

special alfi newsflash:

Side pockets - fast-track procedures 24 March 2009

• **Side Pockets - Fast-track procedure for authorisation by the CSSF**

In consultation with ALFI, the CSSF has approved a fast-track authorisation procedure for the implementation of side-pocketing in Luxembourg UCIs^[1] or SIF^[2].

This fast-track procedure cannot be used if the assets concerned by the side-pocketing represent more than 20% of the total assets of the UCI or SIF sub-fund concerned. Nevertheless, if side-pocketing of a higher portion of assets might be envisaged under certain circumstances this cannot be filed within the fast-track procedure as the CSSF shall assess whether alternative procedures (suspension; liquidation) are not more appropriate in the given circumstances.

I. Prerequisites

- The Board of Directors of the investment company respectively the management company of the investment fund must ensure and confirm that the proposed side-pocketing is not contrary to the articles of incorporation or the fund rules.
- Confirmation must be provided that the central administrator is technically capable of servicing the contemplated side-pocketing for the UCI or SIF.
- The side-pocketing is not allowed to be implemented to solve temporary valuation problems of fund assets.
- Potential or presumed illiquidity of an asset (i.e. not ascertained) is in itself not sufficient for the asset to be part of the side-pocketing.
- For any asset part of the side-pocketing, the UCI shall undertake all necessary steps to promptly realize the asset as soon as the asset is once again liquid.

II. Side-Pocketing Options

This fast-track procedure is limited to the two following side-pocketing options:

1. Spin-Off / New share/unit class(es)

In this context, the UCI decides on a spin-off from (an) existing share/unit class(es) to (a) new share/unit class(es). On the event date, the illiquid assets identified shall be allocated to the new share/unit class(es) and the investors of the existing share/unit class(es) shall receive shares/units of the new share/unit class(es) (pro rata to their share/unit holding in the existing share/unit class(es)). The new share/unit class(es) shall be closed to new subscriptions and suspended for redemptions and is (are) deemed to be in liquidation.

The asset manager shall manage the illiquid assets allocated to the new share/unit class(es) with the aim to sell/realize them in the best interest of the investors. Upon the sale/realization of all illiquid assets, the shares/units of the new share/unit class(es) shall be redeemed/cancelled

•^[1] UCIs subject to **Part II** of the Law of 20th December, 2002 on undertakings for collective investment.. The creation of side-pockets within a UCITS subject to Part I of the 2002 Law is highly restricted and needs to be analysed with the CSSF on a case by case basis.

•^[2] FIS subject to the Law of 13th February, 2007 relating to specialised investment funds

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2. Spin-Off / New sub-fund(s)

In this context, the UCI decides on a spin-off from an existing sub-fund to a new sub-fund. On the event date, the illiquid assets identified shall be transferred from the existing sub-fund to the new sub-fund and the investors of the existing sub-fund shall receive shares/units of the new sub-fund (pro rata to their share/unit holding in the existing sub-fund). The new sub-fund shall be closed to new subscriptions and suspended for redemptions and will be deemed to be in liquidation.

The asset manager shall manage the illiquid assets transferred to the new sub-fund with the aim of selling/realizing them in the best interest of the investors. Upon the sale/realization of all illiquid assets of the new sub-fund, the shares/units of the new sub-fund shall be redeemed /cancelled.

III. Information to be provided to the CSSF

The application for authorization to be submitted to the CSSF (see IV. below) prior to implementing the side-pocket must comprise at least the following information:

1. Description of the illiquid assets

- The percentage of the assets (as of the most recent NAV date) of the UCI/SIF or the sub-fund which are concerned by the contemplated side-pocketing.
- For each line of assets/asset concerned, the reason(s) why such line of assets/ asset is illiquid and part of the contemplated side-pocketing (e.g. suspension, creation of side- pockets or gating at the level of the underlying fund; litigation in relation to asset(s) concerned, etc.)

2. Side-pocketing option

- The side-pocketing option which the UCI/SIF contemplates implementing, and the sub-fund(s)/class(es) concerned by the side-pocketing.
- The reason(s) for selecting a specific side-pocketing option.

3. Description of the fees to be charged to the side-pocket

- The fees charged to the side-pocket are normally expected to be at a reduced level (i.e. less than the TER of the sub-fund initiating the side-pocket) as the management and administrative services rendered to the side pocket are deemed to be provided less actively and/or at a reduced level.
- Except legal expenses for legal actions to preserve the rights and value in relation to the illiquid assets, only charges that are described in the prospectus can be applied.
- Any charging of specific or additional charges in relation to the side-pockets not in line with the aforementioned principles will require a specific description and analysis that cannot be submitted to the CSSF in the scope of this fast-track procedure

4. Communication to investors

- The way the UCI/SIF will communicate the implementation of the side-pocketing option to the investors.
- The investors shall be kept informed of any changes occurring in relation to assets/asset contained in the side pocket or in relation of the framework thereof.
- The unitholders of the constituted side-pocketing shall receive a holdings report at creation and at a frequency close to the frequency of the holding reports of the sub-fund initiating the side-pocket.

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5. Communication to other authorities.

- Confirmation whether the UCI is registered in any other country.
- List of countries where the UCI is registered for the marketing of its units.
- Confirmation whether the supervisory authorities of such other country (ies) have been/will be informed and, if not, why such information procedure is not necessary.

6. Periodical Reports

- Confirmation that the periodical reports will describe the side-pocket(s) existing as at their date of issue.

7. Information to the CSSF

- Confirmation that the CSSF will be informed immediately once a side-pocket (and the corresponding class or sub-fund) is paid out and/or terminated.
- Confirmation that the CSSF will be informed on a quarterly basis on the state and evolution of the side pocket during the past quarter.

IV. Fast-track authorisation procedure

The application for authorisation including the above required information and documents must be submitted to the CSSF.

The CSSF will give its authorisation or, if necessary, provide its comments and observations to the applicant in principle within one week following the receipt of the application by the CSSF. In case of comments or observations, an amended application must be submitted promptly to the CSSF.

If the CSSF has not raised any objection in principle after the first filing or after the transmission of complementary information in response to comments or observations, the CSSF will grant oral approval of the contemplated side-pocketing followed by a confirmation letter.

This note is not intended to exempt in any way the governing bodies of the UCI/SIF from its obligations to ensure compliance with the UCI's/SIF's constitutional documents and, if appropriate, its obligations relating to the modification and/or update of the UCI/SIF documentation. Any information provided in this note is provided for informational purposes only and does not constitute, and should not be viewed in any case as legal advice given by ALFI. This note is not intended to be in any way a substitute for professional advice.

Impressum

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