Financial Services Alert

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Luxembourg draft Law transposing UCITS IV

A draft Law transposing the recast UCITS Directive, UCITS IV, was submitted to the Luxembourg Chamber of Deputies in August 2010. The draft Law (the new Law) will replace the current 2002 Law. The 2002 Law covers both UCITS (Part I UCIs) and non-UCITS[1] (Part II UCIs). As well as transposing the provisions of UCITS IV, it foresees significant flexibility in the transitional period between the entry into force of the new Law and the final phasing out of the 2002 Law; further, it enhances Luxembourg's current investment fund regime.

There are six enhancements to the existing UCITS Directive under UCITS IV:

1. The notification procedure is simplified and accelerated
2. A procedure for UCITS mergers is established
3. Master-feeder UCITS structures may be created
4. A new standardized "key investor information" (KII) document replaces the simplified prospectus
5. The management company passport becomes a reality
6. Existing regulatory requirements, including organizational requirements and rules of conduct for management companies, will be reinforced. Cooperation between supervisory authorities is to be strengthened

Transitional provisions

From the date of entry into force of the new Law, existing UCITS, and UCITS created between the date of entry into force of the new Law and 1 July 2011, may choose to be subject to the new Law or remain under the 2002 Law until 1 July 2011 (exemptions apply in certain cases, such as closed-end UCITS). The creation of new compartments of multiple compartment UCIs does not impact this right for the UCITS as a whole to make a choice. But from 1 July 2011, they all become subject to the new Law.

UCITS which choose to remain under the 2002 Law will have until 1 July 2012 to replace their simplified prospectuses with KIIs. Those subject to the new Law must produce KIIs.

The legislator notes, however, that UCITS which choose to be subject to the new Law may encounter practical difficulties in cross-border situations, such as with host Member States in which the UCITS is distributed which continue to apply the provisions of the previous regime.

Similar transitional provisions are foreseen for management companies of UCITS (Chapter 15 management companies).

For all other UCIs as well as for other management companies, the new Law will be applicable from the date of its entry into force.

Flexibility on delegation of functions

As under the 2002 Law, in the case of delegation of functions by UCITS management companies and UCITS investment companies, the new Law lays down the requirements to be met. However, the new Law does not require Luxembourg management companies and investment companies to delegate to Luxembourg service providers.

[1] A separate regime is applicable to Specialized Investment Funds (SIFs) – the Law of 13 February 2007.

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FCP residency concerns clarified

In order to avoid any issues relating to residency of Luxembourg common funds (FCPs), and in particular FCPs managed cross-border, the new Law clarifies that the management regulations are subject to Luxembourg Law.

Flexibility for merging UCITS

In the case of merging UCITS, the new Law permits the absorbing UCITS to benefit from certain investment restrictions flexibility for a period of six months.

Other enhancements to the current regime

Cross investment

Under the new Law, multiple compartment UCIs may be permitted by their constitutional documents to invest in other compartments of the same UCI (cross investment), provided that certain conditions are met, *inter alia*:

- The target compartment does not invest in the investing compartment
- Not more than 10% of the assets of the target compartment must be invested in other compartments of the same UCI
- The voting rights of the target compartment are suspended during the period of investment.

ETF subscription tax exemption

The new Law exempts from subscription tax UCIs, or individual compartments of multiple compartment UCIs, whose securities are quoted on a regulated market and whose exclusive object is to reproduce the performance of one or more indices, from 1 January 2011. The objective of these provisions is to exempt ETFs from subscription tax.

Other tax measures

UCIs under foreign law whose place of effective management is in Luxembourg, or whose central administration is in Luxembourg, are exempt from taxation in Luxembourg.

The new Law also exempts, in all cases, non-resident investors (including feeders) from taxation on the gains realized on the disposal of shares in Luxembourg UCIs in corporate form.

Translation of statutes and communication of annual reports to investors

The new Law exempts investment companies (variable capital – SICAVs and fixed capital – SICAFs) from the requirement to:

- Translate the statutes or any modifications to the statutes into French or German, if these documents have been prepared in English
- Send the annual report, the auditor's report, the management report, and the observations of the supervisory board (if applicable) to shareholders at the same time as the convocation to the annual general meeting; the convocation must indicate how to obtain these documents and state that the investor may request that these documents be sent to him.

New requirements

The new Law requires management companies and investment companies to submit to the CSSF, on their own initiative, any substantial modifications to the information submitted to the CSSF in its applications for authorization.

For Chapter 15 management companies, it is clarified that the capital of the management companies must be continuously available and invested in the interests of the management company. Further, it is clarified that the conducting officers of the management company must be of good repute and have sufficient experience in relation to the management of the type of UCIs managed.

For Part II UCIs, the provisions on the delegation of the investment management function are substantially aligned with those applicable to Part I UCITS. The delegated investment manager must be authorized and subject to prudential supervision and, in the case of delegation to an investment manager in a third country, there must be cooperation between the CSSF and the third country supervisory authority. The investment management function may not be given to the depositary.

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