

UCITS

Applicable legal framework

As from 1 July 2011, Luxembourg UCITS funds are subject to the following main laws and regulations:

- Part I and Part V of the law of 17 December 2010 on Undertakings for Collective Investment implementing the UCITS IV Directive (the “Fund Law”);
- IML Circular 91/75 of 21 January 1991 clarifying certain aspects of the UCI legislative framework;
- IML Circular 97/136 of 13 June 1997 on financial information to be provided by public funds;
- CSSF Circular 02/77 of 27 November 2002 on the protection of investors in case of NAV calculation error or breach of investment rules;
- CSSF Circular 07/308 of 2 August 2007 on the use of derivatives and management of financial risks (will apply only until 1 July 2011);
- Grand Ducal Decree of 8 February 2008 transposing Directive 2007/16/EC which clarifies certain definitions in the UCITS III Directive;
- CSSF Circular 08/356 of 4 June 2008 on the use of securities lending, “réméré” and repo transactions;
- CSSF Circular 08/371 of 5 September 2008 regarding electronic transmission of prospectuses and financial reports of UCIs and SIFs to the CSSF;
- CSSF Circular 08/380 of 26 November 2008 regarding guidelines of the Committee of European Securities Regulators (CESR) concerning eligible assets for investments by UCITS;
- CSSF Regulation N° 10-04 on organisational requirements, conflicts of interest, conduct of business, risk management and content of agreement between a depositary and a management company;
- CSSF Regulation N° 10-05 of 22 December 2010 on fund mergers, master-feeder structures and notification procedures;
- CSSF Circular 11/498 of 10 January 2011 on entry into force of the Fund Law;
- CSSF Circular 11/508 of 15 April 2011 on the new provisions applicable to Luxembourg management companies subject to Chapter 15 of the Fund Law and to self-managed SICAVs;
- CSSF Circular 11/509 of 15 April 2011 on the new notification procedure to apply by a Luxembourg UCITS wanting to sell its shares in a different Member State and by a foreign UCITS wanting to sell its shares in Luxembourg;
- CSSF Circular 11/512 of 30 May 2011 presenting the main changes to the risk management regulation following publication of CSSF regulation 10-4 and the precisions brought by ESMA; providing some additional CSSF guidance on risk management rules; and defining format and contents of the RMP to communicate to CSSF;
- CESR Guidelines on a common definition of European money market funds of 19 May 2010 (CESR/10-049);
- CESR Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS dated 28 July 2010 (CESR/10-788);
- ESMA Guidelines on risk measurement and the calculation of global exposure for certain types of structured UCITS dated 14 April 2011 (ESMA 2011/112).

Quick Reference Guide

Investors

There is no limitation as to the type of investors in a UCITS fund. Originally created as a true retail product, UCITS funds are sold to the public but also to corporates and institutions. As UCITS funds may be easily marketed across the EU and beyond, investors originate from many parts of the world.

Eligible investments and investment restrictions

An overview of the eligible investments (and associated investment restrictions) is given below (all percentages are % of net assets, unless otherwise stated).

Global limits by type of assets

Type of assets	Article of Fund Law	Limits to be checked at sub-fund level
Transferable securities	Article 41 (1) a) to d)	100%
Money market instruments	Articles 41 (1) a) to d) and 41 (1) h)	100%
Bank deposits	Article 41 (1) f)	100%
UCITS	Article 41 (1) e)	100%
Other UCIs	Article 41 (1) e)	30%
Financial derivative instruments	Article 41 (1) g)	100%
Ancillary liquid assets	Article 41 (2)	49%

Individual limits by type of assets: diversification, counterparty and concentration limits

a. Individual and combined investment limits per security (article 43 of the Fund Law)

Type of instruments	Limits to be checked at sub-fund level		
Transferable securities	10% ¹	25%	35%(100%)
Money market instruments	10%	10%	35%(100%)
Bank deposits	20%	20%	/
OTC financial derivative instruments	5% / 10%	10%	/
Combined total exposure per issuer	Max 20% ²	Max 35%(100%) ²	Max 35%(100%)

¹ This limit of 10% per issuer may be of a maximum of 20% in the case of index funds i.e. UCITS that replicate passively the performance of a financial index.

² Limit to be checked at group level.

b. Individual and combined investment limits per security (article 46 of the Law)

Type of instruments	Limits to be checked at sub-fund level
Units of UCITS*	20%
Units of other UCI	20%

*Under article 181 (8) of the Fund Law, a sub-fund of a UCITS may hold units of other sub-funds of the same UCITS provided it meets the following requirements:

- The target sub-fund should not in turn invest its assets in the sub-fund which intends to hold its units;
- The target sub-fund should not hold, as per its prospectus or constitutive documents, more than 10% in aggregate of its assets in units of the target sub-funds of the same UCITS;
- Any potential voting rights attached to the units of the target sub-fund should be suspended during the holding period;
- For as long as the units are held by the UCI, their value will not be taken into consideration for the calculation of the net assets of the UCI for the purpose of verifying the minimum threshold of the net assets;
- No double taking of subscription/redemption fees or management fees at the level of the UCITS which intends to hold units of a target sub-fund of the same umbrella fund.

c. Permitted holding as a percentage of the securities in issue (article 48 of the Fund Law)

Type of instruments	Article of the Fund Law	Limits to be checked at sub-fund level
No-voting shares of the same issuer	Article 48 (2)	10%
Debt instruments of the same issuer		10%
Units/shares of the same UCITS/ other UCI		25%
Money market instruments of the same issuer		10%

Article 40 of the Fund Law foresees that each sub-fund of a UCITS with multiple sub-funds is considered as a distinct UCITS for the purpose of checking the investment restrictions of Chapter 5. As a result, in contrary to what was done under the previous regime, these concentration limits have to be checked at the level of each sub-fund and not at the level of the UCITS as a whole.

d. Other key limits

Other limits	Article of the Fund Law
UCITS are not allowed to grant loans or act as guarantor for third parties	Article 51 (1)
UCITS may borrow the equivalent of up to 10% of their assets provided that the borrowing is on a temporary basis	Article 50 (1)
UCITS may not acquire either precious metals or certificates representing them	Article 41 (2) c)

Master-feeder UCITS

The Fund Law allows master-feeder structures, where the master and the feeder may be established in the same Member State or in two different ones. These structures may be used for distribution purposes and to gain efficiencies through the pooling of assets.

Investment limits applicable to master feeder structures:

Limits/conditions	Article of the Fund Law
A feeder fund should invest at least 85% of its assets in units of a master fund	Article 77 (1)
A feeder fund should invest up to a maximum of 15% of its assets in: <ul style="list-style-type: none"> Ancillary liquid assets Financial derivative instruments used for hedging purposes Movable and immovable property which is essential for the direct pursuit of its business if the feeder fund is an investment company 	Article 77 (2)
The master fund should: <ul style="list-style-type: none"> Not be itself considered as a feeder fund Not hold units of a feeder fund Have at least one feeder fund among its unit holders 	Article 77 (3)
Articles 41, 43, 46 and 48 (2) third bullet do not apply to feeder funds	Article 77 (1)

Money Market Funds

CESR's "Guidelines on a common definition of European money market funds (CESR/10-049)" aim at improving investors' protection, who usually expect to preserve the principal of their investment while at retaining the ability to withdraw their capital on a daily basis. In this document, CESR makes a distinction between Short-Term Money Market Funds and Money Market Funds.

These guidelines will apply amongst others to any UCITS subject to Part I of Fund Law which label or market themselves as "money market funds". Money market funds that existed before 1 July 2011 are allowed a six month grand-fathering period to comply with these guidelines, in respect of all investment acquired prior to that date.

A money market fund must indicate in its prospectus and in its Key Investor Information Document ("KIID"), whether it is a Short-Term Money Market Fund or a Money Market Fund.

Short-Term Money Market Funds

To be considered as a Short-Term Money Market Fund, a UCITS must comply with the following criteria:

<i>Criteria</i>	<i>Short-term money market funds</i>
<i>Primary investment objective</i>	To maintain the principal of the fund and to provide a return in line with the money market rates
<i>Type of investments</i>	Money market instruments complying with the criteria defined in the Directive 2009/65/EC or deposits with credit institutions
<i>Quality of investments</i>	High quality securities (factors to be taken into account: credit quality, nature of the asset class, the operational and counterparty risk linked to structured financial instruments, liquidity profile)
<i>Securities with a residual maturity until redemption date</i>	Of less than or equal to 397 days (ABS with a residual maturity until the legal date of redemption of 5 years but with an expected maturity of 8 months would not be eligible anymore for Short-term money market funds)
<i>NAV and price calculation frequency</i>	Daily NAV and price calculation, daily subscription and redemption of units
<i>Weighted average maturity</i>	60 days
<i>Weighted average life</i>	120 days
<i>Direct and indirect exposure (via derivatives) to equities and commodities</i>	No
<i>Currency exposure</i>	Should be hedged
<i>Currency derivatives</i>	Only for hedging purposes
<i>Valuation approach</i>	Constant or stable NAV (amortised cost) and fluctuating or variable NAV (market value)
<i>Investment in other UCIs</i>	Permitted but only in short-term money market funds

Money Market Funds

To be considered as a Money Market Fund, a UCITS must comply with the following criteria:

<i>Criteria</i>	<i>Money market funds</i>
<i>Primary investment objective</i>	To maintain the principal of the fund and to provide a return in line with the money market rates
<i>Type of investments</i>	Money market instruments complying with the criteria defined in the Directive 2009/65/EC, deposits with credit institutions and sovereign issuance of at least investment grade quality
<i>Quality of investments</i>	High quality securities (factors to be taken into account: credit quality, nature of the asset class, the operational and counterparty risk linked to structured financial instruments, liquidity profile)
<i>Securities with a residual maturity until redemption date</i>	Of less than or equal to two years provided that the time remaining until the next interest rate reset date is less than or equal to 397 days
<i>NAV and price calculation frequency</i>	Daily NAV and price calculation, daily subscription and redemption of units
<i>Weighted average maturity</i>	Six months
<i>Weighted average life</i>	12 months
<i>Direct and indirect exposure (via derivatives) to equities and commodities</i>	No
<i>Currency exposure</i>	Should be hedged
<i>Currency derivatives</i>	Only for hedging purposes
<i>Valuation approach</i>	Fluctuating NAV
<i>Investment in other UCIs</i>	Permitted but only in short-term money market funds and money market funds

Luxembourg UCITS funds may, as from 1 July 2011, be set-up and managed by a UCITS management company located in a different EU Member State than the Grand Duchy. The description below regarding risk management, organisation requirements and procedures, etc. applies only to UCITS management companies and SIAGs located in Luxembourg.

Risk management

The Fund Law, the UCITS IV Directive and CESR's level 3 Guidelines on Risk Measurement of 28 July 2010 (CESR/10-788) harmonise the interpretation of the rules introduced under the old UCITS III regime. In addition, they impose a few new requirements in terms of reporting, disclosure and monitoring of risks such as the liquidity risk, operational risks, etc.

The major changes compared to the UCITS III framework are listed below:

- The “sophisticated funds” versus “non sophisticated funds” classification, which in the past determined the risk management approach, is now abandoned. Instead, the selection of the methodology used to calculate the global exposure is based on the risk profile of the UCITS, resulting from the complexity of the investment strategies or the use of exotic financial derivative instruments;
- The daily monitoring of the calculation of the global exposure is extended to UCITS using the commitment approach. It is even envisaged to carry out intra-day monitoring in particular conditions;
- CESR recommends an initial validation of the Value at Risk model (“VaR”) by a unit either internal or external to the UCITS;

- Reporting of back testing to the senior management should be done at least on a quarterly basis if the number of overshootings over the last year (250 business days) exceeds four. A similar reporting should be sent to the CSSF on a semi-annual basis when relevant;
- The calculation of the counterparty exposure of a UCITS is simplified. The positive mark-to-market value of over-the-counter financial derivatives is used to assess the UCITS' counterparty risk instead of using the 3 steps method.
- The UCITS should disclose in the prospectus the method used to calculate the global exposure, the expected level of leverage and the possibility of higher leverage levels. The expected level of leverage should be calculated as the sum of the notional of the financial derivative instruments used. For UCITS using a relative VaR, the reference portfolio should also be disclosed in the prospectus;
- The UCITS should disclose in the annual financial statements the reference benchmark, the level of leverage, the lowest, highest and average VaR utilisation of the year under review.

The recent CSSF Circular 11/512 of 30 May 2011 provides a detailed framework in which the risk management procedure has to be communicated to the CSSF and clarifies its format and content. It also details the CSSF approach towards certain rules relating to risk management.

Organisational requirements

Organisational requirements applicable to management companies have been detailed in CSSF Regulation n°10-4. UCITS IV management companies in Luxembourg are required to have sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms. Management companies must also have the necessary and sufficient human and technical infrastructure in order to conduct its activities and to supervise the activities that can be delegated to third party service providers.

Senior management responsibility

People managing the management company must have the relevant experience for their duty and must be approved by the CSSF. Board members will take the ultimate responsibility for the entire activity. At least two conducting officers will control and take in charge the conduct of the day-to-day activity.

Internal control functions

Management companies must have permanent and independent internal control functions:

- Compliance function with one designated physical compliance officer;
- Risk management function;
- Internal audit.

The internal functions have to report to senior management at least annually and on an ad hoc basis if necessary.

These control functions can be externalised to qualified third parties according to the proportionality principle, i.e. when such derogation is appropriate and proportionate in view of the nature, scale and complexity of the management company's business.

Internal administrative procedures

Management companies are required to have a manual of procedures validated by the senior management. These procedures cover the following areas: remuneration policy, compliance, internal audit, personal dealings, record keeping and archiving, accounting procedures, business continuity plan, IT and security policy, recording of portfolio transactions, recording and processing of subscription and redemption orders, complaints handling, conflicts of interests management, exercise of voting rights, due diligence (inv. compliance) of investment portfolio, best execution, handling of orders, policies and procedures for preventing malpractices that might reasonably be expected to affect the stability and integrity of the market (market timing, churning), inducements.

Of course, depending on the size of the organisation, management companies in practice establish additional policies and procedures like for example for the creation, the update/ dissemination of internal procedures, human resources policy, outsourcing policy, monitoring of capital adequacy, governance policy including board functioning and composition rules, decision making and signature power guidance, etc.

Conduct of business rules

Management companies also have to take the necessary arrangements to act in the best interest of UCITS and investors (e.g. accurate asset valuation, market timing and late trading prevention, transparency and duty to prevent undue cost for investors, etc.).

Management companies have to ensure that client's orders will be properly handled and that adequate reporting on subscriptions and redemptions will be provided to investors. They must also ensure that the UCITS is provided with the best possible result for portfolio transactions e.g. best price, cheapest transaction cost, speed of execution, etc. (Best execution).

Financial resources

Management companies must have a minimum capital of EUR 125,000 plus additional own funds calculated as a percentage of the assets under management "AUM" (0.02% calculated on AUM over 250 Mio) with a cap at EUR 10 Mio. Management companies are authorised not to provide up to 50% of the additional amount of own funds referred to above if they benefit from a guarantee of the same amount given by a credit institution or an insurance undertaking.

Self-managed SICAV

SICAV which have not designated a management company have to comply with the same rules as management companies with some exceptions:

- Some administrative procedures are not required (as not really relevant);
- Self-managed SICAV do not have to have an internal compliance function and an internal auditor;
- Minimum capital requirements is EUR 300,000.

The proportionality principle can also be invoked by the SIAG. It is subject to the CSSF approval upon receipt of a duly motivated request.

UCITS main features at a glance

<i>Legal forms available for UCITS</i>	<ul style="list-style-type: none"> • Investment company with variable capital (SICAV) to be incorporated as a public limited company (S.A.); • Investment company with fixed capital (SICAF); • Contractual fund (FCP).
<i>Eligible investors</i>	<ul style="list-style-type: none"> • No restriction on the type of investors authorised to invest in a UCITS.
<i>Licensing requirements</i>	<p>A UCITS fund must receive the CSSF's prior authorisation before it can start its activities. The CSSF will pay particular attention to:</p> <ul style="list-style-type: none"> • The UCITS fund's draft constitutional documents (incl. its prospectus and, for new UCITS, its KIID); • The identity and quality of the sponsor of the UCITS funds; • The quality of the UCITS management company, if there is one; • The identity of the investment manager of the UCITS funds who must be duly licensed for that function in its country of domicile; • The identity of any other delegates or sub-delegates; • The identity of the managers in charge of conducting the business of the UCITS funds, who must show good reputation and adequate experience for acting in such capacity; • The identity of the central administration, of the Luxembourg depositary and of the Luxembourg external auditors; • The risk management put in place which has to cover all the UCITS managed by the management company and all the risks including liquidity and operational risks pertaining to these UCITS.
<i>Compulsory service providers in Luxembourg</i>	<ul style="list-style-type: none"> • Depositary – responsible for safekeeping of the UCITS assets and other supervisory duties – which must be a Luxembourg bank or a Luxembourg branch of a EU bank; • External auditors.
<i>Valuation principle</i>	<ul style="list-style-type: none"> • Valuation is made for officially listed securities on the basis of the last known stock exchange quotation. If it is not representative or for other securities, valuation is made based on the realisable value of the assets, estimated in good faith (unless differently provided for in the constitutional documents of UCITS).
<i>Minimum NAV frequency</i>	<ul style="list-style-type: none"> • Twice a month.
<i>Subscription/Redemption</i>	<ul style="list-style-type: none"> • Subscription at NAV plus subscription fees. A UCITS fund can be closed to subscriptions; • Redemption at NAV minus redemption fees. A UCITS fund must offer the ability to redeem to investors at least twice a month.
<i>Minimum capital requirement in the UCITS</i>	<ul style="list-style-type: none"> • EUR 1.25 Mio to be reached within six months following approval.
<i>Documents to be established according to laws and regulations</i>	<ul style="list-style-type: none"> • Prospectus; • Key Investor Information Document ("KIID"); • Articles of association (in case of a SICAV or SICAF); • Management regulations (in case of an FCP); • Agreements with the service providers; • Annual audited financial statements (annually within four months of period end); • Semi-annual non-audited financial statements (annually within two months of period end); • Long Form Report describing the organisation of the UCITS funds (annually within four months of period end); • Risk management process in accordance with the CSSF Circular 11/512 of 30 May 2011.

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