

wealthy individuals. The domestic savings market, by comparison, was quite large and a withholding tax was obviously a much more efficient way of collecting tax arising. Given the development of cross-border banking markets, it would now make sense to use withholding tax approaches here too, in the cross border market. But fiscal authorities seem to be stuck in a time warp.

LFF: You have compared the withholding tax and the exchange of information systems. If you were the European Commission, which system would you opt for to implement at an EU level?

GM: I would adopt a withholding tax approach. The deduction of real cash by a bank and its transfer to the revenue authorities of another Member State is a more concrete act than the passing of large numbers of data files. It is simpler, more efficient, and more capable of audit. The so-called automatic information exchange is seriously affected by the quality of data received, prone



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to lengthy delays, frequently requires manual follow-up and further enquiries and is prone to confusion on what is taxable. It is disproportionate for small countries without large financial centres and it seems clear that much of the information received under it in the past has gone essentially unused.

ALL ABOARD AS ALTERNATIVES MOVE ONSHORE TO LUXEMBOURG

The trend for re-domiciliation of off-shore funds started some time ago. As a direct result of a circular issued by the financial supervisory authority, CSSF Circular 02/08 of 2002, which set specific rules for Luxembourg investment funds pursuing alternative investment strategies, many fund of hedge funds re-domiciled to Luxembourg from Cayman, Bermuda and the British Virgin Islands. The recently proposed Alternative Investment Fund Managers' (AIFM) Directive is likely to spur further onshore moves.



Didier Prime, Partner and Alternative Investments Leader at PwC Luxembourg describes this growing trend and the possibilities it brings to the Grand Duchy.

LFF: As a direct result of CSSF Circular 02/08 many fund of hedge funds moved onshore to Luxembourg. Do you see this continuing?

DP: Yes I do. Although, at the time, the circular was not considered to be flexible enough for hedge fund managers, it represents a good balance between investor

protection and flexibility of investment rules and this has proven to be very attractive. Some Luxembourg based funds of hedge funds are registered for public distribution in countries and territories that accept foreign based non-UCITS such as Germany, the Netherlands, Switzerland and Hong-Kong. For such products, the “Luxembourg” branding was a crucial element in re-domiciliation.

Today, we observe another type of re-domiciliation. US and UK based hedge fund managers are looking for new distribution opportunities and there is a demand by institutional investors for more regulation and more investor protection, especially in Continental Europe. These hedge fund managers are considering Luxembourg for creating new products and not necessarily just for the creation of specialised investment funds (SIFs). SIFs are well adapted to the hedge fund business, but new entrants are also interested in sophisticated UCITS that replicate hedge fund strategies. The UCITS label is more and more requested by institutional investors. So we observe the creation of sophisticated UCITS platforms by investment banks welcoming US and UK hedge fund managers. Such players are keen to understand all the flexibilities offered by UCITS III and often discover that their main strategy is consistent with UCITS rules.

LFF: What is the potential impact of the proposed AIFM Directive on hedge funds in Luxembourg?

DP: The proposed Alternative Investment Fund Managers (“AIFM”) Directive will have a huge impact on the alternative investment industry in Luxembourg. In the current proposal, the distribution of offshore funds to professional investors will not be possible for a period of three years after its implementation. This could result in a positive impact on Luxembourg and could accelerate the re-domiciliation of offshore funds to the Grand Duchy.

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For many funds of hedge funds distributed cross-border, the “Luxembourg” branding was a crucial element in re-domiciliation.

However, the proposed directive is also the subject of a lot of discussion. The industry is widely criticising the political pressure around hedge funds and the lack of consultation during the drafting of this document. The final directive may be subject to significant modification, but could, in the end, represent a very good opportunity for Luxembourg.

LFF: Is re-domiciliation limited to products?

DP: The AIFM Directive will create a management company passport, as in UCITS IV. It is difficult to assess the impact of this management company passport but, if we consider the tax and regulatory environment, Luxembourg is in a good position to take advantage of it. Domiciling their management company in Luxembourg will allow hedge fund managers and other alternative investment fund managers to benefit fully from the flexibilities of the directive in terms of product and distribution, while benefiting from a secure, flexible, stable and business minded environment.

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The Luxembourg hedge fund regulation represents a good balance between investor protection and flexibility of investment rules.