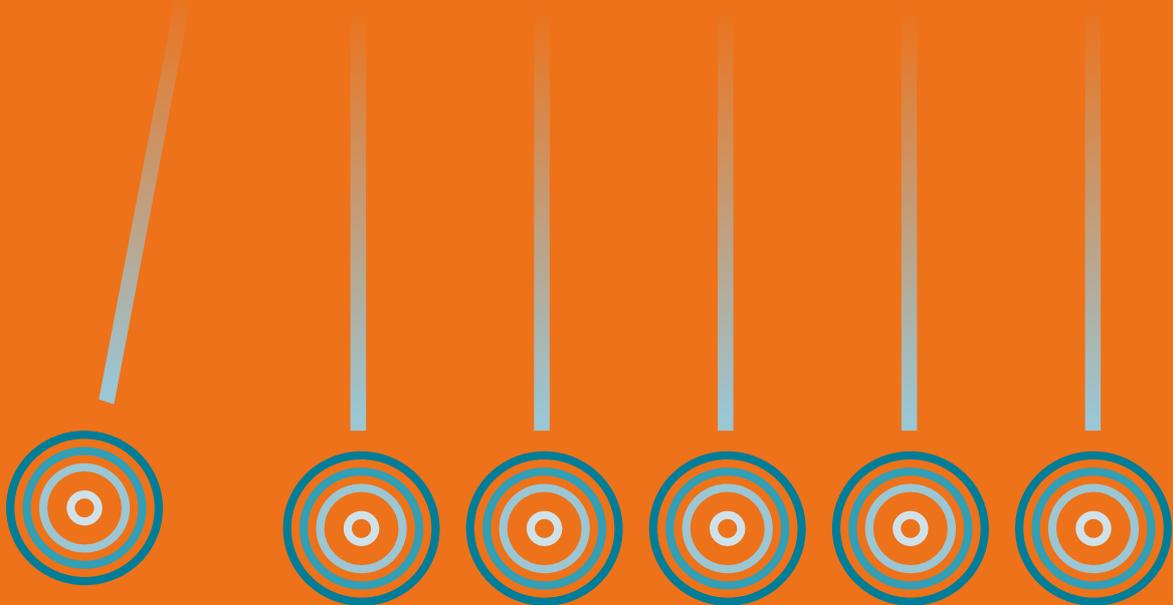




association of the  
luxembourg fund industry

| **hedge funds**

# Luxembourg Hedge Funds



## why luxembourg ?

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- Political, legal and fiscal stability
- State-of-the-art legal and regulatory environment
- High regulatory and investor protection standards
- Solid financial sector supervision
- Rapid and innovative responses to new trends
- Highly international, in terms of origin of financial institutions and fund promoters, clients, population and workforce
- Diversified offer of financial products and services
- Europe's number one investment fund centre
- Unique concentration of investment fund industry experts in all aspects of product development, administration and distribution
- Unrivalled know-how in cross-border investment funds business
- Top-notch market infrastructure for securities trading, clearing and settlement



This brochure has been prepared by the Association of the Luxembourg Fund Industry (ALFI) in order to provide general background information on the legal and taxation aspects of regulated hedge fund vehicles domiciled in the Grand Duchy of Luxembourg.

For the purpose of this brochure the term “hedge fund” refers to “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;
- Broader mandates than traditional funds in order to give managers more flexibility to shift strategy and adapt portfolio composition;
- Usually recourse to a prime broker offering services such as custody of assets, trade execution, clearing and financing.

The choice of the most appropriate investment regime will depend on the target investor base, the type of investments to be made and specific distribution and tax considerations.

Hedge funds in Luxembourg are commonly 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.

Luxembourg based service providers have teams specialising in servicing the hedge fund industry and offer a wide range of customised services in fund and investment structuring, fund administration, custody and audit services.

*This brochure is not intended to be a comprehensive study. ALFI cannot be held responsible for any errors or omissions or for the results obtained from the use of the information contained in this brochure. 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 of November 2014.



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With 3,900 funds, some 13,700 units and assets under management of more than EUR 3,000 billion at the end of September 2014, Luxembourg is Europe's leading and the world's second largest investment fund domicile (after the United States). The Luxembourg fund centre is the prime location for pan-European and global distribution of Undertakings for Collective Investment in Transferable Securities (UCITS).

Drawing on the success of the UCITS brand, Luxembourg has been able to build up a similar track record in alternative funds, including hedge funds and funds of hedge 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 longstanding economic openness to the outside world, has attracted banks, insurance companies, investment fund promoters and specialist service providers from all over the world.

Whereas most Luxembourg alternative investment funds were in the past created as Undertakings for Collective Investment (UCIs) under Part II of the 2010 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 a qualified international 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 2010 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 following regulatory frameworks can accommodate hedge fund products:

- SIFs under the SIF Law;
- UCIs under Part II of the 2010 Law;
- UCITS under Part I of the 2010 Law.

SOPARFIs under the Companies law (1915) are not commonly used and therefore not explored in more detail in the brochure.

The choice will largely depend on the investment strategy selected and the target investor base. UCITS are subject to more stringent regulation and the implementation of alternative investment strategies within the UCITS framework must be in strict compliance with guidelines of the European Securities and Markets Authority (ESMA). Thus, depending on their individual needs, promoters have the choice between regulatory regimes adapted to the strategy and target investor base.

In addition, those hedge funds which do not qualify for one of the exemptions provided for under the Alternative Investment Fund Managers Directive (AIFMD) will have to comply with the provisions of the AIFMD and the implementing legislation.

The AIFMD (the Directive) sets requirements which must be met by alternative investment fund managers (AIFM) and which cover authorisation, capital, marketing, organisation, remuneration, conduct of business, conflicts of interest, delegation and transparency. Specific provisions cover the use of leverage and acquisition of major holdings and control. In return for more regulation of the AIFM, their service providers and the alternative investment funds (AIFs) managed by the AIFMs, the Directive provides for the introduction of a pan-European passport enabling AIFM to offer their management services and to market their AIFs throughout the European Economic Area (EEA).

Although the Directive is in place to regulate primarily AIFMs and indirectly the AIFs they manage, all major stakeholders are affected: managers, investors and service providers. The harmonised distribution regime is an opportunity that will make hedge funds a more widely accessible and attractive asset class than before. It is expected that, over a period of time, the Directive will establish a quality “AIF brand” for AIFMD-compliant funds, comparable to the UCITS brand established by the UCITS Directive for traditional retail funds.

Luxembourg transposed the Directive into law with the Law of 12 July 2013 on Alternative Investment Fund Managers (the Law). However, the Luxembourg regulated hedge fund “products” formed under the SIF Law or Part I or Part II of the 2010 Law already display many of the features that has now become standard under AIFMD. Luxembourg aims at duplicating the Luxembourg UCITS success story in the area of alternative investment funds.

## Overview of legal structures available for hedge funds

	SIF	PART II UCI	PART I UCITS
Applicable law	SIF Law	Part II of the 2010 Law	Part I of the 2010 Law
Eligible investors	Well-informed investors	Retail, institutional and professional investors	Retail, institutional and professional investors
Ease of set-up	CSSF approval required; authorisation must be received prior to starting the activities 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 ESMA 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 issued by the same issuer.	Yes  quantitative & qualitative (e.g. provisions of Part II of the 2010 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 2010 Law and CSSF Circular 08/356 on techniques and instruments relating to transferable securities and money market instruments have to be complied with).
Restrictions on borrowings	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).
Risk management	Appropriate risk management procedures must be 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 Regulation 10-04, CSSF Circular 11/498, CSSF Circular 11/512 and CSSF Circular 12/546).
Cross-border distribution	No European passport; in principle, distribution on a private placement basis unless AIFMD passport applies.	No European passport; distribution on a private placement basis or via specific registration in other countries unless AIFMD passport applies.	Cross-border distribution via European passport within the European Economic Area (EEA).
Approval of promoter/initiator	No	Yes  (financial resources, experience, reputation)	No
Substance in Luxembourg/nationality or residency requirements	Central administration must be in Luxembourg.  No residency requirements for directors/managers.	Central administration must be in Luxembourg.  No residency requirements for directors/managers.	Central administration may be in any EU/EEA country.  In principle, two managers resident in Luxembourg unless foreign UCITS ManCo.

## chapter II - legal and regulatory framework

	SIF	PART II UCI	PART I UCITS
Required service providers	Depository, Central Administration Agent, Auditor	Depository, Central Administration Agent, Auditor	Depository, Central Administration Agent, Auditor
Approval of management	Yes (experience, reputation)	Yes (experience, reputation)	Yes (experience, reputation)
Possible listing	Yes	Yes	Yes
Minimum content of prospectus	No specific content of prospectus prescribed by the SIF Law; must contain essential information enabling investors to make an informed judgement of the contemplated investment.	Yes Detailed provisions prescribed by the 2010 Law.	Yes Detailed provisions prescribed by the 2010 Law.
Legal forms	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> <li>■ Limited partnerships (SCS and SCSp);</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> </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>
Minimum capital/net assets	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)
Paid-up capital	<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);</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);</li> <li>■ Units/shares do not have to be issued or redeemed at NAV.</li> </ul>
Sub-funds	Yes	Yes	Yes
Multiple share classes, series	Yes	Yes	Yes
issue/redemption restrictions	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 once a month)

	SIF	PART II UCI	PART I UCITS
Restrictions on dividend distribution	No (but not below minimum capital/ net assets)	No (but not below minimum capital/ net assets)	No (but not below minimum capital/ net assets)
Exposure to prime broker	<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: <ul style="list-style-type: none"> <li>- the value of the assets transferred by the fund to the prime broker as security and</li> <li>- the debt of the fund owed to the prime broker may not exceed 20% of the assets of the fund.</li> </ul> </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>
Reporting requirements	Yes (annual report)	Yes (semi-annual and annual report+ NAV calculation at least once month)	Yes (semi-annual and annual report+ NAV calculation at least twice a month)
Fixed registration duty	Yes (EUR 75 upon incorporation)	Yes (EUR 75 upon incorporation)	Yes (EUR 75 upon incorporation)
Capital duty	No	No	No
Subscription tax	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%)
Corporate income tax and municipal business tax	No	No	No
Withholding taxes (on dividends)	No (except if EU savings directive is applied)	No (except if EU savings directive is applied)	No (except if EU savings directive is applied)
Double tax treaties benefit	Yes depending on treaty	Yes depending on treaty	Yes depending on treaty

## appendix I - outline of available legal forms

	SA	SARL	SCA	SCS	SCSp	FCP
<b>Key features</b>	Commonly used	Commonly used as special purpose vehicle (SPV)	Convenient for fund initiators who want to retain control over the management	Tax transparent vehicle Convenient for fund initiators who want to retain control over the management Formed by written agreement High contractual freedom	No legal personality Tax transparent vehicle Convenient for fund initiators who want to retain control over the management Formed by written agreement High contractual freedom	No legal personality Tax transparent vehicle Not governed by the Companies Law Formed by written agreement High contractual freedom
<b>Minimum capitalisation (at incorporation/launching)</b>	EUR 31,000	EUR 12,500	EUR 31,000	No requirement	No requirement	No requirement
<b>Shareholding</b>	One or more limited shareholders (no upper limit)	One or more limited shareholders (no more than 40)	One or more unlimited shareholders and several limited shareholders (no upper limit)	One or more unlimited partners and one or more limited partners (no upper limit)	One or more unlimited partners and one or more limited partners (no upper limit)	One or more unitholders (no upper limit)
<b>Liability</b>	Shareholders are liable up to the amount committed	Shareholders are liable up to the amount committed	Unlimited shareholders are indefinitely, jointly and severally liable Limited shareholders are liable up to the amount committed	Unlimited partners are indefinitely, jointly and severally liable Limited partners are liable up to the amount committed	Unlimited partners are indefinitely, jointly and severally liable Limited partners are liable up to the amount committed	Unitholders are liable up to the amount committed
<b>Form of shares/units</b>	Dematerialised, bearer <sup>1</sup> or registered form	Registered form only	Dematerialised, bearer <sup>1</sup> or registered form	Registered form only	Registered form only	Dematerialised, bearer <sup>1</sup> or registered form
<b>Transfers of shares</b>	No restriction	Transfers to non-shareholders subject to the prior approval of the shareholders	No restriction	Transfers not allowed unless authorised by the limited partnership agreement (LPA) or approved by all the partners	Transfers not allowed unless authorised by the LPA or approved by all the partners	As set forth in the Management Regulations

<sup>1</sup> The future immobilisation of all bearer shares was initiated by the Luxembourg law dated 28 July 2014.

	SA	SARL	SCA	SCS	SCSp	FCP
<b>Listing</b>	Yes	No	Yes	No	No	Yes
<b>Management</b>	By a board of directors or by a management board supervised by a supervisory board	By one or several managers	By the general partner Unlimited shareholder acts as general partner	By the general partner or an external manager	By the general partner or an external manager	By the Management Company (chapter 15 or chapter 16 of the UCI Law)
<b>Amendment to constitutive documents</b>	By a quorum representing at least 1/2 of the share capital and a 2/3 majority of shareholders	By a majority in number of the shareholders representing at least 3/4 of the share capital	By a quorum representing at least 1/2 of the share capital and a 2/3 majority of shareholders, including the general partner	By all the partners, unless otherwise provided in the LPA	By all the partners, unless otherwise provided in the LPA	As set forth in the Management Regulations

<b>Glossary of terms</b>	<b>AIFMD</b>	Directive 2011/61/EU on Alternative Investment Funds Managers
	<b>CSSF</b>	<i>Commission de Surveillance du Secteur Financier</i> (the Luxembourg Financial supervisory authority)
	<b>CSSF Circular 07/308</b>	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
	<b>CSSF Circular 07/309</b>	CSSF Circular of 3 August 2007 on risk-spreading in the context of specialised investment funds (SIFs)
	<b>CSSF Circular 08/339</b>	CSSF Circular of 19 February 2008 regarding guidelines of the Committee of European Securities Regulators (CESR) concerning eligible assets for investment by UCITS
	<b>CSSF Circular 08/356</b>	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
	<b>CSSF Circular 11/512</b>	CSSF Circular of 30 May 2011 on risk management in the context of UCITS funds
	<b>CSSF Circular 12/546</b>	CSSF Circular 12/546 of 24 October 2012 on Chapter 15 Management Companies and self-managed UCITS
	<b>CSSF Regulation 10-04</b>	CSSF Regulation 10-04 of 22 December 2010 implementing Directive 2010/43/EU
	<b>EEA</b>	European Economic Area
	<b>ESMA</b>	European Securities and Markets Authority - Committee of European Securities Regulators
	<b>FCP</b>	<i>Fonds Commun de Placement</i> (common investment fund), an unincorporated co-ownership of assets managed by a management company
	<b>LPA</b>	Limited Partnership Agreement
	<b>NAV</b>	Net Asset Value
	<b>SA</b>	<i>Société Anonyme</i> (public limited company)
	<b>Sàrl</b>	<i>Société à Responsabilité Limitée</i> (private limited company)
	<b>SCA</b>	<i>Société en Commandite par Actions</i> (partnership limited by shares)
	<b>SCoSA</b>	<i>Société Coopérative organisée comme une Société Anonyme</i> (cooperative company organised as a public limited company)
	<b>SCS</b>	<i>Société en Commandite Simple</i> (limited partnership)
	<b>SCSp</b>	<i>Société en Commandite Spéciale</i> (limited partnership)

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<b>SICAF</b>	<i>Société d'Investissement à Capital Fixe</i> (investment company with fixed capital)
<b>SICAV</b>	<i>Société d'Investissement à Capital Variable</i> (investment company with variable capital)
<b>SIF</b>	Specialised Investment Funds
<b>SIF Law</b>	Law of 13 February 2007 on Specialised Investment Funds, as amended
<b>SPV</b>	Special purpose vehicle
<b>UCI</b>	Undertaking for Collective Investment
<b>UCI law or 2010 Law</b>	Law of 17 December 2010 on undertakings for collective investment, as amended
<b>UCITS</b>	Undertaking for Collective Investment in Transferable Securities
<b>Well-informed Investor</b>	<p>Institutional investor, professional investor or any other investor who meets the following conditions:</p> <ul style="list-style-type: none"> <li>a) investor has confirmed in writing that he adheres to the status of well-informed investor, and</li> <li>b) (i) investor invests a minimum of EUR 125,000 in the specialised investment fund, or (ii) investor 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 investor's expertise, experience and knowledge in adequately appraising an investment in the SIF.</li> </ul>

*November 2014*  
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