investors of the AIF. The delegation to such latter entity may, however, be allowed if it has functionally and hierarchically separated the performance of its portfolio management or risk management tasks from its other potentially conflicting tasks, and the potential conflicts of interests are properly identified, managed, monitored and disclosed to the investors of the AIF.

1.1.2 AIF Concept

Definition

The AIFM Law defines the "AIF" very broadly as any collective investment undertaking, including investment compartments thereof:

- which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
- which does not qualify and require authorisation as a UCITS pursuant to the UCITS Directive⁷.

The legal structure, legal regime and location of the AIF are irrelevant for the purpose of the AIF definition.

Moreover, the AIFM Law does not limit AIFs in terms of the types of assets in which they invest. Therefore, assets can include, for example, traditional assets (equity, debt, etc.), private equity, venture capital, real estate and also other non-traditional asset classes such as ships, art, wine, patents/rights, forestry, coins, precious metals, endowment policies, carbon instruments, life sciences (pharmaceuticals and biotechnology), commodities, as well as any combination thereof.

Potential Luxembourg AIFs

The AIF definition allows to capture all non-UCITS funds. More specifically, the following currently regulated investment funds may qualify as AIFs under the AIFM Law:

- UCIs governed by Part II of the UCI Law (Part II UCIs), irrespective of their legal form (FCP, SICAV, SICAF) (see 3.1 below);
- SIFs (FCP, SICAV, SICAF) governed by the new Part II introduced in the SIF Law (see 3.2.1 below);
- SICARs governed by the new Part II introduced in the SICAR Law (see 3.2.1 below).

Designation of an AIFM

Under the AIFM Law, each Luxembourg AIF the management of which falls within the scope of the AIFM Law must have a single AIFM responsible for ensuring compliance with the AIFM Law.

The AIFM can either be an external manager appointed by or on behalf of the AIF, or the AIF itself, which shall then qualify and be authorised as the AIFM (see 1.1.1 above).

1.2 Exemptions

1.2.1 Full Exemptions

Vehicles specifically excluded

The following entities will not be subject to the AIFM Law:

- holding companies (as such term is defined, and within the limits set out, in the AIFM Law);
- ASSEPs, SEPCAVs and other institutions which are covered by the IORP Directive⁸, including, where applicable, the authorised entities responsible for managing institutions for occupational retirement provision and acting on their behalf or the appointed investment managers, insofar as they do not manage AIFs;
- supranational institutions, such as the European Central Bank, the European Investment Bank, the European Investment Fund, the World Bank, the International Monetary Fund, EU development finance institutions (DFIs) and bilateral development banks, other supranational institutions and similar international organisations, in case such institutions or organisations manage one or several AIFs insofar as those AIFs act in the public interest;
- Luxembourg central bank and other national central banks;
- national, regional and local governments and bodies or other institutions which manage funds supporting social security and pension systems;
- employee participation schemes or employee saving schemes; and
- securitisation special purpose entities (as such term is defined, and within the limits set out, in the AIFM Law)⁹.

Family offices, joint ventures and insurance contracts

By reference to Recitals 7 and 8 of the AIFMD, family office vehicles which invest the private wealth of investors without raising external capital as well as joint ventures and insurance contracts should also be excluded from the scope of the AIFM Law¹⁰.

Group exemption

The provisions of the AIFM Law shall not apply to Luxembourg AIFMs insofar as they manage one or more AIFs whose sole investors are (i) the AIFM, (ii) the parent undertakings or the subsidiaries of the AIFM, or (iii) other subsidiaries of those parent undertakings, provided that none of the above investors is itself an AIF.

Single investor exemption

Investment fund structures with one single investor will not fall within the scope of the AIFM Law as the AIF definition requires capital-raising from a "number of investors".

1.2.2 Partial Exemptions

In line with the AIFMD, the AIFM Law provides for the so-called *de minimis* or small manager exemption for managers managing AIFs' assets below certain thresholds. As detailed below, these small managers will not be entirely out of scope of the AIFM Law.

€100/500 million thresholds

Under the AIFM Law, the small manager regime applies to Luxembourg AIFMs which either directly or indirectly through a company with which the AIFMs are linked by common management or control, or by a substantive direct or indirect holding, manage portfolios of AIFs whose assets under management:

- including any assets acquired through use of leverage, in total do not exceed a threshold of €100 million; or
- in total do not exceed a threshold of €500 million when the portfolio of AIFs managed consists of AIFs that are not leveraged and have no redemption rights exercisable during a period of 5 years following the date of initial investment in each AIF.

Applicable AIFMD requirements

Small AIFMs are, in principle, only subject to the following requirements laid down in the AIFM Law:

- registration and identification requirements with the CSSF;
- certain disclosure and reporting requirements to the CSSF (re. investment strategies, instruments traded, main exposures and most important concentrations, etc.).

Possible opt-in

Small AIFMs will not benefit from any of the rights granted under the AIFM Law unless they choose to opt-in into the AIFM Law regime, in which case the entire AIFM Law shall apply.

1.3 Grandfathering Provisions

According to the AIFM Law, any legal person performing AIFM's activities within the meaning of the AIFM Law **before 22 July 2013** must fully comply with the AIFM Law and shall submit an application for authorisation as AIFM with the CSSF **by 22 July 2014**.

However, AIFMs may benefit of a grandfathering regime if they manage closed-ended AIFs fulfilling the following criteria:

- AIFMs that manage closed-ended AIFs before 22 July 2013 which do not make any additional investments after that date may continue to manage such AIFs without being required to submit an application for authorisation under the AIFM Law;
- AIFMs that manage closed-ended AIFs whose subscription period for investors has closed prior to 21 July 2011 and have a fixed term which expires at the latest 3 years after 22 July 2013 may continue to manage such AIFs without needing to comply with the AIFM Law, except for the provisions relating to the annual report and, where relevant, the provisions on the obligations for AIFMs managing AIFs which acquire control of non-listed companies and issuers, or submit an application for authorisation under the AIFM Law.

2. Impact on Management Companies

Under the new AIFM regime, Luxembourg management companies will essentially be impacted as follows.

2.1 UCITS Management Companies (Chapter 15)

Double license UCITS/AIFM

Chapter 15 of the UCI Law will continue to apply to UCITS management companies, which are in principle not impacted by the AIFM regime, unless they decide to manage AIFs in addition to UCITS (and other UCIs). In such a case, these management companies will have to cumulate two licenses, i.e. the UCITS license according to Chapter 15 of the

UCI Law and the AIFM license according to Chapter 2 of the AIFM Law.

However, the AIFM authorisation requirements will be lighter for these management companies cumulating the UCITS and AIFM licenses. Amongst other things, the CSSF shall not require these management companies to provide information or documents already provided when applying for authorisation under Chapter 15 the UCI Law, provided that such information or documents remain up-to-date.

Moreover, the minimum initial capital and basic own funds requirements imposed by the AIFM Law when the value of the portfolio managed by an external AIFM exceeds €250 million will not apply to AIFMs which are also UCITS management companies authorised under Chapter 15 of the UCI Law¹¹, meaning that the required total of the initial capital and basic additional own funds amount for these management companies will remain €10 million. This being said, management companies cumulating the UCITS and AIFM licenses will nevertheless need additional own funds or hold professional indemnity insurance to cover liability risks resulting from the performance of their functions as AIFMs under the AIFM Law.

UCITS/AIFMD passport

The EU passport under both UCITS and AIFMD regimes will be available for UCITS management companies cumulating the UCITS and AIFM licenses, provided that certain conditions are complied.

Two passports, a "marketing" and a "management" passport, are introduced by the AIFMD:

- The marketing passport will be available on 22 July 2013 and will allow UCITS management companies cumulating the UCITS and AIFM licenses to market EU AIFs they manage to **professional investors**¹² domiciled in the EU, by using a simplified regulator-to-regulator notification procedure. The benefit of this AIFMD marketing passport may be extended in favour of non-EU AIFs they manage at the earliest in July 2015.

Even if there is no EU passport for the distribution of AIFs to retail investors under the AIFMD, UCITS management companies cumulating the UCITS and AIFM licenses may, under certain conditions laid down in the AIFM Law, market to **retail investors** in Luxembourg the AIFs they manage, irrespective of whether such AIFs are marketed on a domestic or cross-border basis or whether they are EU or non-EU AIFs.

- The management passport will be available on 22 July 2013 (22 July 2014 in case of delayed authorisation under the AIFM Law)¹³ and will allow UCITS management companies cumulating the UCITS and AIFM licenses to manage EU AIFs established in another Member State than Luxembourg. Under certain conditions, these management companies may also manage as from 22 July 2013 (respectively 22 July 2014) non-EU AIFs that are not marketed in the EU.

2.2 Non-UCITS Management Companies (Chapter 16)

Chapter 16 of the UCI Law will continue to apply to non-UCITS management companies, but will be significantly amended so as to introduce a distinction between:

- non-UCITS management companies without AIFM status; and
- non-UCITS management companies with AIFM status.

2.2.1 Non-UCITS Management Companies without AIFM Status

UCI Law license

In principle, these management companies, which do not qualify as AIFMs, will remain regulated entities authorised by the CSSF under the UCI Law only.

However, in the case where their activities fall within the scope of AIFMD/ AIFM Law, these management companies will have to apply for AIFM license according to Chapter 2 of AIFM Law (see 2.2.2 below).

Scope of activities

In brief, the activities of non-UCITS management companies without AIFM status will be exclusively limited to the management of (i) non-AIFs, and/or (ii) AIFs below the €100/500 million thresholds and/or (iii) AIFs for which the management company has designated another external AIFM (provided however that the management company at least manages one regulated investment vehicle).

More specifically, Bill 6471 provides that these management companies are only authorised to:

- manage regulated and/or non-regulated investment vehicles which do not qualify as AIFs under the AIFMD, regardless whether these vehicles are Luxembourg or foreign vehicles;
- act as the management company for one or more FCPs, SICAVs or SICAFs qualifying as AIFs but for which the management company has designated, on behalf of the relevant FCP, SICAV or SICAF, an external authorised AIFM (i.e. the management company will not act itself as the authorised external AIFM);
- manage one or more AIFs the aggregate assets of which are less than the €100/500 million thresholds. In this case, the relevant management company is however subject to specific registration and reporting requirements provided for by the AIFM Law. However, in the case where the aggregate assets under management exceed the €100/500 million thresholds or if the management company decides to opt-in into the AIFM regime, it will then have to apply for AIFM license according to Chapter 2 of the AIFM Law. As a result, it will become a non-UCITS management company with AIFM status (see 2.2.2 below).

Bill 6471 further provides that non-UCITS management companies without AIFM status may not provide the services under (a) without also providing the services under (b) or (c), unless the investment vehicles referred to under (a) are regulated by specific sector laws (e.g. UCI Law, SIF Law and SICAR Law). This aims at avoiding that non-UCITS management companies without AIFM status solely manage non-regulated investment vehicles, such as a Luxembourg soparfi.

No AIFMD passport

The AIFMD passport will not be available for non-UCITS management companies without AIFM status.

2.2.2 Non-UCITS Management Companies with AIFM Status

AIFM Law license

In addition to their authorisation by the CSSF as management company under the UCI Law, these management companies will, due to their AIFM status, be subject to AIFM licence according to Chapter 2 of the AIFM Law.

As a result, they will comply with all the new "AIFMD" provisions introduced by the AIFM Law to the extent applicable¹⁴, including the following:

- AIFMD organisational rules (e.g. initial capital and own funds requirements, conducting persons/substance requirements, appropriate valuation procedures, and delegation rules);
- AIFMD operating rules (e.g. risk management function as well as risk and liquidity management, conflict of interest and remuneration policies);
- AIFMD transparency rules (disclosure and reporting

obligations to the CSSF and investors).

However, the AIFM authorisation procedure may be lighter for these management companies to the extent that the CSSF shall not require these management companies to provide information or documents already provided when applying for authorisation under Chapter 16 the UCI Law, provided that such information or documents remain up-to-date.

Scope of activities

Due to their "AIFM status", these management companies can only manage or act as the management company of AIFs.

According to the AIFM Law, the activities of non-UCITS management companies with AIFM status will be limited to the activities listed in Annex I of the AIFM Law, i.e.:

- investment management of AIFs (i.e. at least portfolio management and/or risk management of AIFs); and
- complementary functions such as administration, marketing and activities linked to the AIF's assets).

To the extent as permitted by the AIFM Law, the provision of additional and non-core services may also be performed by these management companies (see 1.1.1 above).

AIFMD passport

Like UCITS management companies cumulating the UCITS and AIFM licenses, non-UCITS management companies with AIFM status will benefit from the AIFMD management and marketing passports, provided that certain conditions are complied with (see 2.1 above).

3. Impact on Part II UCIs, SIFs and SICARs

Although the main objective of the AIFMD is to regulate AIFMs and not directly AIFs, it contains some provisions impacting AIFs, in particular as regards the substance, depositary regime, the delegation of functions, the valuation of assets, as well as the reporting and disclosure obligations to investors and regulators.

Consequently, amendments to the UCI Law, SIF Law and SICAR Law are also envisaged by Bill 6471. In a nutshell, the following changes are envisaged in relation to the current regulatory regimes of Part II UCIs, SIFs and SICARs.

3.1 Part II UCIs

Bill 6471 provides that all Part II UCIs will always qualify as AIFs.

However a distinction is made under Bill 6471 between:

- Part II UCIs qualifying as full scope AIFs; and
- Part II UCIs benefiting from and using the so-called *de minimis* or small manager exemption (which fall only partially within the scope of the AIFM Law).

3.1.1. Full Scope AIFs

Designation of an AIFM

Unless it benefits from the *de minimis* exemption and effectively uses it (see 3.1.2 below), every Part II UCI must either:

- be managed by an authorised external AIFM; or

- as regards SICAV and SICAF governed by Part II of the UCI Law, be internally managed if the SICAV's/SICAFV's governing body chooses not to appoint an external AIFM (in which case the Part II SICAV/SICAF shall then itself qualify and be authorised as the AIFM).

New applicable product rules

For Part II UCIs qualifying as full scope AIFs, the following new "product" rules coming from the AIFM Law will apply:

- AIFMD substance (i.e. minimum capital and conducting person requirements);
- AIFMD depositary regime;
- AIFMD valuation rules;
- AIFMD delegation rules;
- AIFMD reporting and disclosure requirements.

AIFMD passport

The shares or units of a Part II UCI falling entirely within the scope of the AIFM Law, once admitted to marketing in Luxembourg, will benefit from the AIFMD **marketing passport**, which allows as from July 2013 the free marketing by an authorised EU AIFM of such shares or units to **professional investors** in the EU. Private placement of these Part II UCI's shares or units will remain applicable until 2018 for marketing to professional investors by non-EU AIFMs, subject to some requirements of the AIFM Law and AIFMD.

The AIFM Law also provides that the shares or units of Part II UCIs falling entirely within the scope of the AIFM Law may be marketed, under certain conditions, to **retail investors** domiciled in Luxembourg by an authorised Luxembourg, EU or non-EU AIFM.

3.1.2 Non-Full Scope AIFs¹⁵

Current Part II UCI regime

Every Part II UCI qualifying as AIF, but which benefits from the *de minimis* exemption and decides to make use of it (i.e. it does not opt-in into the AIFM regime), will, to a large extent, remain subject to legal requirements substantially similar to those applicable under the current regulatory Part II UCI regime, subject however to some adjustments including the introduction of new eligibility criteria for the depositary (alignment with the AIFMD eligibility criteria).

New registration and reporting requirements

Every Part II UCI benefitting from and using the *de minimis* exemption will be subject to new registration and ongoing reporting requirements to the CSSF under the AIFM Law. These Part II UCIs are therefore not entirely out of scope of the AIFM regime (see 1.2.2 above).

No AIFMD passport

No AIFMD passport will be available for Part II UCIs benefitting from and using the *de minimis* exemption.

3.2. SIFs and SICARs

Bill 6471 proposes to divide the SIF Law, respectively the SICAR Law, into two parts depending on whether the relevant SIFs or SICARs fall entirely within the scope of the AIFM Law or not:

- Part I of the SIF Law, respectively Part I of the SICAR Law, will include common rules applicable to all SIFs, respectively all SICARs; and
- Part II of the SIF Law, respectively Part II of the SICAR Law, will include new provisions

coming from the AIFM Law and will be applicable only to SIFs/SICARs managed by an authorised AIFM (i.e. full scope AIFs hereinafter referred to as "Part II SIFs", respectively "Part II SICARs").

For the avoidance of doubt, Part II of the SIF Law, respectively Part II of the SICAR Law, will not apply to: (i) SIFs/SICARs that do not qualify as AIFs (e.g. SIFs/SICARs with one single investor), and (ii) SIFs/SICARs benefitting from one of the derogatory regimes provided for by the AIFM Law (e.g. group and *de minimis* exemptions).

3.2.1. Full Scope AIFs

Designation of an AIFM

SIFs/SICARs governed by Part II of the SIF Law, respectively Part II of the SICAR Law, must either:

- be managed by an authorised external AIFM; or
- as regards SICAV-/SICAF-SIF and SICAR, be internally managed if the governing body chooses not to appoint an external AIFM (in which case the Part II SIF/SICAR shall then itself qualify and be authorised as the AIFM).

New applicable product rules

For Part II SIFs/SICARs, the following new "product" rules coming from the AIFM Law will apply:

- AIFMD substance (i.e. minimum capital and conducting person requirements);
- AIFMD depositary regime;
- AIFMD valuation rules;
- AIFMD delegation rules;
- AIFMD reporting and disclosure requirements.

AIFMD passport

Like Part II UCIs falling entirely within the scope of the AIFM Law, Part II SIFs/SICARs will benefit from the AIFMD marketing passport for the distribution, by an authorised AIFM, of their shares or units to professional investors (see 3.1.1 above).

3.2.2 Non-Full Scope AIFs

SIFs/SICARs out of the scope of the AIFM Law

SIFs/SICARs that do not qualify as AIFs are not impacted by the AIFM Law and will remain subject, to a large extent, to requirements similar to those applicable under the current SIF/SICAR regimes.

Some adjustments to the current SIF/SICAR regimes are however envisaged by Bill 6471. The main changes include the introduction of:

- new eligibility criteria for the depositary (alignment with the AIFMD eligibility criteria);
- new provisions relating to the modernisation of the limited partnership regimes (e.g. SIFs/SICARs may adopt the form of the new special limited partnership);
- new provisions relating to the management of conflicts of interests by SICARs (alignment with the SIF regime).

SIFs/SICARs partially in the scope of the AIFM Law

SIFs/SICARs benefitting from one of the derogatory regimes provided for by the AIFM Law (e.g. group and *de minimis* exemptions) remain subject, to a large extent, to requirements similar to those applicable under the current SIF/SICAR regimes (subject to the same adjustments as those referred to above in relation to SIFs/SICARs that do not qualify as AIFs).

However, new AIFMD registration and ongoing reporting to the CSSF must be done in relation to these SIFs/SICARs benefitting from and using the *de minimis* exemption.

No AIFMD passport

No AIFMD passport will be available for (i) SIFs/SICARs that do not qualify as AIFs (e.g. SIFs/SICARs with one single investor or qualifying as joint ventures, etc.), and (ii) SIFs/SICARs benefitting from one of the derogatory regimes provided for by the AIFM Law (e.g. group and *de minimis* exemptions).

4. Impact on Services Providers

Besides the depositary, whose role and liabilities have been redefined by the AIFMD, other service providers to Part II UCIs, SIFs and SICARs (such as the central administration, valuers, investment managers, etc.) will be impacted by new AIFMD operational and compliance requirements in terms of, *inter alia*, valuation, delegation, risk and liquidity management, conflict of interests, disclosure and reporting to investors and regulators.

4.1 Depositary Requirements

Bill 6471 introduces a new AIFMD depositary regime for Part II UCIs, Part II SIFs and Part II SICARs falling entirely within the scope of the AIFM Law (new eligibility criteria, duties and liability standards).

The existing depositary regime will be maintained, to a large extent, for Part II UCIs, SIFs and SICARs which do not fall, or fall only partially, within the scope of the AIFM Law. Some adjustment to the existing depositary

regime will however be made, in particular as regards the extension of the eligibility criteria to act as depositary of Part II UCIs, SIFs and SICARs that do not qualify as full scope AIFs and the possibility for these investment vehicles to appoint as depositary a Luxembourg branch of a non-EU eligible entity .

4.1.1 Eligibility Criteria

The depositary of all Part II UCIs, SIFs and SICARs (regardless whether they are full scope AIFs or not) shall be:

- a credit institution (within the meaning of the Financial Sector Law); or
- a MiFID investment firm (within the meaning of the Financial Sector Law, which is also subject to own funds requirements and other conditions laid down in the AIFM Law).

A new category of professional of the financial sector (PFS) is also introduced in the Financial Sector Law that can act as depositary of any Part II UCI, SIF and SICAR which: (i) is closed-ended for a period of 5 years from the date of their initial investments, and (ii) do generally not invest in assets to be held in custody or generally seek to acquire the control over the issuers or non-listed companies (e.g. mainly private equity and real estate AIFs).

4.1.2 Depositary's Duties (Full Scope AIFs only)

The main duties of the depositary of Part II UCIs, Part II SIFs and Part II SICARs falling entirely within the scope of the AIFM Law shall include:

- safekeeping duties, where a distinction is made between: (i) the custody duties relating to financial instruments of the relevant Part II UCI, Part II SIF

and Part II SICAR that can be held in custody by the depositary, and (ii) the verification duties over the ownership rights of the relevant Part II UCI, Part II SIF and Part II SICAR relating to the other types of assets (such as real estate or commodities);

- monitoring duties over the assets and transactions of the relevant Part II UCI, SIF and SICAR ;
- cash monitoring duties, implying the obligation for the depositary to ensure that the relevant Part II UCIs, SIFs and SICARs cash in- and outflows are properly monitored.

4.1.3 Depositary's Liability (Full Scope AIFs only)

New liability standards have been introduced for depositaries towards Part II UCIs, Part II SIFs and Part II SICARs falling entirely within the scope of the AIFM Law and their investors.

In general, the depositary of these funds shall only be liable for losses due to its negligence or intentional failure to perform its obligations. However, in case of loss of assets held in custody, the depositary will be subject to stricter liability, being required to provide replacement assets (of identical type or corresponding amount) without undue delay. This being said, the depositary shall not be liable if it can evidence that the loss is due to external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. Equally, limitation and/or discharge of the depositary liability are possible in case of delegation of custody tasks provided that the depositary has complied with all prescribed obligations under the AIFM Law and

there is an objective reason for the delegation of the custody tasks.

4.2 Central Administration Agent Requirements

One of the changes resulting from the AIFM Law and impacting Luxembourg central administration agents is that the requirement to have the central administration in Luxembourg will no longer be applicable for Part II UCIs, Part II SIFs and Part II SICARs qualifying as full scope AIFs and that are managed by an authorised foreign external AIFM (EU or non-EU after 2015) exercising itself central administration functions abroad.

However, the central administration will remain in Luxembourg in the following cases:

- every Part II UCI, Part II SIF and Part II SICAR qualifying as internally managed Luxembourg AIF or having a designated external AIFM in Luxembourg will have its central administration in Luxembourg;
- every Part II UCI, Part II SIF and Part II SICAR having a designated external AIFM abroad to which the central administration function has not been delegated (i.e. these functions being performed at the level of the AIF or being delegated to a third party service provider other than the external AIFM), will have its central administration in Luxembourg.

A further change that is also likely to affect the central administration agent of Part II UCIs, Part II SIFs and Part II SICARs falling entirely within the scope of the AIFM Law is the required compliance with the new valuation processes and procedures laid down

in the AIFM Law in the case where the central administration agent is appointed as external valuer.

5. Expected Timeline

Bill 6471 provides that the new AIFM Law, including the proposed modifications introduced in relation to the UCI Law, SIF Law and SICAR Law, will enter into force on the first day of the month following its publication in the *Mémorial*.

5.1 Entry into Force

Although the full legislative process is still to be completed, it is anticipated that Bill 6471 will be passed into law by end of 2012. This means that the new law could theoretically enter into force in or around January 2013, whilst the deadline for each of the Member States to transpose the AIFMD into national law is 22 July 2013.

5.2 Transitional and Grandfathering Provisions

Without prejudice of the transitional provisions of the AIFM Law (see 1.2.3 above), Bill 6471 also contains complex additional transitional and grandfathering provisions specific to Part II UCIs, SIFs, SICARs and their management companies, as summarised below.

5.2.1 Management Companies

UCITS Management Companies (Chapter 15) managing AIFs in addition to UCITS

Existing UCITS management companies authorised under Chapter 15 of the UCI Law that manage **before 22 July 2013**, in their capacity as designated management company,

one or more AIFs within the meaning of the AIFMD, will have **until 22 July 2014** to comply with the new applicable provisions of the UCI Law coming from the AIFM Law (i.e. new article 101-1 of the UCI Law containing new rules as regards, *inter alia*, the double license UCITS/AIFM).

Non-UCITS management companies (Chapter 16) managing AIFs

Existing non-UCITS management companies authorised under Chapter 16 of the UCI Law that manage **before 22 July 2013**, in their capacity as designated management company, one or more AIFs within the meaning of the AIFMD (and therefore qualify as non-UCITS management companies with AIFM status) will have **until 22 July 2014** to comply with the new applicable provisions of the UCI Law coming from the AIFM Law (i.e. new article 125-2 of the UCI Law containing new rules as regards, *inter alia*, the scope of activities of these management companies and the conditions to be complied with to obtain the AIFM licence according to Chapter 2 of the AIFM Law).

5.2.2 Part II UCIs, SIFs and SICARs

Full scope AIFs created before 22 July 2013

Existing Part II UCIs, SIFs and SICARs qualifying as full scope AIFs that are created before 22 July 2013 will have **until 22 July 2014** to comply with the new "product rules" coming from the AIFM regime (i.e. new Chapter 10bis of the UCI Law, respectively new Part II of the SIF Law/ SICAR Law containing new rules as regards, *inter alia*, the conditions for the designation of the authorised AIFM, the substance, the depositary regime, the delegation of

functions, the valuation of assets, as well as the reporting and disclosure obligations to investors and regulators).

Full scope AIFs created between 22 July 2013 and 22 July 2014

New Part II UCIs, Part II SIFs and Part II SICARs qualifying as full scope AIFs that are created between 22 July 2013 and 22 July 2014 must comply with the new product rules introduced in Chapter 10bis of the UCI Law, respectively new Part II of the SIF Law/SICAR Law, **as from the date their creation**.

By way of derogation to the above, Part II UCIs, Part II SIFs and Part II SICARs qualifying as full scope AIFs that are created between 22 July 2013 and 22 July 2014 but that have an **external manager that was existing prior to 22 July 2013**, may continue to be managed by a non authorised AIFM until **22 July 2014**.

Full scope AIFs created after 22 July 2014

All Part II UCIs, Part II SIFs and Part II SICARs qualifying as full scope AIFs that are created after 22 July 2014 are *ipso jure* governed by the new provisions of Chapter 10bis of the UCI Law, respectively Part II of the SIF Law/SICAR Law.

Unless they benefit from the group exemption or the *de minimis* exemption (and effectively use the benefit of the latter), these Part II UCIs, Part II SIFs and Part II SICARs created after 22 July 2014 (or their managers as the case may be), are *ipso jure* subject to the provisions of the AIFM Law.

Closed-ended AIFs

Part II UCIs, SIFs and Part II SICARs qualifying as closed-ended AIFs that

are created before 22 July 2013 and which do not make any additional investments after that date are not required to be managed by an authorised AIFM within the meaning of Chapter 2 of the AIFM Law.

However, Bill 6471 specifies that closed-ended Part II UCIs (as above mentioned), or their managers as the case may be, must comply with the provisions of the AIFM Law that are applicable to Part II UCIs benefiting from and making use of the *de minimis* exemption (e.g. they will be subject to registration and ongoing reporting requirements vis-à-vis the CSSF).

Part II UCIs, Part II SIFs and Part II SICARs qualifying as closed-ended AIFs whose subscription period for investors has closed prior to 21 July 2011 and have a fixed term which expires at the latest 3 years after 22 July 2013 do not need to comply with the provisions of the AIFM Law except for the provisions relating to the annual report and, where relevant, the provisions on the obligations for AIFMs managing AIFs which acquire control of non-listed companies and issuers, or submit an application for authorisation under the AIFM Law.

Conclusion

In conclusion, we see the AIM Law as leading to some level of restructuring and revision of the existing documentation of Part II UCIs, SIFs, SICARs and their management companies. At the same time though, we see these restructurings as a possibility to take advantage of the opportunities offered by the AIFM Law (e.g. double licenses, management and marketing passports, etc.). Finally, we also see the AIFM Law and the proposed legal efficiency package accompanying it as a support to the

attractiveness of Luxembourg as an alternative investment fund domicile as a whole.

One word of caution, the information in this client briefing is based on Bill 6471 at the time of writing, and there remains work to be done to reach the finally agreed text of the new law. Moreover, the European Commission still has to adopt Level 2 measures for the proper implementation and application of the AIFMD provisions. Consequently, industry participants should be careful not to rush to restructure their operations just yet. However, Part II UCIs, SIFs, SICARs as well as their management companies (where applicable) and service providers should already consider the potential impacts, constraints and opportunities coming from the new AIFM Law.

Clifford Chance can provide you with an integrated service and dedicated team who will be happy to discuss with you any question or concerns in relation to all the AIFMD related issues. We will also be pleased to provide you with additional and updated information on any specific issue discussed in this client briefing once the Level 2 measures have been adopted by the European Commission as well as, in a later stage, once the AIFM Law has been adopted.

- ¹ In this client briefing, all references to the "AIFM Law" refer to the draft AIFM Law as contained in Bill 6471 in its version deposited with the Luxembourg Parliament on 24 August 2012.
- ² Luxembourg law of 17 December 2010 (as amended) on undertakings for collective investment.
- ³ Luxembourg law of 13 February 2007 (as amended) relating to specialised investment funds.
- ⁴ Luxembourg law of 15 June 2004 (as amended) on the investment company in risk capital.
- ⁵ Luxembourg law of 5 April 1993 (as amended) on the financial sector.
- ⁶ The AIFM Law will also apply to non-EU AIFMs, which manage and/or market one or more EU or non-EU AIFs, in the case where Luxembourg is defined as the Member State of reference for the non-EU AIFM.
- ⁷ Directive 2009/65/EC of 13 July 2009 of the EU Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities.
- ⁸ Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision.
- ⁹ According to the draft preparatory documents of the AIFM Law, Luxembourg securitisation vehicles governed by the law of 22 March 2004 should in principle benefit to a large extent from this exemption, as the securitisation transactions they perform should comply with the EU definition referred to in the AIFM Law and AIFMD.
- ¹⁰ Draft preparatory documents of the AIFM Law, pp. 118 and 120.
- ¹¹ Indeed, the minimum initial capital (i.e. €125,000) and additional amount of own funds required by the AIFM Law when the value of the portfolio managed by an external AIFM exceeds €250 million (i.e. 0.02% of the value of the portfolio which exceeds €250 million with a maximum of €10 million) are, to a large extent, similar to the requirements imposed to UCITS management companies governed by Chapter 15 of the UCI law.
- ¹² The concept of "professional investors" refers to any investor that is considered as, or may be treated as, a professional client under Annex II of the MiFID Directive.
- ¹³ A Luxembourg UCITS management company which already performs management services under the scope of AIFM Law to EU AIFs before 22 July 2013 must take all necessary measures to comply with the AIFM Law, but it can delay authorisation as AIFM with the CSSF and continue to manage EU AIFs without such authorisation until 22 July 2014 (see 1.3 above).
- ¹⁴ Most of the requirements introduced by the AIFM Law are in fact similar to those applicable to UCITS management companies under the UCITS Directive and Chapter 15 of the UCI Law.
- ¹⁵ The same regime applies to every Part II UCI qualifying as AIF benefitting from the group exemption, except that these Part II UCIs will not be subject to registration and reporting requirements under the AIFM Law.

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