



association of the
luxembourg fund industry



LUXEMBOURG HEDGE FUNDS

Why Luxembourg ?

Luxembourg is the leading investment fund centre in Europe, and second in the world after the United States. Luxembourg has a strong reputation as an international fund centre, and caters to all types of collective investment vehicles, covering all of the primary fund strategies.

The following features make Luxembourg especially attractive to the fund industry (including hedge funds):

- **Political and economic stability** as evidenced, *inter alia*, by the AAA credit rating awarded by Moody's, Standard & Poor's and Fitch;
- **Strategic location in the heart of Europe** with Luxembourg City a short distance from France, Germany and Belgium, and approximately one hour by plane to London, Zurich, Munich, Amsterdam, Paris and Frankfurt;
- **Sophisticated legal and regulatory framework**, offering flexible product design tailored to specific market and client needs, while focusing on rigorous investor protection;

- **Multilingual and multicultural financial centre**, with a long tradition of financial expertise and extensive knowledge of the needs of an international clientele.

- **Quadrilingual country**, where English is widely spoken next to the official languages, Luxembourgish, French and German. Fund documentation may also be drawn up in English.

Unmatched marketing reach, as Luxembourg funds are distributed to over 70 countries in Europe, Asia, the Middle East and the Americas. The world's largest fund managers use Luxembourg as their base for the global distribution of fund products. The above-listed advantages attract asset managers from all over the world, who use Luxembourg as their gateway to Europe and the rest of the world, because Luxembourg funds are globally recognised as high-quality investment products.

This brochure has been prepared by the Hedge Fund Working Group of the Association of the Luxembourg Fund Industry (ALFI) in order to provide general background information on key factors and considerations for establishing hedge funds in the Grand Duchy of Luxembourg. Please refer to the glossary for certain defined terms used herein.

The choice of a hedge fund vehicle will in practice depend on: the proposed investor base; type of investments to be made; any specific tax considerations; and target distribution channels.

The Luxembourg legal and regulatory framework is diverse, as well as flexible enough to meet a wide range of investor and fund manager needs. Luxembourg hedge funds are usually regulated products, and therefore typically subject to CSSF supervision. Nevertheless, and in light of the AIFMD, non-regulated hedge funds (managed by a regulated AIFM) may also be created.

This document reflects the legal situation as at 1 March 2018.

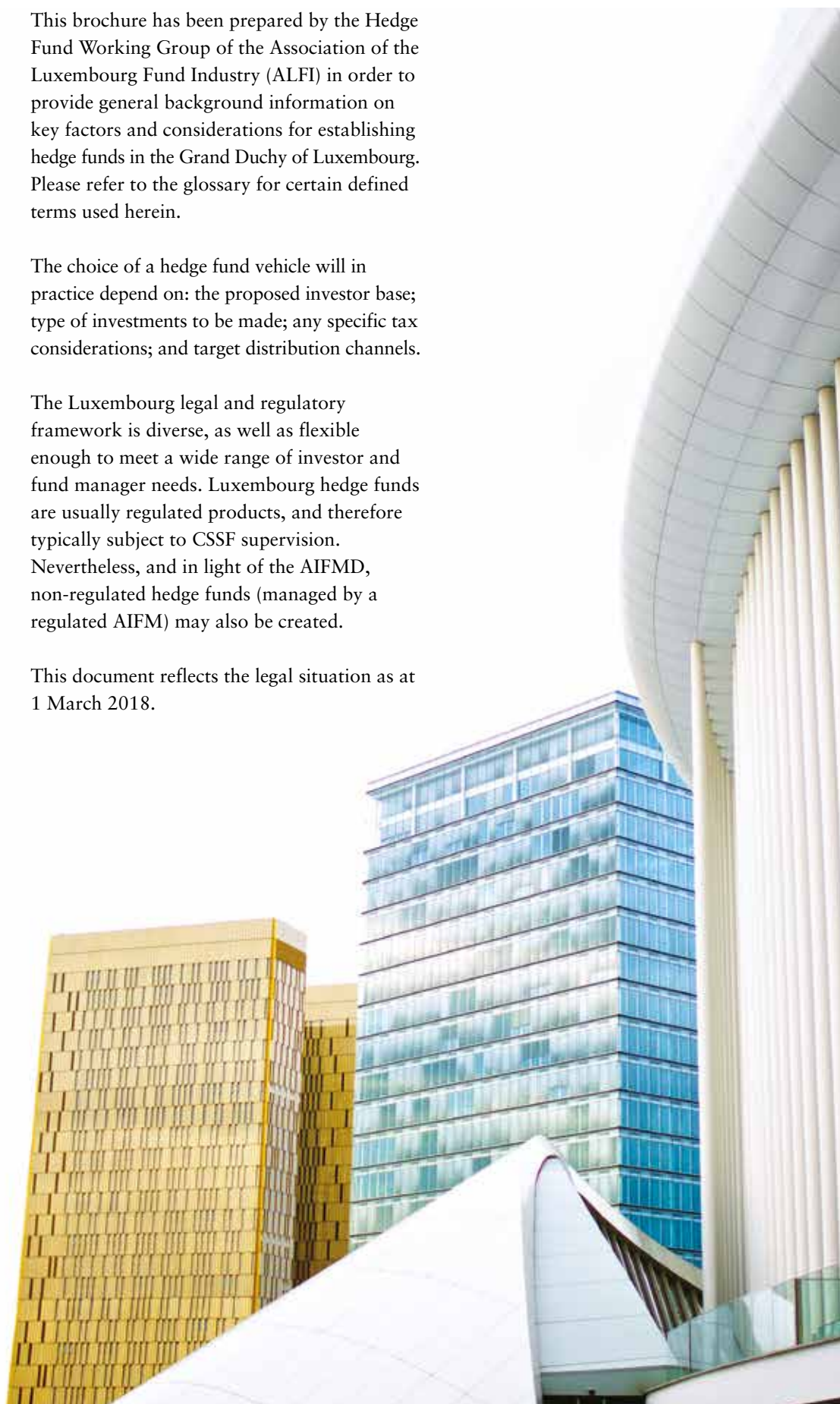


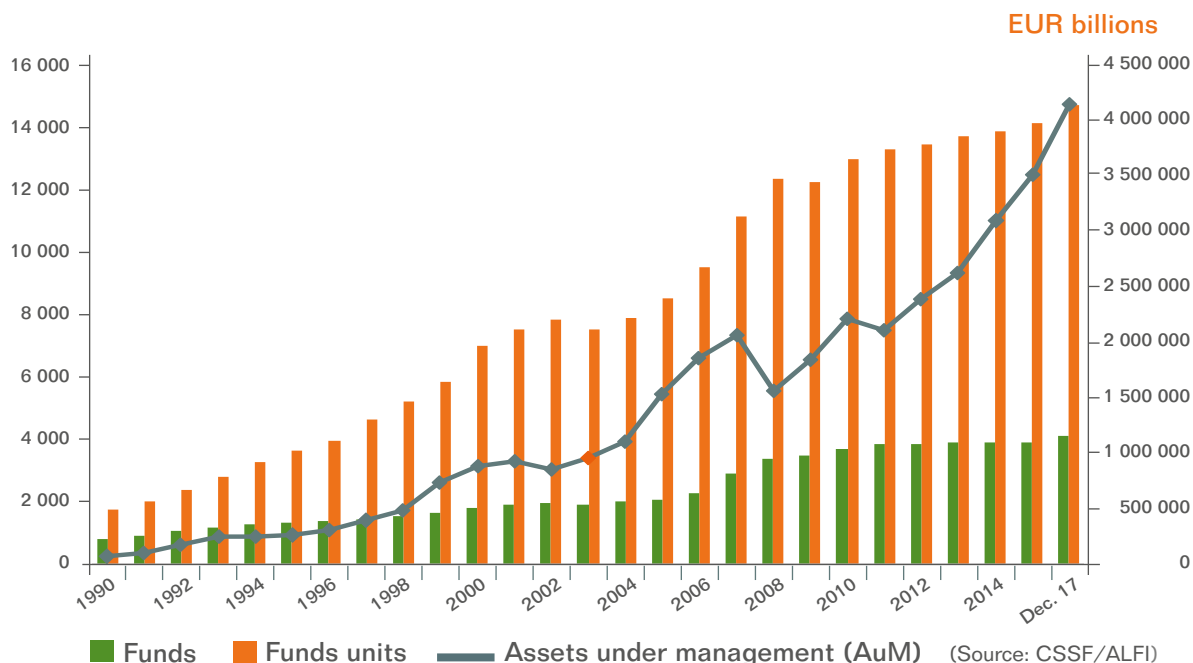
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What is Luxembourg's current market position?

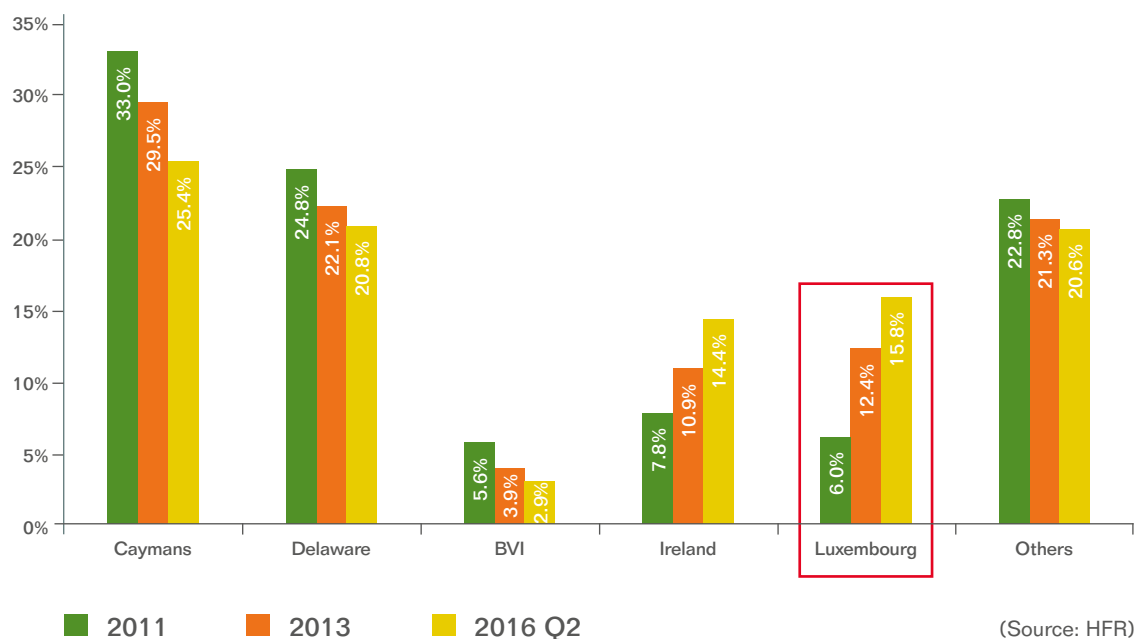
The Luxembourg fund centre continued its impressive year-on-year growth and reached a record high in January 2018, with net assets under management exceeding EUR 4,214 billion.

Assets under management in Luxembourg funds



The Luxembourg hedge fund sector has grown rapidly and Luxembourg is recognised as a premier hedge fund domicile. Meanwhile, several top global hedge fund managers have domiciled funds in Luxembourg. As a result, Luxembourg has recorded the fastest global growth in terms of relative weight of fund domiciliation since the financial crisis, up from 6% of the global market in 2011 to 15,8% in June 2016¹.

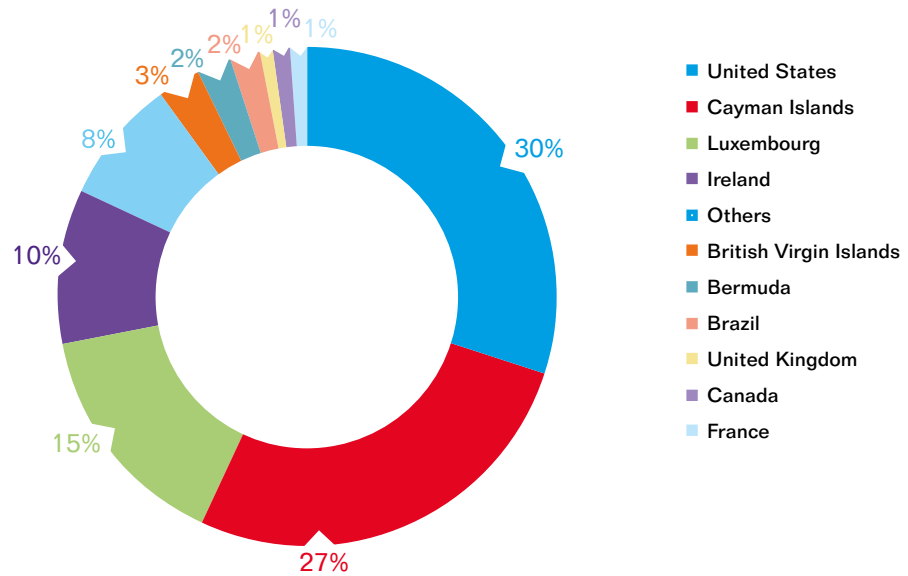
Evolution of the worldwide share of hedge funds by domicile



¹ HFMWeek, special report, Luxembourg 2017

Half of all Europe-based hedge funds are now domiciled in the Grand Duchy – with the balance spread among Ireland and a small number of other jurisdictions.

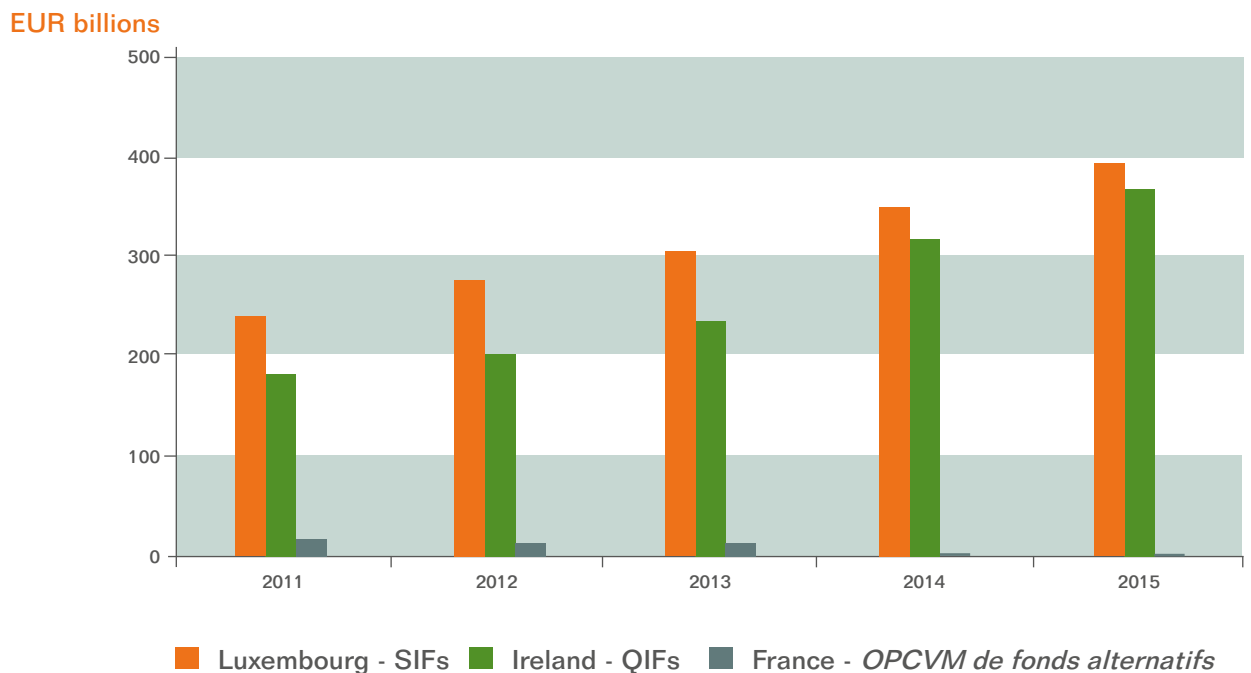
Hedge funds domicile by number of funds (As at June 2016)



(Source: Eurekahedge Global Hedge Funds Trends August 2016)

The Luxembourg SIF is a very popular vehicle for structuring of regulated alternative investment funds. It has attracted higher volumes of assets under management than comparable vehicles existing in other jurisdictions.

Assets under management for alternative products in Europe

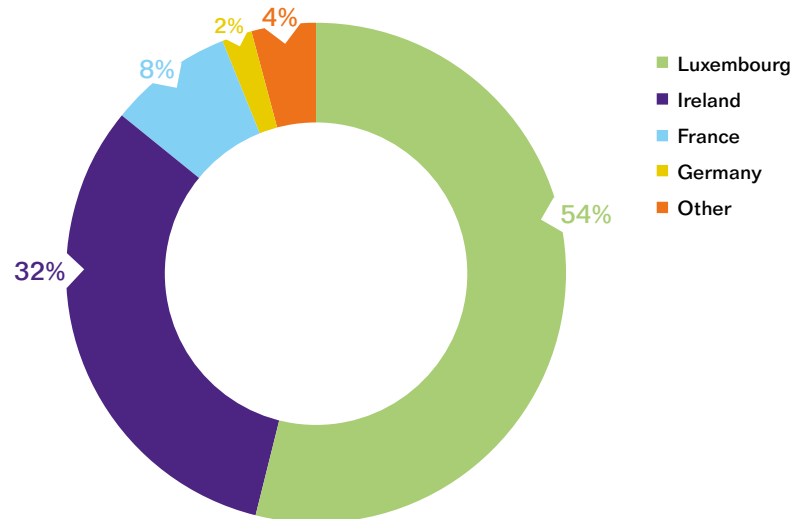


(Source: CSSF, CBI, AMF)

What is Luxembourg's current market position?

In particular, a significant number of hedge funds were launched under the UCITS label, commonly referred to as “alternative UCITS”. Currently, 54% of all alternative UCITS are domiciled in Luxembourg.

Alternative UCITS by domicile in number of sub-funds



(Source: Preqin Hedge Funds Spotlight June 2017)

Alternative UCITS have shown a much stronger growth in AuM than non-UCITS hedge funds over the recent years.

What are the structuring options in Luxembourg?

Luxembourg offers a broad choice of regulatory, legal and tax regimes, which allows the setting up of tailor-made investment vehicles to meet managers' and investors' needs.

Luxembourg regulatory regimes for hedge funds

In addition to non-regulated investment vehicles that are not subject to any specific fund product regime in Luxembourg, the following four regulatory regimes are most suitable for hedge fund vehicles:

	RAIF	SIF	PART II UCI	PART I UCITS
Applicable law	RAIF Law	SIF Law	Part II of the UCI Law	Part I of the UCI Law
Regulatory authorisation	No, only RCS registration	Yes	Yes	Yes
Classification from EU perspective	AIF	AIF/non-AIF	AIF	UCITS
Eligible investors	Well-informed investors	Well-informed investors	Retail, institutional and professional investors	Retail, institutional and professional investors
Eligible assets	Unrestricted	Unrestricted	Unrestricted	Restricted list of instruments, as per applicable law, regulations and guidelines
Investment restrictions	No specific investment or borrowing restrictions, but risk diversification requirement: max. 30% of the RAIF's assets can be invested in securities of the same type issued by the same issuer (unless the RAIF invests exclusively in risk capital)	No specific investment or borrowing restrictions, but risk diversification requirement: max. 30% of the SIF's assets can be invested in securities of the same type issued by the same issuer	Yes, both quantitative and qualitative	Yes, both quantitative and qualitative
Borrowing restrictions	None	None	- Max. 200% of the fund's net assets (for directional strategies); - Max. 400% of the fund's net assets (for market-neutral or relative-value strategies for which short positions are covered by long positions) - Derogations may be applied for on a case-by-case basis	Borrowing for investment purposes in principle prohibited, except that UCITS may borrow on a temporary basis up to 10% of their assets (but the use of derivatives may allow equivalent economic results).
Cross-border distribution	AIFMD passport applies	AIFMD passport applies	AIFMD passport applies	Cross-border distribution permitted via European passport within the European Economic Area (EEA)

What are the structuring options in Luxembourg?

	RAIF	SIF	PART II UCI	PART I UCITS
Substance in Luxembourg/nationality or residency requirements	Central administration must be in Luxembourg No residency requirements for directors/managers	Central administration must be in Luxembourg No residency requirements for directors/managers	Central administration must be in Luxembourg No residency requirements for directors/managers	Central administration may be in any EU/EEA country In principle, two managers must be resident in Luxembourg unless foreign UCITS ManCo
Required service providers	AIFM, depositary, central administration agent, auditor.	Depositary, central administration agent, auditor	Depositary, central administration agent, auditor	Depositary, central administration agent, auditor
Exposure to prime broker	<ul style="list-style-type: none"> ■ Depositary to approve RAIF's choice of prime broker ■ Prime broker must be recognised and experienced financial institution subject to regulatory supervision equivalent to EU standards ■ Requirements re: depositary-prime broker relationship 	<ul style="list-style-type: none"> ■ Depositary to approve SIF's choice of prime broker ■ Prime broker must be recognised and experienced financial institution subject to regulatory supervision equivalent to EU standards ■ Requirements re: depositary-prime broker relationship 	<ul style="list-style-type: none"> ■ Initial and on-going due diligence by depositary on prime broker ■ Requirements re: depositary-prime broker relationship ■ Limitation on counterparty risk: difference between (a) value of assets transferred by fund to prime broker as security and (b) debt owed by fund to prime broker may not exceed 20% of fund's assets 	<ul style="list-style-type: none"> ■ Initial and on-going due diligence by depositary on prime broker; ■ Requirements re: depositary-prime broker relationship ■ Limitation on counterparty risk in relation to OTC derivative transactions, which may not exceed 10% or 5% of fund's assets ■ Max. 20% of fund's assets may be invested in deposits with the same body ■ Combined limit of 20% for: (a) investments in transferable securities or money market instruments issued by the same body, and (b) deposits with a single body, and (c) exposure arising from OTC derivative transactions undertaken with a single body
Reporting requirements	Yes Annual report	Yes Annual report	Yes Semi-annual and annual report NAV calculation at least once a month	Yes Semi-annual and annual report NAV calculation at least twice a month
Fixed registration duty	Yes EUR 75 upon incorporation and amendment of by-laws	Yes EUR 75 upon incorporation and amendment of by-laws	Yes EUR 75 upon incorporation and amendments of by-laws	Yes EUR 75 upon incorporation and amendments of by-laws

SICAV vs FCP

Luxembourg laws and regulations permit the creation of undertakings for collective investment of the contractual type (FCP) and of the corporate type (investment companies). Investment companies may be established either as companies with variable share capital (*sociétés d'investissement à capital variable* or SICAV) or companies with fixed share capital (*sociétés d'investissement à capital fixe* or SICAF). In turn, a SICAV or a SICAF may be in the form of a limited partnership.

A SICAV or SICAF is generally an investment company with legal personality that may benefit from some of Luxembourg's wide network of tax treaties, whereas an FCP is a co-proprietorship of assets without legal personality, which is considered transparent for tax purposes.

A further major difference pertains to the management of these types of vehicles.

A SICAV or SICAF is managed by its board of directors or by the board of directors of its general partner, while an FCP must have a management company.

Finally, from the investors' perspective, shareholders in a SICAV or SICAF in corporate form generally have rights to: participate in the general meetings of shareholders; vote on any amendments to the articles of incorporation; determine whether to liquidate or merge the fund; and review and approve the fund's annual financial statements. On the other hand, investors in an FCP, or in a SICAV or SICAF in the form of a partnership, usually do not have any voting rights (unless otherwise provided for by the constitutional documents), and notably do not have the right to terminate the FCP or the partnership (except in accordance with the provisions of the constitutional documents).

Types of most frequently used Luxembourg legal structures for hedge funds

The following are the most popular legal structures for Luxembourg hedge fund vehicles:

- **SA** (*Société Anonyme*, a public limited company): UCITS *must* take the legal form of an SA, while RAIFs, SIFs and Part II UCIs may opt for this structure. Public limited companies are particularly suitable for structures where the investors will require an involvement in corporate governance. There is no maximum limit to the number of shareholders in an SA, and shareholders are liable only up to the amount of their respective contributions. The so-called 'one-tier' SA with several shareholders is managed by a board of directors of at least three members appointed (at a general meeting) by the shareholders, who determine the remuneration of such directors and may decide upon their dismissal and replacement any time.

- **SCA** (*Société en Commandite par Actions*, a partnership limited by shares): An SCA is distinguished from an SA by its ownership structure, made up of two types of partners: partners whose liability is limited to their investment (limited partners) and partners with joint and several unlimited liability for all commitments entered into by the partnership (general partners). SCAs are particularly convenient for fund initiators who want to retain total control over management. In practice, there is usually one unlimited partner, which is incorporated as a Luxembourg limited liability company that is controlled by the fund initiator. There is no maximum limit to the number of partners in an SCA. The management of an SCA is typically performed by the general partner(s) (who do not need to be unlimited partner(s)) and, as a rule, such management responsibilities cannot be removed without the consent of such general partner(s), unless otherwise provided in the articles of incorporation of the SCA.

What are the structuring options in Luxembourg?

- CLP (*Société en Commandite Simple*, a common limited partnership) and SLP (*Société en Commandite Spéciale*, a special limited partnership): The CLP and the SLP are legal structures similar to the English limited partnership with contractual flexibility as a key feature. In each case, the partnership is formed by written agreement (under private seal or by notarial deed) entered into by one or more general partners (with unlimited and joint liability for all of the partnership's obligations) and one or more limited partners (who are liable only up to the amount of their respective contributions). The CLP and SLP are often chosen by international fund initiators as these forms offer significant structuring flexibility.

The CLP has its own legal personality, separate from that of its partners. The SLP does not constitute a legal person separate from its partners. There are no maximum limits for the number of partners in a CLP or SLP. The unlimited shareholder(s) have the right, but not the obligation, to manage the partnership as general partner(s); if the appointed manager is not an unlimited shareholder, the manager is considered as an agent (*mandataire*) liable only for the execution of its mandate (with the possibility to arrange for delegation) and for any misconduct in the management of the partnership's affairs.



How does the AIFM regime impact hedge fund structures?

The AIFMD was transposed into Luxembourg national law on 12 July 2013 (by means of the AIFM Law). The AIFMD was designed to address a number of risks relating to alternative investment funds, through closer regulatory oversight of systemic risks and more stringent regulation of activities in this sector. In exchange for increased regulatory supervision, a European passport was introduced to allow AIFMs to market alternative investment funds to professional investors, ultimately aiming at the phasing out of existing national private placement rules.

The AIFM regime regulates alternative investment fund managers and, under certain circumstances, alternative investment funds themselves, where the AIFs' legal form permits them to be considered as internally managed. In this respect, the following may qualify as an internally managed AIF:

(i) a SICAV established as an SA; or (ii) a SICAV in the form of an SCA, or as a CLP provided that the purpose of the general partner is limited to the management of the given partnership. Neither FCPs nor SLPs qualify as internally managed AIFs; therefore such vehicles must appoint an external – authorised or registered – AIFM.

All alternative investment funds, which are not covered by the UCITS Directive, are in principle subject to the AIFM regime.

The AIFM Law defines an AIF as an entity raising capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of such investors, and which does not qualify as a UCITS.² With respect to the Luxembourg regulatory regimes available for hedge funds (see above), all investment vehicles established under Part II of the UCI Law and all RAIFs qualify as AIFs. For SIFs, this is typically the case, with limited exceptions.

The AIFM regime not only applies to EU managers managing one or more EU AIFs, but also to:

- (i) EU AIFMs managing one or more non-EU AIFs;
- (ii) Non-EU AIFMs managing one or more EU AIFs; and
- (iii) Non-EU AIFMs marketing AIFs (even if they are not EU AIFs) in the EU.

Only “smaller” structures are exempted from the AIFM regime:

- (i) AIFMs managing AIFs that: are not leveraged; do not offer redemption rights for a period of five years, and which have aggregate assets under management below EUR 500 million; and
- (ii) AIFMs managing AIFs whose assets under management (including any assets acquired through the use of leverage) do not exceed EUR 100 million.

Such exempted below-threshold AIFMs are subject only to the CSSF's registration (and reporting) requirements, but do not benefit from the marketing passport unless they opt in to the application of the full AIFM regime.

Since the entry into force of the AIFM regime, hedge fund managers wishing to launch a Luxembourg-based hedge fund vehicle need to consider the following key questions:

- What is the target size of the fund, and will the structure qualify as a “smaller” structure exempted from the AIFM regime?
- What will be the legal form of the fund, and will the structure qualify as an internally managed AIF or does an external AIFM need to be appointed?
- If an external AIFM needs to be appointed, will the AIFM be established in Luxembourg or another EU country?

² Article 1(39) of the AIFM Law

What are the challenges and advantages of having an authorised AIFM?

In order to be freely distributed to professional investors within the European Union on the basis of the AIFMD passport, a Luxembourg AIF must appoint a duly authorised AIFM, which is established in Luxembourg or in any other EU Member State. As of March 2018,

241 entities in Luxembourg held the AIFM License.³

The license requirements for a Luxembourg AIFM are substantially similar to those which apply to the authorisation of UCITS management companies.

Requirements applicable to AIFMs

Initial capital and own funds

- Internally managed AIFs must have initial capital of at least EUR 300,000.
- External AIFMs must have: (a) initial capital of at least EUR 125,000; and (b) own funds equal to 0.02% of the amount by which the portfolio of AIFs exceeds EUR 250 million, subject to an overall limit of EUR 10 million.
- Both external AIFMs and internally managed AIFs must have either additional own funds or professional indemnity insurance to cover potential liability risks arising from professional negligence.
- Own funds must be invested in liquid assets or assets readily convertible to cash in the short term and should not include speculative positions.

Directors, conducting persons and minimum substance requirements

- The board of directors of an AIFM must be composed of at least three members, who must be approved by the CSSF;
- An AIFM must have at least two conducting officers (in principle, permanently residing in Luxembourg or in the *Grande Région*);
- An AIFM must put in place a permanent independent compliance function, supervised by a compliance officer who must report on at least an annual basis to senior management; and
- An AIFM must establish and maintain an internal audit function.

Procedures

- An AIFM must put in place organisational and administrative arrangements designed to identify, prevent, manage and monitor conflicts of interest;
- An AIFM must establish and maintain remuneration policies and practices in line with the risk profiles of the AIFs it manages;
- An AIFM must functionally and hierarchically separate the functions of risk management from the operating units (including portfolio management), and must implement adequate risk management systems; and
- An AIFM is required for each AIF under management to apply appropriate liquidity management systems and procedures.

³ ALFI Global overview updated on 11 January 2018

Core functions and delegation

- Authorised AIFMs must perform at least one of the two core functions: portfolio management and risk management;
- Additional functions which may be provided by AIFMs are (i) administration (notably, providing legal and accounting services, handling customer inquiries, providing valuation and pricing, preparing tax returns, maintaining shareholder registers, and record keeping); (ii) marketing; and (iii) activities related to the assets of AIFs under management;
- All core functions cannot be delegated in full at the same time, and AIFMs remain liable in the case of delegation.

Main advantages of having an authorised AIFM

Cross-border Marketing

An authorised AIFM benefits from a passport for marketing its EU-based AIFs to professional investors in the EU on a cross-border basis, subject only to a notification procedure between regulators of the AIFM's home state and the EU Member State(s) into which the AIF is marketed.

Cross-border management/third-party AIFM services

An authorised AIFM may act as external AIFM to third-party AIFs based in Luxembourg or in any other EU Member State.

MiFID services

Article 92 of MiFID II amends the AIFMD and provides that henceforth the AIFMD passport covers not only portfolio management, risk management, marketing and administration services, but also:

(a) the management of portfolios of investments in accordance with mandates given by investors on a discretionary client-by-client basis; and (b) non-core services such as (i) investment advice and (ii) receipt and transmission of orders in relation to investment instruments (as referred to in article 6.4 of the AIFMD). Therefore, an authorised Luxembourg AIFM may provide investment advice to third parties on a cross-border basis within the EU, with effect from the entry into force and the transposition of MiFID II into national law.

Super ManCo

An authorised Luxembourg AIFM may also hold a UCITS ManCo license, and therefore market and manage on a cross-border basis both EU AIFs and UCITS funds.

RAIFs

The RAIF structure allows hedge fund initiators to set up Luxembourg-domiciled hedge funds that are not subject to regulatory approval by the CSSF. This option permits the achievement of a significantly enhanced time-to-market for new fund launches.

A RAIF automatically qualifies as an AIF, and must designate an (external) authorised AIFM established in Luxembourg or in another EU Member State. This requirement has the effect of subjecting a RAIF to the AIFMD, through application of the "product" aspects of the AIFMD. For example, the AIFM must comply with duties regarding the appointment of a depositary, disclosure rules, valuation and risk management procedures, and calculation of the level of leverage. As a result, while a RAIF itself is not subject to the approval of the CSSF, the RAIF is nevertheless indirectly subject to supervision, in connection with the product aspects of the AIFMD, which benefits the RAIF's investors.

What is the interaction between the depositary and the prime broker?

The depositary regime applicable to the vast majority of Luxembourg hedge funds is the regime under the AIFMD. This regime also applies to SIFs that do not qualify as AIFs as well as the Part II UCIs that are not marketed to retail investors in Luxembourg. For UCITS and Part II UCIs marketed to retail investors in Luxembourg, the depositary regime resulting from the UCITS V Directive is largely inspired by the AIFMD, with a few exceptions.

Under the AIFMD regime, the core functions of the depositary are:

- (i) Monitoring of cash flows to ensure that investors' money and cash belonging to the AIF are booked correctly on accounts opened in the name of the AIF, the AIFM acting on behalf of the AIF or the depositary acting on behalf of the AIFM;
- (ii) Safekeeping of the assets of the AIF, including: (a) holding in custody all financial instruments that can be registered in a financial instruments account on the depositary's books, and which can be physically delivered to the depositary and registered on its books within segregated accounts; and (b) verification of ownership of all other assets of the AIF (which cannot be held in custody) for which the depositary must maintain up-to-date records;⁴
- (iii) Oversight functions, including the duty to
 - (a) ensure that the sale, issue, repurchase, redemption and cancellation of shares or units of the AIF are carried out in accordance with applicable national law and the AIF's constitutional documents;
 - (b) ensure that the value of the shares or units of the AIF is calculated in accordance with applicable national law and the AIF's constitutional documents;
 - (c) carry out the instructions of the AIFM (unless in conflict with applicable national law or the AIF's constitutional documents);
 - (d) ensure that,

in transactions involving the AIF's assets, any consideration is remitted to the AIF within the usual time limits; and (e) ensure that the AIF's income distributions are applied in accordance with applicable national law and the AIF's constitutional documents.

Under the AIFMD, the depositary is liable for the losses incurred in the performance of its obligations, which are suffered by the AIFM, the AIF and its investors. In cases where the depositary holds assets in custody and those assets are lost, the depositary has an obligation to return to the AIF without undue delay a financial instrument of identical type or in the corresponding amount, unless the depositary can prove that the loss arose as a result of an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. For any other losses, the depositary is liable to the AIF or its investors as a result of the depositary's negligent or intentional failure to properly perform its obligations. The depositary's liability shall not be affected by any delegation to a third party; where financial instruments held in custody by such third party are lost, the depositary will remain liable (unless contractual discharge arrangements have been put in place in accordance with the AIFM Law).⁵

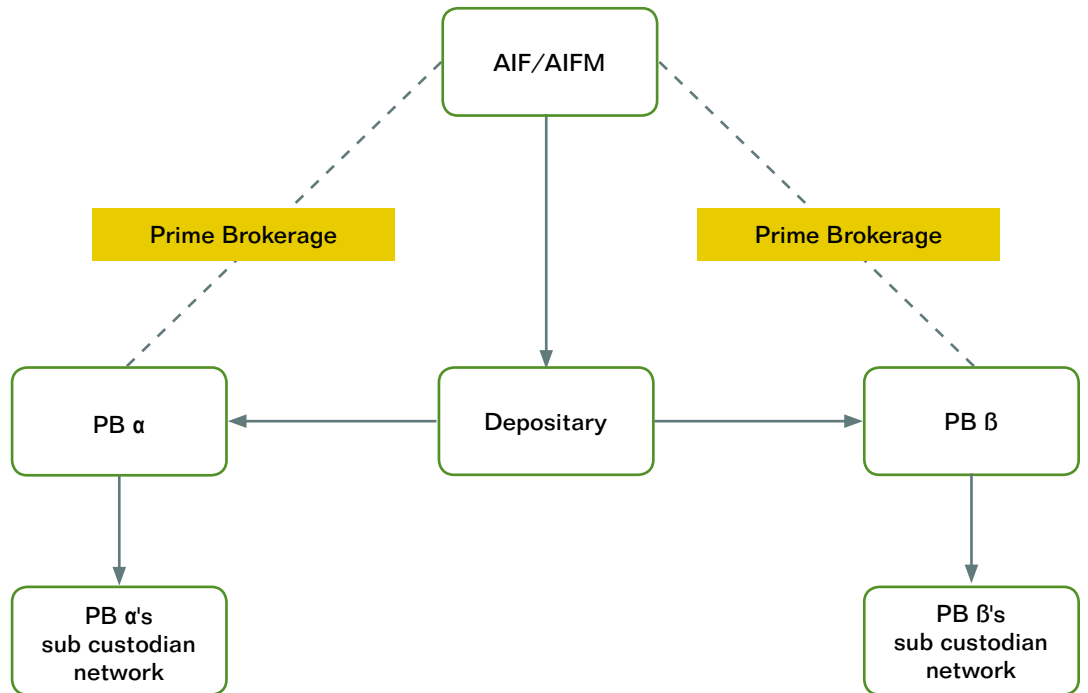
The aforementioned AIFMD depositary liability provisions – particularly the strict liability standard and the provisions regarding discharge of liability – led to fundamental changes to the prime broker operating model, including custody network structures, risk calculation, and due diligence and reporting requirements. Different prime broker models have emerged, which seek to balance the impact of the liability provisions with operational complexity.

⁴ *in respect of assets held in custody, the depositary's safe-keeping duties apply on a look-through basis "to underlying assets held by financial or, as the case may be, legal structures controlled directly or indirectly by the AIF or the AIFM acting on behalf of the AIF (article 89(3) of the AIFMD-CDR).*

⁵ *This possibility of a contractual discharge does not apply to UCITS and Part II UCIs marketed to retail investors in Luxembourg.*

Model 1

PBs acting as “sub-custodians” of Depository and use of PB’s sub-custodian network

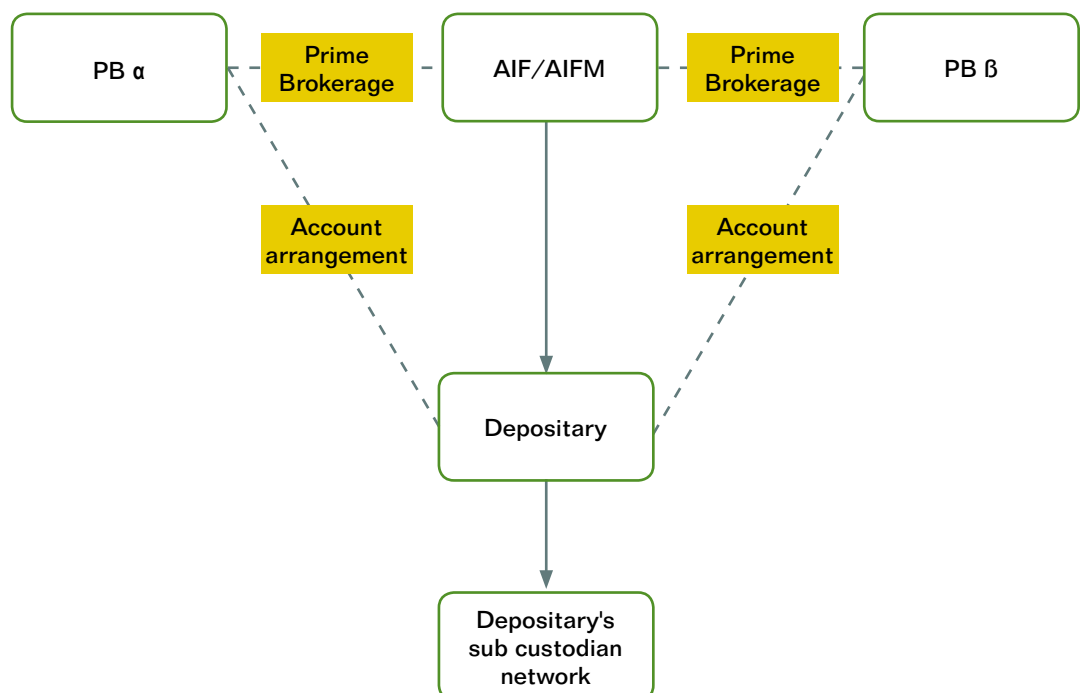


Options:

- Option 1 – Sub-custodian appointment with the depository retaining liability.
- Option 2 – Sub-custodian appointment with depository discharging its liability to the PB
- Option 3 – Sub-custodian appointment with depository retaining liability and obtaining an indemnity from the PB for loss of assets

Model 2

PBs operating accounts with Depository and use of Depository’s sub-custodian network



--- Agreement ---
 — Asset deposit —>

How does one raise capital through Luxembourg hedge funds?

UCITS regime

Alternative UCITS employing hedge fund strategies may be marketed to retail investors on the same basis as other UCITS funds.

The UCITS passport permits the marketing of UCITS to retail investors throughout the European Union. For this purpose, the UCITS must notify its home country regulator, which has 10 working days to transmit the notification file to the supervisory authorities of the host Member State. Upon being informed of the transmission of the notification file, the UCITS may be marketed in the host Member State.

AIFMD regime

With respect to the hedge fund AIFs, marketing is defined in the AIFM Law as:

- A direct or indirect offering or placement;
- At the initiative or on behalf of the AIFM;
- Of units or shares in an AIF managed by the AIFM;
- To or with investors domiciled, or with a registered office, in a Member State.

Rules on marketing will vary depending on a number of factors, such as, among others: the location of the investment manager; the location of the fund managed; and whether the investment manager has been authorised under the AIFMD.

The AIFMD regime creates a passport system among EU Member States, whereby authorised AIFMs are allowed to manage AIFs in any Member State on the basis of their home state authorisation and to market these AIFs to professional investors in any Member State. The concept of professional investor is the same as that used in the SIF Law, which also refers to MiFID.

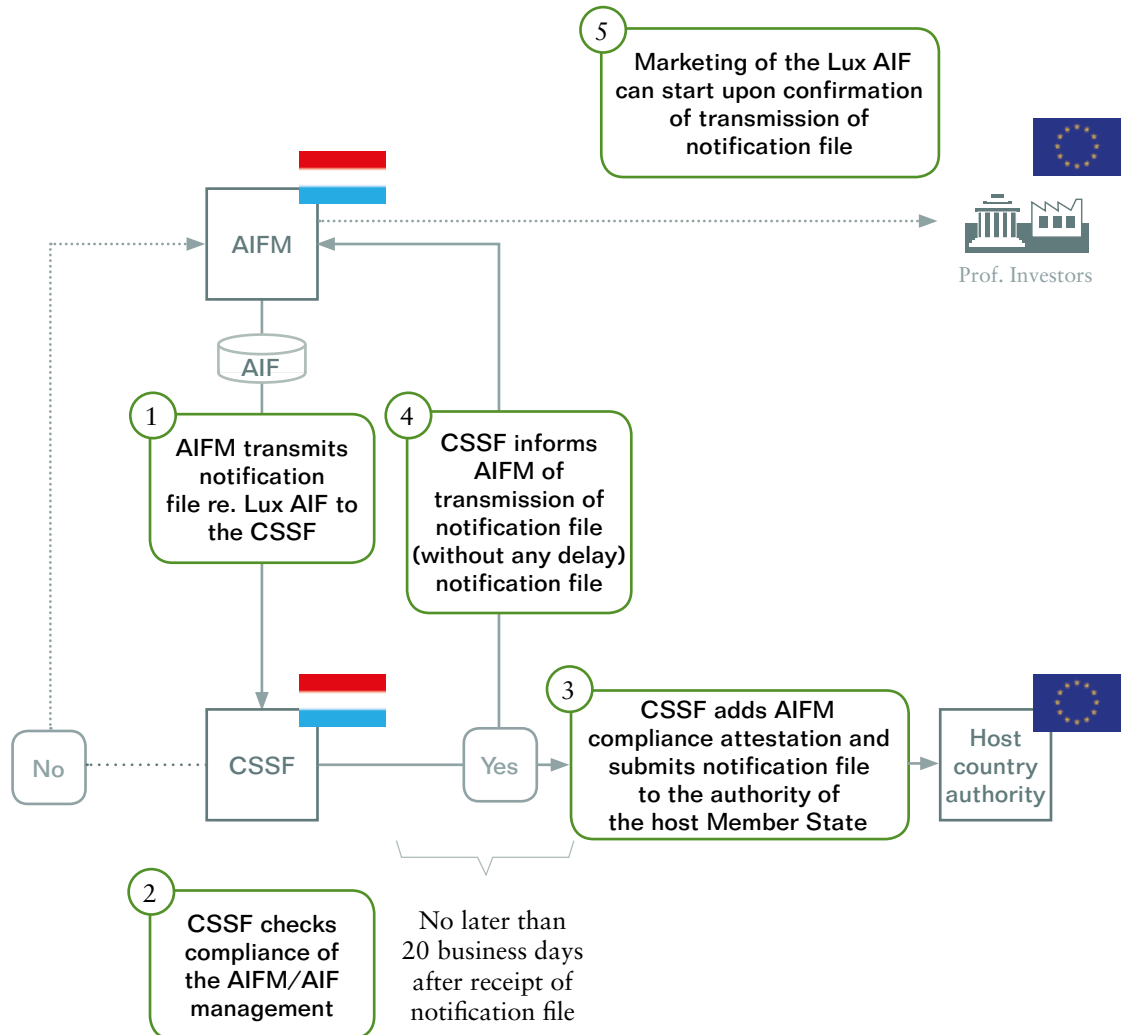
Authorised AIFMs

The AIFMD passport is very similar to the above mentioned UCITS passport and allows authorised AIFMs to distribute AIFs to professional investors within the European Union on the basis of a notification procedure. Units of an AIF may be listed, offered or placed by third parties in a particular Member State only if the AIFM is itself permitted to distribute the AIF in that Member State.

The procedure is initiated by way of notification by the AIFM to its supervisory authority, which has 20 working days from the transmission of the complete notification file to verify whether the AIF and the AIFM comply with the AIFMD. If the regulator determines that the AIF and the AIFM are compliant, such supervisory authority so informs the AIFM, and transmits the notification file to the competent authorities of the host Member State. Upon receiving such information, the AIFM may commence marketing the AIF in the host Member State.

Art. 32 AIFMD - EU AIFM Marketing Passport

Notification Process - ex. Luxembourg AIFM distributing a Luxembourg AIF to another EU country



- Process and content of the notification not as standardised as in the UCITS world
- Notification to be filed with the home country regulator of the AIFM (not of the AIF)
- Notification file per AIF (per country) concerned
- Annex IV AIFMD incl. Art. 23(1)
- Procedures with distributor(s) to avoid sale to non-professionals

Registered AIFMs

Registered AIFMs (i.e., those that manage AIFs below the stated thresholds and which do not opt into full AIFMD compliance) do not benefit from the AIFMD passport and may not freely market the AIFs they manage on a cross-border basis.

Registered AIFMs may, for the time being, continue to market AIFs within the European Union under the national private placement regimes on a country-by-country basis. Indeed,

during a transitional period of three years (from 2015 to 2018), the AIFMD passport will co-exist (in most of the EU Member States) with the relevant national private placement regimes, until the latter are replaced by the passport regime.

Marketing within the meaning of the AIFMD regime is defined by the CSSF as taking place when the AIF, the AIFM, or an intermediary on their behalf, seek to raise capital by actively making units or shares of an AIF available for purchase by a potential investor.

What does *not* constitute marketing

The CSSF has issued useful guidelines on reverse solicitation and marketing in respect of AIFs in Luxembourg. According to the CSSF, reverse solicitation consists of providing information regarding AIFs, and making units or shares of the AIFs available for purchase, only following an initiative of the investor and without any solicitation by or on behalf of the AIF or its AIFM. To demonstrate that solely reverse solicitation was involved, the AIFM can obtain a written confirmation from the investor that the investor decided on its own initiative to invest in the relevant AIF.

The CSSF also confirmed its position that the furnishing of draft documents to prospective investors does not constitute marketing activity, so long as such documents cannot be used by such prospective investors to formally subscribe or commit.

Notwithstanding the foregoing, distance marketing – marketing activity carried out by any means of communication (such as telephone or website) which does not imply simultaneous physical presence in Luxembourg of representatives of the AIF/AIFM and the investor – will however qualify as marketing in Luxembourg when the investors are domiciled or have their registered office in Luxembourg and the relevant materials can be used to subscribe for shares or units of the AIF.

The CSSF also confirmed that no marketing activity takes place in the context of a discretionary mandate for the management of

individual investment portfolios when provided at the initiative of the investment manager. This is likewise the case where a proposal to invest in an AIF in the context of an investment advisory agreement is made at the initiative of an investment advisor.

Further, investments made in target AIFs in the context of the collective portfolio management of a UCI or an AIF by the UCI/AIF or its management company, AIFM, portfolio manager or other agent are not considered as marketing for the purposes of the AIFM Law. Marketing also does not include the secondary trading of units or shares of an AIF, except where there is an indirect offering or placement through one or more intermediaries acting at the initiative, or on behalf, of the AIFM or the AIF.

Non-EU AIFMs

A manager that is not established in a Member State cannot benefit from the passport (for the time being), and it will need to rely on the respective national private placement regimes. The extension of the AIFMD passport to non-EU AIFMs is currently being assessed by the competent European authorities.

Please note that this entire section is provided for purposes of guidance only. Readers should consult with a Luxembourg legal or tax adviser for detailed and up to date tax advice.

Taxation of regulated hedge funds (Part I UCITS, Part II UCIs and SIFs)

Luxembourg regulated hedge funds are essentially tax-exempt vehicles, with the exception of registration duty and the annual subscription tax (in French, *taxe d'abonnement*).

Corporate income tax, municipal business tax, net wealth tax

Since under Luxembourg law, Luxembourg regulated funds are not taxable on their income or capital gains, they are not subject to corporate income tax, municipal business tax or net wealth tax.

Subscription tax

An annual subscription tax of 0.05% of net assets is payable and calculated quarterly, based on the fund's net asset value at the end of each quarter.

The rate is reduced to 0.01% annually for:

- Funds that invest solely in money market instruments and bank deposits;
- Funds governed by the SIF Law; and
- Compartments and classes of shares of UCIs, provided that such compartments or classes are reserved to one or more institutional investors.

Certain subscription tax exemptions apply to funds of funds, institutional-only money market funds, exchange traded funds, microfinance investment funds and pension pooling vehicles.

Withholding taxes on income

Withholding taxes levied at the source on income received by a Luxembourg fund are normally not refundable (unless a relevant tax treaty applies) nor creditable.

A hedge fund formed as an investment company (SICAV or SICAF) may benefit from certain double-taxation treaties. There are currently more than 49 double-taxation treaties potentially applicable to a Luxembourg SICAV/SICAF.

Generally, an FCP itself cannot benefit from a double-taxation treaty. However, a unit holder of the FCP should in theory be able to claim the reduced rate under a double-taxation treaty between the country of the source of the income or gain and the country of residence of the investor – this would typically be possible if the FCP is recognised as tax transparent by both the source country and the investor's country.

Even where there is no double-taxation treaty applicable, there may be several possibilities to mitigate withholding tax costs incurred by SICAV/SICAF or FCP, one of which could involve using an intermediary vehicle. In any event, tax structuring should be discussed with a Luxembourg tax adviser.

There is a possibility that withholding taxes levied by some EU countries might be claimed back (up to five years in some jurisdictions), based upon recent cases brought under EU anti-discrimination laws.

Taxation of unregulated hedge funds

Corporate income tax, municipal business tax, net wealth tax

Hedge funds set up as RAIFs are subject to the tax treatment applicable to SIFs.

Other hedge funds which are not subject to "product" regulation are commonly set up in the form of a Luxembourg partnership (either CLP or SLP). Luxembourg partnerships are transparent for Luxembourg corporate income tax and net wealth tax purposes, and therefore are not subject to corporate income tax or net wealth tax. Further, a Luxembourg partnership that is an AIF is not subject to municipal business tax, provided that (as is usually the case) the Luxembourg general partner holds less than 5% of the interest in the Luxembourg partnership.

Withholding taxes on income

As CLPs and SLPs are transparent for Luxembourg corporate income tax purposes, such partnerships themselves cannot benefit from Luxembourg double-taxation treaties. However, an investor in such a partnership should in theory be able to claim the reduced rate under a double-taxation treaty between the country of the source of the income or gain and the country of residence of the investor – this would typically be possible if the CLP or SLP is recognised as tax transparent by both the source country and the investor's country. Even where there is no tax treaty for a particular country, there may be several possibilities to mitigate withholding tax costs, one of which could involve using an intermediary vehicle. In any event, tax structuring should be discussed with a Luxembourg tax adviser.

Taxation of investors

Under Luxembourg law, distributions made to non-resident investors by the above-mentioned regulated or unregulated hedge funds are not subject to withholding tax in Luxembourg.

Taxation of managers

Management entities of Luxembourg hedge funds often take the form of an SA or Sàrl which are fully subject to income tax (aggregate tax rate of 27.08% in Luxembourg city for 2017) on its worldwide income, as well as annual net wealth tax of 0.5%. However, hedge funds often appoint non-Luxembourg management entities, in which case the relevant entity will be subject to taxation in its home jurisdiction.

VAT treatment

The management of hedge funds that are structured as Part I UCITS, Part II UCIs, SIFs or AIFs is exempt from VAT in Luxembourg. The VAT exemption applies to, among other services, investment management (including risk management) and administration (e.g., investment advice, transfer agent and registrar functions).

Management services outsourced to third-party managers also benefit from the VAT exemption under certain conditions (they should notably be specific to, and essential for the management of, the fund). In addition to management services, services related to the distribution of hedge funds are also exempt from VAT.

Other services rendered to hedge funds, such as legal and audit services, cannot benefit from a VAT exemption and are subject to the standard VAT rate of 17% (the lowest standard VAT rate in the EU).

Depositary services are partly exempt from VAT – services related to the control and supervision functions of the depositary are subject to a reduced VAT rate of 14%.

Hedge funds with corporate form are VAT-taxable persons, and may be subject to Luxembourg VAT registration if they receive goods or services from abroad for which they must account for Luxembourg VAT on a reverse-charge basis. FCPs must account for Luxembourg VAT on a reverse-charge basis through the VAT number of their management company.

FATCA and CRS

Both FATCA and CRS have implications for hedge funds. Readers should consult with a Luxembourg legal or tax adviser for detailed and up to date advice in this respect.

What servicing infrastructure does Luxembourg offer hedge funds?

Latest statistics show that Luxembourg counts 152 central administrations, 69 custodians and 387 management companies. It also has an impressive number of law firms, accountants and other professional financial services providers.

Luxembourg benefits from a large and expertised fund service offering with deep expertise developed over many years as Europe's leading fund jurisdiction.

The world's biggest banking groups are present in Luxembourg and provide depositary services to a wide range of hedge fund vehicles making use of their experience and well-established relationships with the world biggest Prime Brokers.

The following practical aspects largely contribute to Luxembourg's successful servicing infrastructure:

- Existing umbrella platform: Managers may launch a hedge sub-fund within an existing UCITS or AIF with multiple compartments.
- Appointment of a third party AIFM: The most usual set-up in a Luxembourg AIFM appointed for risk management functions, whereas portfolio management is delegated to the initiator;
- Independent directors: Service providers make available resident non-executive directors and conducting persons/compliance officers to back Luxembourg substance;

In addition, most of the world's largest fund administrators, law firms and audit firms are present in Luxembourg and active in the hedge fund sector.

All of the top 5 single manager hedge fund administrators are present in Luxembourg.⁶



⁶ www.institutionalinvestorsalpha.com

Appendix - glossary

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010
AIFMD passport	Cross-border marketing/management regime laid down in the AIFMD
AIFM Law	Luxembourg law of 12 July 2013 on AIFMs
CLP	Common Limited Partnership/Luxembourg SCS (<i>Société en Commandite Simple</i>)
CRS	Common Reporting Standard developed in response to the G20 request and approved by the OECD Council on 15 July 2014
CSSF	Luxembourg regulator <i>Commission de Surveillance du Secteur Financier</i>
EEA	European Economic Area
EU	European Union
FATCA	United States Foreign Account Tax Compliance Act
FCP	Common Fund (<i>Fonds Commun de Placement</i>)
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
NAV	Net Asset Value
OECD	Organisation for Economic Co-operation and Development
OTC	Over-the-counter
PB	Prime Broker
Part I/Part II	Part I/Part II of the UCI Law
RAIF	Reserved Alternative Investment Fund
RAIF Law	Luxembourg law of 23 July 2016 on RAIFs
RCS	Luxembourg trade and companies register (<i>Registre de Commerce et des Sociétés</i>)
SA	Public limited company (<i>Société Anonyme</i>)
Sàrl	Private limited company (<i>Société à responsabilité limitée</i>)

SCA	Partnership Limited by Shares (<i>Société en Commandite par Actions</i>)
SICAF	Investment Company with Fixed Capital (<i>Société d'Investissement à Capital Fixe</i>)
SICAV	Investment Company with Variable Capital (<i>Société d'Investissement à Capital Variable</i>)
SIF	Luxembourg Specialised Investment Fund (<i>Fonds d'Investissement Spécialisé</i>)
SIF Law	Luxembourg law of 13 February 2007 on SIFs
SLP	Special Limited Partnership/Luxembourg SCSp (<i>Société en Commandite Spéciale</i>)
UCI	Undertaking(s) for Collective Investment
UCITS	Undertaking(s) for Collective Investment in Transferable Securities
UCITS V	Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to UCITS as regards depositary functions, remuneration policies and sanctions
UCI Law	Luxembourg law of 17 December 2010 relating to undertakings for collective investment
UCITS ManCo	UCITS Management Company
UCITS passport	Cross-border marketing/management regime laid down in the UCITS
VAT	Value Added Tax



The Association of the Luxembourg Fund Industry (ALFI), the representative body for the Luxembourg investment fund community, was founded in 1988.

Today it represents more than 1,500 Luxembourg-domiciled investment funds, asset management companies and a wide variety of service providers including depositary banks, fund administrators, transfer agents, distributors, law firms, consultants, tax advisers, auditors and accountants, specialist IT providers and communications agencies.

Luxembourg is the largest fund domicile in Europe and its investment fund industry is a worldwide leader in cross-border fund distribution. Luxembourg-domiciled investment structures are distributed in more than 70 countries around the globe, with a particular focus on Europe, Asia, Latin America and the Middle East.

ALFI defines its mission as to **“Lead industry efforts to make Luxembourg the most attractive international centre”**.

Its main objectives are to:

- **Help members capitalise on industry trends**

ALFI’s many technical committees and working groups constantly review and analyse developments worldwide, as well as legal and regulatory changes in Luxembourg, the EU and beyond, to identify threats and opportunities for the Luxembourg fund industry.

- **Shape regulation**

An up-to-date, innovative legal and fiscal environment is critical to defend and improve Luxembourg’s competitive position as a centre for the domiciliation, administration and distribution of investment funds. Strong relationships with regulatory authorities, the government and the legislative body enable ALFI to make an effective contribution to decision-making through relevant input for changes to the regulatory framework, implementation of European directives and regulation of new products or services.

- **Foster dedication to professional standards, integrity and quality**

Investor trust is essential for success in collective investment services and ALFI thus does all it can to promote high professional standards, quality products and services, and integrity. Action in this area includes organizing training at all levels, defining codes of conduct, transparency and good corporate governance, and supporting initiatives to combat money laundering.

- **Promote the Luxembourg investment fund industry**

ALFI actively promotes the Luxembourg investment fund industry, its products and its services. It represents the sector in financial and economic missions organised by the Luxembourg government around the world and takes an active part in meetings of the global fund industry.

ALFI is an active member of the European Fund and Asset Management Association, of the European Federation for Retirement, of the International Investment Funds Association and of the Global Impact Investing Network.

For more information, visit our website at www.alfi.lu and follow ALFI on



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Luxembourg hedge funds