



association of the
luxembourg fund industry

| **UCITS IV**



**master-feeder structures:
made in luxembourg**

What is a master-feeder structure?

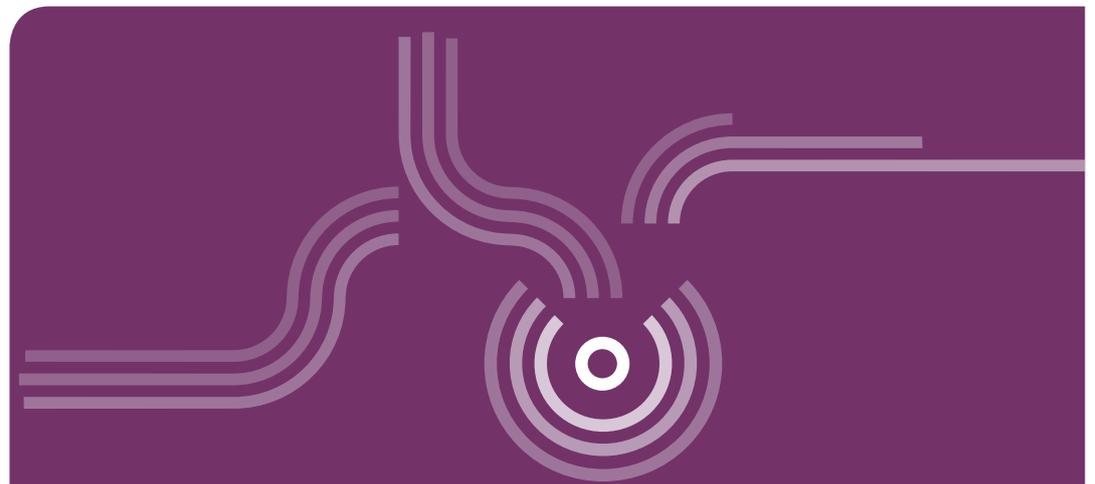
One of the main features of the UCITS IV Directive is the **master-feeder structure**, which provides for pooling of assets. Asset pooling is the aggregation of assets of different investment vehicles into common pools for the purpose of efficient investment management and custody.

There are two basic pooling techniques: **“Entity Pooling”** combines assets into a single legal vehicle, usually an investment fund. A master-feeder structure and a pension pooling vehicle are examples of entity pooling.

“Virtual Pooling” (not within the scope of the UCITS IV Directive) combines assets into separate pools and does not involve the set-up of a legal entity. Legal ownership of the assets remains with the participating vehicles.

Entity pooling is introduced with the UCITS IV Directive, which does allow the continued use of virtual pooling techniques where permitted. In particular, UCITS IV introduces a special regime for master-feeder structures which must respect the following requirements:

- At least 85% of a feeder fund’s assets must be invested in a single master fund. The investment of a feeder in more than one master is prohibited. As a result, both the feeder and the master funds will usually have the same or near-identical investment policy.
- For a maximum of 15% of its assets, a feeder may:
 - hold derivatives for hedging purposes
 - hold cash to satisfy redemption and liquidity requirements.
- Provisions governing risk management controls, governance structures and appointment of depositaries must be complied with by both the master and the feeder.
- Both the master and the feeder may, but are not required to, have the same management company, depositary and auditor.
- If the depositary or auditor of the master and feeder is not the same for both funds, information-sharing agreements must be established.
- When the master and feeder funds have different financial year ends, a report must be drawn up by the auditor of the master and provided to the feeder.
- The feeder’s investors should receive information clearly explaining the fees of both the master and the feeder, together with details of the master’s investment policies.
- Non-UCITS vehicles, as well as other institutional or retail investors, may invest in the master. Non-UCITS investors in the master are not subject to any requirements of the UCITS Directive.
- Both a master and a feeder may be structured as umbrella funds. However, a master must have at least one UCITS feeder, and may have other types of investors.



What are the advantages of a master-feeder structure?

Efficiency and reduced cost Centralisation of core investment management and administration

Product development innovations over time have, for some asset managers, resulted in a number of “clone” vehicles, managed and administered in several jurisdictions. As a result, performance may be impaired by relatively high costs incurred for locally managed funds due to small portfolio trading

size, constant liquidity demands due to relatively high inflows and/or outflows, as well as the costs of registration, legal and administrative work. Pooling fund assets with the same investment strategy into master vehicles should result in economies of scale, cost efficiency and increased liquidity.

Marketing Investor preference for local legal structures

Feeder structures allow investors access to markets through locally recognised vehicles and the benefit of reduced costs and greater

efficiency. This is a key consideration in marketing a product in a jurisdiction with specific local investor needs and expectations.

Product offering Target expertise and flexible features

Master-feeder structures can be designed with tailor-made features to meet the needs of different types of investors. Promoters and distributors can thus promote their own brand by offering feeder vehicles that invest

in masters run by fund managers with expertise in a given strategy or field (so-called “white labelling”), without incurring the costs associated with creating their own products.

Long history

Master-feeder structures, which are also referred to as “hub and spoke vehicles”,

have a long history and are familiar to investors around the world.

Legal segregation

Feeders may invest in assets other than the master fund and may hold up to 15% of their assets in cash or in derivatives for hedging purposes. They may also have specific fee

accruals that are legally distinct from the fee accruals of the master, and therefore offer segregated liability.

Why is Luxembourg the domicile of choice for master-feeder structures?

Efficient, pragmatic legal and regulatory framework and a supportive government

The Luxembourg regulator has many years of experience with new and innovative products, and offers a business-oriented, proactive and highly efficient approach to fund launches and changes to existing vehicles. Luxembourg's

business friendly environment is facilitated by easy access to decision makers in the government, resulting in a strong working relationship between the private and public sectors.

Global distribution centre and largest investment fund centre in Europe

Luxembourg's international distribution experience, expert knowledge and monitoring of international marketing rules and business practices in EU and non-EU countries enable master-feeder promoters to launch their feeder funds under optimal conditions.

More specifically, promoters setting up masters in a global distribution hub such as Luxembourg can use a master-feeder structure to reduce the number of fund vehicles requiring investor tax calculations and thus benefit from cost efficiencies.

Recognised worldwide brand

The Luxembourg UCITS is a brand that is recognised throughout the world – a definite advantage when marketing master and feeder vehicles to a wide audience. Luxembourg funds

are subject to a simplified notification process in a number of non-EU countries, and have access to a distribution network extending far beyond the borders of Europe.

Presence of global players and flexible IT infrastructures

Master-feeder promoters can choose from several comprehensive solutions that are fundamental to the efficient administration of master-feeder structures. Flexible IT systems

make a variety of legal structures possible (e.g. different share classes, varying rights attached to shares) and ensure reporting and data consistency between masters and feeders.

Large talent pool and existing master-feeder knowledge and experience

Luxembourg has multinational, multilingual staff with in-depth knowledge across a variety of disciplines (e.g., law, tax, auditing, consultancy, project management, operations, risk and compliance), servicing cross-border products distributed in over 50 countries. The financial services industry builds on proven foundations

with existing infrastructure, as well as reporting, administration, internal control, governance and risk management capabilities. Luxembourg also has longstanding expertise in handling contributions in kind associated with single and multiple jurisdictions, which is essential when restructuring existing vehicles into master-feeder vehicles.

Tax expertise

Luxembourg has built up unique expertise in the computation, delivery and certification of shareholder tax figures required for UCITS

master funds with feeders in different EU member states (e.g., Germany, Austria, UK, Belgium).

Special offerings

- Luxembourg administrators have in-depth experience in “virtual pooling” and can combine this with a master fund structure, thus further increasing efficiencies and reducing costs.
- Luxembourg offers a choice of accounting standards to match the requirements of a given investor base.
- Fund administrators can accommodate

- different valuation points for feeders investing in a master, which supports the possibility of selecting multiple valuation points at sub-fund or share-class level.
 - Luxembourg offers flexibility in performance and retrocession fee calculation, which, in turn, allows for offerings tailored to specific investor needs.
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How can Luxembourg help you set up a master-feeder structure?

Project planning

Master-feeder structures require a project plan, fund-launch templates and clear provisions for corporate governance. Luxembourg

service providers have extensive experience in these areas, enabling you to draw on well-tested skills and knowledge.

Choice of solutions and strategies

Luxembourg can help you make fundamental decisions for key considerations such as:

- choosing a master-feeder solution as one of multiple alternatives (e.g., mergers, share classes)
- converting existing funds into feeders vs launching new feeders (thus generating economies of scale)

- setting up a global master hub vs country-specific master-feeder structures
 - using cross-jurisdictional master-feeder structures instead of single country distribution platforms
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Cost-benefit analysis

With a deep pool of talented professionals that have developed and launched a multitude of fund structures and have proven experience all

along the value chain, Luxembourg is ideally placed to assist you with a cost-benefit analysis of master-feeder structures.

Product structure

Luxembourg-based service providers can help you determine the best product structure for specific regulatory and operational priorities (e.g., co-ordination of year ends, auditors and

depositories, alignment of valuation timelines, consideration of local regulatory requirements, structures to avoid market timing and the impact of dilution, etc.).

Conversion plan and project plan: execution

Luxembourg's experience in single and cross-jurisdictional conversions and global projects can be leveraged to develop a

conversion plan and to execute a project plan that meets your strategic and business needs.

The Association of the Luxembourg Fund Industry (ALFI), the representative body for the Luxembourg investment fund community, was founded in 1988. Today it represents over a thousand Luxembourg-domiciled investment funds, asset management companies and a wide variety of service providers including depository 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 50 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 organising 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 in economic missions organised by the Luxembourg government around the world and takes an active part in meetings of the global fund industry.

For more information, visit our website at www.alfi.lu



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