

## Luxembourg Law of 12 July 2013 on Alternative Investment Fund Managers

The Luxembourg Parliament adopted bill 6471 on alternative investment fund managers and transposing the AIFMD<sup>1</sup> into Luxembourg law (the “AIFM Law”) in its first constitutional vote on 10 July 2013. The AIFM Law will become effective on its day of publication in the Luxembourg official gazette which will take place in the coming days but in any case before 22 July 2013 to meet the deadline set under the AIFMD.

The AIFMD Law can be split into two parts:

- Chapters 1 to 11 establish the legal regime for a Luxembourg alternative investment fund manager or “AIFM” and conditions to be fulfilled when managing and marketing alternative investment funds or “AIFs” in Luxembourg.
- Chapter 12 amends several existing Luxembourg laws by adjusting and enhancing the different legal regimes to which a Luxembourg AIF may be subject, including:
  - Laws regulating Luxembourg fund vehicles, namely the law of 17 December 2010 on undertakings for collective investment, as amended (the “UCI Law”), the law of 13 February 2007 on specialised investment funds, as amended (the “SIF Law”) and the law of 15 June 2004 on investment companies in risk capital, as amended (the “SICAR Law”);
  - The law of 5 April 1993 on the financial sector act, as amended (the “Financial Sector Law”), creating a new depositary license;
  - The law of 10 August 1915 on commercial companies, as amended (the “Companies Act”), overhauling the limited partnership regime in Luxembourg corporate law; and
  - The law of 4 December 1967 on income tax, as amended (the “Income Tax Law”).

### Luxembourg AIFMs and Other Luxembourg Management Companies

The AIFM Law establishes rules as regards the authorisation, scope of activities and transparency requirements to which a Luxembourg AIFM is subject. The AIFM Law closely replicates provisions of the AIFMD and does not seek to “gold-plate” the AIFMD.

A Luxembourg corporate AIF (for instance, a corporate SIF or a SICAR) that does not appoint an external AIFM will be required to be authorised as an internally managed AIF and meet in principle the same conditions as an external AIFM.

A Luxembourg AIFM providing portfolio management and risk management before 22 July 2013 has until 22 July 2014 to submit an application to the *Commission de Surveillance du Secteur Financier* (the “CSSF”) to be authorised as an AIFM. During this transitional period, such a Luxembourg AIFM can continue to manage and market AIFs created before or after 22 July 2013 under the current regime – the relevant AIF has to comply with the AIFMD regime when the Luxembourg AIFM is authorised as an AIFM. When authorised as an AIFM, the Luxembourg AIFM will be able to benefit from the pan-European marketing passport that is seen as a key benefit of becoming authorised as an AIFM.

Alongside the creation of the Luxembourg AIFM, several provisions applicable to existing Luxembourg management companies will be amended:

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<sup>1</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

- Management companies under Chapter 15 of the UCI Law – that are management companies allowed to manage UCITS – can apply to become AIFMs, but as a result of becoming AIFMs they will not need to file duplicate information and documents that are already available to the CSSF.
- Management companies under Chapter 16 of the UCI Law will in the future only manage non-UCITS and structures that are not caught by the AIFMD (unless the management company appoints a duly authorised AIFM to manage such an AIF) so that they can operate without having to comply with the requirements of the AIFMD. It will be open to such management companies to provide, on an ancillary basis, investment management and advisory services, safe-keeping and administration of units of undertakings for collective investment and reception and transmission of orders with respect to financial instruments.

## Luxembourg AIFs

There will be three types of regulated AIFs under Luxembourg law<sup>2</sup>: Part II UCIs, SIFs (*i.e.*, specialised investment funds) and SICARs (*i.e.*, investment companies in risk capital). Any Luxembourg AIF benefiting from the transitional provisions must submit to the CSSF by 1 April 2014 at the latest a file containing information as regards its compliance with the AIFMD by 22 July 2014.

### *Part II UCIs*

A Part II UCI will in principle always be an AIF within the meaning of the AIFM Law. If the AUM of a Part II UCI is below the AUM thresholds set out in AIFMD, the Part II UCI can opt to be outside of the scope of the AIFMD.

The following additional amendments have been introduced in relation to Part II UCIs:

- The annual report of a Part II UCI must be submitted within six months after the end of the relevant accounting year (instead of four months, as is currently the case) and the semi-annual report must be submitted within three months after the end of the semi-annual period (instead of the current two months); and
- No French or German translation of the notarial deed of the articles of incorporation of a corporate Part II UCI will need to be published – the articles of incorporation can be drafted solely in English.

### *SIFs*

The SIF Law will be split into two parts:

- Part I of the SIF Law will set out common rules applicable to all SIFs, which replicate to a large extent the current regime applicable to SIFs; and
- Part II of the SIF Law will set out additional rules for those SIFs that will fall into the scope of the AIFMD by cross-referring to the AIFM Law.

This will have as a consequence that a SIF covered by an exemption set out in the AIFMD (e.g., a SIF entirely dedicated to the wealth management of a family or an internally managed SIF with AUM below the AUM thresholds set out in the AIFMD) will be governed solely by Part I of the SIF Law. While such a SIF must entrust the safe-keeping of its assets to a depositary, the more stringent provisions under the AIFMD will not need to be applied.

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<sup>2</sup> A Luxembourg non-regulated company can in principle qualify as an AIF within the meaning of the AIFM Law. It will, however, not be allowed to actively raise funds from third-party investors beyond the “small circle of persons” as considered by the CSSF.

## **SICARs**

The same approach has been adopted for the SICAR Law, which will be split into Part I, setting general rules applicable to all SICARs, including those which are outside of scope of the AIFMD, and Part II, providing additional rules for those SICARs falling within the scope of the AIFMD.

As for Part II UCIs and SIFs, no French or German translation of the articles of incorporation will be required for publication purposes.

## **Impact on Luxembourg Depositaries**

Luxembourg will be abandoning the strict requirement for depositaries of Part II UCIs, SIFs and SICARs to be credit institutions. Besides credit institutions, investment firms under the Financial Sector Law can also be appointed as a depositary of any Part II UCI, SIF or SICAR, including those that are outside of the scope of the AIFMD, provided that the investment firm complies with additional conditions mainly related to the level of its own funds.

The Financial Sector Law will also provide a new licensing regime for depositaries servicing AIFs that are mainly invested in assets other than financial instruments that can be held in safe-custody, so long as the AIFs do not allow their investors to request the redemption of their shares/units for at least five years following investment. These depositaries, which need not be authorised as a credit institution or an investment firm, will need to be approved and subject to the prudential supervision of the CSSF. They must have a sound administration and organisational structure and a minimum capital of €500,000. Luxembourg fund administrators, among others, are expected to apply for this authorisation to enable them to be entrusted with the safe-keeping of assets of closed-ended SIFs and SICARs invested in non-financial assets (e.g., private equity and real estate).

Depositaries servicing AIFs within the scope of the AIFMD will need to provide cash monitoring, safe-keeping and oversight duties in accordance with the AIFMD. When providing safe-keeping services for financial instruments held in custody, the depositary is subject to strict liability (that is, the depositary has the burden of proof with respect to the discharge of its liability when assets are lost). Depositaries servicing AIFs outside of the scope of the AIFMD will continue to be subject to the current Luxembourg depositary regime, which is mainly contractually determined in accordance with the regulatory practice of the CSSF. Safe-keeping the assets of an AIF is then an obligation of means of the depositary (that is, the AIFM or internally managed AIF has in principle the burden of proof with respect to the depositary's liability when assets are lost).

## **Marketing in Luxembourg**

The AIFM Law establishes marketing rules for an AIFM established in an EEA<sup>3</sup> member state, or established in a third country if the AIFM contemplates marketing an EEA AIF or a non-EEA AIF in the Grand Duchy of Luxembourg.

### ***Offering of an EEA AIF by an EEA AIFM***

Alongside the AIFMD marketing passport (which applies to professional investors only), it will also be possible to market AIFs that fall within the AIFMD to retail investors in Luxembourg, provided that the AIF is subject to:

- regulation offering investors a level of protection at least equivalent to that applicable to a Luxembourg AIF marketed to retail investors; and

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<sup>3</sup> Iceland, Liechtenstein and Norway are assimilated to EU member states within the limits of the EEA treaty.

- supervision of the AIF considered by the CSSF as at least equivalent to the supervision of a Luxembourg AIF marketed to retail investors.

Additionally, a cooperation arrangement between the CSSF and the supervisory authority of the relevant AIF must be in place. The AIFM Law requires the CSSF to adopt implementing measures on marketing of AIFs to retail investors by way of regulation.

***Offering of a Non-EU AIF by an EEA AIFM and Offering of an EEA AIF or Non-EEA AIF by a Non-EEA AIFM***

Luxembourg will not impose stricter rules on the marketing of AIFs that will be unable to benefit from the AIFMD marketing passport immediately after 22 July 2013 than the rules imposed on EEA AIFMs wishing to make use of the AIFMD marketing passport.

An EEA AIFM will be able to use the Luxembourg private placement regime<sup>4</sup> to market a non-EEA AIF to professional investors in Luxembourg, provided that:

- The AIFM fulfills all requirements under the AIFMD, excluding the depositary provisions that are replaced by a “depositary lite” regime;
- Appropriate cooperation arrangements are in place between the supervisory authority of the AIFM and that of the non-EEA AIF — the AIFM Law provides that the CSSF is the competent authority of the AIFM when the marketing is made in Luxembourg through a Luxembourg AIFM; and
- The non-EEA AIF is not located in a Financial Action Task Force (“FATF”) non-cooperative country.

A non-EEA AIFM will also be able to use the Luxembourg private placement regime to market a non-EEA AIF to professional investors in Luxembourg, provided that:

- The non-EEA AIFM complies with the transparency requirements and controlling interest provisions set out in the AIFMD.
- Appropriate cooperation arrangements are in place between the CSSF and the supervisory authority of the non-EEA AIFM and the supervisory authority of the non-EEA AIF; and
- The non-EEA AIF is not located in a FATF non-cooperative country.

***Offering of a Non-Luxembourg AIF that Does Not Fall Within the Scope of the AIFMD***

Units of an open-ended non-Luxembourg AIF that falls outside the scope of the AIFMD can likely be sold to retail investors<sup>5</sup> in Luxembourg subject to the approval of the CSSF which will, among other considerations, assess whether such open-ended AIF is subject in its home jurisdiction to permanent regulatory supervision, with the purpose of establishing whether there is adequate investor protection.

The AIFM Law is silent on the marketing of units of closed-ended non-Luxembourg AIFs exempted from the scope of the AIFMD. Marketing of these AIFs remains subject to the requirements of the EU-level Prospectus Directive and the exemptions set out in that directive.

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<sup>4</sup> The Luxembourg private placement regime that is referenced here is based on articles 36 and 42 of the AIFMD, which are replicated in the Bill without additional conditions.

<sup>5</sup> Article 100 of the revised UCI Law is silent on marketing to professional investors in Luxembourg. A conservative approach would be to consider that the same rules will be applied to professional investors when marketing in Luxembourg is made beyond the Luxembourg private placement regime discussed above.

### ***Reverse Solicitation***

The AIFM Law does not contain specific rules or guidance that market participants may find helpful in relation to “reverse solicitation”. This concept will be assessed in practice by the CSSF on a case-by-case basis.

### **Reform of Luxembourg Limited Partnerships**

Prior to the adoption of the AIFM Law, two forms of Luxembourg limited partnerships were recognised under Luxembourg law, each of these having a separate legal personality:

- the common limited partnership (*société en commandite simple* or “SCS”), which is an “*intuitu personae*”<sup>6</sup> company issuing partnership interests that are in general not freely transferable; and
- the corporate partnership limited by shares (*société en commandite par actions* or “SCA”), which is a joint-stock company whose capital is represented by shares in principle freely transferable.

The AIFM Law amends existing Luxembourg companies legislation, among other laws, to introduce a third form of limited partnership, namely the special limited partnership (*société en commandite spéciale* or “SCSp”), which is an *intuitu personae* company but, unlike the SCS, does not have a legal personality and consequently is fully transparent from a corporate and tax perspective. The SCSp adopts many of the principles seen in limited partnerships under common law jurisdictions such as England, Cayman Islands and Guernsey. For instance, the SCSp offers the ability for investors to have both capital and loan accounts and can make it easier, through the use of contractual investor excuse provisions, to allow certain investors to be treated as not having invested in certain of the SCSp’s investments.

The SIF Law and the SICAR Law will be amended to permit the organisation of SIFs and SICARs in SCSp form.

From a tax perspective, the concept of carried interest will be clarified in the Income Tax Law, by distinguishing between:

- carried interest as an incentive right not attached to a share or unit, and which will be considered as miscellaneous income to be taxed in principle at the marginal income tax rate; and
- carried interest attached to a share or unit, which qualifies as capital gain for tax purposes (and which is exempted from income tax if it is realised after a minimum holding period of six months and if the participation does not exceed 10% of the issuer’s capital).

Additionally, a favourable tax regime will be created for the carried interest paid to Luxembourg tax residents employed by an AIFM subject to certain conditions.

### **Recent Steps Taken by the CSSF to Ensure Smooth Transposition of the AIFMD into Luxembourg Law**

The CSSF did not wait for the enactment of the bill into law prior to releasing AIFMD application forms and FAQs on its website. The templates and FAQs (which are only available in English) are available at:

[http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués\\_2013/CP\\_1325\\_AIFMD\\_Guidance\\_180613.pdf](http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués_2013/CP_1325_AIFMD_Guidance_180613.pdf)

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<sup>6</sup> Luxembourg corporate law generally distinguishes between joint-stock companies (*sociétés de capitaux*), where creditors’ claims are in principle limited to the company’s capital, and “*intuitu personae*” companies (*société de personnes*), where creditors may extend their claims to some or all shareholders/partners of the company.

Further to ESMA's approval of cooperation arrangements with 34 non-EEA supervisory authorities, the CSSF has signed separate cooperation arrangements with each of these authorities. The list of supervisory authorities with whom the CSSF has entered into cooperation arrangements is available at:

[http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués\\_2013/CP\\_1323\\_34\\_MOUS\\_EN.pdf](http://www.cssf.lu/fileadmin/files/Publications/Communiqués/Communiqués_2013/CP_1323_34_MOUS_EN.pdf)

The execution of these cooperation arrangements enables management companies to engage in the following activities, among others:

- Marketing in Luxembourg of non-EEA AIFs under the Luxembourg private placement regime, as described above; and
- Delegation of portfolio management to an investment manager located outside of the EEA, provided that other conditions for delegation under the AIFMD are fulfilled (e.g., the investment manager must be authorised to manage a portfolio and subject to prudential supervision in its home jurisdiction).

### Conclusion

Luxembourg is one of the first EU member states transposing the AIFMD into their national law. The AIFM Law goes beyond the mere implementation of the AIFMD into Luxembourg law – it overhauls the regime of Luxembourg limited partnerships, creates a new depositary license, extends the scope of services of a management company under chapter 16 of the UCI Law and introduces several technical improvements regarding Luxembourg alternative investment fund vehicles.

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