



# Luxembourg Alternative Investment Funds

Asset Classes - Hedge; Real Estate; Private Equity; Venture; Mezzanine; Infrastructure

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## Introduction

A founder member of the European Union benefiting fully from free movement of capital and freedom of establishment within the EU, Luxembourg is also one of the largest global financial centres, benefiting from flexible and attractive legal, regulatory and tax regimes and a significant concentration of professional service providers to the financial services industry.

Luxembourg's investment funds industry ranks as the largest EU fund domicile jurisdiction and the second largest fund domicile jurisdiction globally. After more than 30 years of development, total net assets under management of Luxembourg undertakings for collective investment and specialised investment funds stood at €2.157 trillion as at January 2012.

As a leading global jurisdiction for the establishment and management of investment vehicles, Luxembourg has demonstrated one of the most solid track records of stability in relation to the challenges arising in global markets since 2008 with a Triple A credit rating, low levels of sovereign debt and one of the highest per capita GDP globally. This economic and political stability, allied to the legal, regulatory and fiscal attributes of its investment funds industry has resulted in Luxembourg's position as a premier-ranking fund domicile.

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## Principal Luxembourg regulated alternative fund vehicles

There are two principal, regulated Luxembourg fund vehicles appropriate for each of hedge, real estate, private equity, venture, mezzanine, and infrastructure funds, available to institutional, professional and sophisticated investors, as follows:

1. specialised investment funds (**SIF**); and
2. investment vehicles in "risk capital", ie private equity and venture (**SICAR**).

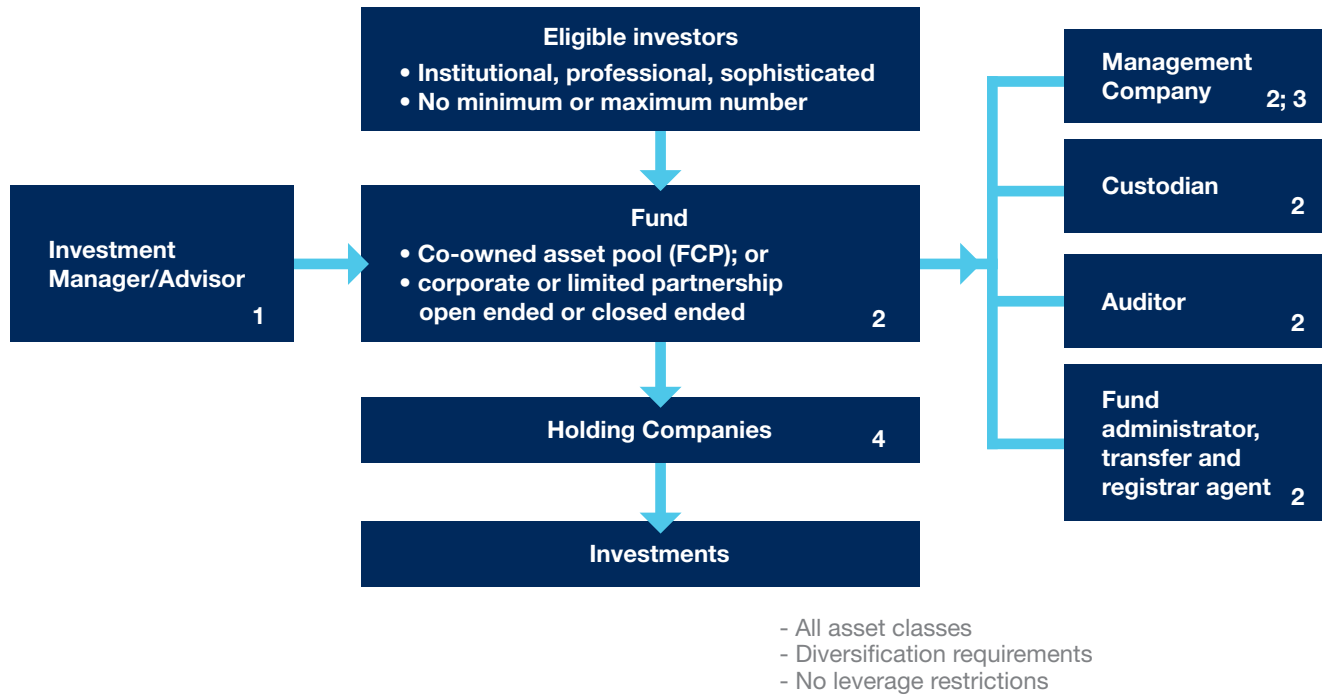
Both SIF and SICAR are regulatory classifications. They describe regulated fund products which can be structured in various legal forms, with tax outcomes following from such selection. A summary of the available vehicles and corresponding tax treatment is set out in relation to the SIF and SICAR respectively below.

As regulated products, both SIF and SICAR are subject to the prior authorisation and ongoing supervision of the Commission de Surveillance du Secteur Financier (**CSSF**), the Luxembourg regulatory authority. In discharge of its duties, the CSSF is charged with maintaining investor protection and the stability of Luxembourg's financial services industry.

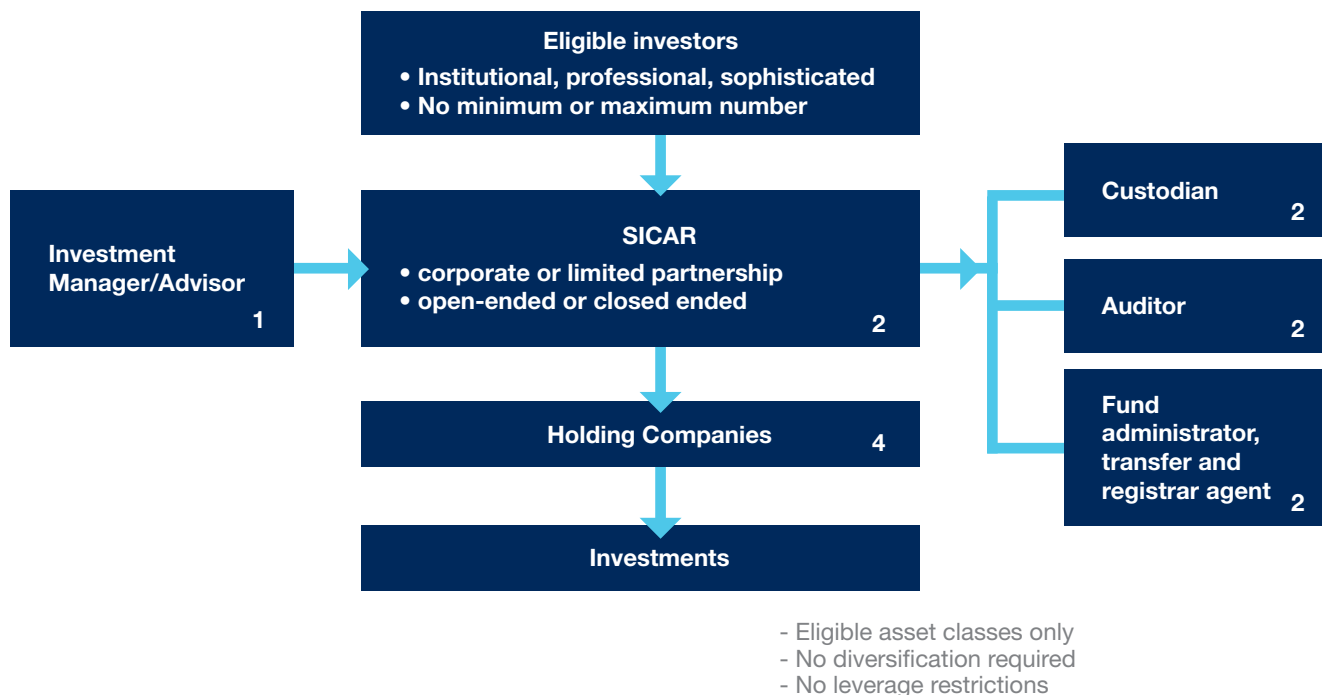
In addition to SIF and SICAR, UCITS are also available to hedge funds meeting the applicable regulatory criteria. Please refer to our separate briefing of May 2012 on this area in the Luxembourg section of [www.ogier.com](http://www.ogier.com).

# Example structures:

## Specialised Investment Funds



## Investment vehicles in “Risk Capital”



**Notes:**

1. Investment advisory role most common in practice but varies with client structuring requirements.
2. Luxembourg situate and regulated (or approved for auditors).
3. ManCos are only required for FCP Funds.
4. Please see separate client briefing of May 2012 in Luxembourg section of [www.ogier.com](http://www.ogier.com).

# Specialised Investment Funds (SIF)

In 2007, Luxembourg introduced a regulated product specifically tailored to the alternative funds industry. The SIF brought greater flexibility in terms of available fund vehicles and applicable investment rules. Subject to adequate offer document disclosure, there are no restrictions on target asset classes.

It is available to funds whose eligible investors comprise: institutional; professional; self-certifying sophisticated private investors with a minimum investment of €125,000; investors certified as sophisticated by a regulated intermediary (no minimum investment required); and carried interest investors acting in the management of the SIF.

There are no minimum or maximum requirements as to investor numbers.

Investment in the SIF must be restricted to such eligible investors and the constitutional documents must expressly refer to the SIF Law.

SIFs are commonly used across the spectrum of different asset classes including: hedge; private equity; venture; mezzanine; infrastructure; real estate; listed securities; bonds; distressed debt; and funds combining different investment strategies or asset classes. A SIF may also invest in various other investment vehicles. Since introduction in 2007, approximately 1,400 SIFs have been set up across these asset classes.

SIF may be constituted as either:

1. a tax transparent, co-owned asset pool, managed by a separate management company (*fonds commun de placement*) (**FCP**);
2. a closed-ended corporate investment vehicle (**SICAF**); or
3. an open-ended corporate investment vehicle (**SICAV**).

An FCP is an undivided pool of assets, co-owned by investors, with no separate legal personality, which is managed by a separate management company. This management company acts in the name and on behalf of the FCP in the interests of the unit-holders. The FCP is therefore similar to the English law unit trust or US mutual fund.

Unit-holders have limited liability, restricted to their agreed level of contribution. Their minimum legal rights are generally more limited than those of shareholders. Subject to any case-specific provisions in a SIF's management regulations (similar in function to its constitutional document), unit-holder rights will commonly be limited to approval of annual accounts and any changes to the offer document or management regulations.

An FCP is deemed to be a Luxembourg fund if its management company has its statutory and effective seat in Luxembourg.

A SICAF is a SIF constituted as a closed-ended corporate vehicle and may take the form of any Luxembourg body corporate or limited partnership.

A SICAV is a SIF constituted as an open-ended corporate investment vehicle and is generally structured in one of the following principal forms: (a) a public limited company (*société anonyme*); (b) an incorporated partnership limited by shares (*société en commandite par actions*); or (c) a private limited company (*société à responsabilité limitée*).

SICAF and SICAV may be constituted as either single asset pool funds or with segregated compartments. In line with market practice, the majority are structured as limited liability vehicles, commonly as limited partnerships with corporate general partners.

All SIF have a minimum capitalisation requirement of €1,250,000, which must be subscribed for within twelve months following their authorisation by the CSSF. Only 5% of the total subscribed capital must however be fully paid up.

Provided this minimum capitalisation requirement continues to be met, there are no restrictions regarding dividends or distributions for FCP

or SICAV (save any that may be applied in the constitutional documents as a matter of private negotiation). SICAF dividends or distributions are restricted by the availability of distributable profits or reserves. SIF are not required to maintain any other legal reserves.

SIF are subject to risk-spreading regulatory requirements. Although not specified in the SIF Law, CSSF policy requires that SIF apply investment restrictions to ensure adequate risk spreading. The general application of this policy requires that no single investment represents more than 30% of the SIF's total net assets.

The general position on short selling is that it cannot result in the SIF holding uncovered securities of the same type issued by the same issuer representing more than 30% of the SIF total net assets. This general position is subject to any other temporary restrictions on short selling in force from time to time. When entering into derivative instruments, SIF must ensure comparable risk diversification through appropriate diversification of the underlying assets.

Exemptions apply in relation to (a) securities issued or guaranteed by an OECD Member State (or by its local authorities) or by certain supranational bodies and/or (b) investments in portfolio funds which are themselves subject to risk spreading requirements at least comparable to those of SIFs. Other exemptions to the risk-spreading requirements may be available on a case-by-case basis.

SIF are not subject to any restrictions on leverage.

SIF assets are valued at fair value, determined in accordance with applicable accounting standards pursuant to the SIF's constitutional documents and confirmed by the SIF's independent auditor. Title to portfolio assets is verified at acquisition and, together with related funds flows, is monitored periodically by a Luxembourg regulated custodian. The extent of the custodial duties depends on the fund type and asset class.

There are no prescribed content requirements for SIF offer documents other than the general requirement to include all information necessary

for investors to make informed judgements of the investment proposition and of the risks attaching to it. The key elements of the offer document must be updated (as required) prior to any future closings involving new investors.

Minimum required investor reporting takes the form of the SIF's annual report. There is no obligation to publish semi-annual reports or to prepare consolidated financial statements, although more frequent investor liaison may be adopted if considered appropriate.

SIF units may be stock exchange listed on meeting the applicable exchange admission and ongoing requirements. Ensuring compatibility between free transferability requirements of the relevant exchange and SIF eligible investor requirements is required.

Closed-ended SIF applying for such stock exchange listings and / or wishing to utilise the EU passport for cross-border distribution will also apply the EU Prospectus Directive requirements (implemented in Luxembourg in 2005) to the SIF offer document.

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## Regulatory application

Commensurate with the sophisticated nature of SIF eligible investors, the regulatory approach to authorisation and ongoing supervision is less onerous than that applied to fund types permitted to admit retail investors.

The application will include regulatory approval of the offer document and constitutional documents. The SIF directors must also be approved as being of good standing with appropriate experience, as must the choice of Luxembourg regulated custodian, fund administrator, transfer and registrar agent and auditor. CSSF may also request any other information or documents considered relevant from time to time.

In contrast to funds legally permitted to admit retail investors, no separate promoter review / authorisation is applied.

In line with anticipated AIFM Directive requirements, since March 2012 SIF are required to implement adequate risk management systems and organisational arrangements to prevent conflicts of interest.

SIF must locate their central administration in Luxembourg.

CSSF authorisation may take three to six weeks depending on investment policy and strategy. On authorisation, the SIF is registered on the official list of Luxembourg specialised investment funds and may hold its first closing.

Any appointment of new directors, change of custodian or amendment of constitutional documents requires CSSF prior approval.

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## Luxembourg tax

All SIF are exempt from Luxembourg direct taxation. They are subject to an annual subscription tax calculated at 0.01% per annum of the net asset value, calculated and payable on a quarterly basis (subject to certain limited exemptions). There is no applicable capital duty.

They are exempt from Luxembourg income tax, municipal business tax and net wealth tax. Distributions by SIFs to investors and payment of proceeds upon redemption of units or shares are not subject to Luxembourg withholding tax (subject to the EU savings tax Directive).

SIF qualify as taxable persons for VAT purposes. Management and administration services provided to SIF are however VAT exempt.

Investors' tax treatment depends on many individual factors including the place of such investor's residency. Investors should seek specific, independent tax advice.

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## Investment vehicles in 'risk capital' (SICAR)

The purpose of a SICAR is to provide an investment vehicle in securities representing 'risk capital', common example of which are venture and private equity. Investment management may be conducted internally by the SICAR's directors. Such 'risk capital' is defined as direct or indirect investment in entities with a view to their set up, development or IPO. CSSF policy applies two criteria when assessing the eligibility of an applicant's proposed investment policy, namely (a) high risk and (b) an intention to develop the portfolio entities.

SICAR may also indirectly invest in real estate (via subsidiaries) provided that such investment may also be considered as equity risk capital under these criteria. Investment in listed securities is also permitted in certain circumstances, such as in portfolio companies listed on immature markets or investment in

distressed companies with a view to de-listing. SICAR may therefore also be used for hedge strategies focussing exclusively on such equities.

The same eligibility criteria apply to investors in SICAR as to investors in SIF. SICAR are therefore available to: institutional investors; professional investors; self-certifying sophisticated private investors with a minimum investment of €125,000; investors certified as sophisticated by a regulated intermediary (no minimum investment required); and carried interest investors acting in the management of the SIF.

There are no minimum or maximum requirements as to investor numbers.

One key distinction from the SIF is that the SICAR is not subject to any regulatory requirements as to prescribed levels of risk spreading, although it is of course free to apply such a strategy to the degree it considers appropriate. In line with the SIF, SICAR are not subject to any leverage restrictions.

SICAR may be structured either as single asset pools or as umbrella vehicles with segregated compartments, each compartment providing a ring-fenced asset / liability pool with the ability to pursue individual investment strategies.

In contrast to the SIF, the SICAR may only be constituted as one of the following corporate or limited partnership vehicles: (a) public limited company (*société anonyme*); (b) incorporated partnership limited by shares (*société en commandite par actions*); (c) ordinary limited partnership (*société en commandite simple*); (d) private limited company (*société à responsabilité limitée*); and/or (e) co-operative constituted as a public company (*société coopérative organisée sous la forme d'une société anonyme*).

In line with market practice, the majority are structured as limited liability vehicles, commonly as limited partnerships with corporate general partners and may be closed-ended or open-ended.

SICAR minimum required issued share capital is a slightly lower threshold than that of the

SIF, standing at €1,000,000, to be subscribed for within twelve months following CSSF authorisation. Only 5% of total subscribed capital from time to time must however be fully paid up. SICAR may also issue debt securities from time to time.

There are no restrictions regarding dividends, distributions or redemptions applicable to SICAR (other than any that may be applied in the constitutional documents on a case-by-case basis) provided that net assets after distribution do not fall below the minimum €1,000,000 capitalisation requirement. SICAR are not required to maintain any other legal reserves.

SICAR assets are valued at fair value, determined in accordance with applicable accounting standards pursuant to the SICAR's constitutional documents. Also in line with the SIF, SICAR portfolio assets are monitored by a Luxembourg regulated custodian. SICAR must appoint an independent auditor and locate their central administration in Luxembourg.

A SICAR may apply for listing of its shares on the Luxembourg Stock Exchange (LSE) or on any other stock exchange in accordance with the rules of that exchange. Similar to the SIF, compatibility requirements between unit transferability and SICAR eligible investor rules may need to be addressed.

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## Regulatory application

As a regulated investment entity, the SICAR is subject to the prior authorisation and ongoing supervision of the CSSF.

On application, CSSF approves the SICAR constitutional documents, offer document, and directors. The directors must be of good repute and sufficiently experienced. CSSF also approves choice of custodian, administrator, transfer and registrar agent and independent auditor. CSSF may also request any other information or documents on the envisaged structure.

In line with the SIF, no separate promoter review / authorisation is applied, nor is any such review applied to investors, other than if necessary to confirm eligible investor status.

The CSSF authorisation process customarily takes four to eight weeks depending on the proposed investment policy and strategy. Once authorised the SICAR is registered on the official list of Luxembourg investment companies in risk capital and may conduct the close of its first fund-raising.

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## Taxation

Any SICAR constituted otherwise than as an ordinary limited partnership (*société en commandite simple*) is subject to Luxembourg income tax at the standard rate and may therefore benefit in principle from the Luxembourg tax treaty network, the EU parent-subsidiary directive and the Luxembourg provisions regarding participation exemption.

However, SICAR income deriving directly from transferable securities (such as dividend distributions) is not included in the SICAR's chargeable tax base. In practice this exemption attaches to the investment instruments most commonly held by private equity / venture funds.

Where constituted as a public company or an incorporated limited partnership (classified as *société de capitaux*), income resulting from the sale or liquidation of such assets is also exempted from the SICAR's chargeable tax base. SICAR are also outside scope in terms of withholding tax and net wealth tax.

SICAR can register for VAT purposes. Management and administration services are however exempt from VAT.

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## About Ogier

The Ogier Group provides international legal and fiduciary services. We employ over 850 people and provide advice on BVI, Cayman, Guernsey, Jersey and Luxembourg law and fiduciary services through our network of offices that cover all time zones and key financial markets. Ogier Luxembourg is a Luxembourg law firm forming part of our network.

Our highly qualified professionals deliver outstanding client service in each location. The Group's legal and fiduciary approach is a successful combination and we regularly win awards for the quality of our client service, our work and our people.

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