CLIFFORD CHANCE

CSSF CIRCULAR 24-856 ON THE PROTECTION OF INVESTORS

CSSF Circular 24/856 on the protection of investors in case of NAV calculation errors, non-compliance with investment rules and other errors at the level of a UCI.

The CSSF published on 29 March 2024 its Circular 24/856 (the "**Circular**") concerning NAV calculation errors, non-compliance with investment rules and other errors (the "**Errors**"). The Circular (49 pages, only in French for the moment) is a crucial piece of regulation for supervised UCIs that will replace Circular 02/77. The Circular incorporates the CSSF regulatory practice built up over more than 20 years. Like Circular 02/77, the Circular deals with NAV calculation errors and non-compliance with investment rules but also addresses more specifically other types of errors (i.e., swing pricing errors, wrong payment of fees and costs, non-compliance with cut-off rules, and investment allocation errors – together the "**Other Errors**").

Scope of application

- The Circular applies to UCITS, Part II UCIs, SIFs and SICARs as well as ELTIFs, MMFs, EuVECAs and EuSEFs (which are not UCITS, Part II UCIs, SIFs and SICARs) for which the CSSF is the competent authority.
- The Circular does not apply to closed-end UCIs as far as NAV calculation errors are concerned (Chapter 4 of the Circular). They are not bound to notify the CSSF about those errors. NAV calculation errors must, however, be rectified, and the independent auditor must verify the correction in the context of its annual audit.

Entry into force

- The Circular will enter into force on 1 January 2025.
- Errors occurring before 1 January 2025 must be dealt with in accordance with Circular 02/77.
- UCIs issuing a prospectus for the first time or updating their prospectus prior to 1 January 2025 must insert in it specific wording to draw the

Key issues

- **Scope of application**: all UCIs supervised by the CSSF (but closed-end UCIs as far as NAV calculation errors are concerned - Chapter 4 of the Circular).
- **Entry into force**: 1 January 2025.
- **NAV calculation errors**: non-UCITS funds reserved to well-informed or professional investors can apply materiality thresholds not exceeding 5%.
- **Non-compliance with investment rules**: distinction between *active* and *passive* breaches clarified.
- **Other errors addressed**: swing pricing errors, fees and costs errors, errors in the application of the cut-off rules and investment allocation errors.
- **Financial intermediaries**: impact of their role and related risks specifically addressed.
- **Intervention of the independent auditor**: *special report* instead of *separate report* in some instances.
- **New CSSF notification form:** to come.
- **New FAQ replacing FAQ on Circular 02/77**: to come.

attention of the ultimate investors to the fact that they may not be fully indemnified in case of Errors when they are invested in the relevant UCI through *financial intermediaries* (see below). In the absence of such a prospectus update, the same information must be conveyed to the investors through the communication channels provided for in the prospectus or constitutive document of the fund.

Roles of the various stakeholders in relation to Errors

- The senior management of the UCI or its investment fund manager, if any ("**IFM**") (including non-Luxembourg IFMs managing Luxembourg UCIs/AIFs on a cross-border basis) must ensure that a suitable organisation is in place to avoid the occurrence of Errors. This also includes suitable contractual arrangements with the various delegates/subdelegates and service providers aiming to avoid that such delegations and subdelegations do not create obstacles to the application of the Circular.

NAV calculation errors

- The Circular provides for materiality thresholds in relation to Money Market Funds (0.2%), UCITS (1% for equity funds, 0.5% for fixed income and mixed funds) and Part II UCIs & ELTIFs not reserved to well-informed or professional investors (0.5% for fixed income and mixed funds, 1% for equity funds and funds investing in other assets).
- Non-UCITS funds reserved to well-informed or professional investors can apply higher materiality thresholds that can never exceed 5% and which must be determined on the basis of specific analysis (considering whether the UCI is closed-end or not, its investment policy, its risk profile, etc.) that will have to be provided to the CSSF upon its initial request. When materiality thresholds higher than the 0.5/1% thresholds are applied, investors must be informed.

Non-compliance with investment rules

- The Circular clarifies the distinction between *active* and *passive* breaches. Passive breaches result from events beyond the control of the UCI whilst active breaches refer to voluntary acts or the absence of action when a breach was predictable and avoidable.
- Materiality thresholds cannot be applied in relation to non-compliance with investment rules.
- Active breaches must be notified to the CSSF whilst passive breaches need not be notified.
- The actions necessary to remedy an active breach must be determined without delay for all types of UCIs. The timing for the implementation of the remediation plan can, however, depend on the liquidity of the investments.

Swing pricing errors

- The UCI must be indemnified in case it suffers a loss. In case of losses affecting the investors, they must be indemnified in accordance with the procedure applicable to material NAV errors. The same rules apply to similar anti-dilution mechanisms (e.g., anti-dilution levy, liquidity fees).

Fees and costs errors

- When the UCI has paid an amount of fees or costs higher than that specified in its prospectus or constitutive document, the UCI must be indemnified, and no materiality threshold can be applied. If the payment of the indemnity results in a material NAV error, such an error must be remedied.
- When the UCI has paid an amount of fees or costs lower than that specified in its prospectus or constitutive document, the UCI must ensure that the remediation (if any) does not entail *ex post* charging of fees or costs to investors who did not benefit from the services.

Errors in the application of the cut-off rules

- These errors entail subscription or redemption orders having been processed on the basis of the wrong NAV. The UCI and its investors must be indemnified for the losses. Investors who have benefited from a gain due to the error cannot be forced to reimburse the UCI unless they qualify as well-informed or professional investors. Indemnification measures may lead to the application of the procedure in case of material NAV errors.

Investment allocation errors

- UCIs must be indemnified for losses incurred because of errors in the allocation of investments to the wrong unit/share class, sub-fund or fund. Profits resulting from those errors must be retained by the UCI. In case of material NAV errors, the procedure for the remediation of such errors must be followed.

Payment of indemnities and financial intermediaries

- Indemnities must be paid to the UCI and its investors without delay. Any delays in the payment of those indemnities must be notified and explained to the CSSF.
- UCIs using financial intermediaries for the subscription and redemption of their units/shares must ensure that appropriate contractual arrangements are in place to enable an indemnification of every ultimate investor. When the UCI is not in a position to verify that every ultimate investor is effectively fully compensated, it must ensure that financial intermediaries receive all the information they need (e.g., timing of the error, wrong and rectified NAVs, listing of subscriptions and redemptions during the relevant period) to indemnify the ultimate investors.
- *De minimis* rules can be applied but only in relation to indemnities payable to the investors, not to the UCI.
- Indemnities can be paid to investors still holding units/shares in the UCI by allocating to them additional units/shares.

Intervention of the independent auditor

- The Circular introduces a distinction between the *separate report* under Circular 21/790 and the *special report* under Circular 24/856. A special report is required in case of Errors in relation to UCITS and Part II UCIs where the aggregate amount of indemnities exceeds EUR 50,000 and/or the indemnity payable to a single investor exceeds EUR 5,000. A *separate report* is required in case of Errors no exceeding any of those two thresholds. No *separate report* is, however, required in case of material NAV error affecting a closed-end UCI.

- The *special report* entails verifications in addition to those required by the *separate report*, meaning (i) compliance with the rules of the Circular in the presence of financial intermediaries, (ii) verification that the expenses and costs resulting from the remediation plan are not borne by the UCI, (iii) compliance with the *de minimis* rules, (iv) verification of the accuracy of the notification made to the CSSF and (v) verification of the analysis of the causes of the Errors and the related corrective measures.

CSSF notification

- Material NAV calculation errors, active breaches of investment rules and Other Errors must be notified to the CSSF by using the *ad hoc* form that will be posted on the CSSF website (i.e., a revised form compared with that existing). The notification must be made within four to eight weeks following the detection of the relevant error. When a *special report* is required, it must be submitted to the CSSF within three months following the above notification. In case of delays, the CSSF must be kept informed of the progress on a monthly basis.
- The CSSF does not approve the remediation actions described in the notification. The CSSF may, however, intervene at any time, on an *ex post* basis, in order to require additional information, other remediation actions or improvements in the organisational set-up of the UCI or IFM in case of identified shortcomings.

Update of the FAQ on Circular 02/77

- A FAQ linked to Circular 24/856 will be published in the coming months (and will replace the current FAQ on Circular 02/77).

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