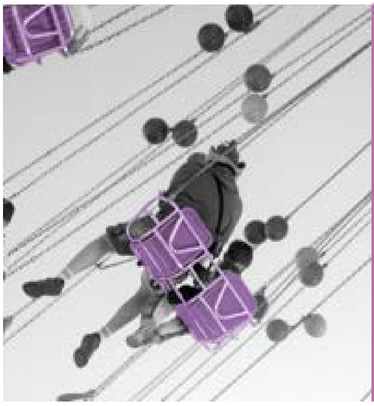

From our Hong Kong Office

May 2020

FAQ on Luxembourg funds and investment vehicles

Introduction

Companies and investors in Asia are investing in a variety of assets worldwide and, in particular, in Europe. Those companies and investors are selecting the domicile of their investment structures based on a series of criterias including the efficiency of th vehicle in terms of control, distribution, co-management, possible exit strategies, cross-border tax implications, etc and the ease of building the substance thereof in order to benefit from neuture tax treatment.

From setting up their holding vehicles in traditional offshore *centres, such as the British Virgin Islands, the Cayman Islands, etc., they are increasingly looking for* onshore options and *onshore partners. Luxembourg, as one of the major cross-border fund domiciles, a unique gateway to access the European market and host to numerous institutions, has become their jurisdiction of choice.*

Luxembourg offers a wide variety of non-regulated and regulated funds and investment vehicles, with various names, often acronyms derived fromtheir name in French, which might be complex to navigate.

We have therefore prepared this short note as a Frequently Asked Questions (FAQ) on Luxembourg vehicles, based on our experience of advising clients in the region.

The content of our FAQ should not be understood as an exhaustive and legal description of each vehicle, but rather a brief summary of the main features thereof, and the reasons for which clients typically choose those structures, based on the questions that we usually receive from them.

What are the main Luxembourg investment vehicles and what are the available corporate structures?

The Luxembourg tool-box offers three families of investment vehicles: (i) regulated retail funds (**UCITS** and **UCI**), (ii) regulated non-retail funds (**SIF** and **SICAR**) and (iii) non-regulated funds and vehicles (**RAIF**, **SLP** and **SOPARFI**), we will review each of them in the following paragraphs.

Those families of investment vehicles comprise vehicles which may take the form of a corporate structure, or of an unincorporated structure. UCITS, UCI, SIF and RAIF can be incorporated or unincorporated, whereas SICAR and SOPARFI are necessarily corporate structures and the SLP is necessarily unincorporated.

For those vehicles which may take the form of a corporate structure, Luxembourg company laws typically allow to choose among different type of company forms, such as the public limited company (*société anonyme* or S.A.), the private limited company (*société à responsabilité limitée* or S.à r.l.), or the corporate partnership limited by shares (*société en commandite par actions* or S.C.A.) or the common limited partnership (*société en commandite simple* or S.C.S.) to name a few.

Based on the brief overview above, one realizes that there is a very large number of options. However, the nature of the investment and purpose of the vehicle will narrow that choice to typically one or two options. We have summarized the main questions below.

When do I use a UCITS versus other type of vehicles, what are the main features to have in mind?

UCITS stands for **Undertaking for Collective Investments in Transferable Securities**.

A UCITS is a regulated retail investment fund that meets the criteria laid down by EU Directives to be eligible for sale in EU Member States to retail investors on the basis of a European passport. UCITS are recognized worldwide as sound investment vehicles for retail distribution and are accepted in Europe, but also in South America, the Middle East, Asia, etc.

A UCITS can only invest in **liquid transferable securities** and must be open to redemption at least twice a month. As a matter of principle, a UCITS cannot invest in non-listed securities, real estate, commodities, precious metals, etc. UCITS are subject to very strict **asset eligibility and diversification** requirements (e.g. no more than 10% of the AuM concentrated on the same issued).

Managers setting up UCITS are looking for the **ease of distribution** and **scalability** of that type of fund, in particular, the possibility to sell it on a **passport** basis to retail and institutional investors **in EU Member States**.

UCITS are highly regulated by the Luxembourg regulator, the CSSF, and can be regarded as high maintenance funds, requiring a sizable AuM, typically above EUR 100 million, in order to be economically viable.

UCITS can be setup as public limited companies or unincorporated structures. The default choice would be the **public limited company** (*société anonyme* or S.A.), with **variable share capital** and with the possibility to **create sub-funds** under the same umbrella (*see below for more details*).

A large number of Asian managers have setup UCITS funds and implemented Asia strategies therein to be distributed worldwide.

When do I use UCI versus other type of vehicles, what are the main features to have in mind?

UCI stands for **Undertaking for Collective Investments**.

UCIs are regulated Luxembourg domestic retail investment funds, which are not governed by EU Directives, but by Luxembourg laws only.

Unlike UCITS which can only invest in liquid transferable securities, a UCI can invest in **non-listed securities**, **real estate**, etc. and can implement **hedge fund strategies** or **private equity and venture capital** strategies.

UCIs are subject to principle based **asset eligibility** and **diversification** requirements.

UCIs do not benefit from the UCITS passport, although they may benefit from the AIFMD passport through their manager if it is an AIFMD compliant manager (*see below for more details*).

UCIs are highly regulated by the CSSF and can be regarded as high maintenance funds, requiring a sizable AuM, typically above EUR 50 million, in order to be economically viable.

UCIs are the only retail regulated vehicles which can invest in the above mentioned asset classes. Since the adoption of the Specialized Investment Funds (SIF) regime in 2007, UCI are less frequently used.

Similarly to UCITS, UCIs can be setup as corporate or unincorporated structures, umbrella or stand alone.

When do I use a SIF or a SICAR versus other type of vehicles, what are the main features to have in mind?

SIFs and SICARs are regulated non-retail funds, which provide flexible fund structures to invest in a variety of asset classes for qualified investors only. SIFs and SICARs can be open-ended or close-ended.

SIF stands for **Specialized Investment Fund** and is a regulated, operationally flexible and efficient multipurpose investment vehicle for qualified investors (defined as **Well-Informed Investors**).

SIFs are characterised by a great flexibility and no particular restrictions as to the type of assets it can invest in, a regulatory regime adapted for Well-Informed Investors and a principle based risk spreading requirement (30% diversification).

SIFs have been setup for investments in traditional assets including private equity and real estate (PERE) and other illiquid investments, as well as atypical assets like life insurance policies, timber, art, cars, etc.

Managers would typically setup a SIF for PERE investments as a corporate vehicle, such as an S.C.A. or an SLP structure, and appoint their wholly-owned subsidiary as the general partner (GP) thereof. For other purposes, the SIF may be setup as a public limited company, the initiator thereof keeping the control by appointing the board members.

SICAR which stands for **investment company in risk capital**, is a structure designed specifically for investment in risk and venture capital.

SICARs are subject to a different set of rules compared to the SIF, in particular tax rules. SICARs do not require to invest in a diversified portfolio as a SIF is expected to.

Both the SIF and the SICAR are regulated and therefore supervised by the CSSF, which may be of interest to European based institutional investors (such as pension funds, insurance companies, etc.) which have to invest in vehicles which are regulated.

Being regulated, SIFs and SICARs can be regarded as medium maintenance funds, requiring typically above EUR 80 million of AuUM in order to be economically viable.

SIFs and SICARs may benefit from the AIFMD passport through their manager if it is an AIFMD compliant manager (*see below for more details*).

When do I use a RAIF versus other type of vehicles, what are the main features to have in mind?

RAIF, which stands for **reserved alternative investment fund**, is a non-regulated fund for professional investors.

RAIFs allow managers to setup a fund with the broadest flexibility in terms of vehicle, combining the legal and tax features of the well-known and tested SIFs or SICARs, without the vehicle being regulated and subject to the supervision of the CSSF.

The main advantages of the RAIF are the **flexibility** thereof, the **absence of direct regulatory oversight** in relation to the fund vehicle as such, the possibility to structure the RAIF as an **umbrella vehicle** (with legally ring-fenced sub-funds and shares/units or partnership interests classes having different features), **ease and speed of the setup process**, **familiarity of investors** with the structures available to setup a RAIF (corporate or unincorporated), the possibility to structure the RAIF with multiple sub-funds and the upfront **AIFMD** compliance.

The only requirements are that (i) a **RAIF must appoint a duly authorised AIFM**, (ii) the **investment restrictions** of either the SIF (30% diversification) or the SICAR (investment in risk capital) must be complied with.

Most sponsors will setup RAIFs to implement PERE strategies, as well as hedge funds or generally alternative investment strategies.

Being non-regulated, but still indirectly subject to the AIFMD, RAIFs can be regarded as medium maintenance funds, requiring AuM typically above EUR 50 million, in order to be economically viable.

RAIFs benefit from the AIFMD passport through their manager (*see below for more details*).

When do I use a limited partnership structure such as the SLP versus other type of vehicles, what are the main features to have in mind?

The special limited partnership (*société en commandite spéciale* or SLP) has been introduced by the law of 12 July 2013 implementing the AIFMD with the purpose of providing the same flexibility as its Anglo-Saxon counterparts, while being an onshore vehicle with possible AIFMD compliance from a European perspective.

As for its Anglo-Saxon equivalent, the Luxembourg SLP is established by a contract between LPs whose liability are limited to their contributions and at least one GP liable for the SLP's obligations.

The SLP offers a number of features sought after by alternative investment fund managers, e.g. among others (i) the flexibility of a contractual vehicle, (ii) full control over the vehicle by the GP, (iii) full tax transparency, (iv) the possibility to replicate in an onshore vehicle all the features of your usual offshore LP structure, (v) confidentiality, (vi) capital accounting, etc.

GPs typically setup SLP structures when there is no requirement for a regulated vehicle and their investors are comfortable / familiar with Anglo-Saxon LP structures.

Being non-regulated, SLPs can be regarded as low maintenance funds, requiring AuM typically above EUR 30 million, in order to be economically viable.

An onshore SLP structure will help in distributing partnership interests or units to EU based investors through an AIFM.

When do I use a SOPARFI versus other types of vehicles, what are the main features to have in mind?

A **SOPARFI** is a Luxembourg company that holds financial participations in other taxable companies.

SOPARFIs are plain vanilla corporate structures, which may be set up in the form of private limited company (*société à responsabilité limitée*), public limited company (*société anonyme*) or corporate partnership limited by shares (*société en commandite par actions*), and subject to the legal provisions of the law of 10 August 1915 on commercial companies,as amended.

SOPARFIs benefit from certain tax exemptions on dividends, capital gains and liquidation proceeds derived from qualifying participations.

Being a plain vanilla corporate entity, a SOPARFI will also grant access to the parent subsidiary directive in the EU as well as the double tax treaty network of Luxembourg (including treaties with the People's Republic of China, Hong Kong S.A.R., Japan, South Korea, Singapore to only name a few).

SOPARFIs are typically used for the acquisition of selected assets in and outside the EU, by itself or in combination with tax transparent or tax exempt vehicles such as SIFs, RAIFs or SLP structures.

If I have the choice between a corporate vehicle or an unincorporated vehicle, which one should I choose?

UCITS, UCIs, SIFs and RAIFs, can be setup as investment companies with variable capital (SICAV) or, and with the exception of UCITS, as investment companies with fixed capital (SICAF). In a SICAV, the share capital increases and decreases automatically as a result of the subscriptions and redemptions of the investors, with no need for any further formality while SICAFs require a formal decision to increase or reduce the share capital in accordance with the requirements applicable to regular companies (which makes SICAFs less attractive except in very specific circumstances).

Both SICAVs and SICAFs offer protection to investors limiting their liability to the amount invested in or committed to the fund. The fact that the members of the governing body in a SICAV or a SICAF are elected by the shareholders, *i.e.* the investors, creates a risk that such members may then also be removed by the investors in a takeover of the structure.

UCITS, UCIs, SIFs and RAIFs can be setup as a common fund (*fonds commun de placement* or FCP). An FCP has no legal personality. It is an undivided co-ownership of assets that proves to be a very flexible vehicle as it is not subject to any specific corporate law requirements. Despite its flexibility, an FCP still offers the protection to investors limiting their liability to the amount invested in or committed to the FCP. An FCP is necessarily managed by a management company (whether a Luxembourg management company or, in some cases, a foreign management company).

A fund structured as an FCP offers the possibility to be protected from hostile takeovers as investors usually do not have voting rights (except if otherwise provided in the management regulations of the FCP).

SIFs and RAIFs can also be setup as SLP, *i.e.* a true contractual limited partnership, with the entire control in the hands of a GP, itself controlled by the initiator. The SLP offers a similar protection against hostile takeovers as the FCP.

It is worthwhile noting that the above corporate and contractual structures may be used in combination with a SOPARFI for tax efficiency.

Is it possible to structure sub-funds under your Luxembourg fund?

Laws governing UCITS, UCIs, SIFs, SICARs and RAIFs permit the creation of funds as stand-alone funds or umbrella funds with different sub-funds, where each sub-fund corresponds to a distinct portfolio of assets and liabilities of the fund. The different sub-funds may thus accommodate different investment policies, strategies or target investors, while offering segregation of the assets and liabilities of each sub-fund recognised by law.

Umbrella funds also typically offer the possibility of cross-investment between sub-funds allowing you, under certain conditions, to develop synergies between your various sub-funds.

One or more classes of shares or units or partnership interests may be created in your stand-alone fund or in each sub-fund of your umbrella fund. The classes of shares or units or partnership interests typically feature a different distribution policy, different currencies, hedging or fees structure.

When do I fall under UCITS rules and when do I fall under the AIFMD rules?

In order to be a UCITS, an investment vehicle must be domiciled in an EU Member State, such as in Luxembourg, be compliant with all UCITS requirements and opt-in to qualify as a UCITS, and be approved as such by a relevant regulator, such as the CSSF.

On the other hand, a fund manager or a fund may fall in the scope of the AIFMD without opting into the AIFMD regime. Under the AIFMD, an alternative investment fund (**AIF**) is broadly defined as an investment fund that is not a UCITS and therefore covers any type of investment fund irrespective of their domicile.

Furthermore, the manager of an AIF which is active in Europe through fundraising may fall within the scope of the AIFMD, irrespective of its location.

What does it mean to have a fund regulated by the CSSF in practice?

Funds that are regulated by the CSSF such as UCITS, UCIs, SIFs and SICARs must be approved by the CSSF prior to being offered to investors.

The file to be submitted to CSSF for assessment normally includes (i) the draft constitutive documents of the fund, (ii) the draft prospectus, (iii) the main agreements with service providers in draft form, (iv) background of the proposed directors of the fund, (v) evidence of the investment manager's experience, (vi) financial statements of the investment manager for the last three financial years, (vii) a confirmation of supervision issued by the regulatory authority of the investment manager.

Once approved the regulated fund structure is registered on an official list held by the Luxembourg regulator and available on its website.

Changes to be made to the constitutive documents, prospectus, composition of the governing body, appointed investment manager, etc. must be approved by the Luxembourg regulator prior to being implemented.

For UCITS and AIFs having appointed a management company or AIFM of a third party service provider, a change in relation to such a management company or AIFM must also be reviewed by the CSSF prior to being implemented.

Furthermore, major corporate actions (such as a merger, a liquidation, etc.) must be approved before implementation by the CSSF as well.

The timeframe for the setup of a Luxembourg regulated fund is typically two to three months from the initial filing to the approval by the CSSF.

What are the requirements for the appointment of management company, AIFM, depositary bank, auditor, administrator and other service providers?

Except for managers having their own human and technical infrastructure (either UCITS or AIFMD compliant) a management company or AIFM will be required should the fund have to be UCITS or AIFMD compliant and have access to the European passport.

Non-UCITS fund structures such as UCIs, SIFs, SICARs can consider not appointing an AIFMD compliant management company if they do not envisage to make use of the AIFMD passport and if their AuM do not exceed EUR 100 million or EUR 500 million if the fund is unleveraged.

RAIFs have to appoint an authorised AIFM, as a rule.

Funds following the UCITS rules or appointing an fully AIFMD compliant management company must as a rule appoint a depositary bank which must be approved by the CSSF. The depositary bank must either have its registered office in Luxembourg or be established in Luxembourg if its registered office is in another EU Member State.

Luxembourg based regulated funds shall have their central administration (which comprises the activities in relation to the calculation of the NAV, keeping of the shareholders/unitholders/partners register, organizing of the general meetings, sending the relevant notices to investors, etc.) established in Luxembourg.

Luxembourg based regulated funds will also have to appoint an independent auditor which will be in charge of reporting on the activities of the fund (financial and organizational aspects) and providing reports to the CSSF.

AIFs created in the form of a SOPARFI or a SLP are not required to appoint an AIFMD compliant management company, a depositary bank, administrator, unless they wish to make use of the AIFMD marketing or management passport or if their AuM exceed EUR 100 million or EUR 500 million if the fund is unleveraged, etc. although they may be required to appoint an auditor by their organic rules.

Is it necessary to have your own physical office in Luxembourg and local directors?

Your Luxembourg vehicle needs to have its domicile in Luxembourg, *i.e.* a corporate address.

There is no requirement under Luxembourg laws to appoint national or local resident to the board of the governing body of the fund or investment vehicle, whether regulated or not, although, such requirements exist at the level of the UCITS or AIFMD compliant management company should one be appointed.

However, it is recommended to grant the structure the necessary substance in Luxembourg and in any event regularly hold proper physical board meetings in Luxembourg and in certain cases have a physical office, employees and local directors/managers.

What are the requirements for fund distribution in Europe?

UCITS can be distributed to all types of EU investors including retail, professional and institutional investors on the basis of the UCITS European passport, by which a UCITS can be sold to any EU Member States based on a simple notification procedure.

Authorised EU AIFMs benefit from a similar European passport for marketing EU AIFs to professional investors in the EU since July 2013. Marketing to retail investors in EU Member States may be authorized according to local private placement regimes.

Is it possible to delegate the portfolio management function to the local portfolio manager?

UCITS management companies and AIFMs may delegate the portfolio management function to portfolio manager located in the EU or outside the EU subject to certain conditions, the main condition being that the local portfolio manager be locally regulated. Sub-delegations are also possible at the same conditions.

The UCITS management company and AIFMs will at all times remain responsible for the proper performance of their functions and compliance with the rules set out in the relevant laws by their delegates.

As your Luxembourg legal adviser, we will ask you a number of preliminary questions before setting up your investment structure.

1) what is the **purpose of the vehicle**, whether it is designed for holding one particular investment or specifics investments, or is it rather a fund?

2) what will be the **nature of the investments** of the vehicle, are they securities of private companies, real estate, other type of illiquid assets or listed securities?

3) what is the **location of those investments**, whether those investments will be located in Europe or in other parts of the world?

4) what is the expectation in terms of **distribution of the fund**, do you anticipate having a series of investors in the structure, are you planning on distributing the fund's shares in Europe or not?
5) what is the **anticipated volume of the assets under management (AuM), cash flows and fee structure** of the vehicle and its managing bodies?

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