



**NEWSLETTER**  
**October 2008**



**1. CSSF Circular 08/356 concerning rules applicable to UCIs when they employ certain techniques and instruments relating to transferable securities and money market instruments**

[Read more on page 3](#)

**2. UCITS IV proposal adopted on 16 July 2008 by the European Commission**

[Read more on page 3](#)

**3. CESR Call for evidence following the Commission's request for advice to CESR on the UCITS management company passport**

[Read more on page 4](#)

**4. Law of 17 July 2008 amending the law of 12 November 2004 on the fight against money laundering and financing of terrorism and other relevant legal provisions (the "AML Law").**

**Grand-ducal Regulation of 29 July 2008 establishing the list of "third countries which impose equivalent requirements" within the meaning of the AML Law**

[Read more on page 4](#)

**5. New CSSF regulatory procedure regarding assessment of eligibility of indexes for UCITS Funds**

[Read more on page 4](#)

**6. CESR consultation paper on "Risk management principles for UCITS"**

[Read more on page 5](#)

**7. CSSF Circular 08/372 concerning rules of conduct applicable to the depository of a SIF adopting alternative investment strategies, in cases where such fund makes use of the services of a prime broker**

[Read more on page 5](#)



**8. CSSF Circular 08/371 concerning the electronic transmission to the CSSF of prospectuses and periodical reports of UCIs and SIFs**

[Read more on page 6](#)

**9. The Luxembourg CSSF prohibits uncovered (naked) short sales of listed shares of credit institutions and insurance companies**

[Read more on page 7](#)

**10. CSSF annual Activity Report 2008 now available in English**

[Read more on page 7](#)



## 1. CSSF Circular 08/356 concerning rules applicable to undertakings for collective investment when they employ certain techniques and instruments relating to transferable securities and money market instruments

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Luxembourg UCITS and UCIs have been actively engaging in securities lending transactions for quite some time. The conditions on which UCITS and UCIs can engage in such activities were initially described in a Circular 91/75 issued by the Commission for the Supervision of the Financial Sector in 1991.

Under UCITS III, securities lending is referred to in the Commission Directive 2007/16/EC and the corresponding CESR guidelines as a “technique relating to transferable securities” which can be used by UCITS for “efficient portfolio management”.

On 4 June 2008, the CSSF issued a Circular 08/356 which describes in detail the techniques and instruments which may be used by UCITS comprising securities lending transactions.

The Circular innovates in particular as regards permitted collateral and permitted assets in which cash collateral can be reinvested. It specifies how collateral and assets acquired upon reinvestment of cash collateral must be safekept in order to avoid a counterparty risk for the UCITS in excess of the legal limits. It re-states that securities lending transactions may not impair the UCITS’ portfolio management activities, its redemption obligations and its adherence to corporate governance principles. Finally, it specifies the information which needs to be included in the prospectus and the financial reports.

You will find on our website a more detailed Memo on the subject<sup>1</sup> as well as an English translation of the CSSF Circular<sup>2</sup>.

## 2. UCITS IV proposal adopted on 16 July 2008 by the European Commission

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The European Commission proposed a number of important amendments to the UCITS Directive on 16 July 2008.

The proposed changes are supposed to improve the competitiveness of the UCITS product to the benefit of investors mostly via reducing costs. The proposed amendments provide for:

I. The removal of administrative barriers to the cross-border marketing of UCITS. The Commission proposes to introduce a simpler (regulator to regulator) notification procedure following which the actual marketing of the units can start within three days. The host authority will only be able to perform its control functions after the placement of the units in the relevant member state will have begun.

II. A harmonised regulatory regime for cross-border mergers of UCITS funds and UCITS master/feeders.

III. The replacement of the simplified prospectus by the new Key Investor Information document providing pre-contractual key elements on each product.

IV. An improved cooperation between the national supervisory authorities.

The management company passport is still being discussed separately.

The UCITS IV proposal is expected to come into force by mid 2011.

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<sup>1</sup> [Securities Lending Applicable Regulations 06-2008](#)

<sup>2</sup> [CSSF 08/356 rules applicable to UCITS](#)



### 3. CESR Call for evidence following the Commission's request for advice to CESR on the UCITS management company passport.

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The Commission's proposal for a directive containing amendments to the UCITS Directive (85/611/EEC) (so-called "UCITS IV"; see also topic 2. above) did not include any provision on establishing an effective management company passport. The reason for this was that the Commission still needs to determine how the current high level of investor protection provided by the UCITS framework can be maintained in the context of such cross-border management arrangements.

Therefore, the Commission requested CESR to provide advice that will help the Commission to develop provisions permitting the introduction of a management company passport under conditions that are consistent with a high level of investor protection.

On this basis, CESR has invited, by means of a call for evidence, all interested parties to submit their views as to what CESR should consider in its advice to the European Commission.

Contributions were to be submitted by 22 August 2008 and responses received to date may be consulted on CESR's website. The Association for Luxembourg Investment Funds (ALFI) has responded to the call for evidence and such response can be viewed on CESR's and ALFI's websites.

It is presently uncertain whether the call for evidence and CESR's advice, to be published in November 2008, will lead the Commission to include the management company passport, in one form or another, in the "UCITS IV" package, but the French presidency at the Commission has clearly expressed this to be a priority objective.

On 30 September 2008 CESR published a Consultation Paper on the subject and market participants have been invited to respond to such Consultation by 15 October 2008.

4. Law of 17 July 2008 amending the law of 12 November 2004 on the fight against money laundering and financing of terrorism and other relevant legal provisions (the "AML Law").

### Grand-ducal Regulation of 29 July 2008 establishing the list of "third countries which impose equivalent requirements" within the meaning of the AML Law.

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The law of 17 July 2008 has implemented Directive 2005/60/EC and Directive 2006/70/EC into Luxembourg law.

On 29 July 2008 Luxembourg issued a list of "third countries which impose equivalent requirements" within the meaning of the AML Law, which as of this date contains the following States outside of the European Union and the EEA:

South Africa, Argentina, Australia, Brazil, Canada, United States, Guernsey, Hong Kong, Isle of Man, Japan, Jersey, Mexico, New Zealand, Russian Federation, Singapore, Switzerland, French overseas territories: Mayotte Island, New Caledonia, French Polynesia, St Pierre and Miquelon, Wallis and Futuna, and Dutch overseas territories: Dutch West Indies, Aruba.

### 5. New CSSF regulatory procedure regarding assessment of eligibility of indexes for UCITS Funds

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Breaking with its former policy, the CSSF will no longer assess the eligibility under Luxembourg laws and regulations of each index, but it will request each investment fund or its management company, as the case may be, to assess the eligibility of any new index and to file with the CSSF the procedure used by the investment fund or its management company to make such assessment. For any subsequent filing,



the CSSF must receive a confirmation from the investment fund or its management company, as the case may be, that such procedure has been followed in respect of the new index targeted.

The internal procedure for the assessment of the eligibility of an index should be filed at the time of the next filing of a prospectus referring to indexes not previously approved by the CSSF. Such procedure should be detailed and especially cover the following points : the departments and/or persons in charge of such assessment, the steps followed therefor, any process of validation or cross-checking in place, the persons authorised to review and/or sign off such assessment and the documentation relating to such assessment.

Once such internal procedure has been filed with the CSSF, the management company would need to issue for filing with the CSSF a written confirmation that for any new index(es) under consideration, an internal assessment of the eligibility has been performed in accordance with the internal procedure filed with the CSSF and that as a result, such index(es) is/are deemed eligible.

It is nonetheless important to mention that the CSSF may proceed to an ad hoc assessment of the eligibility of certain indexes.

## 6. CESR consultation paper on “Risk management principles for UCITS”.

On 20 August 2008, the Committee of European Securities Regulators released a new consultation paper on “risk management principles for UCITS”, in an effort to achieve more convergence in the process throughout the European Union. CESR’s view is that sound risk management systems require organisational requirements and specific safeguards and diligences in order to ensure that all kinds of risks are adequately captured. Such requirements and good practices would be set out through common principles in order both to foster convergence among competent authorities and to provide useful guidance to market participants.

In particular, the August 2008 consultation paper proposes a framework for guidelines concerning risk management, providing principles and an outline of the key elements for a standard in the risk management process, applying both to management companies and investment companies that have not designated a management company.

Such proposed level 3 measures regard the supervision by competent authorities, the definition of roles and responsibilities, the risk management function, outsourcing, identification of risks relevant to the UCITS, risk measurement techniques, the management of model risk concerning the risk measurement framework, the link between risk measurement and asset valuation, risk management procedures, the risk limits system, effectiveness of the risk management process, reporting to the Board of Directors and the Senior Management and the monitoring of the risk management process.

The principles will be complemented by a paper on the aforesaid technical and quantitative issues related to risk management, which is expected to be published for consultation by the end of 2008.

## 7. CSSF Circular 08/372 concerning rules of conduct applicable to the depository of a SIF adopting alternative investment strategies, in cases where such a fund makes use of the services of a prime broker.

On 5 September 2008, the CSSF issued a Circular 08/372 which applies to specialised investment funds (SIFs) governed by the law of 13 February 2007 regarding specialised investment funds, which appoint a prime broker. The purpose of the Circular is to clarify the role and the duties of the SIF’s depository in the choice of the prime broker and in the supervision of the SIFs’ assets held by the prime broker.



The Circular clarifies that it is up to the SIF to choose the prime broker but that this choice must be accepted by the depository. For the purpose of making its decision to accept the choice of the prime broker made by the SIF, the depository must only ensure that the prime broker is a financial institution (i) subject to supervision and (ii) specialised in this type of operation. The depository is not required to undertake any other due diligence on the prime broker.

The Circular further requires that the relationship between the depository and the prime broker is organised in such a manner that the depository is able to obtain information from the prime broker at any time on the composition and the value of the assets of the SIF entrusted to the prime broker. The Circular specifies that the depository does not need to be informed of the subcustodians or agents with which the prime broker holds the assets of the SIF.

The Circular also requires that the relationship between the depository and the prime broker is organised in such a manner that the depository has a right of intervention on the assets of the SIF of which it may make use in case it considers that it is no longer in a position to exercise its duty of supervision on the assets of the SIF.

Finally, the Circular requires that the sales documents of the SIF using the services of a prime broker must contain an adequate description of the involvement of the prime broker and the possible risks connected therewith, including the counterparty risk.

You will find an English translation of the CSSF Circular on our website<sup>3</sup>

## 8. CSSF Circular 08/371 concerning the electronic transmission to the CSSF of prospectuses and periodical reports of UCIs and SIFs.

On 5 September 2008, the CSSF issued a Circular 08/371 which relates to the electronic transmission to the CSSF and, if applicable, publication through CCLux by UCITS, UCIs and SIFs of their prospectuses and periodical reports.

As regards UCITS and UCIs governed by the law of 20 December 2002, the Circular repeats the content of Circular CSSF 03/97 of 21 February 2003 pursuant to which full and simplified prospectuses as well as annual and semi-annual reports are to be filed with the CSSF and published through CCLux. The new Circular also reiterates that the publication can be avoided if an appropriate justification is given to the CSSF.

The Circular specifies that SIFs subject to the law of 13 February 2007 must transmit their information document (prospectus) and annual report to the CSSF by the same technical means. These documents are not published.

The Circular comprises technical specifications on the electronic means which are to be used to forward the documents to CCLux for the said filing and publication purposes.

An English translation of the CSSF Circular will soon be published on our website.

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<sup>3</sup> [CSSF Circular 08/372](#)



## 9. The Luxembourg Commission for the Supervision of the Financial Sector (CSSF) prohibits uncovered (naked) short sales of listed shares of credit institutions and insurance companies.

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On Friday 19 September 2008, the Luxembourg Commission for the Supervision of the Financial Sector (CSSF) issued a press release to inform market participants that uncovered (naked) short sales of listed shares of credit institutions and insurance companies are prohibited. On Monday, 29 September 2008, the CSSF issued an additional press release clarifying the scope of the prohibition.

Luxembourg market participants will, in addition, have to comply with the regulations of foreign market authorities regarding short sales when carrying out transactions on those markets.

The full text of the press releases can be found on the CSSF's website under their Publications section (Press Releases 2008<sup>4</sup>).

For any further information please contact us or visit our website at <http://www.ehp.lu>.

The information contained herein is not intended to be a comprehensive study or to provide legal advice and should not be treated as a substitute for specific legal advice concerning particular situations. We undertake no responsibility to notify any change in law or practice after the date of this document.

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<sup>4</sup> [CSSF Press Release 19 September 2008](#) and [CSSF Press Release 29 September 2008](#)