Commission de Surveillance
du Secteur Financier

CSSF FAQ on Circular CSSF 02/77

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CSSF FAQ on Circular CSSF 02/77

CONTEXT

Please find hereafter a list of questions/answers in relation to the provisions of Circular CSSF 02/77 concerning the protection of investors in case of NAV calculation error and correction of the consequences resulting from non-compliance with the investment rules applicable to undertakings for collective investment.

The CSSF FAQ on Circular CSSF 02/77 applies to UCITS and UCI subject to Part II of the 2010 Law and outlines the principles to be applied by SIFs (hereafter "UCI").

This document will be updated when necessary and the CSSF reserves the right to adapt its approach to any matter covered by the Q&A at any time.
You should regularly check the website of the CSSF in relation to any matter of importance to you to see if questions have been added and/or positions have been adapted.

Update information

20/06/2024	Question 4 was modified and became Q4.b; Q4.a was added
28/07/2020	Question 11 was added
07/07/2020	First publication

Commission de Surveillance du Secteur Financier

CSSF FAQ on Circular CSSF 02/77

Chapter I - General application of Circular CSSF 02/77

Q1. In case of an active non-compliance by a UCITS of the cumulative investment restriction of Article 43(2) of the 2010 Law (i.e. 5/40%), which securities should be sold to remediate the breach and what are the acceptable methods for calculating the related financial impacts?

Published on: 07/07/2020

The 2010 Law foresees in relation to the 5/40% investment restriction for UCITS the following:

"The total value of the transferable securities and money market instruments held by a UCITS in the issuing bodies in each of which it invests more than 5% of its assets shall not exceed 40% of the value of its assets".

In case of an active non-compliance with that investment restriction, the UCITS does not necessarily have to sell the securities that caused the breach.

It is rather the responsibility of the UCITS to determine, in accordance with the rules outlined below, which security should be sold in order to remediate promptly the active non-compliance.

Example: Following the 9% of total net assets (hereafter "TNA") purchase of a position on Equity A, the portfolio is notably composed as follows:

- 9% of TNA of Equity A
- 8% of TNA of Equity B
- 8% of TNA of Equity C
- 9% of TNA of Equity D
- 9% of TNA of Equity E

The portfolio composition in this case is in breach of the 5/40% restriction as the sum of the securities with positions greater than 5% of TNA equals 43%.

Rather than selling the excess position on Equity A, the UCITS remediates the breach through the sale of the excess position on Equity B.

For the financial impact calculation, three methods are acceptable provided the conditions set out in Chapter II of this Q&A referring particularly to the consistency of the remediation methods are complied with:

a) calculate the impact by reference to the security that caused the breach by applying the accounting method in proportion to the amount in breach (i.e. impact calculated on the excess position on Equity A);

b) calculate the impact by reference to the security that has been sold by applying the accounting method in proportion to the amount in breach (i.e. impact calculated on the excess position on Equity B);
c) calculate the impact by using the economic method in proportion to the amount in breach i.e. impact being calculated by comparing the performance of the reference of the portfolio to the average performance of the securities having positions above 5% or to the performance of the securities that generated the breach) with a consistent use of the method over time.

In case the internal policy of the IFM, does not lay down in writing the method to be used, the CSSF considers that method a) should be applied by default.

Q2. In the case of an active non-compliance with investment restrictions ("active investment breach") that corrects itself through market evolution or new subscriptions (i.e. without any sale of the securities involved in the active investment breach), should the financial impact calculation for determining the potential compensation be performed by reference to the unrealised profit or loss of the security that generated the breach?

Published on: 07/07/2020

Yes.

Promptly upon discovering an active investment breach, the necessary steps have to be taken to remediate the breach. In case the active investment breach is corrected by market evolution or by new subscriptions, the unrealised loss generated by the holding of the excess position of security during the period where the fund was in breach (i.e. start of the breach until the correction) should be compensated to the fund.

Q3. Should an active "intraday" investment breach (i.e. an investment breach that occurs and is corrected on the same trade date) be reported to the CSSF and compensated in accordance with the provisions of Circular CSSF 02/77?

Published on: 07/07/2020

Yes.

All active investment breaches that occur between two official NAVs have to be reported to the CSSF. If as a result of such an active "intraday" investment breach the fund suffers a loss the provisions of Circular CSSF 02/77 have to be applied as investment restrictions have to be complied with on an ongoing basis.

Q4.a What are the elements that UCITS have to consider from an investment compliance perspective in the context of the US T+1 move?

Published on: 20/06/2024

The Central Securities Depositories Regulation (CSDR) of 23 July 2014 on improving securities settlement in the European Union and central securities depositories introduced the requirement in the EU that all transactions in transferable securities, which are executed on trading venues, are settled by no later than the second business day after their trade date ("T+2" settlement cycle). With effect from end of May 2024, most securities transactions in the United States, as well as other jurisdictions (Canada and Mexico), have moved from a standard settlement cycle of T+2 to T+1.

The applicable settlement cycles and related developments have an impact on the operations of UCITS (and other investment funds). A particular attention in this context relates to the interaction between the settlement cycles of securities transactions (asset side) and fund dealings (subscriptions/redemptions - liability side). When determining the settlement cycle for the fund dealings, UCITS shall notably consider the target markets of their investment policy and their distribution set-up (e.g. local distribution, international distribution), including the parties/intermediaries involved in the related processes. The settlement cycle of UCITS is generally T+2 or T+3, with deviations relating to the individual features and operating model of the fund. The T+3 cycle is typically applied in cases of cross-border distribution with time zone differences.

UCITS have already in the past (i.e. before the move in the US to shorten the settlement cycle to T+1) been confronted with timing gaps between the settlement cycles of their securities transactions and their fund dealings. Such timing gaps, subject to further increase in the absence of any change in the settlement cycle of UCITS dealings as a result of the developments in the US, might give rise under certain circumstances to operational challenges, including from an investment compliance perspective. More particularly, in relation to subscriptions/redemptions transactions, UCITS could face under certain circumstances investment compliance issues concerning the deposit limit laid down in Article 43(1) of the Law of 17 December 2010 relating to undertakings for collective investment ("2010 Law"), ancillary liquid assets laid down in Article 41(2) of the 2010 Law and the temporary borrowing limit set forth in Article 50(2) of the 2010 Law.

The generally applicable principle is that UCITS adhere on an ongoing basis to the applicable investment restrictions.

As a result, UCITS should in their activities, including in case of subscriptions / redemptions and related securities purchase/sales transactions, take the appropriate measures to ensure their ongoing compliance with the applicable investment restrictions. Compliance checks on a pre-trade basis should consider settlement cycles so as to avoid non-compliance with applicable investment restrictions.

With regard to **timing gaps in settlement cycles** from a general perspective and the recent move in the US to T+1 in particular, UCITS can avail themselves of measures/tools for managing these timing gaps. Subject to a feasibility/impact assessment to be led by the UCITS and the consideration of investors' interests, these **measures/tools** include, for instance, the following:

- A shortening of the settlement cycle of the UCITS dealings in order to ensure a better alignment with the settlement cycle(s) applicable to the securities transactions operated by the UCITS. The feasibility/impact assessment should notably consider the securities markets (with the applicable settlement cycle) in which a UCITS operates as a result of its investment policy as well as its distribution policy, including related operational constraints.

- The operation of cash management solutions such as so-called "cash sweep" programs. Under "cash sweep" programs, cash balances are moved, at the end of the day, to other banks or are invested in cash-like instruments (e.g. money market funds) to ensure that the UCITS adheres to the 20% deposit limit per single body, respectively the 20% limit on ancillary liquid assets.

- The diversification of bank relationships by opening an additional bank account for the UCITS with another counterparty.

- Temporary borrowings, limited to 10% in accordance with Article 50 of the 2010 Law, may permit, under certain circumstances and when deemed in the best interest of investors, to bridge the timing gap between incoming payments from subscriptions (e.g. on T+3 for UCITS operating such a settlement cycle) and outgoing payments for related securities purchases (e.g. on T+1 for securities dealt on US markets).

- The use of extended settlement periods, when possible and in the best interest of investors, that broker-dealers can offer to IFMs / portfolio managers under certain conditions (see SEC.gov | Shortening the Securities Transaction Settlement Cycle).

UCITS should also consider the timing of the investments of the incoming payments from subscriptions in securities markets, considering elements such as for example the settlement cycles, the subscription amounts, investment compliance (notably also temporary borrowing limit), borrowing costs, dilution effects.

Before the US T+1 move, UCITS had already to manage in a proactive manner settlement timing gaps between fund dealings and securities markets operations.

In this context, the CSSF acknowledges that **UCITS**, having well considered the above-mentioned principles, the possibilities given for managing timing gaps and the best interests of investors, might **under certain exceptional circumstances face temporary breaches of investment restrictions** that could **reasonably not be avoided** (so-called "passive breach").

Such passive breaches should, in principle, resolve themselves upon final settlement of the fund dealings or securities transactions. In case of a non-compliance qualifying as beyond the control, UCITS have, in accordance with Article 49(2) of the 2010 Law, to adopt as a priority objective for its sales transactions the remedying of that situation, taking due account of the interests of its investors.

The CSSF expects UCITS to be able to justify the "passive" character of breaches.

Cases of active non-compliance as a result of timing gaps in settlement cycles have to be dealt with and corrected in accordance with the provisions of Circular CSSF 02/77.[1]

Q4.b Should the following situations be treated as an active investment breach by a UCITS of the 20% deposit limit of Article 43(1) of the 2010 Law in accordance with the provisions of Circular CSSF 02/77?

Updated on: 20/06/2024

a) Generally speaking, the internal organisation of a fund should provide for a prompt and timely information to the IFM about subscription and/or redemption requests, especially in case of larger capital transactions, allowing the IFM to anticipate as much as possible fund dealings and related payment flows (in accordance with the settlement cycle of the UCITS) and to take on that basis the necessary measures for ensuring that the portfolio transactions to be carried out as a result of these capital transactions (with their corresponding settlement cycle) allow an ongoing compliance of the UCITS with the applicable investment restrictions.

[1] Circular CSSF 02/77 will be replaced by Circular CSSF 24/856 with effect from 1 January 2025.

Take the example of a fund where, due to a settlement date mismatch between the capital activity and the portfolio transactions, the 20% deposit limit of Article 43 of the 2010 Law is exceeded. More particularly, a fund with regular capital transactions from investors has on T a 18% deposit with a single counterparty. For that fund a 5% redemption that settles on T+3 and a corresponding 5% securities sale instructed by the IFM for settlement on T+1 lead to a deposit position above 20% with the same counterparty during two days.
In that context and given the characteristics of the fund, the IFM should have taken the necessary measures for handling possible excess deposits with a given counterparty and should have anticipated on T that the fund will be non-compliant with the 20% deposit limit. The resulting non-compliance from such anticipated subscriptions/redemptions is avoidable and thus not beyond the control of the UCITS. The breach is considered active.

b) On the same trade date, purchase transactions and sales transactions of securities with different settlement dates are concluded.

For example, a 5% purchase of security A that settles on T+2 and a 5% sale of security B that settles on T+1 lead to a deposit position above 20% with the same counterparty during one day.

The cash inflow in relation to the sale of security B causes the deposit limit to be exceeded between T+1 and T+2.

As the settlement date mismatch is predictable/avoidable and thus not beyond the control of the UCITS, the breach is considered active.

c) In relation to the maturity of a security held in the UCITS portfolio, a cash inflow is generated and leads to an increase of the deposit position above 20% with the same counterparty.

For example, a 5% position in a bond matures that leads to a deposit position above 20% with the same counterparty. As the expiry of a bond is a predictable/avoidable event and thus not beyond the control of the UCITS, the breach is considered active.

Generally speaking, the CSSF expects that the organisation of the portfolio management by the IFM at the level of the UCITS (i.e. the investment operations, the cash management and the subscription/redemption flows) should provide for an ongoing compliance of the 20% limit on deposits made with a single body.

Nevertheless, even if a UCITS has taken the necessary steps to ensure ongoing compliance with the 20% deposit limit and the settlement date mismatch is predictable, it might under certain justified exceptional circumstances face a temporary breach which cannot reasonably be avoided and thus is beyond the control of the fund ("passive breach"). The CSSF expects such UCITS to be able to justify the "passive" character of the breach and to document it accordingly while, in accordance with Article 49(2) of the 2010 Law, adopting as a priority objective for its sales transactions the remedying of that situation, taking due account of the interests of its investors.

Q5. In case of an active investment breach by a UCITS of the 20% deposit limit of Article 43(1) of the 2010 Law where the deposit returns a negative interest to the UCITS, can the UCITS calculate the financial impact of the breach by using a method which consists in comparing the interest rate return borne by the UCITS to the interest rate return of an equivalent deposit made with another credit institution?

Published on: 07/07/2020

No.

The CSSF considers that a UCITS should be indemnified in relation to the interest rate and other charges borne by the UCITS as a result of the excess deposit position.

As a consequence, the application of a method that consists in comparing the interest rates between different bank accounts to determine the financial impact is not allowed.

Q6. For UCI, should a "Remedial Action Plan" or a "Notification", as laid down in Circular CSSF 02/77, be prepared and provided to the CSSF in the following situations?

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a) An investment breach beyond the control of the UCI ("passive breach").

No.

However, the IFM shall adopt as a priority objective for its sales transactions the remediation of the passive investment breach, taking due account of the interests of the investors. This includes notably also the monitoring of the remediation of the situation within a reasonable amount of time.

b) **A material NAV calculation error with no subscriptions and redemptions occurring during the NAV error period and no related compensation amounts to be paid to the fund or to the investors.**

See response c) below.

c) **An active investment breach for which the corrective action resulted in a gain for the fund.**

For (b) and (c) the following answer applies:

Only a notification by means of the CSSF notification form available on the CSSF website (including the financial impact calculation) should be sent to the CSSF.

In accordance with the layout of the notification form, UCIs should include therein the corrective measures taken in order to avoid recurrence of the same kind of material NAV calculation error/compliance breach.

In addition, the approved statutory auditor of the UCI has to review the correction process in the context of its annual audit of the fund and provide the related results in the Long Form Report and/or the Management Letter.

d) **An active investment breach where the compensation amount for the fund exceeds EUR 25,000 and no compensation is to be paid to investors in the fund.**

The notification form (including the financial impact calculation) and a Remedial Action Plan have to be prepared and communicated to the CSSF as foreseen in section I 3 a) of Circular CSSF 02/77. The approved statutory auditor of the UCI has to prepare the specific reports foreseen in section I 3 d) of Circular CSSF 02/77.

For specialised investment funds (SIFs) subject to the Law of 13 February 2007, please refer to Q9 of this FAQ.

Q7. When the UCI makes use of the de minimis amount for compensating the investors who are financially impacted in the context of a material NAV error calculation, should the UCI seek prior approval from the CSSF?

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No.

The CSSF can however ask the UCI to justify on an ex-post basis the level of the "de minimis" amount applied and to provide documentary evidence that such amount represents the bank charges necessary to transfer the compensation amounts to investors (notably where the "de minimis" amount exceeds EUR 25).

In addition, the internal policy of the IFM should provide for the use and the level of the "de minimis" amount in relation to NAV calculation errors.

Q8. Does Circular CSSF 02/77 apply to non-compliance by UCITS with the collateral diversification rules laid down in paragraph 43(e) of the ESMA document "Guidelines on ETFs and other UCITS issues" (ref.: ESMA/2014/937EN, dated 1 August 2014) as implemented by means of Circular CSSF 14/592?

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Yes.

Active non-compliance with the diversification rules set out in point 43(e) of the ESMA Guidelines concerning the diversification of collateral received by UCITS to reduce the counterparty risk exposure arising from OTC financial derivative transactions and efficient portfolio management techniques have to be notified to the CSSF.

A financial impact calculation will however only be necessary in case of a counterparty default.

Circular CSSF 02/77 also applies to all other criteria that the collateral has to observe in accordance with point 43 of the ESMA Guidelines.

Q9. Does Circular CSSF 02/77 apply to NAV calculation errors and active investment breaches that occur in specialised investment funds (SIFs) subject to the Law of 13 February 2007?

Published on: 07/07/2020

Yes.

The CSSF considers that SIFs may either opt for the application of Circular CSSF 02/77 or set other specific internal rules applicable in the context of NAV calculation errors and active investment breaches.

When SIFs opt for the provisions of Circular CSSF 02/77, a remedial action plan need not be prepared in accordance with Circular CSSF 02/77. The approved statutory auditor does however have to review the correction process and the compensation that remedy the situation, and confirm in the management letter that they complied with the provisions of Circular CSSF 02/77.

When opting for specific internal rules, SIFs have to apply appropriate thresholds taking due account of the investment policy of the SIF.

As a result, the CSSF considers that SIFs that do not set specific rules in their internal procedures have to apply the provisions of Circular CSSF 02/77. In addition, all material NAV calculation errors and active investment breaches of a SIF have to be notified to the CSSF by means of the CSSF notification form, whether the SIF applies the provisions of Circular CSSF 02/77 or other specific internal rules.

Q10. In case of a material NAV calculation error or an active investment breach that has to be notified to the CSSF in accordance with the provisions of Circular CSSF 02/77, does the CSSF confirm in writing the closure of the treatment of the notification?

Published on: 07/07/2020

No.

However, the CSSF can, on an ex-post basis, raise additional questions in relation to the notification or require further remedial action if the corrective measures implemented at the level of the fund are not deemed sufficient or in line with the requirements of Circular CSSF 02/77.

Q11. Should a UCITS that exceeds the level of leverage as disclosed to investors in the fund prospectus in accordance with box 24 of the CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR/10/788 dated 28 July 2010) for UCITS, respectively should a regulated AIF") that exceeds the leverage limits as disclosed to investors in accordance with Article 21(1)(a) of the Law of 12 July 2013, notify such situation to the CSSF in the context of the provisions of Circular CSSF 02/77?

Published on: 28/07/2020

No.

However, the CSSF expects that such a breach is adequately monitored and corrected in accordance with applicable internal procedures (escalation, etc.).

Chapter II – Selection of the correction method

Q12. What are the organisational requirements that apply in the context of NAV calculation errors and active investment breaches falling under Circular CSSF 02/77?

Published on: 07/07/2020

In accordance with article 109(1)(a) of the Law of 17 December 2010 relating to undertakings for collective investment, respectively Article 16 of the Law of 12 July 2013 on alternative investment fund managers, investment fund managers (i.e. UCITS management companies, authorised AIFM, self-managed UCITS and AIFs) are required to have, among others, sound administrative and accounting procedures as well as adequate internal control mechanisms.

On that basis, the CSSF considers that the organisation of investment fund managers (whether Luxembourg-based or not) managing Luxembourg domiciled funds shall provide for robust policies, processes and procedures governing the treatment of NAV calculation errors and investment breaches.

More particularly in this context, investment fund managers have to establish and implement a detailed policy approved by the Board of Directors of the investment fund manager and, if applicable, by the Board of Directors of the UCI.

The policy and the related operational procedures should, in particular, cover the following elements (non-exhaustive list):

- the governance process, together with the different stakeholders involved, applied in relation to the NAV calculation errors and investment breaches;
- the oversight of the delegate in case of delegation of activities pertaining to the NAV calculation and investment compliance;
- the definition of active vs. passive investment breach and applicable criteria (considering notably the events that are or not beyond the control of the UCI);
- the different steps, with the associated timeline, in relation to the correction of NAV calculation errors and active investment breaches;
- the NAV error threshold applicable for each sub-fund;
- the use and the level of de minimis;

- the methodology used by sub-fund for the financial impact calculation in case of active investment breaches: accounting (e.g. Average Weighted Cost, LIFO, FIFO) vs. economic method (setting the comparative reference index to be used by sub-fund);

- the application of the compound or non-compound method used by sub-fund for the financial impact calculation in case of material NAV calculation errors (the compound method is a method where each NAV calculated during the material error period, is corrected by (i) the direct effect of the NAV calculation error and (ii) by the indirect effect linked to cumulative subscriptions/redemptions made at an incorrect NAV during the material NAV calculation error period). The non-compound method ignores the cumulative effects of points i) and ii) above in each NAV calculated during the material error period;

- the periodic review of the adequacy and the effectiveness of the policy, processes and procedures applied in relation to Circular CSSF 02/77.

Specialised Investment Funds ("SIFs") which are not referred to in the specific provisions of Part II of the Law of 13 February 2007 (hereafter "2007 Law") and which are subject to the provisions of the CSSF Regulation No 15-07 laying down detailed rules for the application of Article 42a of the 2007 Law as regards the requirements in relation to risk management and conflicts of interest should also establish and implement such a policy.

The CSSF also recommends UCIs subject to Part II of the Law of 17 December 2010 which are not managed by an authorised alternative investment fund manager as defined in the Law of 12 July 2013 to establish and implement such a policy.

Q13. What are the conditions that UCIs have to comply with when applying the economic method to determine the financial impact caused to a UCI in the case of an active investment breach in accordance with Circular CSSF 02/77?

Published on: 07/07/2020

The economic method, in accordance with Circular CSSF 02/77, calculates the compensation by reference to the performance which would have been realised in case the non-compliant investments would have had the same fluctuations as the portfolio invested in compliance with the investment policy and the investment restrictions provided for by law or the prospectus.

Following Circular CSSF 02/77 that allows the use of the economic method if there is an adequate justification therefore, the following principles have to be observed when using an economic method:

- the selected reference is in line with the investment policy as laid down in the prospectus;

- it is used in a consistent way in the sense that active investment breaches of the same nature occurring at the level of a given UCI are dealt with in accordance with the same method;

- it is documented in an adequate way in the internal policy of the Investment Fund Manager covering investment breaches whereby this policy has to cover all UCI, to define, among others, the method for determining the compensation, including the comparative performance to be used once the decision was made to use the "economic method".

The IFM should be able to demonstrate and to evidence with the necessary documentation (including among others, objective elements) that the comparative performance and the method for determining the compensation do not prejudice the investors and have not been chosen with the objective to minimise compensation payments.

The economic method can only be used if it is formally laid down in the internal policy of the IFM. Otherwise, the CSSF expects the accounting method to be used.

Q14. In applying the economic method, can the performance of a non-eligible asset be compared to the performance of a reference being representative of the investment policy of the UCI in order to determine the compensation amount?

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Yes.

The selected reference is only acceptable if it is a fair representation of the investment policy (or part thereof) of the UCI as laid down in the prospectus and therefore provides for a performance that could be expected by the investors. Otherwise, the CSSF expects the accounting method to be used.

An acceptable reference is, for instance, the benchmark index of the UCI. For example, in case the reference index of a mixed fund is a composite index represented by a 50% bond index and a 50% equity index (the combination of those benchmarks being representative of the whole portfolio), then the prejudice in relation to a breach in the equity part of the fund can be calculated by reference to the equity index (with a consistent use of the method over time).

In all cases, the performance of the selected reference will be compared to the performance of the non-eligible asset for calculating the compensation amount.

Q15. In applying the economic method, can the performance of a non-eligible asset be compared to a corresponding eligible asset having the same characteristics in order to determine the compensation amount?

Published on: 07/07/2020

No.

The method that only compares the performance of a non-eligible asset with a corresponding eligible asset is not acceptable.

Q16. Who is responsible for choosing between the economic and accounting method for the determination of the prejudice suffered by the UCI in case of an active investment breach?

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The Board of Directors of the Investment Fund Manager, and, if applicable, the Board of Directors of the UCI, are in charge of the internal policy governing the treatment of investment breaches. On that basis, they are ultimately responsible for the method used for the determination of the compensation amount.

In case of an umbrella fund, the choice of the methodology ("economic" or "accounting") can be done for the entity as a whole or at the level of each sub-fund individually.

Q17. Is it possible, within the same UCI, to use the accounting method to calculate the compensation amount for certain active investment breaches (e.g. Article 50(2) of the 2010 Law) and to use an economic method to calculate the compensation amount for other types of active investment breaches (e.g. diversification limits of the 2010 Law)?

Published on: 07/07/2020

Yes, if this is formally laid down in the internal policy of the IFM and applied on a consistent basis.

Q18. Under what conditions can a change of the method in the correction of an investment breach be accepted within the meaning of Circular CSSF 02/77?

Published on: 07/07/2020

A change of the correction method (e.g. from the accounting to the economic method) is only possible if there is an adequate justification for such a change.

First, a change of the correction method has to be approved by the Board of Directors of the Investment Fund Manager and, if applicable, the Board of Directors of the UCI.

Second, a change of the correction method is in principle not allowed when it is decided in the context of the handling of a given investment breach. For instance, the CSSF considers in principle that if in the past a given type of investment breach has always been corrected by applying the accounting method, then it is not possible to use the economic method afterwards in the context of the occurrence of the same type of investment breach. It is only upon prior approval by the Board of Directors of the Investment Fund Manager and, if applicable, the Board of Directors of the UCI, that the method can be changed for a next investment breach of the same type that will occur.

Finally, the CSSF considers that consistency must exist in the application of the chosen method. For example, when the economic method has been adopted, it must be applied consistently.

Chapter III – Tolerance threshold of Circular CSSF 02/77

Q19. Do the tolerance thresholds provided for by Circular CSSF 02/77 (e.g. 0.50% of the NAV for bond funds, 1% for equity and other funds) also apply to errors in the calculation of fees and costs borne by the UCI that led to payments higher than the fees/costs laid down in the prospectus of the UCI?

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No.

The tolerance thresholds provided for by Circular CSSF 02/77 cannot be used to refuse reimbursement of overcharged fees/costs.

The overcharged fees/costs borne by the UCI have to be reimbursed to the UCI in all cases, irrespective of whether or not the overpayment is material compared to the threshold applicable in accordance with Circular CSSF 02/77.

The recalculation of the NAV is, however, only necessary in situations where the reimbursed fees/costs exceed the materiality threshold applicable in accordance with Circular CSSF 02/77.

Q20. In case the tolerance threshold applied to the fund (according to the internally approved policy) in case of NAV calculation errors is lower than that prescribed in Circular CSSF 02/77 or even not applied at all, do the corresponding NAV calculation errors have to be notified to the CSSF?

Published on: 07/07/2020

Yes.

In that case, all provisions (e.g. remedial action plan) of Circular CSSF 02/77 have to be applied based on the lower thresholds as determined for the UCI.

Q21. What should be the applicable materiality threshold for UCIs being fund of funds, index trackers or feeder funds?

Published on: 07/07/2020

The applicable materiality threshold for NAV calculation errors for such funds should be defined by reference to the investment policy laid down in the prospectus.

For instance:

- a fund which is a fund of funds and whose investment policy provides for investments in other bond funds (resp. money market/cash funds, mixed funds) should be considered as a bond fund (resp. money market/cash funds, mixed funds) for the purpose of determining the materiality threshold;

- a fund which is an index tracker and whose investment policy provides for investments in a bond index (resp. money market/cash index, mixed index) through a synthetic replication method should be considered as a bond fund (resp. money market/cash funds, mixed funds) for the purpose of determining the materiality threshold;

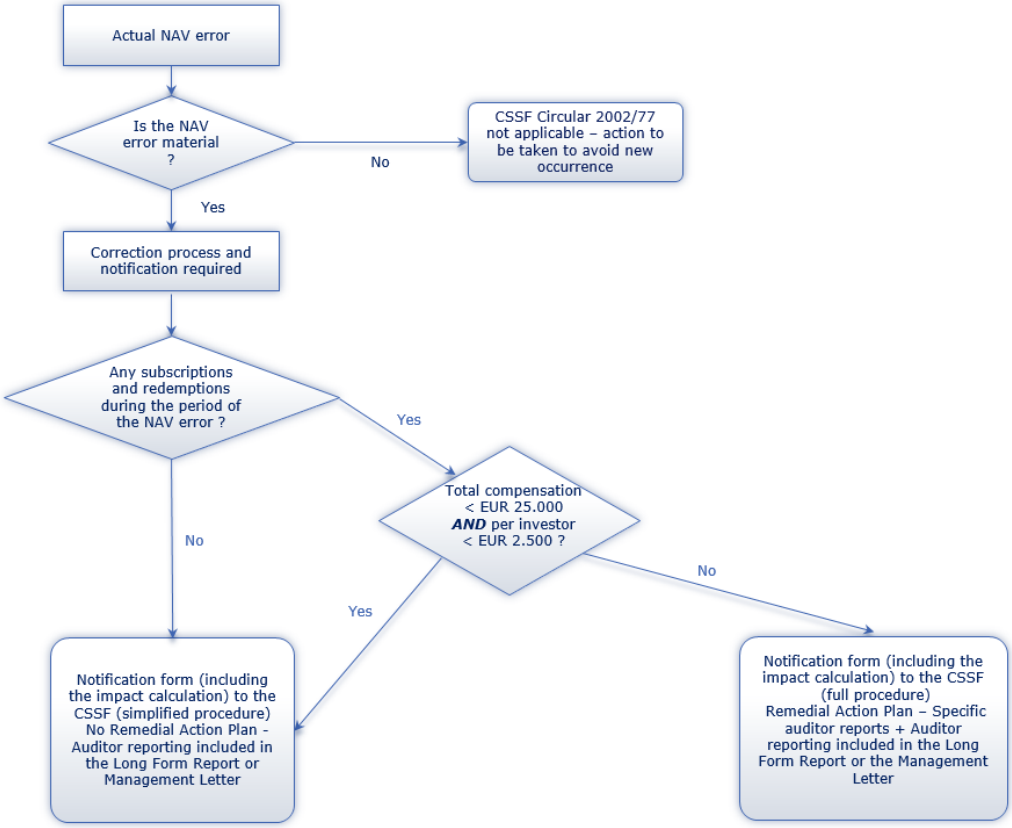
- a fund which is a feeder fund and where the master fund, in accordance with its investment policy, invests only in bonds (resp. money market/cash or mixed instruments) should be considered as a bond fund (resp. money market/cash funds, mixed funds) for the purpose of determining the materiality threshold.

The approach that simply considers fund investments as equity and therefore systematically applies the 1% threshold of Circular CSSF 02/77 applicable to equity and other funds, irrespective of the investment policy, is not acceptable.

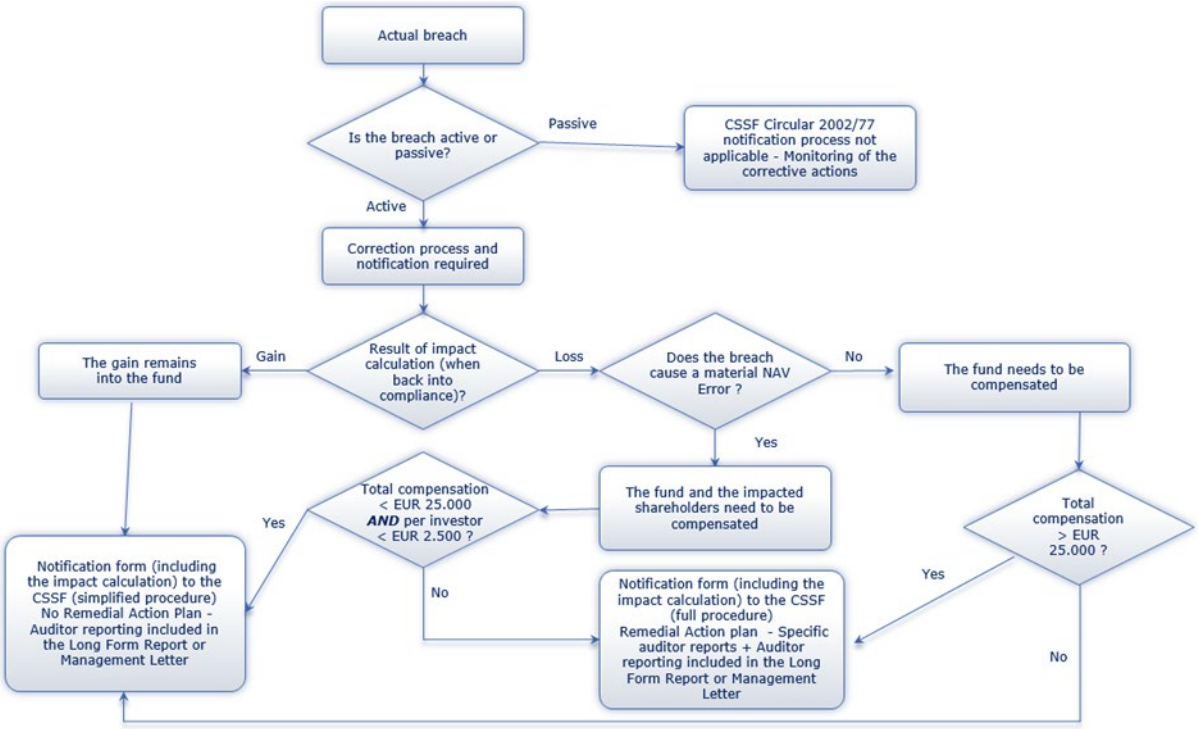
Commission de Surveillance du Secteur Financier

APPENDIX

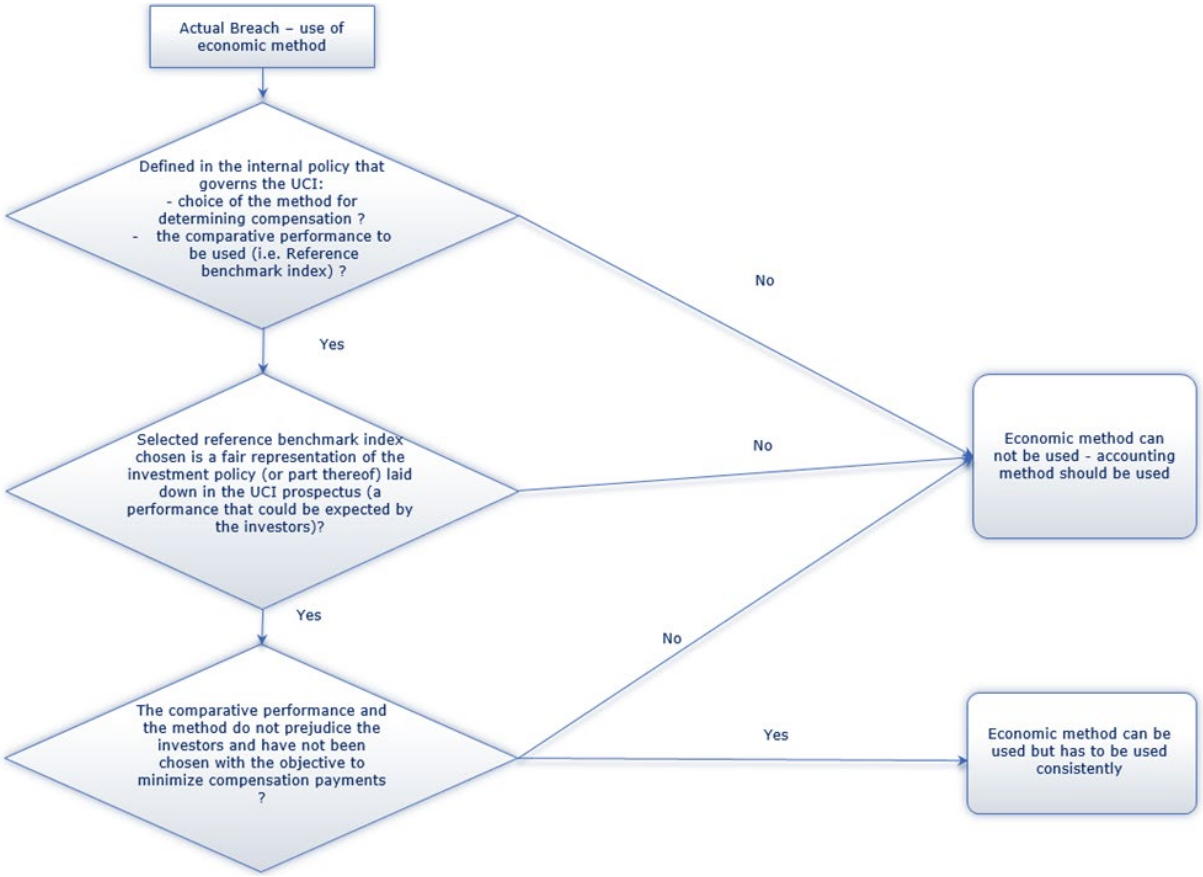
1. Decision tree for NAV calculation errors



2. Decision tree for investment breaches



3. Decision tree for the use of economic/accounting method



Commission de Surveillance du Secteur Financier
283, route d'Arlon
L-2991 Luxembourg (+352) 26 25 1-1
direction@cssf.lu
www.cssf.lu