Hedge funds

Quick Reference Guide

Applicable legal framework

Hedge funds may be created either as Part II funds, SIFs or even as Part I funds ("Alternative UCITS").

Public funds : UCITS ("Part I" funds) and non-UCITS ("Part II" funds):

- Law of 17 December, 2010 on Undertaking for Collective Investment (the "Fund Law");
- IML Circular 91/75 of 21 January 1991 clarifying certain aspects of the UCI legal framework;
- IML Circular 97/136 of 13 June 1997 on financial information to be provided by public funds;
- CSSF Circular 02/77 of 27 November 2002 on the protection of investors in case of NAV calculation error or breach of investment rules;
- CSSF Circular 02/80 of 5 December 2002 which details specific rules applicable to Luxembourg Part II funds pursuing alternative investment strategies (applies to Part II funds only);
- CSSF Circular 07/308 of 2 August 2007 on the use of derivatives and management of financial risks (applies to Part I funds only and only until 1 July 2011);
- Grand Ducal decree of 8 February 2008 transposing Directive 2007/1 6/EC which clarifies certain definitions in the UCITS III Directive (applies to Part I funds only);
- CSSF Circular 08/356 of 4 June 2008 on the use of securities lending, "réméré" and repo transactions (applies to Part I funds only);
- CSSF Circular 08/371 of 5 September 2008 on the electronic transmission of prospectuses and financial reports of UCIs and SIFs to the CSSF;
- CSSF Circular 08/380 of 26 November 2008 on the guidelines of the Committee of European Securities Regulators (CESR) concerning eligible assets for investment by UCITS (applies to Part I funds only);
- CSSF Regulation N° 10-04 of 22 December 2010 on organisational requirements, conflicts of interest, conduct of business, risk management and content of agreement between a depositary and a management company (applies to Part I funds only);
- CSSF Regulation N° 10-05 of 22 December 2010 on fund mergers, master-feeder structures and notification procedures (applies to Part I funds only);
- CSSF Circular 11/498 of 10 January 2011 on entry into force of the Fund Law;
- CSSF Circular 11/508 of 15 April 2011 on the new provisions applicable to Luxembourg management companies subject to Chapter 15 of the Fund Law and to self-managed SICAVs (applies to Part I funds only);
- CSSF Circular 11/509 of 15 April 2011 on the new notification procedure to apply by a Luxembourg UCITS wanting to sell its shares in a different Member State and by a foreign UCITS wanting to sell its shares in Luxembourg (applies to Part I funds only);
- CSSF Circular 11/512 of 30 May 2011 presenting the main changes to the risk management regulation following publication of CSSF regulation 10-4 and the precisions brought by ESMA; providing some additional CSSF guidance on risk management rules; and defining format and contents of the RMP to communicate to CSSF (applies to Part I funds only, as from 1 July 2011);
- CESR Guidelines on a common definition of European money market funds of 19 May 2010 (CESR/10-049) (applies to Part I funds only);
- CESR Guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS dated 28 July 2010 (CESR/10-788) (applies to Part I funds only);
- ESMA Guidelines on risk measurement and the calculation of global exposure for certain types of structured UCITS dated 14 April 2011 (ESMA 2011/112) (applies to Part I funds only).

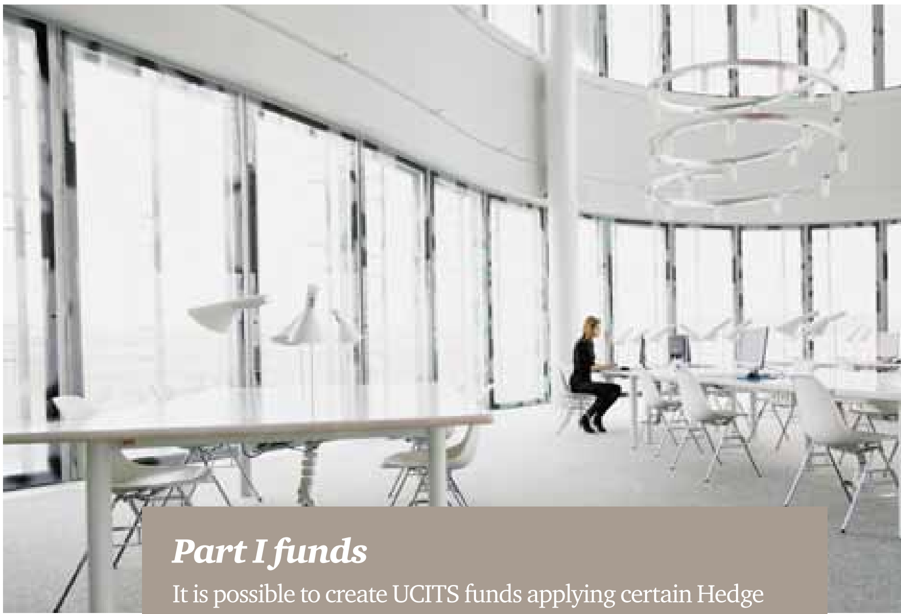
Funds dedicated to well-informed investors ("SIFs"):

- Law of 13 February 2007 on Specialised Investment Funds (SIFs);
- CSSF Circular 07/283 of 28 February 2007 regarding entry into force of the law of 13 February 2007 relating to SIFs;
- CSSF Circular 07/309 of 3 August 2007 concerning risk diversification requirements applicable to SIFs;
- CSSF Circular 07/310 of 3 August 2007 regarding financial information to be provided by SIFs;
- CSSF Circular 08/371 of 5 September 2008 on the electronic transmission of prospectuses and financial reports of UCIs and SIFs to the CSSF;
- CSSF Circular 08/372 of 5 September 2008 on the guidelines for depositaries of SIFs adopting alternative investment strategies, where those funds use the services of a prime broker.

Investors

If the Hedge fund is created under the provisions of the Fund Law, there is no restriction as to the type of investors.
If however, the fund is a SIF, only well-informed investors will be allowed to invest in it. For further details on the "well-informed investors" definition, please refer to the SIF Quick Reference Guide of this brochure.

Eligible investments, investment restrictions and valuation requirements



Part I funds

It is possible to create UCITS funds applying certain Hedge fund techniques. Through derivatives such as futures, Contracts for Difference ("CFD") or swaps on indices, managers can invest in asset classes otherwise not eligible within UCITS, and pursue strategies such as arbitrage, macro, CTA strategies with complex drivers of risk and reward.

Part II funds

The range of investments eligible for Part II funds is not limited: all types of alternative strategies are, from an eligibility of assets point of view, acceptable. Circular 02/80 has defined the investment restrictions applicable to Part II funds pursuing alternative strategies; they are summarised in the table below. The Circular is flexible enough to allow investment managers to achieve their investment objectives through the use of borrowings and short selling or with derivatives or a combination of both.
Within the Part II framework, all known Hedge fund strategies can, and have been, deployed.

SIFs

Similar to Part II funds, the range of investments eligible for SIFs are not limited: all types of alternative strategies are, from an eligibility of assets point of view, acceptable. There is no circular defining the limits specifically applying to SIFs pursuing Hedge fund techniques; the restrictions in the CSSF Circular 07/309 are generic (which leaves greater room for agreeing specific restriction features with the CSSF) and, clearly, provide for even more flexibility than in a Part II fund as shown in the table in the opposite table.

Eligible investments, investment restrictions and valuation requirements

	Part I funds	*Part II funds*	*SIF*
Restrictions on long positions in securities	Max. 10% of the fund's net assets in one issuer.	Max. 20% of the fund's gross assets in one issuer.	Max. 30% of the fund's gross assets in one issuer.
	A fund cannot buy more than 10% of the securities issued by any one issuer.	A fund cannot buy more than 10% of the securities issued by any one issuer.	No limitation in this respect indicated in the Circular 07/309.
	Max. 10% of the fund's net assets in unquoted securities.	Max. 10% of the fund's gross assets in unquoted securities.	No limitation in this respect.
Restrictions on short selling of securities	Short selling is prohibited (but the use of derivatives may allow equivalent economic results. For example, contracts for differences (CFD) may be shorted).	• Sales proceeds from short selling applicable to any issuer cannot exceed max. 10% of the fund's gross assets; • Stop loss limit when short sale results in an unrealised loss representing 5% of the fund's gross assets (does not apply for market neutral or relative value strategies).	Max. 30% of the fund's gross assets exposed to one issuer.
		A fund cannot sell more than 10% of the securities issued by any one issuer.	No limitation in this respect indicated in the Circular 07/309.
Restrictions on borrowings	Borrowing for investment purposes is probihited (but the use of derivatives may allow equivalent economic results).	• Max. 200% of the fund's net assets (for directional strategies); • Max. 400% of the fund's net assets (for market neutral or relative value strategies for which short positions are covered by long positions); • The CSSF has always been opened to discussions if additional borrowing is needed.	No limitation in this respect indicated in the Circular 07/309.
Derivatives	• Global exposure (incl. embedded derivatives) cannot exceed 100% of the fund's net assets; • Counterparty risk (by counter-party) on OTC derivatives of max. 5% or 10% (according to quality of the counterparty) of the fund's net assets; • The fund may not combine investments in transferable securities (incl. indirect exposure), money market instruments, deposits and OTC derivatives with a single body in excess of 20% of the fund's net assets.	• For derivatives admitted to trading on a regulated market, margin deposits on any one position cannot exceed 5% of the fund's gross assets; • For OTC derivatives, any unrealised loss on any position cannot exceed 5% of the fund's gross assets; • Total margin deposits and/or total unrealised loss for OTC derivatives cannot exceed 50% of the fund's gross assets; • Premiums paid on options are taken into account in the 5% and the 50% limits above-described.	• Diversification level similar to the restrictions on long positions in securities; • Such limit may also apply to the counterparty of the OTC derivative depending on the quality and qualification of the counterparty.
Broker	N/A.	The value of the assets transferred to the prime broker cannot exceed the debt of the fund to the prime broker by 20% of the fund's gross assets.	No limitation in this respect indica-ted in the Circular 07/309; limitation applied by the CSSF will probably depend upon the quality and qualifica-tion of the prime broker.

Note that, because these investment restrictions are, as regards to Part II funds and SIFs, laid down in CSSF circulars, they may in certain cases be derogated upon proper justification vis-à-vis the CSSF.

Hedge funds main features at a glance

Provided below are the main characteristics of Alternative UCITS, Part II funds and SIFs.

	Part I funds	*Part II funds*	*SIF*
Legal forms available	• Investment company with variable capital (SICAV) to be incorporated as a public limited company (S.A.); • Investment company with fixed capital (SICAF); • Contractual fund (FCP).	• Investment company with variable capital (SICAV) to be incorporated as a public limited company (S.A.); • Investment company with fixed capital (SICAF); • Contractual fund (FCP).	• Investment company with variable capital, to be incorporated as a public limited company (S.A.), a private limited company (S.à r.l.), a cooperative company organised as a public limited company (SCoopSA) or as a corporate partnership limited by shares (SCA); • Investment company with fixed capital (SICAF); • Contractual fund (FCP).
Eligible investors	No restriction on the type of investors authorised to invest in a UCITS.	No restriction.	Well-informed investors only, i.e. institutional investors, professional investors and other investors provided that they formally declare themselves as well-informed investors and either invest a minimum of EUR 125,000 or obtain a certificate from a regulated entity confirming their understanding of the risks associated to the investment in a SIF.
Licensing requirements	A UCITS fund must receive the CSSF's prior authorisation before it can start its activities. The CSSF will pay particular attention to: • The UCITS fund's draft constitutional documents (incl. its prospectus and for new UCITS, its KIID); • The identity and quality of the sponsor of the UCITS fund; • The quality of the UCITS management company, if there is one; • The identity of the investment manager of the UCITS fund who must be duly licensed for that function in its country of domicile; • The identity of any other delegates or sub-delegates; • The identity of the managers in charge of conducting the business of the UCITS fund. They must show good reputation and adequate experience for acting in such capacity; • The identity of the central administration, of the Luxembourg depositary and of the Luxembourg external auditors; • The risk management put in place, which has to cover all the UCITS managed by the management and all the risks incl. liquidity and operational risks pertaining to these UCITS.	A Part II UCI must receive CSSF's prior authorisation to start its activities. The CSSF will pay particular attention to: • The Part II UCI's draft constitutional documents, notably the prospectus; • The identity of the sponsor and of the persons in charge of conducting the business of the Part II UCI; they must show good reputation, and adequate experience for acting in such capacity; • The identity of the directors; • The identity of the investment manager of the Part II UCI, which must be authorised or registered for the purpose of asset management and subject to the prudential supervision of a regulatory authority; • The identity of the Luxembourg central administration, the Luxembourg depositary and the Luxembourg external auditors.	A SIF may start operations without receiving the CSSF's prior clear-ance but must file an application for approval within one month following its creation. The CSSF will pay particular attention to: • The SIF draft constitutional documents (incl. offering document); • The identity of the persons in charge of conducting the business of the SIF. They must show good reputation and adequate experience for acting in such capacity; • The identity of the Luxembourg central administration, the Luxembourg depositary and the Luxembourg external auditors. Under the current regime, SIFs do not require a promoter identified as such to the CSSF nor are they required to use a duly regulated investment manager.

Hedge funds main features at a glance (continued)

	Part I funds	*Part II funds*	*SIF*
Compulsory service providers in Luxembourg	• Depositary – responsible for safekeeping of the UCITS assets and other supervisory duties – which must be a Luxembourg bank or a Luxembourg branch of a EU bank; • External auditors.	• Depositary – responsible for safekeeping of the UCIs assets and certain other supervisory duties – which must be a Luxembourg bank or a Luxembourg branch of a foreign bank; • Central administration – responsible for accounting, NAV calculation, keeping of the register of the shareholders/unitholders, handling subscriptions and redemptions, communication with investors and preparation of financial statements – which must be a Luxembourg bank or a branch of a foreign bank or a professional of the financial sector with a proper license; • A Chapter 16 Management Company if the Part II fund is set up as an FCP; • External auditors.	• Depositary – responsible for safekeeping of the SIF assets – which must be a Luxembourg bank or a Luxembourg branch of a EU bank; • Central administration – responsible for accounting, NAV calculation, keeping of the register of the shareholders/unitholders, handling with subscriptions and redemptions, communication with investors and preparation of financial statements – which must be a Luxembourg bank or a branch of a foreign bank or a professional of the financial sector with a proper license; • A Chapter 16 Management Company if the SIF is set up as an FCP; • External auditors.
Minimum frequency of NAV calculation	Twice a month.	Monthly (in principle).	Yearly.
Valuation principle	Valuation is made for officially listed securities on the basis of the last known stock exchange quotation. If it is not representative or for other securities, valuation is made based on the realisable value of the assets, estimated in good faith (unless differently provided for in the constitutional documents of the UCITS).	Valuation is made for officially listed securities on the basis of the last known stock exchange quotation. If it is not representative or for other securities, valuation is made based on the realisable value of the assets, estimated in good faith (unless differently provided for in the constitutional documents of the fund).	Fair value, unless otherwise stated in the SIF documentation.
Subscription/ Redemption	• Subscription at NAV plus subscription fees. A UCITS fund can be closed to subscriptions; • Redemption at NAV minus redemption fees. A UCITS fund must offer the ability to redeem to investors at least twice a month.	• Subscription at NAV plus subscription fees. A Part II fund can be closed to subscriptions; • Redemption price must in practice be made at NAV minus redemption fees. A Part II fund can be closed to redemptions.	• Subscriptions and redemptions must be carried out in accordance with the rules laid down in the SIF constitutional documents (i.e. not necessarily linked to the NAV); • Partly paid-up shares may be issued.
Minimum capital requirement in the fund	EUR 1.25 Mio to be reached within six months following approval.	EUR 1,25 Mio to be reached within six months following approval.	EUR 1.25 Mio to be reached within 12 months following the authorisation.
Documents to be established according to laws and regulations	• Prospectus; • Key Investor Information Document (“KIID”); • Articles of association (in case of a SICAV or SICAF); • Management regulations (in case of an FCP); • Agreements with the service providers; • Annual audited financial statements (annually within four months of period end); • Semi-annual non-audited financial statements (annually within two months of period end); • Long Form Report describing the organisation of the UCITS funds (annually within four months of period end); • Risk management process in accordance with the CSSF Circular 11/512 of 30 May 2011.	• Prospectus; • Articles of association (in case of a SICAV or SICAF); • Management regulations (in case of an FCP); • Agreements with the service providers; • Annual audited financial statements (annually within four months of period end); • Semi-annual non audited financial statements (annually within two months of period end); • Long Form Report describing the organisation of the fund (annually within four months of period end).	• Offering document; • Articles of association (in case of a SICAV or SICAF); • Management regulations (in case of an FCP); • Agreements with the service providers; • Annual audited financial statements (annually within six months of period end).

For further information, please contact:

Didier Prime
Luxembourg Asset Management Leader
didier.prime@lu.pwc.com
+352 49 48 48 6130

Régis Malcourant
Hedge Funds Leader
regis.malcourant@lu.pwc.com
+352 49 48 48 2540