

## **IML CIRCULAR 91/75 OF 21ST JANUARY, 1991**

**Revision and remodelling of the rules to which Luxembourg undertakings governed by the Law of 30th March, 1988 on undertakings for collective investment (“UCI”) are subject to**

This circular repeals and replaces IML circular 88/48 of 8th April, 1988 and the former circulars which remained applicable to UCIs following the entry into force of the prementioned Law of 30th March, 1988.

The circulars thus repealed in addition to IML circular 88/48 of 8th April, 1988, are circulars VM 47 of 7th August, 1978, VEF 48 of 7th November, 1978, IML 84/12 of 8th March, 1984, IML 84/13 of 9th March, 1984, IML 84/15 of 30th March, 1984, IML 85/23 of 25th March, 1985 and IML 88/47 of 5th April, 1988.

In accordance with its objective of clarification and simplification, the main object of this circular is to adapt and to specify the rules of the repealed circulars in light of the acquired experience during the practical application thereof and to reproduce the thus revised rules in one single text with the following summary:

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CSSF CIRCULAR 2000/8 OF 15TH MARCH, 2000

## **CHAPTER A.**

### **PURPOSE AND SCOPE OF THE LAW OF 30TH MARCH, 1988.**

The purpose of the Law of 30th March, 1988 is the protection of the investor who is canvassed by promoters the activity of which is the collection of funds in order to invest them collectively in accordance with the principle of risk-spreading.

In accordance with its objective, the Law of 30th March, 1988 determines the legal and regulatory frame in which this activity may be exercised and pursuant to which it is submitted to the supervision of the *Commission de Surveillance du Secteur Financier* (“CSSF”)43 which is the supervisory authority.

The exercise of the activity subject to the Law of 30th March, 1988 is exclusively restricted to those undertakings which qualify as UCIs in accordance with the definition given in Chapter B hereafter; it follows from there that such activity, if exercised in Luxembourg, must be considered as illegal where it is exercised without the scope of this Law.

On the other hand, an undertaking which in practice, does not meet the conditions for application of the Law of 30th March, 1988 may not claim the status of a UCI by voluntarily submitting to the provisions of the Law.

## **CHAPTER B.**

### **DEFINITION OF THE MEANING OF UCI**

#### **I. Criteria by which the meaning of UCI is being defined.**

In order to qualify as an activity governed by the Law of 30th March, 1988, it is required, and it suffices, that the following conditions are cumulatively met:

- the collective investment of savings;
- the savings used for collective investment must have been collected from the public;
- the investment which forms the object of the collective investment must be made in accordance with the principle of risk-spreading.

Collective investment of savings shall be taken to mean the collective investment of funds collected individually from the public. This investment may be made in transferable securities or other assets. The objective is to obtain a yield or a capital gain. Hence the objective of UCIs is not to acquire an interest for a purpose beyond that of obtaining a yield, namely to secure influence or even control. Furthermore, the holding of such an interest entails a long term holding objective, whereas for UCIs the retention of assets in the portfolio only depends upon the yield or the capital gains potential thereof. By way of exception, certain types of UCIs, such as those investing in venture capital, may sometimes acquire more substantial interests in companies of which they hold shares and even intervene in the management of such companies by the appointment of one or several representatives to the board of directors.

Such involvement, however, does not have control as an objective but is dictated by the particular nature of the investments of such undertakings.

The public is canvassed where the collection of funds assigned to collective investment is not restricted to a small circle of persons only.

In respect to the principle of risk-spreading, the purpose of its application is to prevent an excessive concentration of the investments which are the subject of the collective investment.

The above specified criteria of definition are common to all categories of UCIs provided for by the Law of 30th March, 1988. Indeed, depending upon the category to which they belong, UCIs governed by the Law of 30th March, 1988 only differ from one another by their legal form or by their collective investment objective.

## **II. Practical application of the criteria retained for the definition of the meaning of UCI.**

In principle there is no problem to appreciate whether the conditions for application of the Law of 30th March, 1988 are met in case of common funds (“FCP”) and investment companies with variable capital (“SICAV”). In case of undertakings which do not have the legal form of common fund or SICAV, it is however sometimes difficult in practice to determine whether the Law of 30th March, 1988 is applicable to them or not. In such case, the supervisory authority will in the first instance rely on the definition criteria set out in the preceding Section I. in order to determine whether such undertakings do or do not meet the required conditions for UCI qualification.

If the review of the application file based on these criteria is not sufficient to conclude with the necessary certainty as to whether the Law of 30th March, 1988 is applicable, further elements will have to be taken into account such as the organisation and the general structure of such undertakings, i.e. the systematic redemption of shares, the existence of an investment advisory company, the charging of commissions on the purchase of securities in such undertakings and for the management thereof.

Thus, in application of the preceding principles, financial investment companies set up with the purpose of control, are excluded from the scope of application of the Law of 30th March, 1988 because their activity is not the collective investment of savings. The same applies to family holding companies and investment clubs which, even though their objective is the collective investment of savings, do not collect savings from the public.

## **CHAPTER C.**

### **CLASSIFICATION OF THE UCIs SITUATED IN LUXEMBOURG**

A UCI shall be deemed to be situated in Luxembourg if the registered office of the management company of the common fund or the registered office of the investment company is situated in Luxembourg. UCIs situated in Luxembourg will be referred to hereafter as Luxembourg UCIs. Depending on their characteristics, Luxembourg UCIs will be subject either to Part I or Part II of the Law of 30th March, 1988.

This classification permits to distinguish between

- undertakings within the meaning of Council Directive 85/611/EEC of 20th December, 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (the “85/611/EEC Directive”); and - the other undertakings which do not fall within the scope of application of the 85/611/EEC Directive. The consequences of this distinction are more fully specified in section III. hereafter.

#### **I. Definition of the UCIs governed by Part I of the Law of 30th March, 1988.**

Part I of the Law of 30th March, 1988 applies to all undertakings for collective investment in transferable securities (“UCITS”) which are defined as being UCIs the exclusive object of which is the investment in transferable securities.

Considering this definition, the criteria which determines whether a UCI is subject to Part I or Part II of the Law of 30th March, 1988, is the intended investment objective. If the undertaking invests in transferable securities, it is subject to Part I, save for the exceptions commented in section II. hereafter.

UCITS subject to Part I of the Law of 30th March, 1988 are of the open-ended type, since the rules to which they are subject to provide for the obligation to directly or indirectly redeem their units or shares at the request of the investors.

## **II. Definition of the UCIs governed by Part II of the Law of 30th March, 1988.**

Part II of the Law of 30th March, 1988 applies to all UCIs the principal object of which is the investment in securities other than transferable securities and to all UCITS excluded from Part I.

In its Article 2, the Law of 30th March, 1988 provides for exceptions to the basic rule reproduced in section I. above, by excluding from the scope of application of Part I certain categories of UCITS. That is the transposition in national law of the corresponding provisions of the 85/611/EEC Directive.

The following types of UCITS are concerned by this exclusion:

### ***1. UCITS of the closed-ended type.***

These UCITS can be defined by distinguishing them from open-ended UCITS which directly or indirectly redeem their units or shares at the request of investors.

The reimbursement to investors after a decision of the management bodies is not tantamount to a redemption if such reimbursement occurred without any request from investors which would have been based on a right to request redemption.

If the securities issued by UCITS of the closed-ended type are redeemed at the request of investors after a certain date, such undertaking shall fall within the scope of application of Part I of the Law of 30th March, 1988 from such date onwards, unless it belongs to one of the other categories of UCITS described in paragraphs 2. to 4. hereafter. In case this feature is established at inception, the prospectus must from the outset attract the investors' attention to that fact and to the eventual consequences thereof, *inter alia* on the investment policy.

A UCITS, the constitutional documents of which provide for the right of investors to request redemptions, cannot qualify as being of the closed-ended type and as such fall outside the scope of application of Part I of the Law of 30th March, 1988, upon the grounds that it provides for limitations on the exercise of such right. As a UCITS subject to the provisions of Part I, it must relinquish such limitations insofar as their purpose is to subject the exercise of the right to redeem to conditions and procedures which render redemptions practically impossible or unnecessarily and arbitrarily complicated or provide for unnecessary and arbitrary intervals.

### ***2. UCITS which raise capital without promoting the sale of their units or shares to the public within the European Union (“EU”)<sup>44</sup> or any part of it.***

The exclusion from Part I of the Law of 30th March, 1988 does not dispense the UCITS concerned from the condition of the collection of public savings which all undertakings must comply with in order to qualify as UCI; it simply prohibits the UCITS in question to engage in any promotional activity within the EU; the terms “promotional activity” refer in particular to the use of advertisement methods such as press, radio, television or advertisement circulars. It does however not refer to offers for subscription which are addressed to a limited, particularly knowledgeable circle of investors such as pension funds and insurance companies.

It follows from the above that the UCITS concerned hereby are those which, even though they are addressed to the public, renounce to any promotional activity within the EU.

***3. UCITS the units or shares of which may, under their constitutional documents, only be sold to the public in countries which are not members of the EU.***

To this category belong UCITS the units or shares of which are listed on the Luxembourg Stock Exchange and which market those units or shares solely outside the EU.

The supervisory authority does not interfere in the delimitation of the scope of application. The exclusion only operates at the condition that the management regulations or the articles of incorporation of these UCITS provide expressly that the sale of their units or shares is limited to the public of countries which are not members of the EU.

***4. Categories of UCITS determined by the supervisory authority for which the rules laid down in Chapter 5 of the Law of 30th March, 1988 are inappropriate in view of their investment and borrowing policies.***

UCITS covered by this exclusion belong to one of the following categories:

4.1. Undertakings the investment policy of which provides for the investment of 20% or more of their net assets in venture capital. Investment in venture capital shall be taken to mean investment in securities of companies which have been recently constituted or which are still in the early development stage.

4.2. Undertakings the investment policy of which provides for the investment of 20% or more of their net assets (other than liquid assets) in securities other than the transferable securities provided for in Article 40 (1) of the Law of 30th March, 1988.

4.3. Undertakings the investment policy of which provides for the permanent borrowing for investment purposes of at least 25% of their net assets.

4.4. Undertakings the investment policy of which provides for the investment of 20% or more of their net assets in other open-ended UCIs.

4.5. Undertakings the investment policy of which provides for the investment of 20% or more of their net assets in money market instruments and liquid assets (including any regularly negotiated money market instruments the residual maturity of which does not exceed 12 months) other than the transferable securities provided for in Article 40 (1) of the Law of 30th March, 1988.

4.6. Undertakings the investment policy of which provides for the investment of 50% or more of their net assets in liquid assets.

4.7. Multiple compartment undertakings, one compartment of which is not subject to Part I of the Law of 30th March, 1988 by reason of its investment or borrowing policy.

### **III. Status of UCITS (Part I) and of other UCIs (Part II) in the European context.**

For the regulation of UCITS subject to it, Part I of the Law of 30th March, 1988 takes as a basis the provisions of the 85/611/EEC Directive. Consequently, these UCITS conform to the entirety of the requirements of those provisions. They thus benefit from the status of EU UCITS which gives them the right to freely market their units or shares in the whole of the territory of the EU.

UCIs, other than UCITS governed by Part I of the Law of 30th March, 1988, may not rely upon the marketing facilities provided for by the 85/611/EEC Directive since they are excluded from the scope of application thereof. Consequently, where such UCIs wish to market their units or shares in other countries of the EU, they must comply with the specific conditions to which the authorities of the countries concerned may, as the case may be, subject the authorisation of UCIs which do not have the status of EU UCITS.

## **CHAPTER D.**

### **RULES CONCERNING THE CENTRAL ADMINISTRATION OF LUXEMBOURG UCIs.**

Under the provisions of the Law of 30th March, 1988, the central administration of any Luxembourg UCI must be situated in Luxembourg. This requirement must ensure that the supervisory authority, the depositary and the auditor may easily perform their respective legal duties.

#### **I. Definition of the meaning of central administration in Luxembourg.**

The legal requirement that central administration be situated in Luxembourg implies *inter alia* that:

- the accounts must be kept, and the accounting documents must be available, in Luxembourg;
- issues and redemptions must be carried out in Luxembourg;
- the register of participants must be kept in Luxembourg;
- the prospectus, financial reports and all other documents intended for investors must be established in cooperation with the central administration in Luxembourg;
- the correspondence, dispatch of financial reports and of all other documents intended for shareholders or unitholders must be carried out from Luxembourg and in any case under the responsibility of the central administration in Luxembourg;
- the calculation of the net asset value must be carried out in Luxembourg.

It appears from the preceding enumeration that the meaning of central administration in Luxembourg exclusively includes accounting and administrative functions. It therefore neither excludes the possibility for Luxembourg UCIs to obtain assistance for the management of their assets from investment advisors established abroad nor does it prevent that the decisions in relation with that management (investment and disinvestment decisions) are made and executed elsewhere than in Luxembourg.

#### **II. Organisation of the central administration in Luxembourg.**

A Luxembourg UCI or its management company, where it is made up in the form of a common fund, is not obliged to perform itself the tasks connected to the accounting and administrative duties of the central administration in Luxembourg.

By a service contract, it may indeed entrust to a third party established in Luxembourg the exercise of those duties which essentially concern the execution of the tasks set out in section I. above. Upon the condition that a division of such tasks is not detrimental to the satisfactory performance of the central administration, this third party may delegate the execution of specific tasks to one or more other providers of services established in Luxembourg subject to it ensuring the coordination, general supervision and liability therefore.

It is also conceivable that a Luxembourg UCI may by separate service agreements organise itself the division of tasks connected to the duties of central administration amongst various providers of services established in Luxembourg provided that it must, in such case, be in the position to coordinate and supervise itself the execution of such tasks unless it entrusts such mission to a duly qualified agent. Such agent then becomes the contact of the *CSSF* in its relationship with the central administration of the relevant UCI.

In both cases, the division of tasks connected to the duties of central administration must not result in an excessive parcelling which renders the exercise of the coordination and general supervisory function difficult if not impossible or which unnecessarily increases costs by unjustified overlapping.

For the reasons mentioned above, it is therefore recommended not to provide for too complicated and costly constructions or structures.

On the basis of the above, the *CSSF* considers that tasks as intimately connected as the execution of issues and redemptions and the keeping of the register of participants may only be entrusted to one single provider of services. The *CSSF* considers furthermore that it is not conceivable to have different providers of services execute jobs relating to the same task. Thus for instance, it is not admissible to have more than one provider of services perform the execution of the necessary tasks in relation to the keeping of the accounts.

In organising its relationship with the depositary of the UCI which it administers, the central administration in Luxembourg must, by the operation of appropriate procedures, ensure the satisfactory performance of information circuits and information flow necessary to obtain upon request from the depositary all information and data required in order to establish the position of the assets and liabilities of the UCI and to calculate net asset value.

The UCI, in case it ensures itself its own administration, or the providers of services which may be appointed therefore, must have the necessary infrastructure in Luxembourg i.e. sufficient human and technical means in order to accomplish the entirety of the tasks connected to the duties of central administration in Luxembourg. This implies the localisation in Luxembourg of equipment and material used by the central administration as technical support for the execution of its duties.

### **III. Execution of the accounting and administrative duties referred to by the meaning of central administration in Luxembourg.**

#### ***1. Keeping of the accounts, calculation of the net asset value and availability of basic documentation relating to the UCI and its operations.***

Where the central administration in Luxembourg uses a remote-access computing network as technical support for the execution of the tasks connected to the keeping of the accounts

and/or the calculation of the net asset value (such as operations necessary for the valuation of the portfolio of securities, the determination of the amount of income generated by such portfolio and the conversion in the currency of account of the UCI of assets denominated in another currency), the requirement of localisation in Luxembourg of the equipment and material necessary for the operation of such administration does not exclude that the unit which is intended to ensure the processing of accounting and other information which is entered in the network used may be situated elsewhere than in Luxembourg.

The possible location abroad of the processing unit is however subject to the following conditions:

- the central administration must have at its disposal in Luxembourg necessary means to enter information in the processing unit of the remote-access computing network used and to withdraw such information. Its access to the information memorised in the network processing unit must be immediate and unlimited and must *inter alia* permit the instantaneous and full production of any data necessary for normal operation;
- the central administration must be aware of the operating conditions of the processing unit and must give its consent for alterations to its programme;
- the central administration must have the possibility to directly engage in the processing of information memorised in the processing unit;
- information memorised in the processing unit must be transferred upon each valuation of the assets, but at least once a week and, as the case may be, more frequently, if required by safety necessities, on memory supports which are situated and which may be operated in Luxembourg;
- the promoters must have at their disposal the necessary means to enable the central administration to continue to operate normally in case of exceptional events such as the interruption of the means of communication with the processing unit or the nonfunctioning thereof for an extended period;
- where the central administration uses the remote-access computing network together with other users which do not participate in the operations of the UCI, the central administration must ensure by the establishment of adequate protection measures that these users may not, at the level of the processing unit, have access to the information concerning the UCI, in order to prevent them from obtaining knowledge of that information or altering or deleting the same.

The conditions set out under the first, second, third and last indents above apply *mutatis mutandis* where the network processing unit used is situated in Luxembourg.

In principle, it is the central administration's responsibility to proceed in Luxembourg, as the case may be in cooperation with the depositary, with the operations necessary to enter the information relating to the operation of the UCI into the remote-access computing network used wherever the processing unit of the network used is situated. This does not exclude that portfolio managers established abroad may immediately access the relevant network and set in motion the accounting operations connected to the execution of the decisions taken by them within the scope of their management mandate. It does furthermore not exclude that other agents participating in the operations of the UCI may proceed in the same way.

Such intervention by portfolio managers and by other agents the services of which are being used, is however subject to the following conditions:

- the central administration must ensure by the establishment of adequate protection measures that these agents may not access information other than that which is necessary for the execution of their respective duties notwithstanding the provisions concerning professional secrecy;

- the UCI must install, at the management level, supervisory procedures which are able to ensure the regularity of the operations initiated by the portfolio managers with respect to the obligations to which it is subject to under the Law of 30th March, 1988 as well as under its constitutional documents and prospectus.

Since the central administration in Luxembourg assumes the ultimate liability for the accuracy of the financial information relating to the UCI, it alone is authorised to proceed with the allocations, apportionments and provisions necessary for finalising the calculation of the net asset value, these operations concerning in particular the charges, expenses and taxes due by the UCI.

The central administration must have at its disposal in Luxembourg all accounting and other documents which constitute the essential documentation of the UCI and which are necessary for:

- the preparation of accounts and valuations;
- the drawing-up of certificates of title and of indebtedness;
- the establishment of the allotment of units or shares outstanding; and
- the general protection of the interests of the UCI such as the depositary agreement, the agreements made with the portfolio managers as well as any other agreements with providers of services which participate in the operation of the UCI.

The requirement as to availability in Luxembourg of the essential documentation of the UCI implies that the documents relating to transactions initiated from abroad must forthwith be forwarded to Luxembourg.

## ***2. Execution of issues and redemptions.***

### *2.1. Role of the central administration in Luxembourg in connection with the execution of issues and redemptions.*

The requirement for issues and redemptions to take place in Luxembourg implies that the performance of the tasks connected to the processing of subscription and redemption orders for the securities issued by Luxembourg UCIs, is to be carried out by the central administration in Luxembourg of such UCIs. This means that it is in principle up to the central administration in Luxembourg to determine the prices at which the subscription and redemption orders must be calculated, to draw up subscription or redemption contract notes and the share and unit certificates and to dispatch such documents to the individual investors.

The requirement relating to the execution in Luxembourg of issues and redemptions does not prohibit Luxembourg UCIs to appoint Luxembourg or foreign intermediaries as authorised financial agents and representatives for the placing and redemption of their units or shares.

Such intermediaries are then authorised to collect subscription and redemption orders for the units or shares of the UCIs by which they have been appointed. Subject to the conditions specified under heading 2.2. hereafter, they may participate in the placing and redemption operations either as distributors, or as nominees or market makers.

Provided that the recourse to the intermediaries referred to above may in no way restrict the ability of investors to deal directly with the UCI of their choice when placing their subscription and redemption orders. It is therefore necessary for UCIs to explicitly and apparently mention this possibility in their prospectus.

## *2.2. Conditions subject to which intermediaries may participate in placing and redemption operations.*

### *2.2.1. Conditions applicable to distributors.*

Distributors are intermediaries who are part of the distribution process set up by the promoters whether they actively participate in the marketing of the securities issued by a UCI or whether they are appointed in the prospectus or in any other document as being authorised to receive subscription and redemption orders on behalf of that UCI.

For the purposes of the processing of the subscription and redemption orders collected by them, the distributors must forthwith transmit to the central administration in Luxembourg the data necessary for the timely accomplishment of the entirety of the tasks connected to the processing of such orders.

In case the subscription or redemption orders concern registered securities, distributors obviously shall provide the central administration in Luxembourg with the registration data necessary to accomplish on an individual basis the tasks referred to above.

Subject to the provisions of heading 2.3. below, this obligation does not exist in case the issue and redemption orders relate to bearer securities. In such case, distributors act in the capacity of subscribers vis-à-vis the central administration in Luxembourg. They may therefore aggregate individual subscription and redemption orders and transmit them in the form of a combined order to the central administration in Luxembourg. In doing so, the distributors may, where appropriate after set-off, purchase or sell the whole of the securities subscribed to or redeemed from investors to be followed by the subsequent allotment thereof according to the individual orders received.

It is not necessary for distributors to forward to the central administration in Luxembourg the documentation relating to subscription and redemption orders from investors. However, where such documentation is not forwarded to Luxembourg, the distributors must allow the administration in Luxembourg to have access thereto without any restriction in case of need.

Where the distributors are authorised to receive and make settlement payments in respect of the subscription and redemption orders collected by them, they may aggregate and set off individual payments in order to deal on a net basis with the central administration in Luxembourg. This possibility is available for orders relating to registered shares and for orders relating to bearer shares.

In order to facilitate delivery of certificates, a Luxembourg UCI and its depositary may enter into an agreement with the distributors pursuant to which the latter are authorised to hold a stock of unissued certificates. In such case, the distributors must be duly authorised by such agreement to deliver their bearer certificates to subscribers in accordance with the instructions from the central administration in Luxembourg.

### *2.2.2. Conditions applicable to nominees.*

Nominees act as intermediaries between investors and the UCIs of their choice. Where the intervention of a nominee is an integral part of the distribution arrangement set up by the

promoters, the relationship between the UCI, the nominee, the central administration in Luxembourg and the investors must be determined by contract which shall provide for their respective obligations. The promoters must nevertheless, ensure that the nominee presents sufficient guarantees for the proper execution of its obligations towards the investors who utilise its services. The intervention of a nominee is only authorised if the following conditions are met:

- a) the role of the nominee must be adequately described in the prospectuses;
- b) the investors must have the possibility to directly invest in the UCIs of their choice without using a nominee and prospectuses must expressly state this fact;
- c) the agreements between the nominee and the investors must include a termination clause which gives the investors the right to claim, at any time, direct title to the securities subscribed through the nominee.

It is understood that the conditions set out sub b) and c) are not applicable in circumstances where the use of the services of a nominee is indispensable or even compulsory for legal, regulatory or compelling practical reasons.

### 2.2.3. Conditions applicable to market makers.

Market makers are intermediaries which participate for their own account and at their own risk in subscription and redemption transactions on securities issued by UCIs. Where the organisation of a market by such intermediaries is an integral part of the distribution arrangement set up by the promoters, the relationship between the UCI, the central administration in Luxembourg and the market makers must be determined by contract.

Additionally, the following conditions must be met:

- a) the role of the market makers must be adequately described in the prospectuses;
- b) the market makers may not act as counterparts to subscription and redemption transactions without the specific approval of the investors initiating the relevant transactions;
- c) market makers may not price subscription and redemption orders addressed to them on less favourable terms than those that would be applied to such orders had they been directly processed by the relevant UCIs;
- d) market makers must regularly notify to the central administration in Luxembourg the orders executed by them where such orders relate to registered securities, in order to ensure (i) that the data relating to investors are updated in the register of unitholders or shareholders and (ii) that the registered certificates or confirmations of investment may be forwarded from Luxembourg to the new investors.

### *2.3. Duties of the central administration in Luxembourg and of the marketing intermediaries in respect of the prevention of the laundering of drug trafficking proceeds.*

IML circular 89/57 of 15th November, 1989 on the laundering of drug trafficking proceeds is in principle applicable to Luxembourg UCIs.

When considering the particular way the UCI industry is operating, notably in the area of marketing, it appears that it is often extremely difficult for the central administration in Luxembourg to know the identity of investors the subscription and redemption orders of which are collected by Luxembourg or foreign intermediaries.

Considering the above, a derogatory system is applicable to subscription and redemption orders collected by intermediaries established, or the activities of which in this respect are exercised, in a State which belongs to the Financial Action Task Force on Money Laundering established after the “Arch” summit in June, 1989 or which applies the recommendations issued by this Task Force.

The central administration in Luxembourg is not obliged to check the identity of investors, the orders of which emanate from such intermediaries, such checking being made in the State where these orders are collected. The status of the foreign intermediary must however be verified and unusual transactions monitored.

In respect of subscription or redemption orders collected by intermediaries established in States which do not apply the recommendations issued by the Task Force, the central administration in Luxembourg is fully responsible for the compliance with the rules specified in IML circular 89/57.

### ***3. Maintenance of the register of participants.***

The requirement for the register of participants to be kept in Luxembourg not only implies that such register must be permanently available there, but also implies the obligation for the central administration in Luxembourg to perform in Luxembourg the registrations, alterations or deletions necessary to ensure the regular update thereof.

Where the central administration in Luxembourg uses a remote-access computing network as technical support for the performance of these duties, it may, subject to applying the security and protection measures described under heading 1. above and whilst preserving the confidentiality required by legal and regulatory requirements, use the network to access and store the registration data relating to participants in the processing unit. The processing unit then constitutes the storage facility required for the maintenance of the register of participants.

Distributors who are connected to the remote-access computing network used may, through this network, transmit to the central administration in Luxembourg the information relating to the issue and redemption orders collected by them so that it can initiate in the network the necessary operations to update the data of the participants' register stored in the processing unit.

### ***4. Drawing up of prospectuses, financial reports and other documents intended for investors.***

The requirement for prospectuses, financial reports and other documents intended for investors to be drawn up in cooperation with the central administration in Luxembourg only relates to the intellectual tasks necessary for the drawing up of these documents as opposed to the physical realisation thereof. For the performance of these tasks, this requirement does not exclude the limited recourse to experts, advisors and other specialised providers of services established abroad.

Since technical or purely physical tasks are not addressed by this requirement, the central administration in Luxembourg may use the services of printers or other providers of services established abroad in connection with the physical production of the documents intended for investors.

### ***5. Correspondence and dispatch of prospectuses, financial reports and other documents intended for investors.***

The requirement for correspondence and dispatch of prospectuses, financial reports and other documents intended for investors to be made from Luxembourg is intended to safeguard the confidentiality of data relating to investors who directly apply to the central administration in Luxembourg to place their subscription orders or the names of which appear in the register of participants.

Save for the case specified below, only the central administration in Luxembourg may, in accordance with this objective, carry out from Luxembourg, the dispatches intended for the investors referred to above including the case where these dispatches concern documents printed abroad. As an exception to this rule, dispatches to the relevant investors may be carried out from abroad (e.g. from the printer's address) provided such dispatches are made under the supervision of the central administration in Luxembourg.

It must then ensure by adequate measures of protection that non-authorised third parties may not access data relating to investors for whom the dispatches are intended for.

## **CHAPTER E.**

### **RULES CONCERNING THE DEPOSITARY OF A LUXEMBOURG UCI.**

#### **I. Conditions of admission to the activity of depositary.**

The admission to the activity of depositary of a UCITS subject to Part I of the Law of 30<sup>th</sup> March, 1988 is exclusively limited to banks incorporated under Luxembourg Law or Luxembourg branches of banks established in an *EU* Member State.

This also applies to the depositary of a UCI subject to Part II of the Law of 30<sup>th</sup> March, 1988 save that such depositary may also be a Luxembourg branch of a bank established in a non-member State of the *EU*.

Pursuant to Article 71(2) of the Law of 30<sup>th</sup> March, 1988, a UCI may only be authorised if the supervisory authority approves the choice of the depositary. This approval is only given if the proposed depositary can justify that it possesses the necessary infrastructure to perform the totality of the tasks relating to its duties, namely sufficient human and technical resources.

#### **II. General mission of the depositary.**

Pursuant to the Law of 30<sup>th</sup> March, 1988, the custody of the assets of each Luxembourg UCI must be entrusted to a depositary. This requirement is of a general application insofar as it indistinctively refers to all UCIs whatever their status or legal form.

Pursuant to the commentary of the Articles of the Law of 30<sup>th</sup> March, 1988, the concept of custody used to describe the general mission of the depositary should be understood not in the sense of “safekeeping”, but in the sense of “supervision” which implies that the depositary must have knowledge at any time of how the assets of the UCI have been invested and where and how these assets are available.

In accordance with the meaning thus attributed to the concept of custody, the physical deposit of all or part of the assets may be made either with the depositary itself (which represents the most prudent solution) or with any professional designated by the UCI in agreement with the depositary.

This interpretation of the custody mission of a depositary in no way prevents the recourse to a fiduciary agreement to be entered into between the depositary and the UCI for the deposit of

the latter's assets; this solution presents some considerable advantages since the depositary thus receives significant authority for the exercise of its duties.

In the context of its custody duties over the assets of the UCI, the depositary may communicate with foreign correspondents by using electronic means of communication developed or operated by third parties and possibly computer equipment located abroad, provided however that these means are used for the direct communication with the foreign correspondents without the intervention of a third party.

### **III. Specific duties of the depositary.**

#### ***1. Specific duties of the depositary of a common fund subject to Part I of the Law of 30th March, 1988.***

The Law of 30th March, 1988 provides that the depositary carries out all operations concerning day-to-day administration of the assets of the common fund.

This means that the depositary is in particular responsible for the collection of dividends, interest and proceeds of matured securities, the exercise of options and, in general, for any other operation concerning the day-to-day administration of the securities and liquid assets making up the fund.

To the extent that the operations referred to above involve assets that are not held by the depositary itself, it may charge third parties with whom the assets are actually deposited with, with the execution thereof. In such case and in order to comply with its obligation of supervision of the assets of the common fund, the depositary must organise its relationship with its correspondents so as to ensure that it is immediately informed of any operation executed by them within the day-to-day administration of the assets deposited with them.

The depositary is in addition entrusted with the following supervisory and monitoring duties:

- ensure that the sale, issue, redemption and cancellation of units effected on behalf of the fund or by the management company are carried out in accordance with the Law and the management regulations;
- ensure that the value of units is calculated in accordance with the Law and the management regulations;
- carry out the instructions of the management company, unless they conflict with the Law or the management regulations;
- ensure that in transactions involving the assets of the funds, the consideration is remitted to it within the usual time limits;
- ensure that the income of the fund is applied in accordance with the management regulations.

In connection herewith, it is not possible for the depositary to delegate to third parties the execution of tasks relating to the obligation to “ensure” the correct performance of the duties referred to above.

However, the term “to ensure” as used in the provisions of the Law of 30th March, 1988 implies that the depositary need not “carry out” such tasks itself, but that it must verify the correct execution thereof. Thus for instance, it is conceivable that for objective reasons a

depository might set up a structure in which a foreign company assists in the settlement of portfolio transactions.

Finally, the provision pursuant to which the depository must carry out the instructions of the management company unless they conflict with the Law or the management regulations, does not prevent the depository to operate by way of mandate in case the management company entrusts the management of the fund's assets to portfolio managers established abroad.

In such case, the relationship between the depository and its representatives must be organised in such a way that the latter have at their disposal all the resources and data necessary to perform the preliminary verifications required for the appraisal of the conformity of a decision taken by the portfolio managers with the requirements of the Law or the management regulations.

Where in the cases referred to above the depository does not have the possibility to perform these preliminary verifications itself or through its representatives, it must, in conjunction with the central administration in Luxembourg, set up supervision procedures capable to ensure the regularity of the transactions initiated by the portfolio managers in light of the requirements of the Law or the management regulations.

The possibility for the depository not to execute itself all duties incumbent upon it and to be assisted by or to delegate to third parties, must not lead to a situation where all duties are concentrated in the hands of one and the same third party. Such a situation would indeed be contrary to relevant legal provisions since its purpose would be to avoid the application thereof. Additionally, it would constitute a structure leading to unnecessary additional costs and could cast doubt on the Luxembourg nationality of the common fund.

The prohibition of the concentration of duties to be executed by third parties in the hands of the same correspondent of the depository does not apply to situations where one single correspondent has been chosen for technical reasons. This is *inter alia* the case (without being exclusive) in situations where investments are made on a single market.

## ***2. Specific obligations of the depository of a common fund subject to Part II of the Law of 30th March, 1988.***

The depository referred to herein has the same duties as the depository of a common fund subject to Part I of the Law save that it is not obliged to ensure that the calculation of the value of units is carried out in accordance with the Law and the management regulations.

Subject to the conditions specified under the preceding heading 1., it may, to the same extent as a depository of a common fund subject to Part I, seek assistance from third parties for the execution of its tasks or entrust to its representatives the execution thereof.

## ***3. Specific obligations of the depository of a SICAV or any other UCI which has not been constituted as a common fund.***

For this purpose no distinction is made between the depository of a UCI subject to Part I and the depository of a UCI subject to Part II of the Law of 30th March, 1988.

In addition to its role of custodian of the assets entrusted to it, the depository referred to herein must:

- ensure that the sale, issue, redemption and cancellation of units or shares effected by or on behalf of the UCI are carried out in accordance with the Law and the constitutional documents;

- ensure that in transactions involving the assets of the UCI, the consideration is remitted to it within the usual time limits;
- ensure that the income of the UCI is applied in accordance with the constitutional documents.

In light of the preceding enumeration, it appears that the depositary of a SICAV or of any other UCI which has not been constituted as a common fund does not have supervisory and monitoring duties as extensive as those provided for other depositaries by the Law of 30<sup>th</sup> March, 1988.

Thus, the depositary of a SICAV or of any other UCI which has not been constituted as a common fund is not obliged to verify whether the instructions of the management bodies are in accordance with the Law or the constitutional documents.

Likewise to a depositary of a common fund subject to Part II of the Law of 30th March, 1988 it is furthermore not obliged to ensure that the calculation of the value of units or shares is carried out in accordance with the Law and the constitutional documents.

Insofar as they refer to obligations which are shared by all depositaries, the provisions sub 1. herebefore apply *mutatis mutandis* to the depositary of a SICAV or of any other UCI which has not been constituted as a common fund.

#### **IV. Liability of the depositary.**

As stated above, the concept of custody of UCI assets by the depositary is to be understood in the sense of supervision.

With respect to the full range of duties incumbent upon it under the provisions of the Law of 30th March, 1988, the depositary has a duty of supervision which implies a liability for its wrongful failure to perform its obligations or its wrongful improper performance thereof.

Anyone suffering damages must prove the depositary's negligence in respect of its duty of supervision and the correspondence between cause and effect.

This supervision by the depositary is in particular exercised over the third parties with which the assets of the UCI have been deposited with.

As regards the extent of the duty of supervision of the depositary, one can consider that the depositary has discharged its duty of supervision when it is satisfied from the outset and during the whole of the duration of the contract that the third parties with which the assets of the UCI are on deposit are reputable and competent and have sufficient financial resources.

The duty of supervision of the assets of the UCI and consequently the liability for such supervision always resides with the depositary. Any provision of the management regulations and the articles or any other agreement aiming to exclude or limit this liability are null and void.

It follows from there that the depositary may, in no case, release itself from its duty of supervision. Therefore the depositary may in particular not argue that the deposit of the assets of the UCI has been carried out with its general or specific approval. The liability of the depositary is furthermore unaffected by the fact either that it has been assisted by third parties in the execution of its tasks or that it has entrusted the execution thereof to its representatives.

The liability of the depositary in matters of custody is basically different from that in respect of the deposit agreement. Indeed, where the assets of the UCI are on deposit with the depositary itself, its liability is governed by the Law applicable to deposit agreements (Article 1915 and the following Articles of the Civil Code).

In the light of the above, depositary agreements containing liability provisions must distinguish the three following liability regimes:

- liability of the depositary for the tasks incumbent upon it pursuant to the provisions of the Law of 30th March, 1988 where the assets of the UCI are on deposit with third parties;
- liability of the depositary where the assets of the UCI are on deposit with the depositary itself;
- liability of the depositary for the tasks assigned to it by the depositary agreement where such tasks are not expressly referred to by the Law of 30th March, 1988.

## **CHAPTER F.**

### **RULES APPLICABLE TO UCITS GOVERNED BY PART I OF THE LAW OF 30TH MARCH, 1988.**

#### **I. Intervals at which the issue and redemption prices must be determined.**

UCITS must determine the issue and redemption prices of their units or shares at sufficiently close and fixed intervals, but at least twice a month.

#### **II. Redemption by UCITS of their units or shares.**

As already mentioned in heading I. of Chapter C. above, UCITS are required to redeem their units or shares directly or indirectly at the request of investors.

In this connection, one has to recall that UCITS must waive any restrictions the object of which is to submit the exercise of the right to redeem to conditions and procedures which would render the redemption practically impossible or needlessly and arbitrarily complicated and less frequent.

It remains however that a UCITS may, subject to adequate justification of the necessity thereof, provide in its constitutional documents that the management bodies may, in particular circumstances (e.g. in case of temporary liquidity shortage) or where redemption requests received in connection with the same dealing day exceed a certain level in respect of the number of securities outstanding, either provide for a delay of settlement of redemptions during a determined period of time, or for a proportional reduction of all redemption requests so that the set level is not exceeded provided however that in such case any proportion of a redemption request which would not have been honoured by virtue of this possibility, must be treated as if the request had been made for the next following dealing day or days until full settlement of the original requests.

#### **III. Requirements in respect of the constitution of assets.**

##### ***1. Investment in transferable securities.***

Subject to the exceptions provided for in Chapter 5 of the Law of 30th March, 1988, the investment of the assets of UCITS must be exclusively made in transferable securities which

are either admitted to official stock exchange listing or dealt in on another regulated market which operates regularly and is recognised and open to the public.

It follows that the authorised investments of UCITS must simultaneously meet the following two essential conditions:

- firstly, they must qualify as transferable securities;
- secondly, these transferable securities must be admitted to official stock exchange listing or dealt in on another regulated market which operates regularly and is recognised and open to the public.

Neither the 85/611/EEC Directive, nor the Law of 30th March, 1988 give a definition of the concept of “transferable securities”.

A problem may therefore arise where in actual cases involving Luxembourg or foreign securities, it is not clear, *prima facie*, whether the securities qualify as transferable securities.

In case of Luxembourg securities, the *CSSF* will continue to rely on the Luxembourg practice which adopted the interpretation according to which the words “transferable securities” mean quoted securities, that is securities which are capable of being quoted irrespectively of whether their admission to official stock exchange listing has been effectively realised or not. According to this practice, a quotation is deemed possible where the determination of a single price can be contemplated; this is the case where securities do not appreciably differ from one another either by their amount, maturity or in any other material respect.

The above criteria are not applied however where foreign securities are to be qualified. In this case, it is the *CSSF*'s policy to align itself with the definition of the relevant securities made by the respective regulations of the countries concerned.

The words “regulated, operating regularly, recognised and open to the public” as used to designate the definition criteria of the markets referred to above are likewise not defined by the 85/611/EEC Directive nor by the Law of 30th March, 1988.

In the absence of such definition, the *CSSF* considers that the following meaning should be given to these words:

- *regulated*: the essential characteristic of a regulated market is the clearing which presupposes the existence of a central market organisation for the settlement of orders. Such a market can furthermore be distinguished by multilateral order matching (general matching of bid and offers enabling the setting of a single price), transparency (maximum distribution of information amongst buyers and sellers giving them the possibility to follow the evolution of the market so that they may ensure that their orders have been carried out at current conditions) and the neutrality of its organisor (the organisor's role must be limited to recording and supervision);

- *recognised*: the market must be recognised by a state or by a public authority which has been delegated by that state or by another entity which is recognised by that state or by that public authority such as a professional association;

- *operating regularly*: securities admitted to this market must be dealt in at a certain fixed frequency (no sporadic dealings);

- *open to the public*: the securities dealt in thereon must be accessible to the public.

***2. Debt instruments which are treated as equivalent to transferable securities pursuant to Article 40(2)b) of the Law of 30th March, 1988.***

Securities referred to here are regularly traded money market instruments the residual maturity of which exceeds 12 months.

***3. Investments in liquid assets.***

In addition to the investments authorised pursuant to heading 1. above, a UCITS may hold ancillary liquid assets.

This term not only covers cash and short-term bank deposits, but also regularly traded money market instruments the residual maturity of which does not exceed 12 months.

The term “ancillary” means in this context that liquid assets may not in themselves constitute an investment objective, the exclusive object of UCITS being the investment of their assets in transferable securities. The Law of 30th March, 1988 does therefore not prohibit a UCITS to hold an important amount of liquid assets during a certain amount of time because of circumstances provided such UCITS does not transform such investment in liquid assets in an investment purpose onto itself.

***4. Investments in closed-ended UCIs.***

The restrictions to which Article 44 of the Law of 30th March, 1988 submits the purchase of units of open-ended UCIs does not apply to the investment in units of closed-ended UCIs. The units of closed-ended UCIs are indeed considered as being similar to any other transferable security and are therefore, in respect of investment rules, subject to the general rules applicable to transferable securities.

**IV. Borrowings.**

The restrictions to which the borrowings of UCITS are subject to, will not prohibit a UCITS to acquire currency by way of a back to back loan. A “back to back” loan is given in case of a UCITS which borrows currency in the context of the acquisition of foreign transferable securities and the holding thereof while depositing with the lender, its agent or any other person designated by it, an amount in national currency equal or larger than the amount borrowed.

**V. Method of calculation of the investment limits provided for by Chapter 5 of the Law of 30th March, 1988.**

The investment limit percentages to be complied with by UCITS must be applied to the net assets of UCITS.

**CHAPTER G.**

**RULES APPLICABLE TO UCITS SUBJECT TO PART II OF THE LAW OF 30<sup>TH</sup> MARCH, 1988.**

**I. Intervals at which the issue and redemption prices must be determined.**

UCITS must determine the issue and redemption prices of their units or shares at sufficiently close and fixed intervals, but at least once a month, subject to the exceptions provided for by the Law of 30th March, 1988.

## **II. Investment limits.**

The purpose of the investment limits is to ensure that investments are sufficiently liquid and diversified. Certain of these limits do not apply to the categories of UCITS defined in heading II.4. of Chapter C. above insofar as they are incompatible with the investment policy assigned to each such category. Subject to this exception UCITS may not in principle:

- a) invest more than 10% of their net assets in securities not listed on a stock exchange nor dealt in on another regulated market which operates regularly and is recognised and open to the public;
- b) acquire more than 10% of the securities of the same kind issued by the same issuing body;
- c) invest more than 10% of their net assets in securities issued by the same issuing body.

The restrictions mentioned hereabove are not applicable to securities issued or guaranteed by a Member State of the OECD or their local authorities or public international bodies with *EU*, regional or worldwide scope.

The restrictions mentioned in a), b) and c) above are applicable to the purchase of units of UCIs of the open-ended type if such UCIs are not subject to risk diversification requirements comparable to those provided for by this circular for UCIs subject to Part II of the Law of 0th March, 1988.

It is reminded that units of closed-ended UCIs are treated in the same way as other transferable securities and are therefore subject to the general rules applicable to transferable securities.

The possibility to invest in units of other UCIs must not be used to avoid the provisions of Article 70 of the Law of 30th March, 1988.

If it is intended to make investments in other UCIs, the prospectus must expressly state this possibility. In case it is intended to make investments in other UCIs of the same promoter, the prospectus must also specify the nature of the fees and expenses which may arise out of such investment.

## **III. Borrowings.**

UCITS may borrow the equivalent of up to 25% of their net assets without restriction in respect of the intended use thereof. This limit does not apply to the category of UCITS defined in heading II.4.3. of Chapter C. above.

## **IV. Provisions applicable to UCITS which are subject to Chapter 11 of the Law of 30th March, 1988.**

### ***1. Information to be provided in the constitutional documents.***

The constitutional documents must *inter alia* specify

- the principles and methods of valuation of assets;
- the time allowed for payment in respect of issues (and redemptions, if any);
- the conditions which enable suspension of issues (and redemptions, if any).

### ***2. Valuation of assets.***

Unless otherwise provided for in the constitutional documents, the valuation of the assets of UCITS referred to herein must be based, in the case of officially listed securities, on the last known stock exchange price, unless such price is not representative. For securities not so listed and for securities which are so listed but for which the latest price is not representative, the valuation shall be based on the probable realisation value which must be estimated with care and in good faith.

### ***3. Purchases and sales of securities held in the portfolio.***

The purchase and sale of securities held in the portfolio of these UCITS can only be carried out at prices consistent with the valuation criteria specified in heading 2. above (“Valuation of assets”).

## **CHAPTER H.**

### **RULES APPLICABLE TO ALL UCITS.**

Pursuant to Article 41 of the Law of 30th March, 1988 UCITS are authorised

- to employ techniques and instruments relating to transferable securities provided that such techniques and instruments are used for the purpose of efficient portfolio management;
- to employ techniques and instruments intended to provide protection against exchange risks in the context of the management of their assets and liabilities.

The techniques and instruments which UCITS are authorised to use under this provision are more fully described under headings I. and II. of this Chapter. The use of other techniques and instruments is in principle not permitted.

Where a UCITS wishes to use the techniques and instruments described below, this must be expressly mentioned in its prospectus. In such case, the prospectus must list the envisaged types of transactions and specify the purpose thereof and the conditions and limits within which such transactions may be made. As the case may be, the prospectus must also include a description of the risks inherent to the envisaged transactions.

#### **I. Techniques and instruments relating to transferable securities.**

For the purpose of efficient portfolio management, a UCITS may participate in transactions relating to

- financial futures and related options;
- securities lending;
- repurchase agreements.

##### ***1. Transactions relating to options on transferable securities.***

The purchase and writing of call and put options by a UCITS is permitted provided such options are traded on a regulated market which is operating regularly, recognised and open to the public.

When entering into these transactions, the UCITS must comply with the following rules:

### *1.1. Rules applicable to the purchase of options.*

The total premiums paid for the acquisition of call and put options outstanding and referred to herein may not together with the total of the premiums paid for the purchase of call and put options outstanding and referred to in heading 2.3. below, exceed 15% of the net assets of the UCITS.

### *1.2. Rules to ensure the coverage of the commitments resulting from option transactions.*

Upon the conclusion of contracts whereby call options are written, the UCITS must hold either the underlying securities, or equivalent call options or other instruments capable of ensuring adequate coverage of the commitments resulting from such contracts, such as warrants. The underlying securities related to call options written may not be disposed of as long as these options are in existence unless such options are covered by matching options or by other instruments that can be used for that purpose. The same applies to equivalent call options or other instruments which the UCITS must hold where it does not have the underlying securities at the time of the writing of such options.

As an exception to this rule, a UCITS may write call options on securities it does not hold at the entering into the option contract provided the following conditions are met:

- the aggregate exercise (striking) price of such uncovered call options written shall not exceed 25 % of the net assets of the UCITS;
- the UCITS must at any time be in the position to ensure the coverage of the position taken as a result of the writing of such options.

Where it writes put options, the UCITS must be covered during the entire duration of the option contract by adequate liquid assets that may be used to pay for the securities which could be delivered to it in case of the exercise of the option by the counterpart.

### *1.3. Conditions and limits for the writing of call and put options.*

The aggregate of the commitments arising from the writing of put and call options (excluding call options written in respect of which the UCITS has adequate coverage) and the aggregate of the commitments from the transactions referred to in heading 2.3. hereafter may not, at any time, exceed the value of the net assets of the UCITS.

In this context, the commitment on call and put options written is deemed to be equal to the aggregate of the exercise (striking) prices of those options.

### *1.4. Rules concerning the regular information of the public.*

In its financial reports, the UCITS must identify the portfolio securities which are the subject of an option and individually indicate the writing of call options on securities which are not held in the portfolio. It must also breakdown by category of options the aggregate of the exercise (striking) prices of options outstanding as at the reference date of the relevant reports.

## ***2. Transactions relating to futures and option contracts relating to financial instruments.***

Except for transactions by private agreement mentioned under heading 2.2. below, the transactions described herein may only relate to contracts that are dealt in on a regulated market which is operating regularly, recognised and open to the public.

Subject to the conditions specified below, these transactions may be made for hedging or other purposes.

*2.1. Transactions with the purpose of hedging risks connected to the evolution of stock markets.*

A UCITS may sell stock index futures for the purpose of hedging against a global risk of an unfavourable evolution of stock markets. For the same purpose, it may also write call options on stock indices or purchase put options thereon.

The hedging purpose of these transactions presupposes that there exists a sufficient correlation between the composition of the index used and the corresponding portfolio.

In principle, the aggregate commitments resulting from futures contracts and stock index options may not exceed the aggregate estimated market value of the securities held by the UCITS in the corresponding market.

*2.2. Transactions with the purpose of hedging interest rates.*

A UCITS may sell interest rate futures contracts for the purpose of achieving a global hedge against interest rate fluctuations. It may also for the same purpose write call options or purchase put options on interest rates or enter into interest rate swaps by private agreement with highly rated financial institutions specialised in this type of operations.

In principle, the aggregate of the commitments relating to futures contracts, options and swap transactions on interest rates may not exceed the aggregate estimated market value of the assets to be hedged and held by the UCITS in the currency corresponding to those contracts.

*2.3. Transactions made for a purpose other than hedging.*

Besides option contracts on transferable securities and contracts on currencies, a UCITS may, for a purpose other than hedging, purchase and sell futures contracts and options on any kind of financial instruments provided that the aggregate commitments in connection with such purchase and sale transactions together with the amount of the commitments relating to the writing of call and put options on transferable securities does not exceed at any time the value of the net assets of the UCITS.

The writing of call options on transferable securities for which a UCITS has adequate coverage are not considered for the calculation of the aggregate amount of the commitments referred to above.

In this context, the concept of the commitments relating to transactions other than options on transferable securities is defined as follows:

- the commitment arising from futures contracts is deemed equal to the value of the underlying net positions payable on those contracts which relate to identical financial instruments (after setting off all sale positions against purchase positions), without taking into account the respective maturity dates and
- the commitment deriving from options purchased and written is equal to the aggregate of the exercise (striking) prices of net uncovered sales positions which relate to single underlying assets without taking into account respective maturity dates.

It is reminded that the aggregate amount of premiums paid for the acquisition of call and put options outstanding which are referred to herein, may not, together with the aggregate of the

premiums paid for the acquisition of call and put options on transferable securities mentioned in heading 1.1. above, exceed 15% of the net assets of the UCITS.

#### *2.4. Periodical information of the public.*

In its financial reports, the UCITS must separately indicate for each of the categories of transactions mentioned in headings 2.1, 2.2. and 2.3. above the total amount of commitments deriving from operations outstanding as at the date of reference of the relevant reports.

### **3. Securities lending transactions.**

UCITS may enter into securities lending transactions provided the following rules are complied with:

#### *3.1. Rules intended to ensure proper completion of lending transactions.*

A UCITS may only participate in securities lending transactions within a standardised lending system organised by a recognised securities clearing institution or by a highly rated financial institution specialised in that type of transactions.

In relation to its lending transactions, the UCITS must in principle receive security of a value which, at the conclusion of the lending agreement, must be at least equal to the value of the global valuation of the securities lent.

This collateral must be given in the form of cash and/or of securities issued or guaranteed by Member States of the OECD or by their local authorities or by supranational institutions and organisations with *EU*, regional or worldwide scope and blocked in favour of the UCITS until termination of the lending contract.

#### *3.2. Conditions and limits of lending transactions.*

Lending transactions may not be carried out on more than 50% of the aggregate market value of the securities in the portfolio. This limit is not applicable where the UCITS has the right, at any time, to terminate the contract and obtain restitution of the securities lent.

Lending transactions may not extend beyond a period of 30 days.

#### *3.3 Periodical information of the public.*

The UCITS must indicate in its financial reports the global valuation of securities lent at the date of reference of the relevant reports.

### **4. Repurchase agreements.**

UCITS may enter into repurchase agreements which consist in the purchase and sale of securities whereby the terms of the agreement entitle the seller to repurchase from the purchaser the securities at a price and at a time agreed amongst the two parties at the conclusion of the agreement.

The UCITS may act either as purchaser or seller in repurchase transactions. Its entering in such agreements is however subject to the following rules:

#### *4.1. Rules intended to ensure the proper completion of repurchase agreements.*

The UCITS may purchase or sell securities in the context of a repurchase agreement only if its counterpart is a highly rated financial institution specialised in this type of transactions.

#### *4.2. Conditions and limits of repurchase transactions.*

During the lifetime of a repurchase agreement, the UCI may not sell the securities which are the object of the agreement (i) either before the repurchase of the securities by the counterparty has been carried out or (ii) the repurchase period has expired.

Where the UCITS is open-ended, it must ensure to maintain the importance of purchased securities subject to a repurchase obligation at a level such that it is able, at all times, to meet its obligations to redeem its own shares.

#### *4.3. Periodical information of the public.*

In its financial reports, the UCITS must separately indicate for purchases and sales subject to repurchase obligations, the total amount of repurchase agreements outstanding at the date of reference of the relevant reports.

## **II. Techniques and instruments intended to hedge currency risks to which UCITS are exposed to in the management of their assets and liabilities.**

In order to protect its assets against currency fluctuations, UCITS may enter into transactions the objects of which are currency forward contracts as well as the writing of call options and the purchase of put options on currencies. The transactions referred to herein may only concern contracts which are traded on a regulated market which is operating regularly, recognised and open to the public.

For the same purpose, the UCITS may also enter into forward sales of currencies or exchange currencies on the basis of private agreements with highly rated financial institutions specialised in this type of transactions.

The herebefore mentioned transactions' objective of achieving a hedge presupposes the existence of a direct relationship between them and the assets to be hedged. This implies that transactions made in one currency may in principle not exceed the valuation of the aggregate assets denominated in that currency nor exceed the period during which such assets are held.

In its financial reports, the UCITS must indicate, for the different types of transactions made, the aggregate amount of commitments relating to transactions outstanding as at the date of reference of the relevant reports.

## **CHAPTER I.**

### **RULES APPLICABLE TO UCIs OTHER THAN UCITS.**

The Law of 30th March, 1988 does not provide for the collective investment objective of UCIs other than UCITS which means that such UCIs may carry out investments in assets other than transferable securities.

The detailed provisions which provide investors in traditional UCITS with certain safety guarantees may not be applied entirely as they stand to UCIs the objective of which differs from that of such UCITS, in particular with respect to the particular nature of the investment policy of these UCIs which makes it impossible to apply certain operational rules which must be obeyed by traditional UCIs. UCIs the objective of which differs from the objective of

traditional UCITS must therefore be submitted to a certain extent to a particular regime the rules of which are differentiated according to the nature of their investments.

To date, the supervisory authority has set up separate rules for three types of specialised UCIs the principal object of which is either:

- the investment in venture capital which means the investment in securities of unlisted companies either because these companies have been recently formed or because they still are in the course of development and therefore have not yet obtained the stage of maturity required to have access to stock markets; or
- the investment in commodity futures contracts and/or financial futures contracts and/or in options; or;
- the investment in real estate.

The separate rules established by the supervisory authority for each of the three specialised types of UCIs do not replace the general rules which remain applicable, but only modify certain rules in order to adapt them to the particularities of each type of UCI.

The particular rules applicable to the UCIs referred to here are specified under headings I., II. and III. hereafter.

In specific cases, the *CSSF* may grant certain derogations from these rules on the basis of adequate justification.

### **I. Rules of the particular regime applicable to UCIs the principal object of which is the investment in venture capital.**

The rules provided for hereafter modify the rules of the general regime on the following points:

#### ***1. Management and supervisory bodies.***

With regard to the professional qualification, the directors of the management bodies and, where applicable, the investment advisors, must establish a specific experience in the field of investment in venture capital.

#### ***2. Investment restrictions.***

The investment restrictions applicable to traditional UCITS do not apply to UCIs subject hereto except that the investment in venture capital must be diversified to such an extent that an adequate spread of the investment risk is warranted. In order to ensure a minimum spread of such risks, the UCIs concerned may not invest more than 20% of their net assets in anyone company.

#### ***3. Issue and redemption of units or shares.***

The date of determination of the issue and redemption prices will depend upon the frequency of the periods of issue and redemption of units or shares.

Should the investors have the right to present their units or shares for redemption, the UCI may provide certain restrictions to such right. These restrictions must be clearly and precisely described in the prospectus.

#### ***4. Special regulations.***

Apart from these general rules which, fundamentally, are based upon those applicable to traditional UCITS, UCIs the principal object of which is the investment in venture capital must also comply with the following special regulations:

##### *4.1. Type of securities.*

Bearer certificates of the UCI and entries in the register of participants must represent a number of shares or units the value of which at the time of issue is at least equal to 12,394.68 euro.

##### *4.2. Remuneration of investment management and advisory bodies.*

If the remuneration of the investment management and advisory bodies is higher than that usually received by similar bodies from traditional UCITS, the issue prospectus must state whether the additional remuneration is also payable on assets which are not invested in venture capital.

##### *4.3. Information for investors.*

The annual and semi-annual reports of the UCI must contain information on the development of the companies in which it has invested. In the case of sale of securities of the portfolio, the UCI must publish separately for each investment the amount of profit or loss. In addition, the financial statements must mention where there is a potential conflict of interest between the interests of a director of the investment management or advisory bodies and the interests of the UCI.

##### *4.4. Special indications to be made in the issue prospectus.*

The issue prospectus must contain a detailed description of the investment risks inherent to the investment policy of the UCI and of the type of conflict of interest which could arise between the interests of a director of the investment management and advisory bodies and the interests of the UCI.

Furthermore, the prospectus must include a statement indicating that since an investment in such UCI represents an above average risk, the UCI in question is only suitable for those persons who can afford to take such risks and that it is advisable for the average subscriber to invest therein only a part of the sums such subscriber intends for a long-term investment.

## **II. Rules of the particular regime applicable to UCIs the principal object of which is the investment in futures contracts (commodity futures and/or financial futures) and/or in options.**

The rules provided for hereafter modify the rules of the general regime on the following points:

### ***1. Management and supervisory bodies.***

With regard to the professional qualification, the directors of the management bodies and, where applicable, the investment advisors must establish a specific experience in the field of investment in commodities, financial futures and options respectively.

### ***2. Investment restrictions.***

2.1. Margin deposits relating to commitments taken on futures purchase and sale contracts, and call and put options written may not exceed 70% of the net assets of the UCI, the balance of 30% representing a liquidity reserve.

2.2. The UCI may only enter into futures contracts dealt in on an organised market. Futures contracts underlying options must also comply with this condition.

2.3. The UCI may not enter into commodity contracts other than commodity futures contracts. As a departure therefrom, the UCI may, for cash consideration, acquire precious metals which are negotiable on an organised market.

2.4. The UCI may only acquire call and put options which are dealt in on an organised market. Premiums paid for the acquisition of options outstanding are included in the 70% limit provided for under heading 2.1. above.

2.5. The UCI must ensure an adequate spread of investment risks by sufficient diversification.

2.6. The UCI may not hold an open forward position in anyone futures contract for which the margin requirement represents 5% or more of net assets. This rule also applies to open positions resulting from options written.

2.7. Premiums paid to acquire options outstanding having identical characteristics may not exceed 5% of net assets.

2.8. The UCI may not hold an open position in futures contracts concerning a single commodity or a single category of financial futures for which the margin required represents 20% or more of net assets. This rule also applies to open positions resulting from options written.

### ***3. Borrowings.***

The UCI may only borrow up to the equivalent of 10% of its net assets provided such borrowings may not be used for investment purposes.

### ***4. Special regulations.***

Apart from these general rules which, fundamentally, are based upon those applicable to traditional UCITS, UCIs the principal object of which is the investment in futures contracts and/or options must also comply with the following special regulations:

#### ***4.1. Type of securities.***

Bearer certificates of the UCI and entries in the register of participants must represent a number of shares or units the value of which at the time of issue is at least equal to 12,394.68 euro.

#### ***4.2. Remuneration of managers and investment advisors.***

If the remuneration of the investment management and advisory bodies is higher than that usually received by similar bodies from traditional UCITS, the issue prospectus must state whether the additional remuneration is also payable on assets which are not invested in futures contracts and/or options.

#### ***4.3. Information for investors.***

The annual and semi-annual reports of the UCI must contain information, for each category of futures and option contracts that has been carried out, the amount of profit or loss realised by the UCI. In addition, the financial statements must quantify the commissions paid to brokers and the fees paid to the investment management and advisory bodies.

#### *4.4. Special indications to be made in the issue prospectus.*

The issue prospectus must contain a detailed description of the trading strategy followed by the UCI with respect to futures contracts and options as well as the investment risks inherent to the investment policy. In particular, mention must be made that the futures contracts and option markets are extremely volatile and that the risk of loss is very high.

In addition, the prospectus must include a statement indicating that the UCI in question is only suitable for persons who can afford to take such risks since the investment in that UCI represents an above average risk.

### **III. Rules of the particular regime applicable to UCIs the principal object of which is the investment in real estate assets.**

By real estate assets this circular means:

- property consisting of land and/or buildings registered in the name of the UCI;
- share holdings in real estate companies (including claims on such companies) the exclusive object and purpose of which is the acquisition, promotion and sale as well as the letting and agricultural lease of property provided that these share holdings must be at least as liquid as the property rights held directly by the UCI;
- property related long-term interests such as surface ownership, lease-hold and options on real estate assets.

The rules provided for hereafter modify the rules of the general regime on the following points:

#### ***1. Management bodies.***

With regard to the professional qualification, the directors of the management bodies and, where applicable, the investment advisors, must establish a specific experience in real estate assets.

#### ***2. Investment restrictions.***

The investment restrictions applicable to traditional UCITS do not apply to UCIs subject hereto. Nevertheless, the investment in real estate assets must be diversified to an extent that an adequate spread of the investment risk is warranted. In order to achieve a minimum spread of such risks, UCIs subject hereto may not invest more than 20% of their net assets in a single property, such restriction being effective at the date of acquisition of the relevant property. Property whose economic viability is linked to another property is not considered a separate item of property for this purpose.

This 20% rule does not apply during a start-up period which may not extend beyond four years after the closing date of the initial subscription period.

#### ***3. Issue and redemption of securities.***

The net asset value on which the issue and redemption prices of the securities are based must be determined at least once a year, namely at the end of the financial year, as well as on each day on which shares or units are issued or redeemed. In respect of real estate assets, management may use the valuation established at the year end throughout the following year unless there is a change in the general economic situation or in the condition of the properties which requires new valuations to be carried out under the same conditions as the annual valuation.

Should the investors have the right to present their securities for redemption, the UCI may provide for certain restrictions thereto. In addition, where it is justified, notably with regard to a specific investment policy, the UCI has the obligation to restrict such right of redemption. These restrictions must be clearly and precisely described in the prospectus.

The UCI may *inter alia* provide for delays of payment in case it does not hold sufficient liquid assets to immediately settle redemption requests.

#### ***4. Special regulations.***

Apart from these general rules which, fundamentally, are based upon those applicable to traditional UCITS, UCIs the principal object of which is the investment in real estate must also comply with the following special regulations:

##### ***4.1. Remuneration of investment management and advisory bodies.***

If the remuneration of investment management and advisory bodies is higher than that usually received by similar bodies from traditional UCITS, the issue prospectus must indicate whether such additional remuneration is also payable on assets which are not directly or indirectly invested in real estate assets.

##### ***4.2. Valuation of properties.***

Management must appoint one or more independent property valuers with a specific experience in the field of property valuation.

At the end of the financial year, management must instruct the property valuer(s) to examine the valuation of all properties owned by the UCI or by its affiliated real estate companies.

In addition, properties may not be acquired or sold unless they have been valued by the property valuer(s), although a new valuation is unnecessary if the sale of the property takes place within six months after the last valuation thereof.

Acquisition prices may not be noticeably higher, nor sales prices noticeably lower, than the relevant valuation except in exceptional circumstances which are duly justified. In such case, the managers must justify their decision in the next financial report.

##### ***4.3. Borrowings.***

The aggregate of all borrowings of the UCI may not exceed in average 50% of the valuation of all its properties.

##### ***4.4. Financial statements.***

The audit of the accounts of the UCI and of real estate companies which are funded for more than 50% by the UCI either by way of equity or loans, must be carried out under the

responsibility of one and the same auditor. The accounts of these entities must in principle be drawn up as at the same date.

At the end of each half year, the accounts of the UCI must be consolidated with those of the real estate companies referred to in the preceding paragraph subject to the relevant legal requirements.

Where the UCI holds minority interests in real estate companies the securities of which are not listed on a stock exchange nor dealt in on another regulated market operating regularly, recognised and open to the public, the UCI must provide either for a partial consolidation at year end or for a valuation on the basis of the probable sale value estimated with prudence and in good faith by the management. For the valuation of minority shareholdings held in real estate companies the securities of which are listed on a stock exchange or dealt in on another regulated market operating regularly, recognised and open to the public, the stock exchange or market value must be taken into consideration.

In its annual and semi-annual reports, the UCI must clearly explain the accounting principles applied for the consolidation of its own accounts with those of affiliated real estate companies.

The inventory of properties included in the annual and semi-annual reports must, for each category of property held by the UCI or its real estate companies, indicate the aggregate of the purchase price or cost, the insured value and the valuation. In the financial statements, properties must be shown as valued.

#### *4.5. Specific indications to be disclosed in the issue prospectus.*

The issue prospectus must give a description of the investment risks inherent to the UCI's investment policy. In addition, the prospectus must provide details of the type of commissions, expenses and charges to be borne by the UCI and the way in which they are calculated and charged.

## **CHAPTER J.**

### **RULES APPLICABLE TO MULTIPLE COMPARTMENT UCIs.**

#### **I. General principle.**

The Law of 30th March, 1988 introduced in Luxembourg law the concept of UCIs with multiple compartments commonly referred to as “umbrella funds”.

These are UCIs formed as common funds or investment companies with a multitude of compartments within a single entity. These compartments are for instance used for investment in transferable securities denominated in different currencies or of different geographic regions or economic sectors. From a practical point of view, it appeared attractive to offer investors the possibility to select within a single entity between a multitude of currencies or assets. Furthermore, after having invested in one compartment, the investor may easily switch in one or several other compartments. The conversion from one compartment to the other within the same UCI does in principle not give rise to the payment of commissions of the category of those which would be provided for if the investor had invested in legally separate and independent undertakings.

The Law of 30th March, 1988 provides that a multiple compartment UCI constitutes a single legal entity. This implies that a multiple compartment UCI, certain compartments of which

would normally fall under Part I of the Law of 30th March, 1988 whilst other compartments would fall under Part II, is to be considered to fall in its entirety under Part II because of the criterion of the “single legal entity”.

Nevertheless, the Law of 30th March, 1988 provides that the constitutional documents of multiple compartment UCIs may provide that in respect of the relations between unitholders, each compartment will be treated as a separate entity.

Considering that the multiple compartment UCI, existing as a single legal entity, is consisting of different compartments and that the investor may restrict his investment to one or the other compartment, it appears that it is inevitable that the units or shares of this single legal entity can have different values. For this reason, the Law of 30th March, 1988 provides in its Article 111 that the units or shares may be of different values with or without par value depending on the legal form which has been chosen. This is a derogatory provision to Article 37 of the Law of 10th August, 1915 on commercial companies (as amended) which, *inter alia*, provides that the capital of limited liability companies is divided into shares of equal value.

The experience of multiple compartment UCIs has led to the drawing up of the rules set out under headings II., III. and IV. hereafter.

## **II. Common funds.**

In order to remain within the scope of Article 111(2) of the Law of 30th March, 1988 which provides that multiple compartment UCIs constitute a single legal entity, the following conditions must be met:

- the different compartments of the fund must have a collective generic denomination and a single management company which determines the investment policies and their application to the relevant compartments through a single board of directors of the management company;
- the custody of the assets of the different compartments of the fund must be ensured by a single depositary who may however utilise, to the same extent as in respect of funds with a single portfolio, correspondents in different geographic regions;
- the fund must be governed by a single set of management regulations which form its legal basis. Subject to derogations which may be granted by the *CSSF* on the basis of adequate justification, the management regulations must notably determine for each compartment the same redemption conditions for each category of units and the same general valuation, suspension, redemption and investment restriction principles;
- the supervision of the fund must be carried out by a single auditor;
- the unitholders shall in principle, subject to reasonable limits, be able to switch from one compartment to the other without payment of commissions;
- the management regulations must indicate the currency in which the combined position of the fund is expressed and which is obtained by aggregating the financial positions of all the compartments in the fund.

In addition to the more specific preceding conditions, common funds with multiple compartments must also comply with the following conditions:

- the certificates or other documents evidencing the rights of unitholders may only differ on the designation of the respective compartments in respect of which they are issued;

- the issue and redemption of units attributable to each compartment must be carried out at a price arrived at by dividing the net asset value of the corresponding compartment by the number of outstanding units in such compartment;

- the investment and borrowing restrictions provided for by the Law of 30th March, 1988 or by this circular must be complied with inside each compartment with the exception of those restricting the holding of securities of a single issuer which shall also apply to the different compartments taken together.

As regards more particularly the condition of minimum net assets resulting from Article 22 of the Law of 30th March, 1988, it is considered that this condition is complied with if a common fund with multiple compartments reaches minimum assets of 1,239,467.62 euro<sup>47</sup> in respect of all its compartments taken together within a period of 6 months following its authorisation.

As a consequence of the above, the provisions of the first paragraph of Article 23 of the Law of 30th March, 1988 only become applicable after the aggregate net assets of all the compartments of a multiple compartment common fund taken together have fallen below two thirds of the legal minimum of 1,239,467.62 euro<sup>47</sup>.

### **III. Investment companies.**

The inherent specifics of the concept of multiple compartment investment companies call for the following commentaries:

1. In a multiple compartment investment company the net asset value of a share is calculated on the basis of the net assets of the compartment in respect of which the share is issued. The value of shares of the same company shall therefore necessarily differ from one compartment to the other.

However, this difference of value of shares representing share capital of a multiple compartment investment company bears no consequence on the voting rights attached to such shares. Indeed, each share gives right to one vote within the exercise of voting rights and all shares participate equally in the decisions to be taken in general meetings.

For the sake of clarity, it is recommended that this equal treatment of shareholders in respect of the exercise of their voting rights is emphasised in the articles of incorporation of a multiple compartment investment company.

Furthermore, the articles should in addition distinguish between the decisions affecting all shareholders and which are to be considered in a single general meeting and decisions only affecting specific rights of shareholders of one compartment and which are therefore taken by the general meeting of one compartment.

2. Every company must have a share capital represented by shares.

The Law implies that there be

- a single share capital;
- denominated in a single currency;
- the nominal or accounting par value being expressed in that same currency;
- the annual accounts being also expressed in that same currency.

It follows from there that the share capital of a multiple compartment investment company must be denominated in a single reference currency. However, the net asset value of each compartment is denominated in the currency of the relevant compartment.

In the interest of a clear understanding of the operating mechanism of multiple compartment investment companies, it is recommended that the articles of these companies clearly indicate the preceding particularities.

3. The articles of a multiple compartment investment company, similarly to the articles of investment companies with a single portfolio, must enumerate the circumstances of suspension of the calculation of the net asset value of the company and consequently the suspension of issues and redemptions of shares of that company.

The articles of a multiple compartment investment company must furthermore provide for the circumstances of suspension of the calculation of the net asset value (and consequently of issues and redemptions) of the individual compartments.

4. The investment and borrowing restrictions provided for by the Law of 30th March, 1988 or by this circular must be complied with inside each compartment with the exception of those restricting the holding of securities of a single issuer which shall also apply to the different compartments taken together.

#### **IV. Common rules to all multiple compartment UCIs.**

It must clearly result from the constitutional documents of multiple compartment UCIs irrespective of whether they are established in the form of common funds or in the form of investment companies, that for the purposes of the relations between unit- or shareholders, each compartment shall be treated as a single entity with its own funding, capital gains and losses, expenses etc.

The opening of a new compartment is subject to the authorisation of the *CSSF* and the update of the prospectus, as the case may be by means of an insert.

#### **CHAPTER K.**

#### **CONTENTS OF THE FILE IN SUPPORT OF THE APPLICATION FOR AUTHORISATION OF UCIs.**

In support of their application for entry on the list provided for by Article 72(1) of the Law of 30th March, 1988 Luxembourg UCIs must submit to the *CSSF* on application file which, *inter alia*, contains the following:

a) Drafts of

- the constitutional documents (articles of incorporation of the management company and management regulations or articles of incorporation of the UCI),
- the prospectus and all other information and/or advertisement document intended for investors,
- any agreements such as depositary and advisory agreements;

b) Indication of the name of the depositary in Luxembourg with a precise and detailed description of the human and technical resources at its disposal for the accomplishment of all the tasks related to its duties;

c) Indication of the name of the auditor;

d) Indications on the organisation of the central administration of the UCI in Luxembourg with a precise and detailed description of the human and technical resources at its disposal for the accomplishment of all the tasks linked to its duties;

e) Information on the promoter(s) such as recent financial reports;

f) Biographical notices of directors and officers;

g) Indication on the method of marketing of the securities issued by the UCI, on the countries of marketing and on the targeted investors.

Where the information and documents mentioned in items b), d), e) and f) hereabove have already been furnished to the *CSSF* in respect of a previous application they must not be resubmitted provided that no change has occurred in the interim.

## **CHAPTER L.**

### **INFORMATION AND ADVERTISEMENT DOCUMENTS INTENDED FOR INVESTORS.**

#### **I. Prospectus.**

##### ***1. Contents of the prospectus.***

The prospectus must include the information necessary for investors to be able to make an informed judgment on the investment proposed to them.

It shall contain the information provided for in Schedule A annexed to the Law of 30<sup>th</sup> March, 1988 insofar as such information does not already appear in the documents annexed to the prospectus in accordance with Article 87(1) of the same Law. In addition, it must carry a statement that no person is authorised to give any information other than that contained in the prospectus or in the documents referred to therein which are available for inspection by the public.

The *CSSF* may require the publication of such additional information it deems necessary in order to provide for an objective and complete information of the public.

Every prospectus must be dated and may be used only as long as the information contained therein remains accurate. The essential elements of the prospectus must be kept up to date. This may be achieved by the periodical financial reports.

UCIs may in principle only enter into the transactions specifically mentioned in their prospectus. This particularly applies to the transactions concerned by Chapter H above. Reference is made to the detailed provisions of that Chapter.

##### ***2. Particular rules applicable to multiple compartment UCIs.***

In the interest of a correct information of investors, it is recommended that the characteristics set out under headings II. to IV. of Chapter J. above should be stated clearly not only in the constitutional documents of multiple compartment UCIs, but also in the prospectuses of such UCIs.

Multiple compartment UCIs must make provision for a single prospectus for all their compartments. In that prospectus, it must be specified that commitments in relation to a single

compartment bind the whole of the UCI unless contrary arrangements have been agreed with the relevant creditors.

Besides this prospectus, multiple compartment UCIs may provide for the publication of separate prospectuses for each of their compartments. Where this facility is used, the following indications, adequately emphasised, must compulsorily be included in the separate prospectuses:

- Indication that the particular compartment, to which the separate prospectus relates, does not constitute a separate legal entity, but that there exist other compartments which together with the particular compartment form a single entity;
- Indication that for the purposes of the relationship between unit- or shareholders, each compartment is considered a separate entity with its own funding, capital gains and losses, expenses etc.;
- Indication that commitments in respect of the compartment to which the separate prospectus relates, bind the whole UCI unless contrary arrangements have been agreed to with the relevant creditors;
- Indication that there exists a prospectus which includes a complete description of all the compartments of the UCI with an indication of the locations where that prospectus may be obtained.

### **3. *Visa.***

In order to ensure an identification of the prospectuses which have obtained the “*nihil obstat*” of the *CSSF*, such prospectuses are enfacé with its visa by the *CSSF* and remitted with such visa to the person who submitted the dossier.

For this purpose, the *CSSF* must receive five copies of each prospectus, when final with respect to both content and presentation. The enfacement with the visa may in no circumstances be used as an advertisement means.

## **II. Advertising documents.**

The advertising material used by those responsible for the placing and their agents must be submitted for supervision to the *CSSF* where such material is not subject to the supervision of the competent authorities of the countries in which it is to be used.

## **III. Financial reports.**

### ***1. Periodicity and content of financial reports.***

Every UCI must publish an annual report for each financial year and a semi-annual report covering the first six months of the financial year.

The financial year ends in principle on the last calendar day of a month.

The annual and semi-annual reports must be published within the following time limits with effect from the end of the period to which they relate:

- four months in the case of the annual report;
- two months in the case of the semi-annual report.

In respect of the content of the financial reports, reference is made to Article 86(2), (3) and (4) of the Law of 30th March, 1988 as well as to Schedule B annexed to that Law. In the same context, it is reminded that the financial reports must include the indications required by the provisions of Chapter H. above in respect of the transactions referred to in that Chapter.

The auditor's report provided for by Article 89(1) of the Law of 30th March, 1988 must be included in the annual reports.

## ***2. Specific rules applicable to multiple compartment UCIs.***

Multiple compartment UCIs must include in their financial reports separate information on each of their compartments as well as combined information on all of their compartments. The information referred to hereby is provided for by Article 86(2), (3) and (4) of the Law of 30th March, 1988 as well as in Schedule B annexed to that Law, provided that headings II., III., IV., VI. and VII. of that Schedule are not to be considered for the establishment of combined information.

The separate financial reports, which must be established for each of the compartments, must be expressed in their respective reference currency. For the purpose of the establishment of the combined situation of the UCI, these financial reports must be aggregated after having been converted in the denomination of the share capital, where the UCI has been formed as an investment company, or in the currency determined for that purpose by the management company, where the UCI has been formed as a common fund.

Alongside the full report to be established pursuant to these rules, multiple compartment UCIs may provide for the publication of separate financial reports for each of their compartments. Where this facility is used, the conditions provided for the publication of separate prospectuses are applicable to this case by analogy. Reference is made in this connection to heading I.2. above.

Where a separate annual report is established for each compartment of a multiple compartment UCI, the auditor's report provided for by Article 89(1) of the Law of 30<sup>th</sup> March, 1988 must also be included in the relevant report unless the auditor establishes separate reports for each compartment. If such separate auditor's reports are established, they may be published in the separate annual reports of the relevant compartments in lieu of the report covering all the compartments which make up the UCI.

## ***3. Publication of the financial reports and communication thereof to the CSSF.***

The UCI must transmit to the *CSSF* two copies of its annual and semi-annual reports, when final with respect to both contents and presentation, at the latest on the time of publication. It is not necessary to submit drafts to the *CSSF* prior to publication.

Financial reports are not subject to the formality of the visa.

Where periodical reports contain errors or omissions, the *CSSF* reserves the right to appreciate if an amended report must be published.

## **IV. Use of the prospectus and periodical reports.**

Pursuant to the provisions of Article 91(1) of the Law of 30th March, 1988 the prospectus and the latest annual report as well as the subsequent semi-annual report, if published, must be offered to subscribers free of charge before the conclusion of a contract.

In this respect, the question arises whether the above-mentioned documents must, before the conclusion of a subscription contract, be supplied to the subscriber only upon his request or whether they must be supplied in any event even in the absence of such request.

On this matter, the *CSSF* considers that the subscription contract may be entered into without the subscriber having actually looked into or, even received, a copy of the prospectus and periodical reports, provided these documents had been offered to him in the prescribed fashion.

It follows from the above that Article 91(1) of the Law of 30th March, 1988 does not prohibit that the subscription form is attached not to the prospectus, but to a brief information brochure which includes the offer to subscribers to obtain the prospectus and the periodical reports.

It naturally remains that for the purposes of marketing their securities abroad, Luxembourg UCIs must comply with the legal, regulatory and administrative provisions which govern the use of the prospectus and periodical reports in the respective countries of marketing.

## **CHAPTER M.**

### **FINANCIAL INFORMATION INTENDED FOR THE *CSSF* AND *THE STATEC***

The following indications intend to clarify for the concerned undertakings for collective investment the requirements concerning the establishment and communication of the required financial information.

#### **I. Content of the monthly and annual financial information**

The monthly and annual financial information of undertakings for collective investment are to be drawn up pursuant to the tables O 1.1., O 4.1. and O 4.2. annexed to this circular as appendices A, B and C respectively. The appendices also include definitions and discussions concerning the various headings of such tables.

#### **II. Collection of data provided for by tables O 1.1., O 4.1. and O 4.2.**

The *Centrale de Communications Luxembourg S.A.* (“CC Lux”) is entrusted with the duty to electronically collect the information provided for in tables O 1.1., O 4.1. and O 4.2. and to transmit them to the *CSSF* which will serve as an intermediary between CCLux and STATEC for the transmission of the data required by the latter.

The central administrations of the undertakings for collective investment concerned by this collection of information will forward the required information under the format defined by CC Lux either directly or by using the software put at their disposal by CCLux.

In order to securitise the data transmission, data may be encrypted from dispatch by the central administrations until their receipt by the *CSSF*. In the absence of encryption by the central administrations, CC Lux will encrypt the data for the purpose of their transmission to the *CSSF*.

CC Lux will separately communicate to each central administration instructions for the input of data.

#### **III. Reference date**

*Monthly financial information*

In principle, the last day of each month shall be taken as the reference date for the preparation of the monthly financial information to be transmitted by undertakings for collective investment.

However, the preceding rule is not compulsory for undertakings for collective investment which calculate their net asset value at least once a week. For this category of undertakings for collective investment, the reference date may be the last day on which the net asset value of that month is calculated.

This derogation is also valid for those undertakings for collective investment which calculate the per unit or per share net asset value at least monthly if the day of such calculation falls either on the last week of the reference month or on the first week of the following month. The financial information to be transmitted must then be prepared on the basis of the data available at the calculation date nearest to the last day of the month.

Undertakings for collective investment which do not calculate their per unit or per share net asset value on a monthly basis need only indicate in their monthly statements the amounts effectively booked in the accounts at the end of the month excluding any non-accounting estimates.

#### *Annual financial information*

The fiscal year-end date is the reference date for the preparation of the yearly financial information to be transmitted by undertakings for collective investment.

#### **IV. Delay for transmission**

Undertakings for collective investment must provide the monthly and yearly financial statements to CCLux within a period of 20 days respectively 4 months after the reference date.

#### **V. Currency used in the statement**

The monthly and yearly tables must indicate in the place provided therefor the reporting currency used for the preparation of the numbered information which they contain. This reporting currency must be the currency used to calculate the net asset value. All amounts are to be set out without decimals with the exception of the amounts concerning items 120, 130 and 520 of the monthly table which are, if required, to be indicated with decimals.

#### **VI. Undertakings for collective investment with multiple compartments**

The monthly and yearly financial statements must be drawn up for each compartment separately. The relevant tables must indicate in the place provided for that purpose the reporting currency used to set out numbered information contained therein. The reporting currency must be the currency used to determine the net asset value of the compartment.

It is not required to draw up a combined situation of the whole undertaking for collective investment.

#### **VII. Identification number**

The *CSSF* will attribute to each undertaking for collective investment and, if applicable, to each compartment of an undertaking for collective investment an identification number. The *CSSF* will separately communicate such numbers to the undertakings for collective

investment which must indicate that number in the space provided for that purpose on the monthly and annual tables.

### **VIII. Reference period**

The annual tables must indicate in the space provided therefor the reference period which they cover. This period which is identical to the period covered by the annual report is to be expressed in number of months (in principle 12 months) and, if required, in number of days if the period does not in its entirety cover full month (in this last case the number of full month and of days remaining are to be indicated).

### **IX. Name of staff member**

In each table it has to be indicated in the space reserved therefor the name of the staff member responsible for the drawing-up of the relevant table as well as the telephone number at which the relevant staff member may be contacted by the *CSSF* if appropriate.

### **X. Date of the first drawing-up of monthly and annual financial information**

The monthly and annual financial information pursuant to tables O 1.1., O 4.1. and O 4.2. are to be drawn up for the first time at 31st December, 1997.

## **CHAPTER N.**

### **RULES APPLICABLE TO MANAGEMENT COMPANIES OF COMMON FUNDS.**

#### **I. Information obligation of management companies vis-à-vis the *CSSF*.**

Immediately following the approval thereof by the general meeting of shareholders, the management companies of common funds must transmit to the *CSSF* their annual accounts together with the directors' report and the report of the external auditors responsible for the audit of the s.

#### **II. Authorisation of the shareholders of a management company.**

Pursuant to Article 71(3) of the Law of 30th March, 1988 the directors of a management company must be of sufficiently good repute and have the experience required for the performance of their duties.

To that end, the names of the directors of the management company, and of every person succeeding them in office, must be communicated forthwith to the supervisory authority.

The Law of 30th March, 1988 defines directors as being the persons who represent the management company or who effectively determine the policy thereof.

This raises the question as to whether the shareholders of the management company are to be considered as directors which require the authorisation of the supervisory authority. This question must be answered by the affirmative insofar as one has to consider that the shareholders actually determine the policy of the management company.

The principal shareholders of the management company of a common fund must therefore be of sufficient good repute and have the experience required for the performance of their duties and must, in this respect, obtain the authorisation of the *CSSF*.

## **CHAPTER O.**

## **MARKETING RULES APPLICABLE IN LUXEMBOURG.**

The marketing rules which UCIs must comply with in Luxembourg when their units or shares are distributed therein derive in particular from:

- the Law of 25th August, 1983 on the legal protection of consumers;
- the Law of 27th November, 1986 regulating certain commercial practices and penalising unfair competition; and
- the Law of 16th July, 1987 on door-to-door sales, itinerant trade, display of goods and canvassing for orders.

## **CHAPTER P.**

### **OBLIGATION OF UCIs TO INFORM THE *CSSF* ON THE AUDIT MADE BY THE AUDITOR.**

UCIs must forthwith communicate to the *CSSF* without being specially requested to do so, the certificates, reports and written commentaries made by the auditor within the scope of the supervision which he must carry out pursuant to Article 89 of the Law of 30th March, 1988. The documents to be communicated must *inter alia* include the written commentaries issued by the auditors which generally take the form of a management letter to the UCI.

## APPENDIX

To be forwarded to the  
*Commission de Surveillance du Secteur Financier*  
L-2991 Luxembourg

### MONTHLY FINANCIAL INFORMATION CONCERNING UNDERTAKINGS FOR COLLECTIVE INVESTMENT (Table annexed to IML circular 91/75 of 21st January 1991.)

Name of the undertaking for collective investment:

\_\_\_\_\_

Reference month: \_\_\_\_\_ Currency: \_\_\_\_\_

I. Information concerning the net asset value at the month end:

1. Total net asset value (in millions): \_\_\_\_\_

2. Net asset value per unit or share: \_\_\_\_\_

3. Percentage change (+ or -) in the value at sub 2. in relation  
to previous month's value: \_\_\_\_\_

II. Percentage value of the portfolio in relation to the total net asset  
value at the end of the month: \_\_\_\_\_

III. Information concerning the amount of issues and redemptions  
of units or shares during the reference month (in millions):

1. Net proceeds of issues: \_\_\_\_\_

2. Payment made in respect of redemptions: \_\_\_\_\_

3. Net issues (net repurchases) (3=1-2): \_\_\_\_\_

IV. Information concerning distributions declared during the  
reference month:

1. Total amount of distributions (in millions): \_\_\_\_\_

2. Amount per unit or share: \_\_\_\_\_

Authorised signature(s) and stamp:

Name of employee(s):

\_\_\_\_\_  
Tel.: \_\_\_\_\_

## CSSF CIRCULAR 2000/8

**Re: Protection of investors in case of NAV calculation error and compensation of the consequences resulting from non-compliance with the investment rules applicable to undertakings for collective investment.**

The purpose of this circular is to set out the minimum rules of conduct to be followed by professionals in collective investment management operating in Luxembourg in case of errors in the administration or management of the undertakings for collective investment ("UCIs") for which they are responsible.

Errors which occur in practice are essentially those resulting from the incorrect calculation of the net asset value ("NAV") or from non-compliance with the investment rules applicable to

UCIs. In most cases, non-compliance is caused either by investments which are not within the scope of the investment policy which the UCIs define in their prospectus or because of a breach of the investment or borrowing restrictions provided for by law or their prospectus. It is the responsibility of the UCIs' promoters to ensure that any errors are correctly dealt with in strictest compliance with the rules of conduct specified in this circular. This is of a primordial importance not only because the interests of the UCIs and/or of the investors having suffered a loss need to be protected, but it must be ensured that investors maintain their trust in the integrity of professionals in collective investment management which exercise their activities in Luxembourg and the effectiveness of the supervision exercised over UCIs.

The corrective and compensatory actions to be taken in case of NAV calculation errors or in case of non-compliance with the investment rules applicable to UCIs are separately dealt with under sections I. and II. hereafter. That presentation is necessary to take account of the fact that the circular takes a different approach to deal with losses in each of the two situations.

## **I. The treatment of NAV calculation errors.**

### **1. Definition of a calculation error.**

It is reminded that the NAV per unit/share of UCIs is obtained by dividing the value of their net assets, meaning assets less liabilities, by the number of units/shares outstanding. Unless provided differently in their constitutional documents, the valuation of the assets of UCIs, whose investment policy provides for the investment in transferable securities, must be based, in case of securities admitted to official stock exchange listing, on the last known price on such stock exchange, unless such price is not representative. Securities which are not so listed or securities which are so listed but of which the last price is not representative, are valued on the basis of the reasonably foreseeable sales price which must be determined prudently and in good faith.

It is presumed that the NAV is correctly calculated where the rules provided for its determination in the constitutional documents and prospectus of the UCI are strictly applied, consistently and in good faith, on the basis of the most current and most reliable information available at the time of the calculation.

An error in the NAV calculation occurs as a result of one or more factors or circumstances which cause the calculation to yield an incorrect result. Generally, these factors and circumstances are related to inadequate internal control procedures, management shortfalls, imperfections or deficiencies in the operation of the IT, accounting or communication systems as well as to non-compliance with the valuation rules provided in the constitutional documents and the prospectus of UCIs.

### **2. The materiality concept in the context of the NAV calculation errors.**

It is generally recognised that the NAV calculation process is not an exact science and that the result of the calculation constitutes the closest possible approximation of the true market value of the assets of a UCI. The level of precision with which the NAV is calculated will indeed depend on a series of external factors more or less linked to the complexity of each particular UCI such as volatility of the markets on which an important part of the assets of the UCI are invested in, the availability at the appropriate time of up-to-date information on market prices and/or other elements relevant for the calculation of the NAV as well as the reliability of the price information sources used.

In consideration of these factors, it is accepted in the majority of the principal centres for collective investment management that only those calculation errors, which have a significant impact on the NAV and whose proportion compared to the NAV reaches or exceeds a certain

threshold, referred to as the materiality or tolerance threshold, must be notified to the supervisory authority and corrected in order to protect the interests of the investors concerned. It is indeed considered that in all other cases, the immateriality of the errors does not justify the recourse to relatively long and costly administration procedures which must be put into place in order to recalculate incorrect NAVs and indemnify affected investors.

Following the use and practices adopted abroad, this circular introduces the materiality concept for Luxembourg UCIs whilst determining acceptable tolerance thresholds at different levels depending on the type of UCI concerned by the NAV calculation error. This differentiating approach is justified to the extent that the implicit level of imprecision in each NAV calculation can vary from one type of UCI to the next by virtue of the external factors referred to above and in particular market volatility. That factor is indeed of a primordial importance in this context as it is generally admitted that the volatility of a market depends to a large extent on the risks associated with the financial assets dealt on that market and that such volatility increases depending on whether those assets are money market instruments, debt obligations or shares and other types of securities.

In conformity with that approach, different tolerance thresholds are provided for UCIs which invest in money market instruments and/or cash assets (“money market UCIs/cash funds”), UCIs which invest in debt obligations or similar debt instruments (“bond UCIs”), UCIs which invest in shares and/or financial assets other than those referred to above (“equity or other financial assets' UCIs”) and UCIs which follow a combined debt / equity investment policy (“debt / equity UCIs”).

For each of these types of UCIs the tolerance threshold is specified hereunder:

money market UCIs/cash funds	0.25 % of NAV
bond UCIs:	0.50 % of NAV
equity and other financial assets UCIs:	1.00 % of NAV
debt / equity UCIs:	0.50 % of NAV.

The introduction of the materiality concept does not mean that UCI promoters will in case of calculation errors be obliged to apply the tolerance thresholds specified above. Promoters are on the contrary free to apply less high tolerance thresholds or even not apply any at all.

It is the responsibility of the governing bodies of Luxembourg UCIs whose units/shares are admitted to distribution abroad to ensure that the tolerance thresholds they propose to adopt in case of NAV calculation errors are not in conflict with the requirements that may be applicable in those circumstances in the countries of distribution.

### **3. Procedures to be followed for the correction of calculation errors which have a significant impact on the NAV.**

The indications given under the points below relate to the principal stages of the correction process and fix the detail of the rules of conduct to be followed in the correction of the calculation errors whose impact on the NAV reaches or exceeds the acceptable tolerance threshold and which are thereby considered to constitute significant errors. These rules of conduct concern in particular

- the information to be furnished to the promoter and the custodian of the UCI and to the supervisory authority;
- the determination of the financial impact of the calculation errors;

- the indemnification of the damages which result from the calculation errors for the UCI and/or its investors;
- the implication of the independent auditor in the monitoring of the correction process;
- the communications to be made to those investors which have to be indemnified.

“Significant errors” not only means isolated calculation errors which have a significant impact on the NAV but also non-correction processed simultaneous or successive calculation errors which each remains below the acceptable tolerance threshold but which if considered on an aggregate basis reach or exceed that threshold.

The correction procedures must form an integral part of the internal control procedures which the central administration of UCIs must put into place to limit as much as possible the risk for calculation errors and detect any errors that occur.

**a) The information to be furnished to the promoter and the custodian of the UCI and to the supervisory authority.**

As soon as a significant calculation error is discovered, the central administration of the UCI must immediately advise the promoter and the custodian of the UCI as well as the supervisory authority of the occurrence of the error and submit to the promoter and the supervisory authority a corrective action plan dealing with the steps which are proposed or have been taken to cure the problems which have caused the ascertained calculation error and to put into place the improvements to the administrative and control structures which are necessary to avoid the subsequent occurrence of the same problems.

The corrective action plan must also specify the steps which are proposed or which have been taken to

- identify the different categories of investors who are affected by the errors in the most appropriate way;
- recalculate the NAVs which have been applied to subscription and redemption requests received during the period starting on the date on which the error became significant and the date on which it was corrected (“the error period”);
- determine, on the basis of the recalculated NAVs, the amounts which have to be repaid to the UCI and the amounts payable by way of indemnity to investors who have suffered a loss as result of the error;
- notify the error to the supervisory authorities of the countries in which the units/shares of the UCI are authorised for distribution, to the extent the latter so require;
- notify the error to the investors who have to be indemnified and inform them on the steps that will be put into place for indemnifying their losses.

**b) The determination of the financial impact of significant calculation errors**

In case of a significant calculation error, the central administration of the UCI must as quickly as possible take the steps necessary to correct the error. In particular it must recalculate the NAVs which have been determined during the error period and quantify the loss for the UCI and/or its investors on the basis of the corrected NAVs provided however that the recalculation of incorrect NAVs is required only in case subscription or redemption requests have been processed during the error period.

In determining the financial impact of calculation errors, the central administration of the UCI must fundamentally distinguish between

- investors which have joined the UCI before the error period and which have redeemed their units/shares during such period and
- investors which have joined the UCI during the error period and which continued to hold their units/shares after such a period, provided that investors other than those belonging to the above categories may be affected depending on actual circumstances.

The indications below give an overview of the situation of the UCI and the concerned investors in the following cases:

*Cases where the NAV is undervalued.*

In that case

- investors which have joined the UCI before the error period and which have redeemed their units/shares during such period, must be indemnified of the difference between the recalculated NAV and the undervalued NAV which was applied to the redeemed units/shares;
- the UCI must be indemnified of the difference between the recalculated NAV and the undervalued NAV which has been applied to units/shares subscribed to during the error period and which remained outstanding beyond that period.

*Cases where the NAV is overvalued.*

In that case

- the UCI must be indemnified of the difference between the overvalued NAV which was applied to units/shares redeemed during the error period but which were subscribed to before that period and the recalculated NAV;
- investors which have joined the UCI during the error period and which have held their units/shares beyond such period must be indemnified of the difference between the overvalued NAV applied to the units/shares subscribed to and the recalculated NAV.

The investors having suffered a loss as a result of a calculation error may be indemnified out of the assets of the UCI in case the payments due to the relevant investors correspond to excess sums within the assets of the UCI and the payment of which can therefore not affect the interests of the other investors. It remains nevertheless that the central administration of the UCI or as the case may be its promoter may decide to themselves support the payments necessary to indemnify affected investors.

There is an open issue as to whether the UCI affected by a calculation error has the right to require investors who have involuntarily benefited from that error to subsequently pay to the UCI the amount not paid by them in respect of units/shares subscribed by them on the basis of an undervalued NAV or to repay the excess of the sums received by them in respect of units/shares redeemed at an overvalued NAV. Since this is a controversial issue to which no clear response can be given in the absence of a court precedent, it is not recommended to call upon the investors concerned to indemnify the UCI for its losses, unless the beneficiaries are institutional investors or other sophisticated investors who accept in full knowledge of the circumstances to cover the loss of the UCI.

In those circumstances, it is in principle the obligation of the central administration of the UCI or as the case may be of its promoter, to make the payments due to the UCI in lieu of the investors who have benefited from the error. This solution is particularly justified because any claim on the investors having benefited from the error could have a negative effect on the promoter's reputation and result therefore in a non negligible commercial prejudice for the promoter.

As soon as the operations consisting in the recalculation of the incorrect NAVs and the computation of the losses resulting from the calculation error for the UCI and/or its investors have been concluded, the central administration of the UCI must make the entries in the

accounts of the UCI which are necessary to reflect the payments to be received and the payments to be made to the UCI.

**c) The correction of the consequences for the UCI and/or its investors of calculation errors**

The compensation for damages is only compulsory by reference to the specific dates on which NAV calculation errors were significant. Insofar as other dates are concerned, it is the responsibility of the governing bodies of the UCI to determine whether it is necessary to determine the financial impact of the error and establish an indemnification plan.

The central administration of the UCI must diligently put into place the measures provided for in the correction plan referred to in item a) above for the recalculation of the incorrect NAVs and the determination of the loss suffered by the UCI and/or the affected investors.

It must also act with diligence in the organisation of the indemnity payments due to the UCI and/or the affected investors provided however that these payments can only be made after the auditor has completed the special report referred to in item d) below.

In order to accelerate the process of calculation error correction, the central administration of the UCI can initiate the different stages of that process without having obtained the prior consent of the supervisory authority. It suffices in that case that the supervisory authority is informed of the steps taken subsequently thereto.

It remains however that the supervisory authority can intervene in the correction process on a subsequent basis if it deems such intervention necessary in order to preserve the interests of the UCI and/or the affected investors.

In most of the principal centres for collective investment management, UCIs are authorised by the supervisory authority to apply the *de minimis* rule to the amounts to which individual investors can pretend.

In accordance with that rule, the UCIs which benefit from such an authorisation may decide not to pay to individual investors sums which do not exceed a specific amount, the level of which is generally fixed as a lump sum figure, referred to as the *de minimis* amount. That lump sum figure is applied in order to avoid that investors who have a right to be paid lesser amounts, end up with no real benefit because of the bank charges (cheque collection charges for cheques issued to their order or bank transfer charges) and other costs they have to bear.

For the reasons specified in the preceding paragraph, Luxembourg UCIs can also take advantage of the *de minimis* rule. This document does however not introduce a single lump sum for the *de minimis* amount Luxembourg UCIs can apply.

It is therefore the responsibility of each UCI to determine, with the approval of the regulatory authority, the lump sum of *de minimis* amount it intends to apply provided that in determining such lump sum it must take into account the level of bank charges and other costs which are charged to investors to whom payments are made. This approach is justified because a large majority of Luxembourg UCIs are distributed abroad and that the level of those charges can appreciably vary between UCIs depending on the geographic location of investors.

Concerning the indemnification of investors who already hold units/shares at the moment of payment of the amounts due to them, UCIs may decide the attribution to them of new units/shares (or, as the case may be, fractions of units or shares) instead of making a payment by cheque or bank transfer. For those investors, recourse to this particular method of indemnification is even recommended since such investors then avoid the bank charges which

would otherwise be charged to them and since it additionally allows a complete indemnification without any consideration being given to the actual amounts they are entitled to, as in those circumstances there is no justification to apply a *de minimis* amount.

It is clear that UCIs which issue new units/shares to indemnify affected investors may not deduct commissions or other entry costs in respect to those units/shares.

Where affected investors have subscribed units/shares through a “nominee”, the central administration of the UCI must remit to such “nominee” the amounts which are intended for the relevant investors. In such case, the “nominee” must commit to the central administration that it will forward the amounts received by it to the persons effectively entitled thereto.

The term “nominee” as used herein means an intermediary who intervenes between the investors and the UCI they have selected and who offers nominee services which the investors may use in the conditions set out in the prospectus of the UCI.

The *de minimis* rule can in no case be used to refuse payment to investors of amounts which are less than the *de minimis* amount applicable to such investors in case such investors expressly claim such payment.

#### **d) The implication of the independent auditor in the monitoring of the correction process.**

At the same time as the central administration notifies the promoter and the custodian of the UCI and the supervisory authority of the occurrence of a significant calculation error, the central administration of the UCI also notifies the UCI's auditor and instructs him to report on the adequacy of the method it intends to use in order to:

- identify the different categories of investors affected by the error;
- recalculate the NAVs applied to subscription and redemption requests received during the error period; and
- determine, on the basis of the recalculated NAVs, the amounts which must be repaid to the UCI and the amounts payable on an indemnity basis to investors who have suffered a significant loss because of the error.

The conclusions of the auditor on the proposed methods must be documented in writing and must be attached to the correction plan referred to in item a) above.

When the calculation error is discovered by the auditor, the auditor must immediately notify the central administration of the UCI thereof and request it to immediately inform the promoter, the custodian and the supervisory authority thereof. If the auditor realises that the central administration does not comply with that request, the auditor must notify this fact to the supervisory authority.

As soon as the central administration of the UCI has carried out the entries in the accounts of the UCI which are necessary to correct the calculation error, the auditor must draw up a special report in which he opines whether the correction process is appropriate and reasonable or not. This opinion must address the following:

- the methods referred to above,
- the incorrect NAVs which have been recalculated,
- the losses for the UCI and/or its investors.

The central administration must forward a copy of the special audit report to the supervisory authority as well as to the supervisory authorities of those countries in which the units/shares of the UCI are admitted for distribution, in case such authorities so request.

Finally, the auditor must establish a confirmation in which he certifies that the amounts due on an indemnity basis to the UCI and/or affected investors have effectively been paid.

A copy of that confirmation must also be forwarded to the supervisory authority and, as the case may be, the foreign supervisory authorities referred to above.

**e) The communications to be made to those investors which have to be indemnified.**

Significant calculation errors must be brought to the attention of the investors who are to be indemnified.

If applicable, the communications which are made for that purpose through individual notices or by publication in the press must *inter alia* include particulars on the calculation error and the steps taken to correct it and to indemnify the UCI and/or the affected investors.

These communications must be submitted in draft form to the supervisory authority and, as the case may be, the supervisory authorities of those countries in which the units/shares of the UCI are admitted for distribution, in case such authorities so request.

**4. Responsibility for the costs resulting from the correction operations of a calculation error.**

The costs caused by the correction operations of a calculation error, including the costs associated with the intervention of the auditor, cannot be charged to the assets of the UCI. These costs must be fully supported by the central administration of the UCI, failing which, by the promoter of the UCI, in each case irrespective of the impact of the error on the NAV.

The auditor will be responsible to ascertain within the framework of the audit of the accounting information contained in the s of the UCI that the costs referred to herein will not be charged to the UCI.

**II. The compensation of the consequences resulting from non-compliance with the investment rules applicable to UCIs.**

Promptly upon discovering a non-compliance with investment rules, the officers<sup>51</sup> of the UCI concerned must take the steps which are necessary to regularise the situation of the UCI caused by such non-compliance.

In case the ascertained non-compliance results from investments which do not comply with the investment policy defined in the prospectus, the UCI must realise those investments.

In case the investment restrictions provided for by law or by the prospectus are breached in circumstances other than those referred to in Article 46 of the Law of 30th March, 1988 relating to undertakings for collective investment, the UCI must realise the excess positions.

Where the borrowing limits provided for by law or by the prospectus are breached, the UCI must reduce its borrowings to the authorised limit.

In the three circumstances referred to above, the UCI must be indemnified to the extent of any damage suffered.

In the first two circumstances, the damage must be determined in principle by reference to the loss of the UCI resulting from the realisation of the non-authorized investments. In the third circumstance, the UCI must in principle be indemnified to the extent of its interest and other charges resulting from the non-authorized portion of the borrowings.

In the presence of a number of simultaneous breaches of investment rules, the indemnity, if any, is to be calculated in respect of the net result of the corrective actions concerning all the breaches.

In case the corrective actions have a net positive result for the UCI, it will retain the benefit thereof. In those circumstances, it suffices for the central administration of the UCI to notify the supervisory authority and the auditor.

By exception to the preceding principle and to the extent there is adequate justification therefor, methods other than those described above may be used to determine the suffered damage including in particular the method which consists in determining the damage by reference to the performance which would have been realised if the non-authorized investment had been subject to the same fluctuations as the portfolio invested in compliance with the investment policy and the investment restrictions provided for by law or the prospectus.

**Provided that the tolerance levels which are provided for NAV calculation errors cannot be applied to damages of UCIs resulting from non-compliance with investment rules.**

Because they did not comply with their obligations it is the responsibility of the persons who have caused the losses to ensure that such losses are repaid. In case this principle cannot be applied, the promoters will have to indemnify.

The principles which determine the procedures to be followed for the processing of NAV calculation errors will apply *mutatis mutandis* in all cases where an UCI suffers a loss as a result of non-compliance with investment rules. The principles referred to herein which have to be applied are in particular those concerning

- the information to be furnished to the promoter and the custodian of the UCI and to the supervisory authority;
- the identification of the categories of investors which are affected because of the loss suffered by the UCI;
- the determination of the financial impact of the loss for individual investors and the measures to be taken for their indemnification;
- the implication of the independent auditor in the monitoring of the correction process;
- the communications to be made to those investors which have to be indemnified.

As regards the procedures for indemnifying investors, the rules set out in section I. (3) (c) of this circular will apply.