

Alternative Funds Industry

Quarterly Update

October to December 2021



Legal , Tax & Regulatory Quarterly Update on selected matters in the AIF industry

The European alternative investment funds (AIF) market is one of the fastest growing industries in the financial sector. It is all the more important to keep up to date with developments in this dynamic industry. To help financial market participants stay on top of current trends in the AIF space, AKD quarterly updates provide information on selected Luxembourg and Dutch legal, tax and regulatory matters within the AIF industry.

In the Quarterly Update covering Q4 2021, you will learn about the latest news and updates on *inter alia* review of the AIFMD, ESG compliance, Covid's impact and VAT exemption in the funds industry.

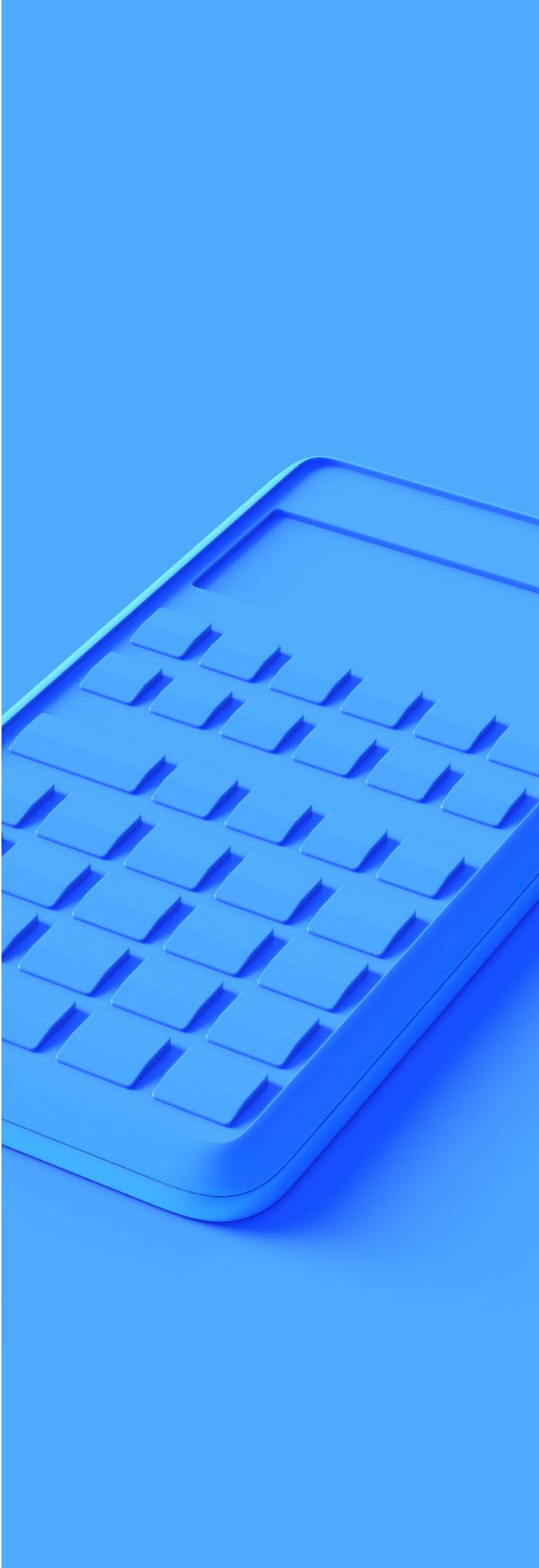
Enjoy the read and get in touch with us if you have any questions.

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I. AIFMD

The new alternative investment funds directive (AIFMD) proposal

On 25 November 2021, ten years after its first publication, the European Commission issued a [legislative proposal](#) to amend the alternative investment funds manager directive (AIFMD).

This AIFMD review offers improvements to the current regulatory framework, addressing a number of regulatory gaps and identifying areas where European Commission action is required.

Common rules on loan-originating funds:

The proposal establishes a set of minimal standards for alternative investment funds (AIFs) to lend directly to companies. These rules will recognize lending as legitimate activity for alternative investment funds manager (AIFM) allowing AIFs to develop their activities by originating loans to operate cross-border. Simultaneously, the new guidelines will address the risks associated with this sort of lending including implement and maintain effective lending policies, procedures, and processes that must be reviewed at least annually

Efficiency of reporting to the supervisory authorities:

The idea intends to facilitate national and European Union (EU) authorities' access to important data gathering and remove inefficient reporting duplications requirements that exist under EU and national legislation.

Harmonised Liquidity Management Tools (LMT):

In accordance with the recommendations from the European Systemic Risk Board (ESRB) and the European Securities and Markets Authority (ESMA). The legislative proposal harmonises the set of liquidity management tools to better facilitate liquidity risk management by managers of open-ended AIFs to ensure that investors are informed of LMTs' conditions of use.

Improved availability of depositaries in concentrated markets:

The objective is to alleviate issues in concentrated

markets with limited depositaries by allowing national competent authorities (NCAs) to give AIFs the authority to appoint a depositary from another Member State.

Smooth functioning of the custody chain:

The central securities depositaries (CSDs) that appear in the custody chain will be considered the depositary's delegates. Where the fund's assets are held by a CSD, this allows depositaries to get the essential information on portfolio movements and perform their oversight tasks.

Ensuring the protection of investor interests in case of delegation:

The proposal clarifies the regulations on delegation and ensures that when fund managers utilise delegation, they adhere to high standards that apply across the EU. The idea aims for AIFMs and their supervisors to have a consistent approach to delegation activities. ESMA will receive data on delegation, undertake peer reviews, and submit its findings to the European Commission and co-legislators in order to establish an accurate picture of delegation operations in the EU.

EU AIFMs marketing non-EU AIFs without a passport:

New requirements for EU AIFMs marketing non-EU AIFs without a passport will be added under Article 36 of the AIFMD, as follows: (i) the third country in which the non-EU AIF is established is not listed on the EU list of non-cooperative jurisdictions for tax purposes; (ii) the third country has signed a qualifying agreement on the exchange of information in tax matters with the home Member State of the EU AIFM and with the Member States where the marketing takes place; and (iii) the third country is not identified as a high-risk country under the most recent European anti-money laundering legislation.

When considering these changes, the impact of the Undertakings for Collective Investment in Transferable Securities Directive (UCITS) was also contemplated in the proposal, to better align the AIFM and UCITS requirements, for instance on liquidity management tools, delegation, and reporting.

II. ESG

Sustainable Finance update (asset management): Final Report on SFDR RTS regarding taxonomy-related disclosures

On 22 October 2021, the European supervisory authorities (ESAs), including European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), and European Securities and Markets Authority (ESMA), published a [final report](#) setting out draft regulatory technical standards (RTS) on taxonomy-related product disclosures under the SFDR regarding Articles 8 and 9 SFDR funds that make sustainable investments contributing to environmental objectives.

The draft RTS aims to:

- provide end investors with disclosures about financial product investments in environmentally sustainable economic activities, providing them with comparable information to make informed investment decisions, and
- establish a uniform rulebook for sustainability disclosures.

SFDR & Taxonomy Regulation – the CSSF fast track procedure

On 2 December 2021, the CSSF published a [communication](#) on a fast track procedure to facilitate compliance with the taxonomy-related disclosure requirements of Articles 5, 6, and 7 of the [Taxonomy Regulation](#).

The CSSF requests to receive from the AIFMs the updated issuing documents and/or any other applicable documents of AIFs as required by Article 23(1) of the AIFMD to include the environmental objectives of climate change mitigation and climate change adaptation.

AIFMs must clearly indicate in which document and where exactly the specific information related to the Taxonomy Regulation has been disclosed.

AIFs managed by a Luxembourg-based registered AIFM, as defined in Article 3(2) of the AIFM Law, are subject to the same requirements.

SFDR - implementation date postponed to 2023

On 25 November 2021, the European Commission announced that the implementation date of underlying

provisions under the [Sustainable Finance Disclosure Regulation 2019/2088](#) (SFDR) was to be postponed from 1 July 2022 to 1 January 2023. The reasons given for the postponement were that the draft regulatory technical standards have not yet been adopted, and smooth implementation by product manufacturers, financial advisors and supervisors requires more time. In addition, the transitional arrangement earlier envisaged in Article 4(3) of the draft regulatory technical standards are set to be abolished (and thus will no longer apply). Financial market participants will have to comply with the disclosure requirements on principal adverse impacts on sustainable matters laid down in the delegated act the first time by 30 June 2023.



III. COVID-19

The impact of COVID-19 on large redemptions in the Luxembourg investment fund market

On 4 October 2021, the Commission de Surveillance du Secteur Financier (CSSF) published a [working paper](#) on the impact of COVID-19 pandemic on large net redemptions (LNRs) by asking to the largest investment fund managers under its supervision to start providing on a daily basis, with retroactive effect from 9 March 2020, a specific reporting containing information on the Luxembourg funds they manage and, in particular, the daily net redemptions exceeding 10% of the NAV, the weekly net redemptions exceeding 30% of the NAV, the portfolio responses to these net redemptions and finally information on the use of liquidity management tools (LMTs).

The results for the AIF differ slightly from those found for Undertakings for the UCITS and reflect the specific nature of AIFs as compared to UCITS in terms of investment policies (AIFs are much more heterogeneous), size (AIFs are on average smaller than UCITS) and investor profile and attitude (well-informed/institutional investors versus

retail investors). CSSF findings confirm, in the context of large redemptions, that UCITS and AIFs are different products designed for different investors with different risk profiles.

For AIFs, the CSSF's observation results in the following four outcomes:

- the size is not negatively but positively associated with the LNRs (with a marginal effect of much smaller magnitude)
- The leverage proxy (gross leverage) has no relationship with the LNRs. This is not to say that leverage is not a relevant proxy variable for AIF risk assessments in general, or from a macroprudential standpoint, such as the one embedded in the AIFMD framework's Article 25 on the imposition of leverage limits
- The liquidity shortage, a key concept that captures the potential lack of portfolio liquidity given the investors' redemption options, is found to be negatively associated with the likelihood of having an LNR
- The equity share of the top five investors, which is a proxy for investor concentration, is unrelated to AIFs LNRs



IV. NCA UDPATES

CSSF guidance on virtual assets

On 29 November 2021, the CSSF published its guidance on virtual assets along with [FAQ](#).

The guidelines include clarification related to whether a UCITS or AIF may invest in virtual assets, as well as the authorisation investment fund managers must obtain to manage these types of assets and on considerations to mitigate risks concerning money laundering and terrorist financing.

From the FAQ, four questions are addressed:

- **May a UCITS invest in virtual assets?**

Article 1 (20b) of the AML/CFT Law prohibits UCITSs, UCIs addressing non-professional consumers, and pension funds from investing directly or indirectly in virtual assets.

The definition of virtual assets in the context of the above Article excludes digital assets that fulfil the conditions of financial instruments within the meaning of the law of 5 April 1993, on the financial sector, and could potentially fall within the scope of eligible investments for UCITSs.

- **May an AIF invest in virtual assets?**

Investments in virtual assets as defined in the AML/CTF Law could be compatible with funds aimed at the professional investor, as long as they meet the following criteria:

- (i) in the event of an AIF with an authorised AIFM, the AIF exclusively sells its units to professional investors, and
- (ii) the authorised AIFM gets a new investment strategy extension from the CSSF.

Furthermore, any such activity necessitates that investment managers assess specific risks and their impact on the investment fund's risk profile on a case-by-case basis, implement adequate internal controls, and update the investment fund's documentation in order to provide transparent information to its investors.

- **Do Luxembourg AIFMs need any authorisation for the management of virtual assets?**

The following points should be considered before investing in virtual assets, according to the FAQ:

Every authorised AIFM that invests in virtual assets must first receive prior CSSF approval by extending its current licence for the strategy "Other-Other Fund-Virtual Assets." The FAQ provides a non-exhaustive list of information/documents that must be filed with the CSSF in connection with this authorisation (for example, a description of the project, including target investors, distribution, delegation arrangements, specific portfolio manager experience, depositary arrangements, access/control over cryptographic keys).

The CSSF expects that each initiator of an AIF that intends to invest in virtual assets should present its project to the CSSF in advance.

- **Are there any specific considerations regarding the mitigation of the Money Laundering and Terrorist Financing risks?**

The CSSF emphasises that the mitigating measures must be proportional to the increased risks of money laundering, terrorist financing, and proliferation financing, and that the roles responsible for anti-money laundering and terrorist financing (Responsable du Contrôle (RC) and the Responsable du Respect (RR)) must demonstrate adequate understanding in this regard.

SICAR – Electronic submission of prospectus

As from 16 December 2021, following the cue of the special investment funds (SIF), the CSSF requires that venture capital investment companies (SICARs) as special investment funds (SIF) submit their prospectuses in electronic form through the e-file communication platform.

Upon submission, an electronic prospectus will receive a visa - an electronic stamp of the first page of the offering document containing a visa number, the information that the Visa may not be used as a sales argument, the date of the visa, the issuer of the visa (the CSSF) and the scanned signature of a director of the CSSF.

Three new CSSF circulars to improve the CSSF risk-based supervision tools

1. [Circular CSSF 21/788](#) introduces a new CSSF AML/CFT external report to be prepared by the approved statutory auditor (réviseur d'entreprises agréé), as mentioned in Article 49 of the RCSSF 12-02, and applies to all Luxembourg investment fund managers and investment funds supervised by the CSSF for AML/CFT purposes, with effect from 31 December 2021.

The AML/CFT External Report will be divided into two sections. The first section will be devoted to the verification of the answers provided by the investment fund managers and investment funds in the context of the CSSF's annual AML/CFT online survey. The second section will be devoted to sample testing or specific work to be performed by the approved statutory auditor, who will be required to answer the CSSF's questions.

2. [Circular CSSF 21/789](#) introduces the following requirements and regulatory framework for all authorised investment fund managers (IFMs), management companies within the meaning of Article 27 of the law of 17 December 2010 (SIAGs), and internally managed alternative investment funds (FIAAGs):
- On an annual basis, authorized IFMs, SIAGs, and FIAAGs must complete a self-assessment questionnaire (SAQ)
 - An approved IFM, SIAG, or FIAAG's approved statutory auditor (réviseur d'entreprises agréé) is required to review specific questions of the SAQ on an annual basis and submit a separate report
 - This circular also establishes a regulatory framework for the management letter that must be prepared annually by an authorised IFM's approved statutory auditor
 - The aforesaid rules and regulatory framework will take effect on 31 December 2021, for the first time
3. [Circular CSSF 21/790](#) introduces the following regulatory requirements and regulatory framework for UCITS, UCIs subject to part II of the Law of 17 December 2010, specialised investment funds (SIFs) and investment companies in risk capital (SICARs):

- In the event that the approved statutory auditor (réviseur d'entreprises agréé) issues a modified audit opinion in the context of the regulated UCI's statutory audit, the regulated UCI is required to complete an annual self-assessment questionnaire (SAQ) and to communicate certain information to the CSSF
- The approved statutory auditor of regulated UCIs is required to review specific questions of the SAQ on an annual basis and provide a separate report based on that evaluation
- This circular also establishes a regulatory structure for the management letter that must be prepared annually by a regulated fund's approved statutory auditor
- CSSF Circular 02/81 on guidelines for auditors of UCIs, as well as Chapter P of CSSF Circular 91/75, are repealed by this Circular.

Use of the LEI codes for the identification of legal entities

Further to the [recommendation](#) released by the European Systemic Risk Board (ESRB) on the use of Legal Entity Identifier (LEI) codes for the identification of legal entities on September 24, 2020. This recommendation intends to encourage all legal entities participating in financial transactions to adopt and use LEI codes, particularly in the context of reporting and public disclosures.

As a result, in a communiqué dated 28 December 2021 the CSSF encourages all legal entities engaged in financial transactions that fall under the CSSF's supervisory competence but are not required to have an LEI under existing national or European legislation to obtain and maintain one.

When contacting and reporting to the CSSF, supervised entities are also asked to identify themselves using an LEI, if one is available.

V. TAX

Dutch VAT exemption fund management

On 2 November 2021, the Dutch Ministerial decree on the value-added tax (VAT) exemption for fund management was updated. The update was necessitated by Dutch Supreme Court case law from December 2020, which paved the way for a broader interpretation of specific state supervision than the earlier decree envisioned.

By way of introduction and before addressing the update regarding the interpretation of the conditions of specific state supervision, we wish to note that the updated decree includes an additional (fourth) condition that needs to be met to allow classification as a special investment fund. The fourth condition stipulates that each investor must have a proportionate stake in the investments through participation in the fund but cannot own the fund's investments. Below we have stipulated all conditions to be met to enable classification as a special investment fund.

1. The fund must be financed by more than one participant of the fund
2. The contributed funds must be pooled for collective investment including risk-spreading
3. The investment risk must be borne by the participants
4. Through their participation in the fund, each investor has a proportionate stake in the investments, but does not own the fund's investments as such
5. The fund must be subject to specific state supervision

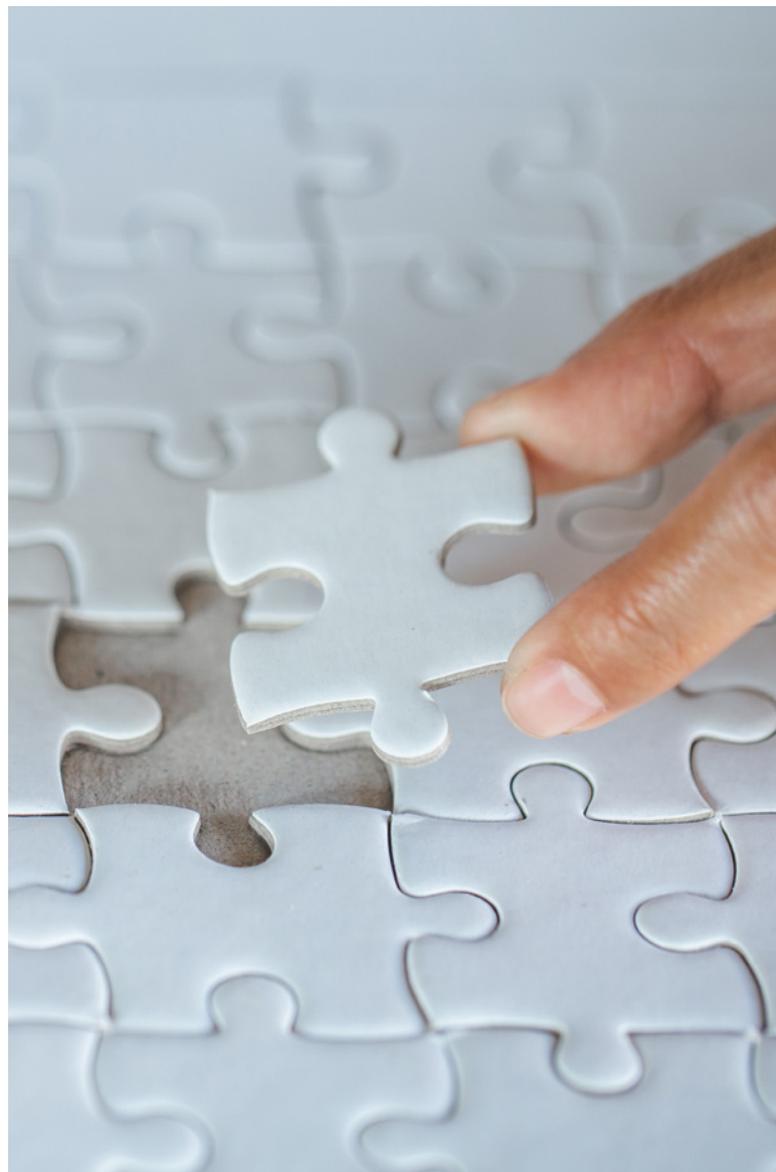
The fourth condition, it should be noted, derives from the Dutch Supreme Court case law and has not been identified as a separate condition by the Court of Justice of the European Union in its case law.

Specific state supervision

The main reason for updating the VAT decree was the broader interpretation of the required specific state supervision by the Supreme Court. The updated VAT decree addresses a few specific situations concerning institutions and funds where, because of the broader interpretation by the Supreme Court, the condition of specific state supervision is met. Please find below an overview of the updates.

- The updated VAT decree addresses the licensing obligations of banks. Banks that have a banking licence from the Dutch Central Bank are allowed to provide investment services under this licence and are now also eligible for the fund exemptions
- The VAT decree also confirms that the criterion of specific state supervision can be met in relation to investment funds exempt from corporate income tax, mutual funds, etc., if they fall within one of the categories of specific state supervision referred to in the policy statement. The VAT decree explicitly states that conditions 1 through 4 must also be met for the VAT exemption for management services to apply

As a final note, the VAT decree does not address all situations that may occur in practice. Situations not explicitly referred to in the VAT decree must continue to be assessed on a case-by-case basis to establish whether they are subject to specific state supervision.



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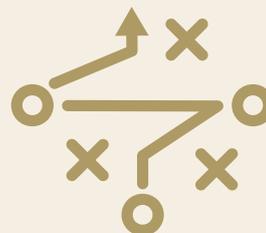


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