

# Luxembourg Hedge Funds



# Why choose Luxembourg?

What Luxembourg has to offer to hedge fund promoters and investors.



## Political and social stability

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Legislative agility: a close working relationship between the business community, the Government and the legislator underpins the innovative legal framework of the Grand Duchy

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A knowledgeable and responsive regulator

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Strong culture of investor protection

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Tradition of financial expertise across all related professions

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Thorough client understanding across borders

## Multilingual and multicultural staff

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Unique concentration of investment fund industry experts in all aspects of product development, administration and distribution

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Extensive experience in technical investment fund solutions such as multiple share classes and pooling

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Fund lawyers and audit firms experienced at handling the cross-border registration of both UCITS and non-UCITS funds

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Ideally situated in the heart of Europe

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Pleasant working and living environment

# Preface

This brochure has been prepared jointly by Luxembourg for Finance (LFF) and the Association of the Luxembourg Fund Industry (ALFI) in order to provide general background information on the regulatory framework, basic legal requirements and taxation aspects of hedge funds in the Grand Duchy of Luxembourg.

For the purpose of this brochure the term "hedge funds" refers to so called "alternative investment funds" which can inter alia be characterised by the following criteria:

- use of alternative investment strategies;
- use of short selling, derivatives and increased leverage;
- pursuit of absolute returns, rather than measuring investment performance relative to a benchmark;
- charging performance-based fees in addition to a management fee based solely on assets under management;
- broader mandates than traditional funds which give managers more flexibility to shift strategy;
- usually use of the services of a prime broker that offers services such as custody of assets, trade execution, clearing and financing.

The choice of the most appropriate investment regime will depend on the targeted investor base, the type of investments to be made and specific distribution and tax considerations. Hedge funds in Luxembourg are regulated products. While offering a diverse and flexible legal and regulatory framework for a wide range of investor needs, Luxembourg-based hedge funds are supervised by the Luxembourg supervisory authority, the CSSF. Luxembourg-based service providers such as fund administrators, depositaries, auditors and lawyers have the appropriate expertise and tools to service hedge funds. Hedge funds may be domiciled and administered in Luxembourg but can also be located off-shore and have their administration in Luxembourg.

This brochure is not intended to be a comprehensive study. Readers should seek the advice of qualified professionals before making any decision as to the most appropriate Luxembourg hedge fund structure.

This document reflects the legal situation as at May 2009.

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# Luxembourg, a prime location for hedge funds

Luxembourg is the second largest investment fund centre in the world after the United States, the premier captive reinsurance market in the European Union and the premier private banking centre in the Eurozone. The financial sector is the largest contributor to the Luxembourg economy. Luxembourg is also an established European centre for hedge funds.

From its origins as a Eurobond domicile in the 1960s, the financial centre subsequently developed as a private banking centre and then, from the late 1980s, as a centre for investment funds.

The success of the financial centre is grounded in the social and political stability of the Grand Duchy and on a modern legal and regulatory framework that is continuously updated, inspired by regular consultation between the Government, the legislator and the private sector.

The legal and regulatory framework that has been created over the years, combined with Luxembourg's long-standing economic openness to the outside world, has attracted banks, insurance companies, investment fund promoters and specialist service providers from all over the world.

Over the last 20 years Luxembourg has built up its position as the most popular domicile for undertakings for collective investments in transferable securities (UCITS). Originally created as a retail product, UCITS funds are offered to the public, but also to corporate and institutional investors. Benefiting from a European passport UCITS funds may be easily marketed across the EU and beyond and have become one of the most successful globally accepted and trusted products in the field of investment funds. In Luxembourg, UCITS funds are regulated by the Law of 20 December 2002 on undertakings for collective investment (UCIs).

At the same time Luxembourg has developed a strong track record in alternative investment products and bespoke investment structures such as hedge funds and funds of hedge funds, private equity vehicles and real estate funds.

Whereas most Luxembourg alternative investment funds were in the past created as UCIs under Part II of the 2002 Law, the introduction of the specialised investment fund (SIF) in 2007 has successfully paved the path for a new generation of alternative investment funds for an international,

qualified investor base. A convergence of traditional hedge fund products and UCITS products has also become noticeable as more and more alternative investment strategies are implemented under the provisions of Part I of the 2002 Law (UCITS).

Supervised by a competent and proactive regulatory authority, the Luxembourg financial centre is characterised by a strong culture of investor protection and rigorous anti money laundering policies. The workforce is multilingual and multi-cultural, with a long tradition of financial expertise and extensive experience of the needs of an international clientele.

# The Luxembourg hedge fund market: facts and figures

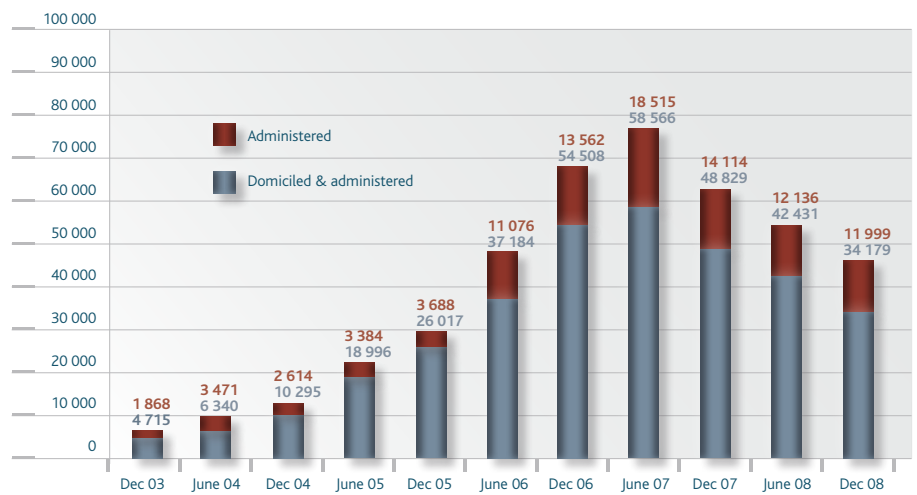
As at December 2008, the total Luxembourg investment fund market represented 1,559.6 billion euros held in 12,325 Luxembourg domiciled fund units, making Luxembourg the second largest fund centre in the world after the United States.

As at 31 December 2008, 46.2 billion euros of hedge funds assets were under administration in Luxembourg. This figure includes both funds that are domiciled in Luxembourg and funds that are domiciled elsewhere but administered in Luxembourg. Due to investor demand for regulated structures, Luxembourg has evolved into a domicile of choice. 74% of assets under management in hedge funds are held in funds that are both domiciled and administered in the Grand Duchy.

Luxembourg also has extensive expertise in the field of asset allocation which is evidenced by the fact that Luxembourg has 94 billion euros under administration in 1,451 fund of hedge fund units.

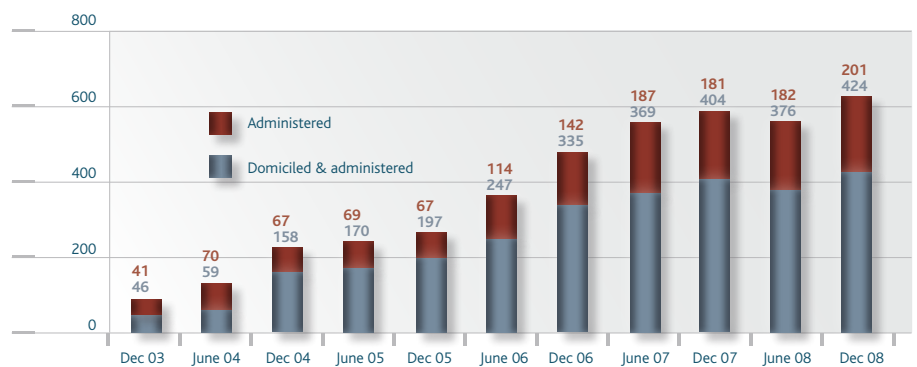
## Assets under administration in hedge funds in Luxembourg

EUR millions



Source: ALFI

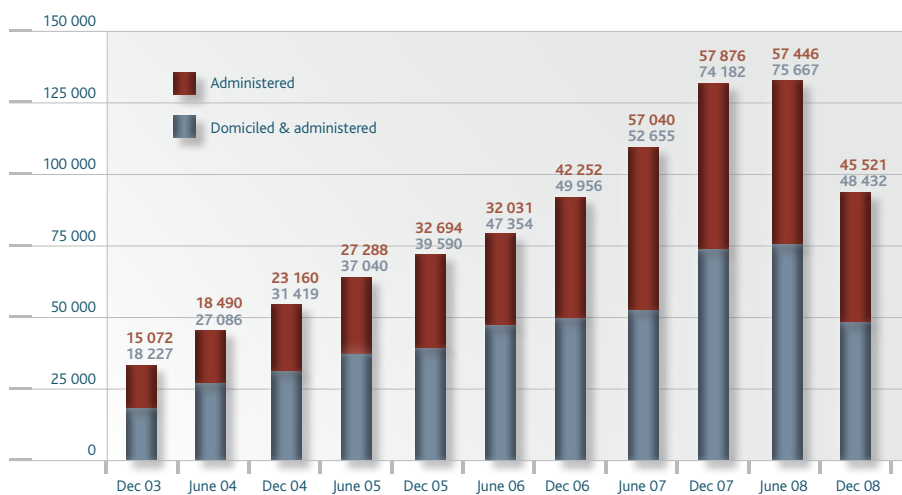
## Number of hedge fund units under administration in Luxembourg



Source: ALFI

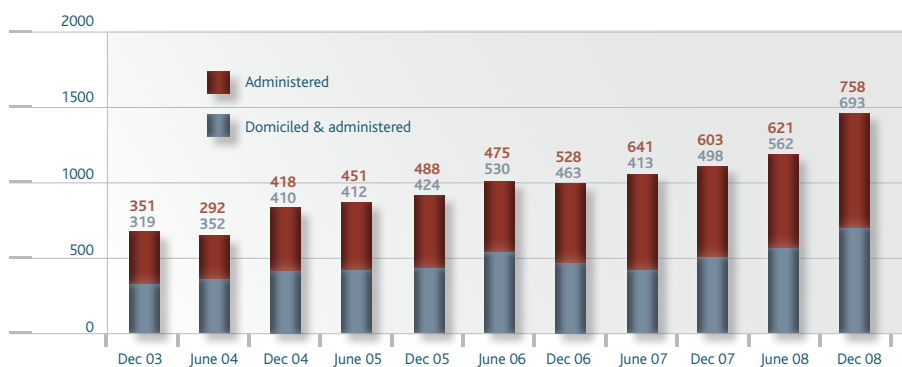
## Assets under management in funds of hedge funds administered in Luxembourg

EUR millions



Source: ALFI

## Number of fund of hedge fund units under administration in Luxembourg



Source: ALFI

# Legal and regulatory framework

Hedge funds can be set up under three different regimes:

- SIFs under the SIF Law
- UCIs under Part II of the 2002 Law
- UCITS under Part I of the 2002 Law

The choice will largely depend on the investment strategy selected and the targeted investor base. UCITS are subject to tighter regulation and the implementation of alternative investment strategies within the UCITS framework must be

in strict compliance with CESR guidelines. Thus, depending on their individual needs, promoters have the choice between more strongly regulated investment vehicles (UCITS and Part II UCIs) and more lightly regulated ones (SIFs).

## Overview of legal structures available for hedge funds

	SIF	Part II UCI	Part I UCITS
Applicable law	SIF Law	Part II of the 2002 Law	Part I of the 2002 Law
Eligible investors	Well-informed investors	Retail, institutional and professional investors	Retail, institutional and professional investors
Ease of set-up	CSSF approval required, but launch possible prior to approval. Approval application must be made within one month from creation of the SIF.	CSSF approval required; authorisation must be received prior to starting the activities of the UCI.	CSSF approval required; authorisation must be received prior to starting the activities of the UCITS.
Eligible assets	Unrestricted	Unrestricted	Detailed provisions according to CESR guidelines (CSSF Circular 08/339; Grand-Ducal Regulation of 8 February 2008)
Investment restrictions	No specific investment and borrowing restrictions, but flexible principle based risk diversification requirements.  Max. 30% of the SIF's assets can be invested in securities of the same type of the same issuer.	Yes  quantitative & qualitative (e.g. provisions of Part II of the 2002 Law, respectively provisions of CSSF Circular 02/80 on alternative investment strategies and CSSF Circular 08/356 on techniques and instruments relating to transferable securities and money market instruments have to be complied with).	Yes  quantitative & qualitative (e.g. provisions of Part I of 2002 Law and CSSF Circular 08/356 on techniques and instruments relating to transferable securities and money market instruments have to be complied with).



	SIF	Part II UCI	Part I UCITS
<u>Restrictions on borrowings</u>	No limitation in this respect indicated in the CSSF Circular 07/309.	<ul style="list-style-type: none"> <li>• Max. 200% of the fund's net assets (for directional strategies);</li> <li>• Max. 400% of the fund's net assets (for market neutral or relative value strategies for which short positions are covered by long positions).</li> </ul> Flexible approach by the CSSF	Borrowing for investment purposes is in principle prohibited, except that UCITS may borrow on a temporary basis up to 10% of their assets (but the use of derivatives may allow equivalent economic results).
<u>Risk management</u>	Although the CSSF does not systematically request to see the documentation with respect to the risk management procedure, there should be an appropriate risk management procedure in place.	While no specific legal and regulatory provisions are applicable, the CSSF nevertheless requires that an appropriate risk management procedure is in place.	Appropriate risk management procedure must be in place (CSSF Circular 07/308).
<u>Cross-border distribution</u>	No European passport; in principle, distribution on a private placement basis	No European passport; distribution on a private placement basis or via specific registration in third countries	Cross-border distribution via European passport
<u>Approval of promoter/initiator</u>	No	Yes (financial resources, experience, reputation)	Yes (financial resources, experience, reputation)
<u>Substance in Luxembourg/nationality or residency requirements</u>	Head office of SICAV/SICAF or management company of FCP in Luxembourg  No nationality /residency requirements for directors/managers	Head office of SICAV/SICAF or management company of FCP in Luxembourg  No nationality /residency requirements for directors/managers	Head office of SICAV/SICAF or management company of FCP in Luxembourg  No nationality /residency requirements for directors/managers
<u>Required service providers</u>	Depositary Central administration agent Auditor	Depositary Central administration agent Auditor	Depositary Central administration agent Auditor

	SIF	Part II UCI	Part I UCITS
<u>Approval of management</u>	Yes (experience, reputation)	Yes (experience, reputation)	Yes (experience, reputation)
<u>Possible listing</u>	Yes	Yes	Yes
<u>Minimum content of prospectus</u>	No specific content of prospectus prescribed by the SIF Law; must contain essential information enabling investors to make an informed judgment of the contemplated investment.	Yes Detailed provisions prescribed by the 2002 Law	Yes Detailed provisions prescribed by the 2002 Law
<u>Legal forms</u>	<ul style="list-style-type: none"> <li>• Investment company with variable capital (SICAV) to be incorporated as a:               <ul style="list-style-type: none"> <li>- public limited company (SA)</li> <li>- private limited company (Sàrl)</li> <li>- cooperative company organised as a public limited company (SCoSA)</li> <li>- partnership limited by shares (SCA)</li> </ul> </li> <li>• Investment company with fixed capital (SICAF) to be incorporated in various legal forms, such as e.g. a public limited company (SA) or a corporate partnership limited by shares (SCA)</li> <li>• Common fund (FCP)</li> </ul>	<ul style="list-style-type: none"> <li>• Investment company with variable capital (SICAV) to be incorporated as a public limited company (SA)</li> <li>• Investment company with fixed capital (SICAF) to be incorporated in various legal forms, such as e.g. a public limited company (SA) or a corporate partnership limited by shares (SCA)</li> <li>• Common fund (FCP)</li> </ul>	<ul style="list-style-type: none"> <li>• Investment company with variable capital (SICAV) to be incorporated as a public limited company (SA)</li> <li>• Investment company with fixed capital (SICAF) to be incorporated in various legal forms, such as e.g. a public limited company (SA) or a corporate partnership limited by shares (SCA)</li> <li>• Common fund (FCP)</li> </ul>
<u>Minimum capital/net assets</u>	Yes (EUR 1,250,000 to be reached within 12 months)	Yes (EUR 1,250,000 to be reached within 6 months)	Yes (EUR 1,250,000 to be reached within 6 months)

	SIF	Part II UCI	Part I UCITS
<u>Paid-up capital</u>	<ul style="list-style-type: none"> <li>• Possibility to issue partly paid shares in a SICAV/SICAF (up to 5% at least) and partly paid units in a FCP</li> <li>• Units/shares do not have to be issued or redeemed at NAV</li> </ul>	<ul style="list-style-type: none"> <li>• Possibility to issue partly paid shares in a SICAF (up to 25% at least) and partly paid units in a FCP</li> <li>• Units/shares have to be issued or redeemed at NAV, except in a SICAF</li> </ul>	<ul style="list-style-type: none"> <li>• Possibility to issue partly paid shares in a SICAF (up to 25% at least) and partly paid units in a FCP</li> <li>• Units/shares have to be issued or redeemed at NAV</li> </ul>
<u>Sub-funds</u>	Yes	Yes	Yes
<u>Multiple share classes, series</u>	Yes	Yes	Yes
<u>Issue/Redemption restrictions</u>	No (freely determined)	No (freely determined, but redemptions must be possible at least once a month)	No (freely determined, but redemptions must be possible at least twice a month)
<u>Restrictions on dividend distribution</u>	No (but not below minimum capitals/net assets)	No (but not below minimum capitals/net assets)	No (but not below minimum capitals/net assets)
<u>Exposure to prime broker</u>	<ul style="list-style-type: none"> <li>• Approval of SIF's choice of prime broker by the depositary (recognised and experienced financial institution subject to regulatory supervision equivalent to EU standards)</li> <li>• Appropriate organisation of the depositary-prime broker relationship (CSSF Circular 08/372)</li> </ul>	<ul style="list-style-type: none"> <li>• Initial and on-going due diligence by depositary on prime broker</li> <li>• Appropriate organisation of the depositary-prime broker relationship</li> <li>• The counterparty risk resulting from the difference between (i) the value of the assets transferred by the fund to the prime broker as security and (ii) the debt of the fund owed to the prime broker may not exceed 20% of the assets of the fund</li> </ul>	<ul style="list-style-type: none"> <li>• Initial and on-going due diligence by depositary on prime broker</li> <li>• Appropriate organisation of the depositary-prime broker relationship</li> <li>• Counterparty risk in relation to OTC derivative transactions may not exceed 10% or 5% of the fund's assets</li> <li>• Max. 20% of the fund's assets invested in deposits with the same body</li> <li>• Combined limit of 20% for: <ul style="list-style-type: none"> <li>- investments in transferable securities or money market instruments issued by the same body</li> <li>- deposits with a single body</li> <li>- exposure arising from OTC derivative transactions undertaken with a single body</li> </ul> </li> </ul>



	SIF	Part II UCI	Part I UCITS
<u>Reporting requirements</u>	Yes (annual report)	Yes (semi-annual and annual report + NAV calculation at least once a month)	Yes (semi-annual and annual report + long-form report + NAV calculation at least twice a month)
<u>Fixed registration duty</u>	Yes (EUR 75 upon incorporation)	Yes (EUR 75 upon incorporation)	Yes (EUR 75 upon incorporation)
<u>Capital duty</u>	Abolished as of 1 January 2009	Abolished as of 1 January 2009	Abolished as of 1 January 2009
<u>Subscription tax</u>	Yes (0.01% of net assets, except exemptions)	Yes (0.05% of net assets, except exemptions or reduced rate, i.e. 0.01%)	Yes (0.05% of net assets, except exemptions or reduced rate, i.e. 0.01%)
<u>Corporate income tax and municipal business tax</u>	No	No	No
<u>Withholding taxes (on dividends)</u>	No (except if EU savings directive is applied)	No (except if EU savings directive is applied)	No (except if EU savings directive is applied)
<u>Double tax treaties benefit</u>	Yes, depending on treaty	Yes, depending on treaty	Yes, depending on treaty

# Glossary

<u>2002 Law</u>	Law of 20 December 2002 on undertakings for collective investment, as amended
<u>FCP</u>	<i>Fonds commun de placement</i> (common investment fund), an unincorporated co-ownership of assets managed by a management company
<u>SA</u>	<i>Société anonyme</i> (public limited company)
<u>Sàrl</u>	<i>Société à responsabilité limitée</i> (private limited company)
<u>SCA</u>	<i>Société en commandite par actions</i> (partnership limited by shares)
<u>SCoSA</u>	<i>Société coopérative organisée comme une société anonyme</i> (cooperative company organised as a public limited company)
<u>SCS</u>	<i>Société en commandite simple</i> (limited partnership)
<u>SICAF</u>	<i>Société d'investissement à capital fixe</i> (investment company with fixed capital)
<u>SIF Law</u>	Law of 13 February 2007 on specialised investment funds
<u>SICAV</u>	<i>Société d'investissement à capital variable</i> (investment company with variable capital)
<u>UCI</u>	Undertaking for collective investment
<u>UCITS</u>	Undertaking for collective investment in transferable securities
<u>CESR</u>	Committee of European Securities Regulators
<u>CSSF</u>	<i>Commission de Surveillance du Secteur Financier</i> , the Luxembourg financial supervisory authority
<u>CSSF Circular 07/309</u>	CSSF Circular of 3 August 2007 on risk-spreading in the context of specialised investment funds (SIFs)



<u>CSSF Circular 07/308</u>	CSSF Circular of 2 August 2007 on rules of conduct to be adopted by UCITS with respect to the use of a method for the management of financial risk, as well as the use of derivative financial instruments
<u>CSSF Circular 08/339</u>	CSSF Circular of 19 February 2008 regarding guidelines of the Committee of European Securities Regulators (CESR) concerning eligible assets for investment by UCITS
<u>CSSF Circular 08/356</u>	CSSF Circular of 4 June 2008 regarding rules applicable to undertakings for collective investment when they employ certain techniques and instruments relating to transferable securities and money market instruments
<u>Well-informed Investor</u>	<p>institutional investor, professional investor or any other investor who meets the following conditions:</p> <ul style="list-style-type: none"><li>a) he has confirmed in writing that he adheres to the status of well-informed investor, and</li><li>b) (i) he invests a minimum of 125,000 Euro in the specialised investment fund, or</li><li>(ii) he has been the subject of an assessment made by a credit institution within the meaning of Directive 2006/48/EC, by an investment firm within the meaning of Directive 2004/39/EC or by a management company within the meaning of Directive 2001/107/EC certifying his expertise, his experience and his knowledge in adequately appraising an investment in the SIF.</li></ul>

# Luxembourg for Finance

Agency for the Development of the Financial Centre

Luxembourg for Finance is a public-private partnership between the Luxembourg Government and the Luxembourg Financial Industry Federation (PROFIL). It consolidates the efforts made by the public authorities and principal actors of the financial sector to ensure the development of an innovative and professional financial centre through a coherent and structured communications policy.

Thus Luxembourg for Finance will enhance the external presentation of the financial centre, communicating the advantages of its products and services to a wider public and highlighting the numerous opportunities available to investors and clients, whether institutional or private, from around the world.

Luxembourg for Finance organises seminars in international financial centres and takes part in selected world class trade fairs and congresses.

The agency also develops its contacts with opinion leaders from international media and is the first port of call for foreign journalists.



## Luxembourg for Finance

Agency for the Development of the Financial Centre

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