Reserved Alternative Investment Funds: Luxembourg is one step ahead of the game

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Almost six months following the publication on the Luxembourg Parliament's website of the bill of law n°6929 on reserved alternative investment funds (**RAIF**s), the funds industry is looking forward to the updated version of the bill of law, which was initially planned for enactment during the first semester of 2016.

Although the Council of State pointed out that "*it understands the usefulness and even the need for reform due to the unintended consequences of the law of 12 July 2013 on alternative investment fund managers*" (the **AIFM Law**), three formal oppositions to the bill of law were raised by the Council of State in its opinion of 8 March 2016, leading to amendments and redraft of the bill by the Budget and Finance Commission.

RAIF: a newcomer in the Luxembourg AIFs landscape

The long standing approach taken so far has been to dictate sound regulation around the fund products (so-called "products laws") on the one hand and to impose more or less burdensome licensing requirements on financial service firms active in the production and distribution of such fund products (e.g. managers, depositary banks, fund administrators, IT support, distributors and advisors) on the other hand.

This regulated environment has been beneficial to the development of Luxembourg's role as a global fund domicile by creating a brand for its fund products (UCITS and SIFs) and a label of quality. The downside, however, has undoubtedly been costs, entry barriers and slowness in the regulatory approval process.

The entry into force of the AIFM Law implementing in the Grand-Duchy of Luxembourg the alternative investment funds managers' directive (AIFMD) have had an unforeseen undesirable effect on the funds industry by introducing an additional layer of supervision: at the level of the alternative investment fund (AIF) itself under the products law and at the level of its alternative investment fund manager (AIFM), which may be based in a different country of that of the AIF.

This dual layer of supervision has created a competitive disadvantage for Luxembourg as compared with its traditional competitors (both onshore and offshore) and accelerated the modernisation and emergence of unregulated vehicles taking the form of common limited partnership (*société en commandite simple*) and special limited partnership (*société en commandite spéciale*) appointing an authorised AIFM, giving them access to the European marketing passport.

The international fund promoters' strong appetite for these unregulated vehicles attested since their implementation in Luxembourg simultaneously with the AIFM Law, has evidenced that the funds industry did no longer perceive products laws as a key and essential factor. Instead, reducing administrative burdens and costs and above all, cutting time-to-market are key motivations for initiators.

The initiative taken by the Luxembourg government to introduce the bill of law on RAIFs demonstrates the willingness and continuing commitment to improve the Luxembourg funds structuring toolbox in line with market expectations and widen the marketability of Luxembourg investment funds, thus contributing to the development and success of the European investment funds industry.

The bill of law introduces the possibility to set-up, using a variety of corporate and contractual forms - some of which are still reserved to date to regulated funds - unregulated alternative investment funds having the same features as our well-known and tested regulated investment vehicles (typically the specialised investment funds subject to the so-called SIF law as well as the investment companies in risk capital subject to the so-called SICAR law) but without the regulatory approval and prudential supervision of the CSSF.

Criteria and main features of RAIFs

Pursuant to the bill of law, the RAIF must meet the criteria of an AIF in the sense of the AIFM Law and appoint a fully authorised AIFM established in Luxembourg or in another EU Member State.

Management and supervision of the RAIF will therefore be ensured through the regulated AIFM's supervisory oversight making sure the RAIF complies with the AIFMD. Thus, the RAIF will benefit from the EU marketing passport available to its AIFM.

RAIFs are exclusively reserved to well-informed investors[1] and subject to a minimum capital requirement of EUR 1,250,000 (including share premiums or value of the partnerships interests) that must be reached within twelve months following its set-up.

Similarly to existing regulated AIFs, like SIFs and SICARs, RAIFs may be set up in the forms set out hereafter: (i) partnership limited by shares (*société en commandite par actions, SCA*), common limited partnership (*société en commandite simple, SCS*) and special limited partnership (*société en commandite spéciale, SCSp*), (ii) public limited company (*société anonyme, SA*), private limited liability company (*société à responsabilité limitée, Sàrl*), cooperative company in the form of a public limited company (*société coopérative organisée sous forme de société anonyme, SCOSA*) or (iii) common fund (*fonds commun de placement, FCP*).

RAIFs may also adopt a variable capital structure by taking the form of an investment company with variable capital (SICAV) or a fixed capital structure under the form of an investment company with fixed capital (SICAF).

The set-up of the RAIF will have to be recorded by a notarial deed in front of a Luxembourg notary, who will ensure that the RAIF is registered on a list held by the Luxembourg trade and companies register within ten days following its creation.

All other features and requirements of the RAIFs regime are similar to those of SIFs and SICARs including in terms of investment policy and eligible assets.

Such features include amongst others the possibility for RAIF to be organised with segregated compartments and/or multiple classes’ structures, flexible capital calls and redemption mechanics, no legal constraints in respect of dividends distributions, reserves, etc.

In addition RAIFs will have to appoint a Luxembourg-based central administration agent, a Luxembourg depositary bank (or a Luxembourg branch of a depositary bank registered in the EU) and an external auditor. Depending upon its investment policy, the RAIF will follow SIF or SICAR risk-spreading requirements[2] and tax regimes.

If the RAIF elects to adopt the SIF model, it will be subject to an annual subscription tax of 0.01% on its net assets (with certain exemptions available) and will be exempt from municipal business tax, corporate income tax and net wealth tax, where if adopting the SICAR model, the RAIF will be fiscally treated as a SICAR: it will be fully subject to tax but any income arising from qualifying investments in risk capital are exempt and benefit from double tax avoidance treaties (unless it is established under the form of a common limited partnership or a special limited partnership, in which case as a transparent entity, it will benefit from a fully tax neutral regime subject to certain conditions).

What about existing regulated funds?

One likely phenomenon to be anticipated is the conversion of existing regulated structures (SIFs and SICARs) into unregulated Luxembourg limited partnerships or RAIFs once the RAIF legislation is adopted. Indeed investors and fund sponsors familiar with unregulated or lightly regulated structures may well find attractive the new features introduced on the Luxembourg funds market. This is likely to appeal to US managers and also emerging Asian asset managers seeking European investors. They like Cayman funds (rightly so) but may also find useful the Luxembourg new models, a combination of both being a perfect design to satisfy both non-EU and EU investors.

Next steps

Following a parliamentary group's proposal, decision has finally been taken not to refer the bill of law to the systemic risk committee for opinion.

Although it is commonly admitted that loans granted by unregulated AIFs which are managed by regulated AIFMs do not require their originator to be licensed to perform such lending activities under the law of 5 April 1993 on the financial sector, as amended (the **Financial Sector Law**), it is interesting to note that the bill of law did not foresee any amendments of the Financial Sector Law to exclude the RAIFs from its scope, likely to UCIs, SIFs and SICARs. Perhaps a mere oversight.

Reexamination of the opinion of the Council of State with the proposed amendments to the bill of law is scheduled to take place on 16 June 2016. If the Budget and Finance Commission adopts the proposed amendments, the amended bill of law will go back to the Council of State. Enactment of the law is therefore not expected before Q4 of this year.

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(1): A well-informed investor is defined as any institutional investor, professional investor or any other investor confirming in writing that it adheres to the status of well-informed investor and investing a minimum of EUR 125,000 in the RAIF or benefiting from an assessment by a credit institution within the meaning of the Directive 2013/36/EC, an investment company within the meaning of Directive 2004/39/CE, a management company within the meaning of Directive 2009/65/EC or an authorised alternative investment fund manager within the meaning of the AIFMD certifying its expertise, experience and knowledge to adequately assess an investment in the RAIF concerned.

(2): While there is no specific provision in the bill of law on risk-spreading requirements, the position has been taken to follow the risk-spreading requirement applicable to SIFs. Similarly to SICARs, no risk-spreading requirement will apply for RAIFs investing in qualifying risk capital investments.

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