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Regulatory News

Luxembourg Aligns Specialised Investment Funds Law with AIFMD

On 6 March 2012, the Luxembourg Parliament adopted a new bill, amending the Luxembourg law of the 13 February 2007 on Specialised Investment Funds (“SIF”). The Law will introduce several important changes to the regime governing SIFs and will effectively create an Alternative Investment Fund Managers Directive (“AIFMD”) compliant Alternative Investment Fund (“AIF”) vehicle, ahead of AIFMD coming into effect. The amended SIF Law introduces rules on delegation, risk management and the handling of actual or potential conflicts of interest.

Background

SIFs are authorised and supervised by the Commission de Surveillance du Secteur Financier (“CSSF”). They are specialised Luxembourg investment fund vehicles intended for the qualified, professional or sophisticated investor (“well informed”) such as institutional and high net worth investors. SIFs can be either a single fund or have an umbrella (multi-compartment) structure. A fund can be constituted as either a contractual fund or an investment company. If launched as an investment company, then initiators can choose between a number of corporate forms, including limited partnerships, to suit investors’ tax requirements. They can employ an investment within certain guidelines and there is no restriction on the asset classes in which the fund can invest, be they traditional or highly exotic. There are light diversification and leverage rules.

Since the introduction of the first SIF law in 2007, the vehicle has been widely used to launch alternative investment funds products. By 31 December 2011, there were 1,374 SIF vehicles, comprising around 2,800 funds in single and multiple compartment SIFs, with net assets of nearly €240 billion.¹

Key Components of SIF Law

Some of the key components the new change in the Law have been captured and summarised below:

Prior Authorisation

A SIF is now required to obtain CSSF approval before launching its activities. The documentation required should include information on choice of depositary, the identity of the members of the management body of the SIFs and the identity of the persons charged with managing the portfolio. The directors and investment managers will need to demonstrate that they are of good standing and have suitable experience with regard to the investment policy of the SIF. The CSSF will also be required to approve any subsequent material amendments to the file and the issuing document.

Risk Management

SIFs may only be sold to well informed investors who are capable of understanding the risks associated with the investment. Under the new risk management rules, the fund will be required to implement risk management systems in order to detect, measure, manage and monitor appropriately all relevant risks to the fund. Currently, it is not required to disclose to precise details when issuing the document however the CSSF is due to provide further guidance in this respect.

Conflict of Interest

SIFs are required to be structured and organised in such a way that they minimise any potential or perceived conflicts of interest arising:

- between the fund and any persons contributing to activities of the SIF; or
- any person linked directly or even indirectly with the SIF; or
- that may damage the interest of the investors.

The law requests segregation of the assignments between the board members within the fund. The CSSF will detail further requirements on conflicts of interests.

Delegation

A SIF that delegates one or more of their functions to a third party will have to inform the CSSF and have to comply with certain rules. There is a distinction in the new SIF Law between the investment management functions and other functions delegated. The SIF will need to provide all appropriate information to the CSSF and prove that rigorous due diligence and due care in the selection of the delegate have been carried out. The issuing document must also list all delegated functions. Where the mandate is entrusted to an investment manager, the new SIF Law requires the delegate to be regulated under the local applicable law and be subject to ongoing prudential supervision.

Where the investment manager is located in a third country (outside the European Union) a co-operation arrangement will need to be in place between the CSSF and the local supervising authority. While, it is still possible to delegate the investment management function even if the terms are not fully satisfied, this will wholly depend on the CSSF approving the delegation based on good standing and professional experience.

Authorisation and withdrawal of authorisation

SIF Law provides for the authorisation of the sub-funds and clarifies that the withdrawal of the sub-fund's authorisation does not involve the withdrawal of the umbrella SIF from the CSSF's official list of authorised funds.²

Timing for Compliance

The new SIF law shall enter into force the first day of the month following the publication in the Luxembourg official journal, the *Mémorial*. The Law provides transitional provisions such as "grandfathering arrangements" applicable to SIFs existing before the Law becomes effective. During the transitional period, existing SIFs will be given a moratorium to comply with the new requirements.

The procedures for ensuring investors are well informed are scheduled to be implemented by 30 June 2012. Risk Management systems and arrangements to avoid conflict of interest are also planned for the 30 June 2012. By 30 June 2013, compliance with the conditions applicable to delegation of functions and oversight should be in force.

For more information, please consult the Bill of Law No. 6318.

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² Article 15 of the Bill

Source: Commission de Surveillance du Secteur Financier

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