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AVOCATS A LA COUR

Legal Updates relating to Investment Funds and other Investment Vehicles
March 2007

1. Law of 13th February 2007 on Specialised Investment Funds (SIF), related Grand-Ducal Decrees and CSSF Circular 07/238 on the entering into force of the law of 13th February 2007 on SIFs

This new legislation replaces the institutional investment fund law of 1991. The SIF offers greater flexibility in terms of corporate structure and investment rules as well as lighter prudential supervision notably by the fact that no promoter is required to be approved by the CSSF. Eligible investors are not only institutional investors and professional investors but also sophisticated private investors.

In connection with the SIF law, the following Grand-Ducal Decrees have been published on 27th February 2007:

- Grand-Ducal Decree relating to the levy of the subscription tax[1] (i) defining, in its article 1, the term "money market instruments" for the purpose of the provisions of article 68(2) of the SIF law exempting certain type of money market funds[2] entirely from the subscription tax and (ii) requiring, in its article 2, SIFs to separately declare investments in other Luxembourg UCIs subject to the subscription tax to achieve exemption of such investments from the tax and thus avoid double taxation.

- Grand-Ducal Decree fixing, in application of Article 67 of the SIF law, the once and for all capital duty payable at the constitution of the SIF at 1,250 Euro.

- Grand-Ducal Decree fixing the CSSF initial registration fee for SIFs at 1,500 Euro (2,650 Euro for Umbrella SIFs) and the annual CSSF maintenance fee at the same amounts.

On 28th February 2007, the CSSF has issued Circular 07/283 informing about the entry into force of the SIF law and summarising its main features.

On 20th February 2007, the Luxembourg tax authorities have published a Newsletter confirming that Circular RIUE n° 1[3] describing, inter alia, the impact of the Luxembourg law of 21st June 2005 which has implemented the provisions of the EU Savings Directive is also applicable to SIFs. This implies that income and distributions from SIFs having adopted the legal form of a corporation (such as SICAVs) are outside of the scope of the EU Savings Directive.

[1] Such tax (*taxe d'abonnement*) is levied at a rate of 0.01% p.a. of the NAV pursuant to article 68 of the SIF law.

[2] Article 68(2)b) imposes the following requirements for the exemption: (i) exclusive object to invest in money market instruments and deposits, (ii) the portfolio must have a weighted residual maturity not exceeding 90 days and (iii) highest possible rating from a rating agency.

[3] Circular RIUE n°1 issued by the Director of Direct Taxes on 29th June 2005

A memo on the new SIF, an English translation of the law and an English translation of CSSF Circular 07/283 are published in the Legal Topics section of our website www.ehp.lu .

2. Clarification by CSSF Circular 07/280 of the practical implications of the law of 9th May 2006 on market abuse in general and on UCIs in particular

2.1 General

CSSF published in its circular CSSF 07/280 (the "Circular") some precisions and guiding principles as to the law of 9 May 2006 on market abuse (the "Law") and its implementation in various areas.

Elements of market manipulation

As to the elements that might constitute a market manipulation, the Circular refers to the CESR document "Market Abuse Directive Level 3 – first set of CESR guidance and information on the common operation of the Directive Ref: CESR/04 – 505b" which specifies more concrete examples of what can be considered to be an element of a market manipulation.

Notification of suspicious transactions

Regarding the notification requirements relating to transactions being suspected to constitute insider dealing or market manipulation (article 12 of the Law), the CSSF specifies that credit institutions or other finance sector professionals ("FSPs") are required to take the necessary measures in order to be able to proceed to a specific analysis of the suspicious transaction. The CSSF emphasised that credit institutions or other FSPs are not required to perform a systematic analysis of all prior transactions by the same persons. In case of notification of a suspicious transaction to the CSSF, the form annexed to the Circular should be used.

List of insiders

The following persons shall be on the list of those persons who have regular or occasional access to inside information (article 10 of the Law) in particular:

- persons having access at inside information due to their position at managerial level;
- persons working regularly on sensitive subjects (e.g. annual accounts);
- persons working occasionally on matters giving rise to inside information.

Persons who could potentially by accident come across inside information are excluded from this requirement.

Notification of transactions in shares of a listed company by persons discharging managerial responsibilities shall be made to the CSSF by those persons, in case of Luxembourg companies, or by the relevant company in case of non-EEA companies, by using the form annexed to the CSSF Circular. The CSSF has indicated that the notification requirement does not apply to acquisitions as result of inheritance or donation or to acquisitions in application of labour contracts or as part of a remuneration.

Buy-back and stabilisation transactions

The Circular also contains some indications on buy-back and stabilisation transactions falling under the scope of the safe harbour exemption provided by Regulation (EC) no 2273/2003 of the Commission of 22 December 2003.

The notification and publication of details of buy-back transactions in accordance with article 4 of the Regulation and the notification of details of stabilisation transactions in accordance with article 9 of the Regulation shall be done by using the form annexed to the Circular.

As to article 8 of the Regulation setting out the time-related conditions for stabilisation, CSSF specifies that Luxembourg permits trading prior to the commencement of trading on a regulated market.

Abrogation

Circular CAB 91/2 of 1 July 1991 concerning the law of 3 May 1991 on insider transactions is abrogated.

2.2 UCIs

The general interdiction on insider dealing and market manipulation applies to all Luxembourg undertakings for collective investment ("UCIs"). The shares of Luxembourg UCIs which are listed on the Luxembourg Stock Exchange ("LSE") are also subject to guidelines set out below. They do however not apply to UCIs admitted to trading on the Euro MTF.

In essence, the Circular clarifies that the Law has only a limited impact (if any) on UCIs the portfolio of which is broadly diversified and which calculate their Net Asset Value on a frequent basis.

a) Obligation to make public privileged information

The obligation to make public any privileged information is in practice unlikely to have implications or cause obligations on UCIs (such as Part I UCITS) which calculate an NAV daily, which are broadly diversified and for which the Stock Exchange price is equivalent or extremely close to the net asset value. Indeed, it is in that case highly unlikely that there is information that could in any way influence the Stock Exchange price.

For such UCIs, the correction of an already published NAV could constitute privileged information that would need to be published but the obligation to publish any calculated NAV is already covered by the regulations on UCIs.

The obligation to make public this type of information should in practice only be relevant for UCIs which are not diversified in the same manner as UCITS funds or which do not calculate their NAV at regular and short intervals.

b) Obligation to establish a list of insiders

The obligation to establish a list of insiders is normally not relevant for UCIs (such as Part I UCITS) that are broadly diversified and publish their NAV daily.

A list will need to be drawn up for UCIs which are not investing in a broadly diversified manner or do not calculate their NAV at regular and short intervals and for which the Stock Exchange price of their shares is likely to diverge notably from its calculated NAV. This list would typically comprise the persons responsible for the preparation of the annual accounts and those implicated in the determination of the NAV.

c) Obligation to declare transactions by directors

CSSF Circular 07/280 confirms that obligation to declare operations on listed shares effected by "dirigeants" is not applicable to UCIs.

d) Obligation to notify suspicious transactions

The CSSF Circular clarifies that UCIs and their management companies are not subject to the obligation to notify suspicious transactions under article 12 of the law. This obligation does however apply to the Luxembourg banks and other professionals of the financial sector which act as the UCIs custodian, transfer agent or administrative agent.

3. CSSF Circular 07/277 on the simplification of the notification procedure for UCITS in application of the CESR guidelines

By reference to the CESR document CESR/06-120 b) (see our Newsletter of August 2006), the CSSF has introduced a simplified notification procedure and changed the rules for the issuing of documentation for registration in foreign countries.

For countries outside of the European Economic Area (EEA) the situation remains unchanged and the CSSF will continue to issue the number of original prospectuses and certificates as required by the local authorities concerned.

For the member states of the EEA, the CSSF will issue only one document (in three languages: French, German and English) certifying UCITS compliance. Such document must be used duly certified by a person authorised by the UCITS. A new attestation under the new format is only issued by the CSSF in case the information contained in the previous attestation is amended.

In terms of prospectuses, the CSSF will only deliver one original prospectus with the visa and, in the same way as for the provision of certified copies of the attestation to the relevant authorities, the CSSF considers that the UCITS has to submit certified copies of the visaed prospectus to the relevant local authorities. The same is true for the simplified prospectus. In case some EEA authorities refuse to apply the CESR guidelines, the CSSF will be flexible and upon duly motivated request issue "old style" original certificates as requested by those authorities. It appears that, at present[4] the regulators in the following countries accept self-certified documents: Austria, Denmark, Estonia, France, Iceland, Ireland, The Netherlands, Poland, Portugal, Slovenia, Spain, Sweden and the United Kingdom.

The self-certification procedure referred to above implies that the board of directors of UCITS or their management companies should specifically appoint representatives authorised to certify copies of the relevant originals issued or stamped by the CSSF.

Finally, the submission of the documents to the relevant authorities should be made by way of the new standard notification letter also available on the CSSF website in French, German and English.

[4] Source: CSSF on 16.3.2007

4. The Luxembourg VAT regime for UCIs: Circular 723/06

The Luxembourg VAT authorities (*Administration de l'Enregistrement et des Domaines*) issued on 29th December 2006 a circular n°723 (hereafter referred to as the "Circular") clarifying the VAT status of investment funds.

4.1 Following the decision of the European Court of Justice in the Abbey National case (see our Newsletter dated August 2006), the Circular clarifies that the "supervision and control" functions performed by the custodian of a UCI do not fall under the VAT exemption of investment management services and are therefore subject to VAT with effect from 1 April 2007. The VAT treatment of other "custodian" services (such as safekeeping fees) remains unchanged. It will be up to the custodian to establish the VAT taxable part of the fees on the basis of objective criteria and the custodian must be in a position to justify to the VAT authorities the criteria retained.

4.2 Following the decision of the European Court of Justice in the BBL case, the Circular clarifies that Luxembourg based investment vehicles, whose management is VAT exempt under article 44-1 d) of the Luxembourg VAT Law, have the status of taxable persons for VAT purposes.

Therefore, as from 1 April 2007, SICAVs (*société d'investissement à capital variable*) have in principle to register with the Luxembourg VAT authorities and will receive a VAT identification number. For FCPs, as divided pool of assets, without own legal personality, the VAT authorities consider that the management company carries out the investments and thus must register for VAT purposes. Umbrella funds with multiple compartments will be considered as one single entity for VAT purposes (and receive one single VAT identification number). Due to the fully VAT-exempt status of investment funds, the administrative burden is however lightened.

From a practical perspective, it is possible to distinguish the following two cases:

1. Where an investment fund (or the management company on behalf of the FCP) does not receive goods or intangible services from abroad (from within or outside the EU), the investment fund is released from the obligation to register for VAT purposes.

2. Where an investment fund (or the management company on behalf of the FCP) receives goods or more likely intangible services from abroad, the investment fund will be required to register with the Luxembourg VAT authorities. It will have to self-assess Luxembourg VAT on the goods and/or services received, and file a simplified annual VAT return. However, *prima facie* the investment

fund will not be able to deduct this input VAT, given its fully VAT-exempt status. As from VAT registration, the intangible services received from abroad are in the scope of Luxembourg VAT and thus potentially may benefit from the Luxembourg VAT exemption for management services under article 44-1 d) of the Luxembourg VAT Law which – despite the impact of the Abbey National case - is perceived to be larger than in other jurisdictions. If the intangible services are not in the scope of the above exemption, the investment fund will be liable to account for Luxembourg VAT under the so-called reverse-charge mechanism, applying therefore the Luxembourg VAT rate instead of being charged at generally higher foreign VAT rates. The difference in applicable VAT rates and the application of the larger management services exemption may after all result in VAT savings for the investment funds. Finally, there may also be cash-flow advantages in case of receipt of intangible services. The investment fund self accounts for Luxembourg VAT in the frame of the simplified annual VAT return rather than paying immediately VAT upon invoicing from the foreign supplier of the service. On the other hand, the status as VAT taxpayer of Luxembourg investments funds might result in a VAT liability for certain services rendered by suppliers established outside the EU which previously were outside the scope of VAT.

Finally, regarding the issue of invoices, investment, vehicles, as taxable persons whose activities are fully VAT-exempt without the right to deduct input VAT, are relieved from the invoicing obligation, even if they registered for VAT purposes.

To conclude, whether it makes sense for a UCI to register for VAT depends on whether the UCI (or the management company on behalf of the FCP) receives goods or intangible services from within or outside the EU (foreign lawyer fees; printing expenses from abroad).

5. CSSF Circular 06/267 on technical specifications regarding communications to the CSSF of documents for the approval or for filing and of notices for offers to the public and admissions to trading on a regulated market of units or shares issued by Luxembourg closed-ended UCIs

Since 1 January 2006, the CSSF is the only party involved in the approval process of prospectuses in relation to offers to the public and admissions to a regulated market of securities in accordance with the law of 10th July 2005 (the "Prospectus Law").

In this context, the CSSF issued in December 2005 the CSSF Circular 05/226, the second part of which describes the technical procedure for communications to the CSSF, pursuant to the Prospectus Law, of documents for the approval or for filing

and of notices for offers of securities to the public and admission of securities to trading on a regulated market. Prospectuses drawn up for offers to the public and admission to trading on a regulated market of units or shares issued by Luxembourg closed-ended undertakings for collective investment ("UCIs") were expressly excluded from the scope of this Circular, which indicated that communications to the CSSF in the context of such UCIs should be made by using the existing means of communication regarding applications for authorisation of UCIs.

On 22 November 2006, the CSSF issued a further circular, CSSF Circular 06/267, which specifies the technical procedure in relation to the communications to the CSSF, in accordance with the Prospectus Law, of documents for the approval or for filing or of notices for offer to the public and admission to trading on a regulated market of units or shares of Luxembourg closed-ended UCIs. This Circular specifies the practical aspects of the technical procedure in relation to such communications. This procedure is *mutatis mutandis* the same as the one described in Circular CSSF 05/226. The Circular notably specifies that before proceeding to an official filing for approval of a prospectus under the Prospectus Law, a Luxembourg closed-ended UCI must be approved by the CSSF.

The Circular exclusively applies to UCIs of the closed-ended type. It is reminded that, in this context, closed-ended UCIs are UCIs, which offer no right to their investors to request redemption of their units or shares in these UCIs. In any other case, whatever the number or frequency of redemptions contemplated, the UCI is of the open-ended type and then not covered by the Prospectus Law or by this Circular.

6. EU Commission implementing Directive and CESR guidelines concerning eligible assets for investment by UCITS

The EU Commission has adopted on 19 March 2007 an implementing Directive aiming at clarifying certain definitions used in the UCITS Directive[5]. The implementing Directive largely reflects CESR's advice on the subject to the EU Commission[6]. The aim of the CESR guidelines on the same subject (CESR/07-044) is to cover the text of its previous advice which was not included in full in the implementing Directive[7].

The implementing Directive and the CESR guidelines aim at clarifying the following terms and concepts:

- transferable securities (including units of closed-end funds);

[5] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:079:0011:0019:EN:PDF
[6] CESR/06-005
[7] http://www.cesr.eu/index.php?page=document_details&id=4421

- money market instruments;

- liquid financial assets with respect to financial derivative instruments;

- financial indices (including certain indices based on financial derivatives on non-eligible assets such as commodities and indices on property). The classification of hedge fund indices as eligible assets is not covered by the implementing Directive and these CESR guidelines (for hedge fund indices, see 7. below);

- transferable securities and money market instruments embedding derivatives;

- techniques and instruments for the purpose of efficient portfolio management (comprising collateral arrangements, repurchase agreements, guarantees received, securities lending and securities borrowing);

- index replicating UCITS;

- other UCIs (concepts of equivalent supervision and equivalent protection of unitholders).

Member States have to publish by 23 March 2008 the laws, regulations and administrative provisions necessary to comply with the implementing Directive and such provisions shall become applicable from 23 July 2008.

7. CESR Consultation Paper of February 2007 on the classification of hedge fund indices as eligible financial indices for the purpose of UCITS (CESR 07-045)

This Consultation Paper[8] describes CESR's preliminary conclusions and proposed draft measures to be taken on the basis of the feedback received from market participants on questions concerning the ability of hedge fund indices ("HFIs") to fall within the definition of "financial indices" contained in the UCITS Directive raised in CESR's initial Consultation Paper on the subject published in October 2006[9].

[8] http://www.cesr-eu.org/index.php?page=consultation_details&id=88
[9] http://www.cesr-eu.org/index.php?page=consultation_details&id=79

8. Practices and Recommendations aimed at reducing the risk of money laundering and terrorist financing in the Luxembourg UCI Industry

The Association of the Luxembourg Fund Industry, the Luxembourg Bankers' Association and the Association of Luxembourg Compliance Officers have issued in December 2006 a document giving a practitioners view on the implementation of the law of 12th November 2004 on the fight against money laundering and terrorist financing and the subsequent CSSF Circular 05/211 on the same subject.[10]

The document has not been officially approved by the CSSF but the regulator has not raised objections and the aim is clearly that the document should become guidance on best practice for the Luxembourg UCIs.

The document aims to capture the practical responses to the challenges faced by the UCIs while at the same time already incorporating most of the recommendations of the European Directive 2005/60/EC ("3rd anti-money laundering directive") which has not yet been implemented into Luxembourg law.

The document takes a practice oriented view on the main challenges faced by Luxembourg professionals, mainly transfer agents, in their daily KYC operations and tries to provide clear guidance to avoid divergent interpretation of the regulations.

- The document defines from a UCI perspective the exemption from and delegation of KYC duties and outlines the principles of the proposed risk based approach for assessment of equivalence of identification requirements in different jurisdictions.

- It also provides useful guidance on the due diligence to be performed on distributors of UCI units / shares.

- The document comprises in its annexes a list of documentation required for the purpose of identifying trusts, investment funds, pension schemes, nominees and foundations when they invest into Luxembourg UCIs.

10 http://www.alfi.lu/fileadmin/files/Statements%20%26%20Publications/Recommendations/AML_ALFI-ABBL-ALCO_2006-12-20.pdf

9. Amendments to the law dated 10 August 1915 relating to commercial companies made by the law dated 25 August 2006 that have a potential impact on the articles of incorporation of UCIs incorporated as société anonyme (with a board of directors), including UCIs having adopted the legal form of a SICAV or SICAF

The law of 25 August 2006 on the *société européenne*, the *société anynome* with a management board and a supervisory board and the single-shareholder *société anonyme* (*société anonyme unipersonnelle*) has come into force on 4 September 2006 and has amended certain provisions of the law dated 10 August 1915 (the "Law").

Certain of these amendments may have an impact on the articles of incorporation (the "Articles") of UCIs incorporated in the form of a *société anonyme*:

- Article 26 of the Law provides that a *société anonyme* may be incorporated with only one shareholder and may become a single shareholder company as a result of the holding of all the share capital by a single shareholder.

- Article 57 of the Law has been amended to provide that the conflict of interest rules and formalities do not apply to transactions with a director which relate to current operations entered into under normal conditions.

- Article 64 of the Law has been amended to provide that the board of directors shall elect a chairman from among its members. Previously, this was not mandatory.

- Article 64bis of the Law has been inserted to provide that, unless otherwise provided for in the Articles, the following rules are applicable to the board meetings.

  (i) at least half of the members of the board of directors must be present or represented,
  (ii) resolutions must be carried by at least the majority of the members present or represented,
  (iii) the chairman of the board of directors shall have a casting vote in the event of tie,
  (iv) if provided for in the Articles, possibility for the members of the board of directors to attend the board meetings by way of videoconference or telecommunication means permitting their identification. Such means must satisfy technical characteristics which ensure an effective participation at the meeting whose deliberations shall be on-line without interruption.

- Article 67 of the Law has been amended to provide for the possibility for the shareholders to attend a general meeting by way of videoconference or

telecommunication means permitting for their identification, if provided for in the Articles.

- Article 67-3 of the Law has been amended to provide for the possibility for the shareholders to vote by correspondence by means of a voting form the content of which shall be laid down in the Articles.

- Article 67-1 of the Law has been amended to provide that resolutions to amend the Articles, in order to be adopted, must be carried by at least two thirds of the votes cast (and not as previously of the shareholders present or represented). Votes cast shall not include votes attaching to shares in respect of which the shareholders have not taken part in the vote or have abstained or have returned a blank or invalid vote.

- Article 70 of the Law has been amended to specify that one or more shareholders holding at least 10% of the subscribed share capital may request that one or more additional items be put on the agenda of any general meeting.

- Article 70 of the Law has been amended to specify that one or more shareholders holding at least 10% (instead of previously 20%) of the subscribed share capital may request the convening of a general meeting of shareholders.

The further changes made to the Law by the laws of 23rd March, 2007 (see 15. below) has further interesting bearings on the possibility for cross-border mergers of corporate UCITS on which we will report in our next newsletter.

10. EU and CESR developments on the prospectus directive

Frequently asked questions regarding Prospectuses: Common positions agreed by CESR Members (CESR/07-110)

The Committee of European Securities Regulators (CESR) has published on 16 February 2007 an updated version of the joint responses of all EU securities supervisors to commonly asked questions on the day-to day application of the Prospectus Directive (2003/71/EC) and the Commission's regulation on prospectuses (EC 809/2004) to provide marked participants with clarification and greater certainty to their most common questions.

Commission Regulation (EC) No 211/ 2007 of 27th February 2007 amending Regulation (EC) No 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards financial information in prospectuses where the issuer has a complex financial history or has made a significant financial commitment

Commission Regulation (EC) No 211/ 2007 was published on 28th February 2007 in the Official Journal of the European Union and entered into force the day after its publication. Regulation (EC) No 809/2004 has been amended to allow for the competent authority of the home Member State, in cases where the issuer of a security has a complex financial history, or has made a significant financial commitment, and in consequence the inclusion in the registration document of certain items of financial information relating to an entity other than the issuer is necessary to enable the investor to make an informed assessment of the issuer's financial position and prospects, to request that the issuer, the offeror or the person asking for admission to trading include those items of information in the registration document.

11. Laws of 23rd March, 2007 amending the law of 10th August, 1915 on commercial companies

The law of 10th August, 1915 on commercial companies has been amended by two laws of 23rd March 2007.

The first law of 23rd March 2007 (resulting from bill of law 4992) essentially introduces provisions regarding:

(i) mergers and divisions involving all types of Luxembourg law legal entities (including economic interest groupings);
(ii) cross border mergers and divisions;
(iii) transfers of assets, transfers of branches and all assets and liabilities transfers;
(iv) transfers of professional assets and liabilities; and
(v) the removal of certain timing constraints regarding the payment of interim dividends in *sociétés anonymes* and *sociétés en commandite par actions*.

The second law of 23rd March 2007 (resulting from bill of law 5658) contains certain additional rules concerning cross-border mergers.

You will find on our web site under the following links a memorandum containing a summary of these new provisions, as well as an unofficial up to date consolidation in French of the law of 1915 on commercial companies and an English translation of such law:

- Memorandum on the amendments to the law of 1915 on commercial companies by the two laws of 23rd March, 2007
- Loi du 10 août 1915 concernant les sociétés commerciales (mise à jour officieuse au 2 avril 2007)
- Consolidated Version of the Law of 10th August, 1915 on commercial companies and of the amending laws in force as at 2nd April, 2007