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CSSF publishes circular on the authorisation and organisation of Luxembourg management companies subject to chapter 15 of the law of 2010 on UCIs and investment companies which have not designated a management company.

We would like to inform you that the *Commission de Surveillance du Secteur Financier* (the "**CSSF**") has released on 26 October 2012 a new circular CSSF 12/546 (the "**Circular**") on the authorisation and organisation of Luxembourg management companies subject to Chapter 15 of the law of 17 December 2010 on undertakings for collective investment ("**UCIs**") and investment companies which have not designated a management company (*i.e.* self-managed investment companies or *sociétés d'investissement autogérées*, also known as "**SIAG**"). The scope of application of this Circular extends to branches and representative offices which have been established abroad.

This new Circular replaces the CSSF circulars 03/108 and 05/185 applicable to Luxembourg management companies and SIAG and incorporates the recent Circular 11/508.

As indicated below, the Circular implements various changes impacting the CSSF's regulatory practice and also provides for additional clarifications on a range of topics.

1. Board of Directors

- With respect to the composition of the board of directors, the Circular specifies that, where a bank is a shareholder of a management company and where this bank assumes the function of depositary bank for one or more fund(s) managed by the management company, it must be ensured that the board of directors of the management company is not predominantly composed of representatives of the business line "depositary bank".

In addition, in the case of a SICAV having appointed a management company, it is recommended that the board of directors of each of the two entities is not predominantly composed of the same individuals.

- Further, the Circular requires that every member of the board of directors of the management company dedicate the required time and attention to his or her duties. Consequently, each and every member of the board shall ensure that he or she limits the

number of other professional engagements (e.g. other mandates in other companies) as may be necessary to properly perform his or her tasks.

2. Conducting persons / Comité de Direction

- The requirements in relation to the appointment of two conducting persons remain to a large extent unchanged. Such conducting persons must, in principle, reside on a permanent basis in Luxembourg (as long as this allows them, in principle, to commute to Luxembourg on a daily basis). Indeed, the conducting persons are the contact point for the CSSF, which must have the possibility of reaching them directly while the conducting persons must be in turn able to supply the CSSF with all necessary information.

Having regard to the nature, scale and complexity of the activities of the management company, the CSSF may nevertheless agree, through a duly supported request for derogation made in advance, that only one of the conducting persons of the management company shall permanently reside in Luxembourg.

- The CSSF continues to require that the different areas of responsibility (e.g. risk management, portfolio management, central administration and custodian, compliance, internal audit) be allocated to different conducting persons responsible for the entrusted functions. The CSSF nonetheless specifies that any potential conflict of interest should be avoided in the allocation of the different functions (e.g. the functions of risk-taking (portfolio management) and the independent control of these same risks shall not be assigned to the same conducting person).

- With respect to internal organisation, the conducting persons shall establish a “Comité de Direction” (the “Management Committee”). The Management Committee is responsible for the fulfilment of the purpose of the management company as far as day-to-day business is concerned. The Committee shall work in accordance with a method of operation adapted to the activities of the management company and its members shall work in close relationship to take all actions falling within the scope of their responsibilities.

In particular, the conducting persons shall be in regular contact with each other and hold periodic meetings. More specifically, these meetings shall be formalised in written minutes, available at the offices of the management company in Luxembourg. The agenda of these periodic conducting persons' meetings includes, amongst other things, a discussion on the management information which is clarified in the Circular.

In addition, it is required that the Management Committee regularly inform the board of directors, exhaustively and in writing, on the activities of the management company and the UCITS/UCIs managed.

- The Circular further gives guidelines on the responsibilities borne by the Management Committee. In particular, the Management Committee formed by the conducting persons is responsible for:

- implementing strategies and guidelines regarding central administration and internal governance through written and detailed internal policies and processes;
- implementing appropriate internal control mechanisms (*i.e.* permanent compliance function, permanent internal audit function, permanent risk management function);
- ensuring that necessary technical infrastructures and human resources are at the disposal of the management company;

- implementing the general investment policy of each UCITS;
 - supervising the adoption of investment strategies for managed UCITS;
 - implementing an appropriate risk management policy;
 - implementing the marketing policy and distribution network of each UCITS/UCIs managed.
- The CSSF does not expect the conducting persons to conduct the management company's activity alone but requires that such conducting persons be supported by enough qualified staff working in Luxembourg.
 - The above aspects are also applicable to the management board in the case where the management company has adopted a dual structure.

3. Shareholders

- Specific requirements may arise where one shareholder or member who has a qualifying holding in the management company is a depositary bank of one of the investment funds managed by the management company.

The Circular provides that the management company must identify all potential conflicts of interest which may arise from this holding and must strive to avoid them in accordance with the procedures provided for in the conflicts of interest policy of the management company.

In addition, and as mentioned above, the board of directors of the management company shall not be predominantly composed of representatives of the business line "depositary bank".

- The Circular also provides that the CSSF may now require a letter of intent (from the main shareholder(s) or member(s) with a qualifying holding in the entity to be authorised) in which the issuer undertakes to ensure that the entity to be authorised as a management company complies with the prudential requirements, notably those relating to own funds.

4. Own Funds

- The CSSF requires that the minimum own funds be put at the permanent disposal of the management company and be available in case of need.

The Circular now clarifies that it is permissible for own funds to be invested in liquid assets or assets easily convertible into liquid short term assets, to the extent that they do not contain any speculative positions.

5. Central administration and internal governance

a) A decision-making centre in Luxembourg

- Every management company must have a head office in Luxembourg, consisting of a "decision-making centre" and an "administrative centre". This implies that the management company must have its own office in Luxembourg.

b) Procedures and policies

- The CSSF reserves the right to demand a copy of certain procedures and other policies at any time (e.g., procedures relating to personal transactions, conflicts of interest policy,

strategy for the exercise of voting rights, procedures, arrangements and policies regarding rules of conduct).

- The following specifications apply to management companies with respect to specific procedures and policies. Notably, the Circular requires that:
 - the strategy for the exercise of voting rights be regularly updated;
 - each management company must communicate to the CSSF a list of third parties authorised to handle complaints and an annual report indicating the number of complaints filed by investors, the reason for these complaints as well as the progress made in handling them.This statement must be obtained by the CSSF one month after the ordinary general meeting that approved the annual accounts of the management company.

- The Circular recalls that, so as to promote sound and effective risk management, every management company must implement a remuneration policy in conformity with CSSF Circular 10/437.

6. Delegation

- The Circular expressly authorises management companies to delegate one or several tasks to third parties (the “delegates”) under certain conditions:
 - the management company must verify and monitor that the delegates have taken suitable measures so as to comply with the requirements in the areas of organisation, conflicts of interest and rules of conduct set out in the CSSF Regulation 10-4. The management company must effectively monitor the compliance with these requirements by the delegate. Especially, in the case of a delegation of the portfolio management and/or the administration, including the maintenance of the register of unitholders, to a third party, the management company must monitor continuously from the start of the relationship that every delegate has suitable electronic systems in order to satisfy the requirements of Articles 8, 9, 15 and 16 of Regulation 10-4. In particular, arrangements shall be implemented which allow the conducting persons and the staff to control and access the data documenting the activities performed by the delegates.

- However, the Circular provides the following non-exhaustive list of the specific tasks the management company cannot delegate:
 - the determination of the general investment policy for each UCITS not having taken the form of a company;
 - the fixing, where applicable together with the board of directors of the UCITS having taken the form of a company, of the risk profile of each managed UCITS;
 - the interpretation of analyses of risk management, including corrective measures which may be necessary, as the case may be;
 - the implementation and monitoring of a conflicts of interest policy;
 - the implementation and monitoring of a best execution policy;
 - in the absence of a representative price, to ensure that the governing bodies of the UCITS have taken a decision relating to the determination of the probable realisation value estimated with care and in good faith and to give the governing bodies of the UCITS the necessary support for this kind of decision;
 - the decision regarding the choice of service providers to be appointed; and
 - the monitoring and control of delegated functions.

7. Risk Management

a) Permanent risk management function

- As a matter of principle, the permanent risk management function cannot be exercised by a member of the board of directors of the management company.
- On the contrary, and in accordance with the principle of proportionality, one of the conducting persons of the management company may also be directly appointed as the person responsible for the permanent risk management function provided that he or she has the necessary qualifications, knowledge and expertise in the area.

However, the conducting person responsible for the oversight of the risk management may not be responsible for the oversight of the portfolio management at the same time, even in case the portfolio management has been delegated to a third party, and the risk management function cannot be performed by the person responsible for the internal audit function.

On the contrary, it shall be permitted to carry out the permanent risk management function and the permanent compliance function at the same time.

- A regular report assessing the adequacy and effectiveness of the risk management must be submitted to the CSSF at least once a year and at the latest one month after the ordinary general meeting having approved the annual accounts of the management company. This report may take the form of a consolidated report covering all the UCITS managed by the management company.

b) Risk management process

The Circular indicates that an update of the risk management process must be provided to the CSSF at least once a year and at the latest one month after the closing date of the financial year of the management company. If there are significant amendments to the risk management process (e.g. new financial products), the management company must update the risk management process and inform the CSSF by submitting an up-to-date version of this document.

The management company must also provide the CSSF at least once a year at the closing date of its financial year with a report detailing the financial derivative instruments used, the underlying risks, the quantitative limits and the methodologies chosen for evaluating the risks linked to these transactions.

8. Permanent compliance and internal audit functions

- Each management company must establish permanent compliance and internal audit functions. Each management company may apply the principle of proportionality in the establishment of such functions (e.g. delegate one or both functions). Nonetheless, this does not entitle the management company to have no compliance and internal audit functions.
- The CSSF confirms that the permanent compliance and internal audit functions cannot be cumulated by the same natural person and that these functions cannot be performed by a member of the board of directors of the management company.

In addition, the Circular clarifies that where the permanent compliance and the permanent internal audit functions have been delegated, these functions may not be monitored by the same natural person.

- The compliance and internal audit functions must take into account the activities of the management company's branches, representative offices, agencies and subsidiaries (where applicable).
- Both functions must provide the CSSF with an annual report which must be delivered at the latest one month after the ordinary general meeting that approved the annual accounts of the management company.

9. IT- infrastructure and Business Continuity Plan

- Every management company must have in its office a suitable technical and IT infrastructure for its activity.
- However, distinct requirements apply to management companies which exercise one or several functions included in the activity of collective portfolio management and management companies which have delegated one or more of these functions to one or several third parties.

10. Principle of proportionality

- The Circular recalls that management companies may invoke the principle of proportionality in the application of certain requirements set forth in the CSSF Regulation 10-4.
- In addition, the Circular expressly mentions that the principle of proportionality may apply to the organisation of the compliance, internal audit and risk management functions, subject to a prior and motivated application; it being understood however, that, under no circumstances may the principle of proportionality be invoked so as not to implement the abovementioned functions.
- Every management company may also, with respect to the general requirements regarding procedures and organisation, the clarifications on the operating staff of a management company and the conflicts of interest policy, take into account the nature, scale and complexity of its activity, as well as the nature and range of services and activities undertaken.
- With respect to SIAGs below, the Circular allows such principle of proportionality to apply to the organisation of its permanent risk management function, though it may nonetheless not lead to the non-implementation of such function.

11. SIAG

- The CSSF insists on the fact that every SIAG must respect the majority of requirements in the areas of organisation, rules of conduct, conflicts of interest and risk management which are also applicable to management companies (e.g., the provisions of the Circular relating notably to the letter of intent, the board of directors / governing bodies, the complaints handling, the permanent risk management function and risk management process, the remuneration policy, the conflicts of interest policy, the rules of conduct and the delegation, with the exception of the administration function).

In particular, it is worth noting that every SIAG must not only have its registered office in Luxembourg but also its decision-making centre and its administrative centre as mentioned above, which implies that it must have its own office in Luxembourg.

12. Transitional provisions

- Every management company existing at the moment of the entry into force of this Circular has until 30 June 2013 to comply with the provisions relating to the use of own funds, management bodies, to the provisions relating to central administration as well as to the rules of delegation.
- Also, every SIAG existing at the moment of the entry into force of this Circular has until 30 June 2013 to comply with the provisions relating to the management bodies as well as to the rules of delegation. Furthermore, it must take the necessary measures to implement a decision-making centre and an administrative centre in Luxembourg.

Arendt & Medernach are at your disposal should you need to implement any of these new measures relating to Luxembourg management companies or investment companies which have not designated a management company.

For further information please contact:



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