Commission de Surveillance
du Secteur Financier

Thematic Review
–
Self-assessment questionnaires submitted by IFMs relating to Circular CSSF 21/789 (as amended by Circular CSSF 23/839)
–
Findings and recommendations

TABLE OF CONTENTS

Acronyms 4

I. Context 6

II. Findings and recommendations 6

1. Section I – Shareholding structure and own funds 6

1.1. Shareholding structure 6
1.2. Own funds 6

2. Section Ia – Premises in Luxembourg, resources and accounting function 8

2.1. Premises in Luxembourg 8
2.2. Human resources 8
2.3. Accounting function 9

3. Section II – Governance 9

3.1. Members of the governing body or management body 9
3.1.1. Depositary independence provisions 9
3.1.2. Similar composition of the governing body/management body of IFMs and managed SICAV(s) 9
3.2. Senior management 10
3.2.1. Frequency of meetings 10

4. Section III – Permanent risk management function 10

4.1. Organisation and independence 10
4.1.1. Organisation 10
4.1.2. Independence of the valuation function 11
4.1.3. Independence of the internal audit function 11
4.2. Scope of work of the function 11
4.3. Limits and controls 12
4.3.1. Involvement of the management body/governing body and the executive committee 12
4.3.2. Documentation of the work carried out by the function 12
4.3.3. Stress tests and scenario analyses 12

5. Section IV – Permanent compliance function 13

5.1. Organisation and independence 13
5.1.1. Organisation 13
5.1.2. Policy, procedures and compliance charter 13
5.2. Scope of work of the function 13

6. Section V – Permanent internal audit function 14

6.1. Organisation 14
6.2. Summary report of the internal audit function 14

7. Section VI – Procedures and policies 15

7.1. General information 15
7.1.1. Approval of new business relationships and new products 16
7.2. Conflicts of interest 16

8. Section VIa – Remuneration 18
9. Section VII – Delegation 18
9.1. Delegation of the functions other than portfolio management 18
9.1.1. Delegation and sub-delegation framework procedure 18
9.2. Delegation of the portfolio management function 19
9.2.1. General information 19
10. Section VIII – IT function 19
10.1. Policies and procedures 19
10.2. IT systems 20
10.2.1. IFMs carrying out portfolio management internally - Assessment of the systems used 20
10.2.2. IFMs acting as UCI administrator - Assessment of the systems used 20
11. Section IX – Other key functions 21
11.1. Marketing function 21
11.2. Valuation function 21
11.2.1. Depositary acting as external valuer 21
11.2.2. Segregation of the valuation and portfolio management functions 21
12. Section X – Other requirements 22
12.1. General information 22
13. Section XI – General remarks 22

Acronyms and definitions

AIFM	Alternative Investment Fund Manager
AIFM Law	Law of 12 July 2013 on alternative investment fund managers, as amended
CMP	Compliance Monitoring Plan
Circular CSSF 18/698	Authorisation and organisation of investment fund managers incorporated under Luxembourg law; Specific provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent
Circular CSSF 21/789	Circular CSSF 21/789 (as amended by Circular CSSF 23/839) Practical rules concerning the self-assessment questionnaire to be submitted annually by investment fund managers. The engagement of investment fund managers' approved statutory auditors and practical rules concerning the management letter and the separate report to be drawn up annually
Circular CSSF 21/782	Adoption of the revised guidelines, by EBA, on money laundering and terrorist financing risk factors
Circular CSSF 22/811	Circular CSSF 22/811 (as amended by Circular CSSF 25/900) Authorisation and organisation of entities acting as UCI administrators
Circular CSSF 25/882	Circular CSSF 25/882 (as amended by Circular CSSF 26/915) on requirements on the use of ICT third-party services for Financial Entities subject to the Digital Operational Resilience Act (DORA)
CISERO	Collective Investment Sector Reporting Tool
CSA	Common Supervisory Action
CSSF	Commission de Surveillance du Secteur Financier
DR 2016/438	Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries
DR 231/2013	Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision
EBA	European Banking Authority
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
FTE	Full-time equivalent
IFM	Investment Fund Manager
ManCo15	Management company subject to Chapter 15 of the UCI Law
MiFID II Directive	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
ML/TF	Money Laundering/Terrorist Financing
RCSSF 10-4	CSSF Regulation No 10-4 transposing Commission Directive 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company
RCSSF 12-02	CSSF Regulation No 12-02 of 14 December 2012 on the fight against money laundering and terrorist financing
PRCF	Person responsible for the permanent compliance function

PRMF	Person responsible for the risk management function
UCI Law	Law of 17 December 2010 relating to undertakings for collective investment, as amended
UCITS Directive	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
Questionnaire	The self-assessment questionnaire to be submitted on an annual basis by investment fund managers in accordance with Circular CSSF 21/789

I. Context

On 21 December 2021, the CSSF published Circular CSSF 21/789 with the purpose of improving the CSSF's risk-based prudential supervision of IFMs.

Circular CSSF 21/789 introduced a Questionnaire through which the IFMs falling within its scope periodically carry out a self-assessment of their compliance with the legal and regulatory requirements. The Questionnaire, available to IFMs via the CISERO module on the CSSF's eDesk portal, is organised into predefined themes that can be customised based on the IFM's authorisations.

Depending on the developments of the legal and regulatory requirements applicable to IFMs and of the prudential supervision, the Questionnaire may be subject to adaptations. During the first two years of its application, the Questionnaire was updated by the CSSF in order to clarify certain subjects, taking into account the applicable legislation. One major change to the Questionnaire to be submitted as from 31 December 2024 concerned IFMs also subject to the MiFID II Directive.

This thematic review includes:

- **the findings of the CSSF resulting from the analysis of the Questionnaires for the years 2021, 2022 and 2023 following the publication of Circular CSSF 21/789; and**
- **the recommendations related to these findings.**

The CSSF invites all IFMs to compare their self-assessment with these findings and to proceed, where relevant, with the necessary corrective measures.

II. Findings and recommendations

1. Section I – Shareholding structure and own funds

1.1. Shareholding structure

The CSSF observed that, in most cases, the modifications to the (direct or indirect) qualified shareholding of IFMs were notified in advance for the purpose of authorisation.

However, as notifications are not systematically submitted by all IFMs, and referring to Article 108(1) of the UCI Law and/or Article 9(1) of the AIFM Law, **the CSSF reiterates that any modification to the direct or indirect qualified shareholding of IFMs is subject to prior notification for the purpose of authorisation by the CSSF**.

1.2. Own funds

Control of required own funds

Pursuant to point 44 of Circular CSSF 18/698, IFMs must implement procedures that allow them to calculate at any time the minimum amount of own funds required under the applicable laws and regulations (i.e. required own funds) as well as the eligible capital available to them. In this context **the CSSF expects IFMs to verify, at least on a quarterly basis, that their eligible capital covers the required own funds**. While a vast majority of IFMs (87% in 2021, 95% in 2023)

perform this verification on a monthly or quarterly basis, for a minority of IFMs such verifications are carried out less frequently.

The CSSF would like to remind IFMs that they must comply, at all times, with the legal and regulatory own funds requirements, and that they must carry out, on a quarterly basis at least, the necessary controls to meet this requirement.

Availability and investment of own funds

While an increasing number of IFMs (88% in 2021, 92% in 2023) regularly ensure that their own funds are invested in liquid assets or easily convertible assets in the short-term and that they do not include speculative positions, a limited number of IFMs do not perform such reviews.

Consequently, the CSSF reiterates that IFMs must regularly perform controls to ensure compliance with minimum own funds under Article 102(1)(b) of the UCI Law and/or Article 8(8) of the AIFM Law. These requirements must be maintained at their permanent disposal and invested in their own interest to guarantee the continuity and regularity of their activities and services.

The CSSF also restates that, as mentioned in the document FAQ – Submission of closing documents and financial information by managers, **the "à recevoir" items are not to be considered as liquid assets** for the purpose of application of the rules on own funds.

Guarantee

The CSSF also observes that, although provided for by Article 102(1)(a) of the UCI Law or Article 8(6) of the AIFM Law, as applicable, only a restricted number of IFMs benefit from a guarantee allowing them not to provide up to 50% of the additional amount of own funds required. Some IFMs did not notify the CSSF of the use of such guarantee.

In this context, and with reference to point 34 of Circular CSSF 18/698, **the CSSF restates that the provision or withdrawal of such guarantee as well as any change regarding the conditions of this guarantee are subject to prior notification to the CSSF**. Moreover, some IFMs mistook this guarantee for the professional indemnity insurance used to cover professional liability risks. The CSSF would like to specify that the guarantee indicated in the Questionnaire only relates to the additional own funds requirement. The Questionnaire was updated accordingly.

Professional indemnity insurance

Finally, slightly more than half of the AIFMs (with a downward trend over the last three years) chose, where applicable, to cover potential professional liability risks resulting from activities carried out pursuant to the AIFM Law through professional indemnity insurance. In this context, the CSSF reiterates that:

- **AIFMs are responsible for monitoring, on a regular basis, that this insurance complies with the provisions of Articles 12 and 15 of DR 231/2013**;
- pursuant to Article 15(2) of DR 231/2013, **any agreed defined excess must be fully covered by own funds**. The amount of this defined excess must thus be added to the required own funds;
- **AIFMs may cover potential professional liability risks within the framework of the activities carried out by them pursuant to the AIFM Law either through additional own funds or through a professional indemnity insurance, taking into consideration that the two options cannot be combined.** A tooltip was included in the

Questionnaire to clarify this point. Where an AIFM holds an insurance but decides to cover potential liability risks arising from professional negligence through own funds, the AIFM must not report the fact that it holds an insurance in the Questionnaire. **Any change will have to be notified to the CSSF.**

Finally, as a reminder, clarifications on the own-funds calculation methods are provided in the document FAQ concerning the Luxembourg Law of 12 July 2013 on alternative investment fund managers.

2. Section Ia – Premises in Luxembourg, resources and accounting function

2.1. Premises in Luxembourg

As regards the three years under review, access to the premises of about 93% of IFMs was secure and restricted to their staff. However, for a limited number of IFMs, persons who were not part of their staff, such as persons linked to the group to which the IFMs belong, had access to the premises.

As a consequence, referring to point 152 of Circular CSSF 18/698, **the CSSF would like to highlight the importance of securing access to the IFMs' premises and limiting such access to their staff and, where applicable, to certain persons previously authorised by the IFM** (e.g. internal audit, IT team members, management of the group). Where this is not the case, mitigation measures must be implemented in order to prevent confidentiality, conflicts of interest and security issues. Thus, the CSSF reminds IFMs not fulfilling this provision to comply with it.

2.2. Human resources

Between 2021 and 2023, IFMs recorded a substantial increase in their staff numbers. The personnel employed in Luxembourg rose from 6,528 staff members in 2021 to 7,708 in 2023, i.e. an 18.1% growth over two years.

By incorporating the staff of IFM branches, the total figure rose from 8,404 to 10,532 employees, representing a 25.3% progression over that period.

This progression is notably reflected in the increase of average staff members per IFM, which rose from 21 to 26 employees in Luxembourg, and approximately 27 to 35 employees per IFM where branches are included.

This development was also associated with an increase in the average number of managers, from 3 to 4 per IFM over the same period.

Thus, all IFMs effectively employ at least three FTE employees who spend their work time performing key functions as provided for in point 595 of Circular CSSF 18/698.

The CSSF points out that the key functions are those laid down in point 1(15) of Circular CSSF 18/698 and that the persons referred to are not limited to persons in management positions.

2.3. Accounting function

Most IFMs maintain a sound organisation of the accounting function, in line with Section 5.1.3. of Circular CSSF 18/698, which sets out that:

- **every IFM must establish, implement and maintain accounting policies and procedures** providing financial information which reflects a true and fair view of the IFM's financial situation;
- **the accounting documents relating to the activities of the IFM must always be available and/or accessible electronically at the head office of the IFM in Luxembourg** to enable the IFM to draw up a balance sheet and a profit and loss account in an independent way;
- **IFMs must have in place accounting procedures** that comply with the provisions laid down in points 150 and 151 of Circular CSSF 18/698.

Referring to sub-chapter 1.3. of Circular CSSF 25/882, the CSSF reminds IFMs **using an accounting system that is located outside of Luxembourg** (accounting system hosting services) independently or in connection with the outsourcing of operational tasks of the accounting function, that they must have, at the end of each day, **a secure backup of all end-of-day accounting positions**, including client positions, in a readable format, to guarantee an autonomous preparation of a balance sheet, a profit and loss account and client positions.

This backup must be **stored at the premises of the IFM in Luxembourg, of a group entity located in the EEA or of another service provider** (i.e. a service provider different from the one that provides the accounting system hosting service) **located in the EEA**.

3. Section II – Governance

3.1. Members of the governing body or management body

3.1.1. Depositary independence provisions

In 2023, the members of the governing body/management body of a very limited number of IFMs were also employed by the depositary of one or several investment funds that they manage.

The IFMs concerned, which hold at the same time an authorisation as an AIFM and as a ManCo15, adopted a dualistic structure fulfilling the independence requirements as regards the ManCo15 and the depositary activities set out in DR 2016/438 and further detailed in Section 5 of the FAQ concerning the Luxembourg Law of 17 December 2010 relating to undertakings for collective investment – CSSF.

The CSSF strongly recommends AIFMs to comply with the independence provisions of the UCITS Directive.

3.1.2. Similar composition of the management body/governing body of IFMs and managed SICAV(s)

One fifth (20%) of IFMs do not comply with the recommendation set out in point 65 of Circular CSSF 18/698, according to which "with respect to the management of UCIs which adopted the form of a

company, it is recommended that the management body/governing body of the IFM and of the UCI concerned do not mainly consist of the same persons".

The CSSF stresses that IFMs must take all reasonable steps to avoid conflicts of interest. **Consequently, the CSSF requests that IFMs review the composition of these two bodies in order to avoid as much as possible potential conflicts of interest. In this respect, a different composition of the boards of directors of the two entities or, alternatively, the appointment of one or more independent directors at the level of the management body/governing body of the IFM and/or the UCI, constitute measures aimed at ensuring the impartiality of decisions and reducing the risk of conflicts of interest. Furthermore, this type of conflicts of interest must at least be included in the IFMs' record of conflicts of interest and mitigated through appropriate mitigation measures.**

Conflicts of interest

A vast majority of IFMs (96% in 2023) perform controls on the mandates held by the members of their management body/governing body.

With reference to points 67 and 68 of Circular CSSF 18/698, **the CSSF reiterates the importance of performing such controls in order to "identify the conflicts of interest which could result from this organisation and strive to avoid them in accordance with the procedures provided for in the conflict of interest policy of the IFM" and to ensure that every member of the management body/governing body of the IFM "dedicates the required time and attention to his/her duties**".

3.2. Senior management

3.2.1. Frequency of meetings

In 2023, 84% of IFMs (77% in 2021) held meetings of their executive committee at least on a monthly basis.

With reference to point 100 of Circular CSSF 18/698, the CSSF draws attention to the fact that "the conducting officers must be in regular contact with each other and hold periodic meetings in Luxembourg **at least on a monthly basis** or more frequently having regard to the size and organisation of the IFM and the nature, scale and complexity of its activities". As already highlighted in the CSSF's 2023 Annual Report, **such meetings must be properly documented in writing**. This documentation includes, inter alia, the agenda and the minutes of the meetings recording the decisions and measures taken by the executive committee.

4. Section III – Permanent risk management function

4.1. Organisation and independence

4.1.1. Organisation

In 2023, for 65% of IFMs (67% in 2021), the PRMF was also the conducting officer (*dirigeant*) in charge of this function.

The CSSF would like to remind IFMs that, in order to ensure sound governance and compliance with the four-eyes principle, it is the IFM's responsibility to assess the relevance of such combination of roles from both an organisational and conflicts of interest perspective while taking into account the nature, scale and complexity of the IFM's activities. For information purposes, it should be noted that, for these 65% of IFMs over the three years analysed, the risk management function has consisted of an average of three persons.

4.1.2. Independence of the valuation function

In 2023, where the risk management function and the valuation function were under the responsibility of the same conducting officer, 94% of AIFMs had implemented mitigation measures in order to reduce the risk of conflicts of interest.

In accordance with Article 14 of the AIFM Law pursuant to which the risk management function must be independent from the business units, the CSSF reiterates that AIFMs must, in particular, ensure the independence between the risk management and valuation activities. In this context, reference is made to point 533 of Circular CSSF 18/698, which recommends the separation of the risk management function and the valuation function where AIFMs predominantly manage strategies and complex and illiquid financial instruments.

4.1.3. Independence of the internal audit function

In most cases, the internal audit function is performed collectively by the executive committee.

The CSSF restates that it is essential for the internal audit function to operate independently and in compliance with the principle of segregation of duties in order to identify any risk of non-compliance by the IFM with the applicable legal and regulatory requirements. **To this end, the RRMF cannot be in charge of the internal audit function and s/he must perform his/her function under the direct responsibility of the conducting officer in charge of the risk management function, unless the RRMF also acts as conducting officer in charge of the risk management function and that the internal audit function reports to the executive committee in a collegial manner.**

4.2. Scope of work of the permanent risk management function

For the three years reviewed, a minority of IFMs reported that the risk management function does not cover the activities of branches, representative offices, agencies and subsidiaries.

Referring to, inter alia, points 168, 569 and 576 of Circular CSSF 18/698, **the CSSF emphasises that the risk management function must cover the activities carried out in the above-mentioned entities and that the description of the risk management process must also be appropriate and proportionate to the activities of these entities.**

4.3. Limits and controls

4.3.1. Involvement of the governing body/management body and of the executive committee

Over the three years analysed, nearly all IFMs have reported having involved the governing body/management body in validating the risk profile for each managed fund and the executive committee in adopting the risk limit system for each managed fund.

In this context, the CSSF notes that IFMs are properly taking into account the importance of the risk profile and internal limit systems in their risk management arrangements, as highlighted in the CSSF's 2015 Annual Report (pp. 181-182) and under point 92 of Circular CSSF 18/698, as well as the importance of the involvement of and validation by the above-mentioned bodies.

4.3.2. Documentation of the work carried out by the permanent risk management function

For nearly all IFMs, the interventions by the permanent risk management function have been documented.

In this respect, **the CSSF underlines, in line with point 195 of Circular CSSF 18/698, the importance of the permanent risk management function documenting all its interventions. Furthermore, it is crucial that the RRMF ensures effective follow-up to its recommendations regarding identified issues, deficiencies, and irregularities and that s/he reports regularly on this subject to the senior management and management body/governing body of the IFM.**

4.3.3. Stress tests and scenario analyses

Some IFMs conduct neither periodic stress tests nor scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the managed funds and in particular within the context of liquidity management.

Consequently, the CSSF reiterates, with reference to points 205 and 207 of Circular CSSF 18/698 that the risk management policy must cover at least the elements referred to in Article 43 of RCSSF 10-4 and Article 40 of DR 231/2013, in particular the description of the techniques, tools and arrangements allowing IFMs to measure and manage risks. **In this respect, IFMs must, among others, conduct periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions that might adversely impact the managed funds.** The risk management policy of IFMs must also include the techniques, tools and arrangements concerning the liquidity risk management procedure which IFMs must apply, where appropriate. This procedure must ensure that the liquidity profile of the investments of each fund is appropriate to the redemption policy laid down in the management regulations or the instruments of incorporation or the prospectus, in accordance with the provisions laid down in Article 45 of RCSSF 10-4, Article 15 of the AIFM Law and Articles 46 to 49 of DR 231/2013. These provisions specify also the IFMs' obligations with respect to stress tests in the context of liquidity management.

5. Section IV – Permanent compliance function

5.1. Organisation and independence

5.1.1. Organisation

For over 90% of IFMs, the permanent compliance function is performed internally. In more than half of these cases, the PRCF also serves as the conducting officer in charge of this function. Moreover, the number of IFMs with this overlap (i.e. the combination PRCF and conducting officer) grew (54% in 2021 to 63% in 2023).

The CSSF would like to remind that, in order to ensure sound governance and compliance with the four-eyes principle, it is the IFM's responsibility to assess the relevance of such combination of roles from both an organisational and conflicts of interest perspective, taking into account the nature, scale and complexity of the IFM's activities.

In 2023, two-thirds IFMs had between two and five persons in their permanent compliance function.

The CSSF emphasises, per point 178 of Circular CSSF 18/698, that all staff engaged in control functions - both conducting officers and persons performing these functions —must regularly update their knowledge and undergo relevant training.

5.1.2. Policy, procedures and compliance charter

All IFMs reported having a compliance policy, procedures, and charter in 2023. They confirmed compliance with points 163, 164, 165, 171, 173, and 227 of Circular CSSF 18/698.

The CSSF expects each IFM to have a CMP adopted using a risk-based approach which includes the monitored activities, the risk assessed for each activity and the timetable set for carrying out the monitoring provided for following a multi-year programme.

The CSSF emphasises that the CMP must, at a minimum, address the following areas: governance and procedures of the IFM, administration of managed funds, functions outlined in point 94 of Circular CSSF 18/698, depositaries, supervision of delegates. Moreover, it is essential that the CMP clearly highlights the monitoring carried out by the other departments within the IFM where the permanent compliance function relies on this monitoring.

Since end 2023, all IFMs have been complying with points 229 and 230 of Circular CSSF 18/698.

Finally, the CSSF expects the PRCF to report at least monthly to the senior management and at least quarterly to the IFM's management body/governing body. This report must be discussed and documented during the above-mentioned meetings.

5.2. Scope of work of the permanent compliance function

As already mentioned for the permanent risk management function in point 4.3. and although mentioned in points 168 and 576 of Circular CSSF 18/698, **for a few IFMs, the permanent compliance function does not cover the activities of branches, representative offices, agencies and subsidiaries owned by these IFMs, where appropriate. In this regard, the CSSF would like to remind that these activities must be covered by the function.**

Although only a limited number of IFMs do not comply with this, it also seems necessary to reiterate the aspects mentioned in point 233 of Circular CSSF 18/698 on the responsibilities of the compliance function.

In this context, the CSSF underlines the importance of consulting the permanent compliance function beforehand, particularly before taking major strategic decisions such as the launch of a new type of activity, product or business relationship, as well as when expanding the IFM's transactions at international level.

6. Section V – Permanent internal audit function

6.1. Organisation

Over the three years, 87% of IFMs have constantly used a specialised external firm to implement the permanent internal audit function.

As regards the internal audit function reports, the CSSF observed a **quality difference** between the reports from specialised firms to which the function was entrusted and those drawn up by the internal audit function of the group to which the IFM belongs, where appropriate.

Charter and internal audit plan

It should be noted that over the three years and with very few exceptions, the operational arrangements of the internal audit function in terms of objectives, responsibilities and powers have been laid down in an internal audit charter. Moreover, for at least 99% of IFMs over the three-year period, the internal audit function effectively has assessed the various elements set out in point 270 of Circular CSSF 18/698.

Although point 287 of Circular CSSF 18/698 states that all internal audit duties must be planned and executed in accordance with an "internal audit plan" drawn up by the person responsible for the internal audit function for a period of several years **(generally three years), in 2023**, 20% of IFMs had an audit plan covering either a shorter period (16% over a period of one year), or a longer period (3% over a four-year period and 1% over a five-year period).

In this context, the CSSF recommends that IFMs having an internal audit plan with a periodicity of more than three years implement a three-year internal audit plan. The CSSF further restates, with reference to point 288 of Circular CSSF 18/698, that "the plan [must be] discussed with the senior management and submitted to the latter for approval, confirmed, where appropriate, by the audit committee and ultimately approved by the management body/governing body".

6.2. Summary report of the internal audit function

Over the three-year period, more than 95% of IFMs have confirmed that the summary report of the internal audit function covered at least the elements referred to in point 299 of Circular CSSF 18/698.

The CSSF points out that the internal audit function must cover at least these elements for a period of several years (generally three years). In this respect, and with reference to, inter alia, Article 10(4) of RCSSF 10-4 and Article 60(4) of DR 231/2013 which provides that "an

AIFM shall ensure that its senior management receives on a frequent basis, and at least annually, written reports on matters of compliance, internal audit and risk management indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies", **the CSSF reminds that the internal audit must carry out this monitoring annually**.

The CSSF also stresses, with reference to Article 44(2) of RCSSF 12-02, that **compliance with the professional obligations as regards the fight against money laundering and terrorist financing must be part of the annual mission of the internal audit function.**

Moreover, the CSSF would like to remind IFMs that if they make use of the internal audit function of the group to which they belong, the internal audit function must cover the activities carried out by IFMs and the summary report must be dedicated to the latter (i.e. it must not cover other activities carried out by other entities within the group).

Finally, it should be borne in mind that the **summary report** must be provided to the CSSF **within five months following the end of the financial year** of the IFM.

7. Section VI – Procedures and policies

7.1. General information

Whilst all AIFMs confirmed that, over the past three consecutive years, they have had a procedure in place for handling claims and complaints and, in 2023, a policy on conflicts of interest and remuneration, this has not been the case for procedures relating, in particular, to personal transactions, rules of conduct and the exercise of voting rights.

The CSSF restates that:

- pursuant to Article 14 of RCSSF 10-4 and Article 63 of DR 231/2013, **IFMs must have written procedures regarding personal transactions.** A list of all personal transactions notified to or identified by the IFM must be available at its head office in Luxembourg;
- RCSSF 10-4 and DR 231/2013 explain the content of some rules of conduct and operating conditions provided for in Article 111 of the UCI Law and Article 11 of the AIFM Law. **Thus, the IFM must act in the best interests of the managed UCIs and of the investors in these UCIs.** IFMs must also implement procedures, arrangements and policies that allow them to ensure, inter alia, that the elements referred to in point 386 of Circular CSSF 18/698 are complied with;
- pursuant to Article 23 of RCSSF 10-4 and Article 37 of DR 231/2013, **the IFM must, among others, develop an adequate and effective strategy for determining when and how voting rights attached to instruments held in the managed portfolios are to be exercised**, to the exclusive benefit of the UCI concerned and its investors.

The CSSF further reiterates, with reference to point 357 or 358 of Circular CSSF 18/698 that every IFM must, in accordance with Article 5(1)(a), (b) and (d) of RCSSF 10-4 and Article 57(1)(a), (b) and (d) of DR 231/2013, **have a precise and clear manual of procedures which describes, in particular, its internal functioning, the allocation of tasks among its staff as well as the reporting lines.** This manual of procedures must be available at the head office of the IFM, accessible to its staff and kept up to date taking into account the evolution of the IFM's business.

7.1.1. Approval of new business relationships and new products

Although most of the IFMs confirm that they give their approval for the launch of new products and new relationships, it is not the case for around 20% of IFMs.

The CSSF reiterates, with reference, among others, to Article 26 of RCSSF 10-4, Articles 18 and 19 of DR 231/2013 and to RCSSF 12-02, **that every IFM must implement arrangements allowing the identification and assessment of risks, including with respect to ML/TF notably regulatory and operational risks, related to:**

- the launch of a UCI, a compartment or a new type of assets;

- the creation of any new business relationship (especially with a new UCI initiator, a delegate or any business relationship during the exercise of the discretionary management and ancillary services, where appropriate) ; and

- the intervention of an IFM on new markets or geographic areas.

To this end, the IFM must refer to Chapter 9 of Title III of the Joint Guidelines (EBA/ESMA/EIOPA) on ML/TF risk factors adopted by Circular CSSF 21/782, in particular, to points 16.5 to 16.12. These arrangements must be based on the implementation of adequate procedures and the use of an approval committee within the IFM. The procedures must provide for the consultation with the risk management and compliance functions as well as escalation measures, particularly in case of disagreement between the stakeholders. **The CSSF requests the IFMs concerned to implement an approval procedure for new business relationships and new products.**

7.2. Conflicts of interest

All IFMs keep and regularly update a conflict of interest record in accordance with Article 22(1) of RCSSF 10-4 and Article 35 of DR 231/2013. In 2023:

- 35% of IFMs did not identify any conflicts of interest;
- 60% of IFMs identified between 1 and 25;
- 5% of IFMs identified more than 25.

The CSSF reiterates the importance, for all IFMs, of:

- **identifying possible conflicts of interest** which may arise between the manager, the managed funds, the investors and the other parties, notably the general partner, the investment adviser, the external valuer and the delegates;
- **preventing and managing these conflicts** through a written policy for the identification, prevention and management of conflicts of interest;
- **keeping a conflict of interest record** which lists the identified cases and the corrective measures applied
- **informing the investors of significant conflicts of interest** which cannot be avoided, with an explanation of the related risks;
- **implementing control mechanisms**, such as, among others, segregation of duties, independent supervision and escalation procedures;
- **ensuring** that the CSSF has **access, upon request, to the documents** in order to guarantee transparency and compliance.

For example, the following situations may constitute conflicts of interest:

-
- overlap of persons between the management body/governing body of the IFM and that of the UCI which adopted the form of a company;
- the dominant role of a person through the combination of key functions in the IFM's organisation, notably majority shareholder, member of the management body/governing body, member of the senior management responsible for business functions;
- combination of the risk management and compliance functions by the same person without additional employees supporting the person responsible for the two functions during the daily work;
- implementation of committees composed of members belonging to the group to which the IFM belongs or representing a service provider such as an investment adviser;
- financial gain of the IFM to the detriment of a fund or a client: excessive rotation of the portfolio to generate commissions;
- financial advantages to the detriment of a client or a fund: the IFM or its delegate generates a gain or avoids financial loss to the detriment of a managed fund or a client by investing, for example, preferentially in internal or group products instead of more relevant products for the client or the fund;
- unjustified breakdown of market orders: where an IFM or its delegate affects primarily certain securities or positions to specific portfolios to the detriment of other funds;
- related-party transactions: the acquisition, on behalf of a fund, of securities issued by a company affiliated with the IFM or the group to which the IFM belongs constitutes a situation likely to generate a conflict of interest, the moment the interests of the affiliated company or, more broadly, those of the group could diverge from those of the fund and its investors. Consequently, this situation requires an identification, management and, where applicable, an appropriate prevention of the conflict of interest in order to ensure that the investment decisions are taken in the interest of the fund and of its investors;
- divergent interests on the redemption of units: conflict between investors wishing to get their investment reimbursed and those preferring to remain invested, which may encourage the IFM or its delegate to invest in less liquid assets despite the redemption policy;
- interdependence between the IFM and one or several clients: business dependence vis-à-vis one or several clients that is too great. The IFMs managing products on the initiative of third parties (white-label platform) must in particular assess their business dependence on their clients;
- group link: common shareholder at the level of the IFM, the portfolio manager, the investment adviser and/or the depositary: risk that individual interests of companies might be subordinated to the group's global interests.

Given the different forms that conflicts of interest may take, the CSSF encourages the IFMs managing UCIs marketed to retail investors to designate as member of their governing body or their servicer - except in case of stricter regulatory provisions - at least one independent director.

Finally, the CSSF requests all IFMs and in particular those that did not identify conflicts of interest to review and update their conflict of interest records, notably in view of the examples cited above.

8. Section VIa – Remuneration

All IFMs confirm that they implemented a remuneration policy that complies with Articles 111a, 111b of the UCI Law, or with Article 12 of the AIFM Law, and compatible with a sound and prudent risk management. However, in 2023, 6% of IFMs (10% in 2021) indicated that the remuneration of the staff of the internal control functions was linked to the performance of the activities they controlled or was determined according to other criteria which compromised the objectivity of the work carried out by the internal control functions.

The CSSF reiterates that, when implementing a remuneration policy, IFMs must, among others:

- adopt a proportionate approach, aligned with the size, the structure and the level of risk of the managed funds;
- structure the remuneration so as to avoid excessive risk-taking and ensure the independence of the internal control functions;
- identify the categories of staff concerned;
- use risk-adjusted performance indicators;
- ensure that the variable remuneration can be reduced or cancelled in case of under-performance or bad risk management.

9. Section VII – Delegation

9.1. Delegation of the functions other than portfolio management

9.1.1. Delegation and sub-delegation framework procedure

Over the three years, most of the IFMs have defined and implemented a procedure covering all aspects of the delegation, as well as the sub-delegation.

With reference to point 422 or 423 of Circular CSSF 18/698, **the CSSF reiterates nevertheless that the requirements which apply when delegating the performance of functions on behalf of IFMs must apply *mutatis mutandis* in case the delegate sub-delegates the functions which were delegated to it and in case of any subsequent level of sub-delegation**. **Thus, the conditions associated with a sub-delegation are subject to the same requirements and IFMs must consequently include the sub-delegation in their framework procedure.**

For the sake of sound governance, risk monitoring and risk management, the CSSF recommends that IFMs implement a tool for monitoring critical and/or important delegations and sub-delegations allowing them to have a structured and documented view of the relations with third parties, including notably for every (sub-)delegation:

- **a unique identifier;**
- **key information on (sub-) delegates (names, registration country, LEI, contact details);**
- **key contractual terms (start date, next contract renewal date, end date and/or notice period, legislation applicable to the contract, competent jurisdiction, annual cost);**

- **identification of the type of delegated function (IT, control function, portfolio management, etc.) and the nature of the delegation (succinct description of delegated tasks);**
- **monitoring of the assessments (date and conclusion of criticality assessments, date of the next contemplated due diligence, name of the person or the body of the IFM that approved the (sub-)delegation).**

The CSSF deems that the implementation of a register listing the above-mentioned elements is a good practice.

Moreover, it should be noted that a vast majority of IFMs has indeed implemented a multi-year plan for conducting periodic due diligence on delegates, updated according to a risk-based approach. 55% of due diligence was carried out every three years, 25% every two years, 20% every year.

9.2. Delegation of the portfolio management function

9.2.1. General information

As regards the IFMs delegating the portfolio management function, the countries where the delegates were mainly located in 2023 were, in descending order: the United Kingdom, the United States, Switzerland, Germany and France.

In 99% of the cases, the delegate is an undertaking authorised or registered for the purposes of asset management. In this context, **the CSSF reiterates that an AIFM contemplating to delegate portfolio management to an undertaking that is not authorised or registered for the purposes of asset management and not subject to supervision, must request a prior authorisation from the CSSF in accordance with Article 18(1)(c) of the AIFM Law**.

The CSSF also refers to the thematic review on the delegation of the portfolio management function and **the measures to be implemented by IFMs**: Communication on the CSSF thematic review on the delegation of the portfolio management function by investment fund managers (IFMs) – CSSF Feedback report.

10. Section VIII – IT function

10.1. Policies and procedures

Over the three years, most of the IFMs (95% in 2021, 99% in 2023) have confirmed, with reference to Article 5(2) of RCSSF 10-4 or Article 57(2) of DR 231/2013, to have implemented policies and procedures covering the organisation of the IT function, IT security as well as the business continuity plan and the disaster recovery plan.

10.2. IT systems

10.2.1. IFMs carrying out portfolio management internally - Assessment of the systems used

Constantly over the three years, about 70% of IFMs carrying out portfolio management internally have confirmed, in accordance with Articles 8 and 15 of RCSSF 10-4 as well as Articles 58 and 64 of DR 231/2013, that they regularly assessed and that they had suitable IT systems so as to permit the timely and proper recording of each portfolio transaction.

For 30% of IFMs that indicated not to comply with this requirement, the information provided for 2023 allowed establishing that:

- the large majority of IFMs had alternative systems that were less elaborate taking into account the low volume of transactions to be carried out;
- for other IFMs, the assessment carried out has not been documented. **In this context, the CSSF reiterates the importance of all the work carried out by IFMs being documented**.

The CSSF also highlights that in case of delegation of portfolio management, IFMs must ensure that the delegates have suitable IT systems so as to permit the timely and proper recording of each portfolio transaction in accordance with Articles 8 and 15 of RCSSF 10-4 as well as Articles 58 and 64 of DR 231/2013.

10.2.2. IFMs acting as UCI administrator - Assessment of the systems used

Constantly over the three years, about 65% of IFMs carrying out registrar and/or NAV calculation and accounting functions have indicated, in accordance with Articles 8 and 16 of RCSSF 10-4 as well as Articles 58 and 65 of DR 231/2013, that they regularly assessed and that they had suitable IT systems so as to permit the timely and proper recording of each repurchase/subscription and maintenance of the shareholder register.

For 35% of IFMs that indicated not to comply with this requirement, the explanations provided for 2023 allowed establishing that:

- a large majority of IFMs had alternative systems that were less elaborate taking into account the low volume of transactions to be carried out;
- some IFMs did not select the option "Not applicable". The CSSF highlights that if the IFM does not act as UCI administrator within the meaning of Circular CSSF 22/811, "Not applicable" must be indicated in the Questionnaire;
- for other IFMs, the assessment carried out has not been documented. **In this context, the CSSF reiterates the importance of all the work carried out by IFMs being documented**.

The CSSF also highlights that in case of delegation of the registrar and/or NAV calculation and accounting functions, IFMs must ensure that the delegates have suitable IT systems so as to permit the timely and proper recording of each repurchase/subscription and maintenance of the shareholder register in accordance with Articles 8 and 16 of RCSSF 10-4 as well as Articles 58 and 65 of DR 231/2013.

11. Section IX – Other key functions

11.1. Marketing function

Despite a positive development over the three years analysed, it has to be noted that, in 2023, about 9% of IFMs (24% in 2021) did not have a marketing procedure.

The CSSF reiterates that, irrespective of the organisation of the function (i.e. delegated or carried out internally), **each IFM must implement the procedures and arrangements so as to ensure that the marketing of UCIs is carried out in compliance with the legal and regulatory provisions in force** particularly those of the UCI Law and AIFM Law. This concerns especially the initial due diligence and ongoing monitoring obligations of intermediaries responsible for the marketing function, and with whom the IFM has a direct relationship, as well as legal and regulatory provisions on the fight against money laundering and terrorist financing.

11.2. Valuation function

11.2.1. Depositary acting as external valuer

A minority of AIFMs (4% in 2021, 3% in 2022 and 2% in 2023) designated the depositary as external valuer. Across all the AIFMs concerned, except for one, all confirmed, with reference to Article 17(4) of the AIFM Law, that they ensured that the depositary had indeed functionally and hierarchically separated the performance of its depositary functions from its tasks as external valuer and the potential conflicts of interest are properly identified, managed, monitored and disclosed to the investors of the AIF. As regards the non-compliant AIFM, the latter and the depositary ended their contractual relation as the above-mentioned regulatory requirements could not be observed.

11.2.2. Segregation of the valuation and portfolio management functions

Over the three years, most of the AIFMs (96%) have repeatedly indicated that the persons active in portfolio management had not been involved in the valuation function. As for the AIFMs that have mentioned an involvement of persons in those two functions (among others via the participation in a committee without voting rights or by providing certain information useful for the valuation), in most cases the explanations provided allowed concluding that there was a segregation of the two functions. **The other AIFMs are reminded, with reference to Article 17(4)(b) of the AIFM Law, that the valuation function may be carried out internally within the AIFM "provided that the valuation task is functionally independent from the portfolio management and the remuneration policy and other measures ensure that conflicts of interest are mitigated and that undue influence upon the employees is prevented".**

The CSSF also refers to the CSA carried out on the valuation function and the CSSF's observations: CSSF feedback report on ESMA Common Supervisory Action on valuation.

12. Section X – Other requirements

12.1. General information

It has to be noted that, over the three years analysed, the number of IFMs with branches outside Luxembourg increased (from 28% in 2021 to 35% in 2023). The IFMs concerned also confirmed that their procedures indeed covered the activities of their branch(es).

The CSSF reiterates that the internal control functions must also cover the activity of branches and, pursuant to Circulars CSSF 15/633 and 10/467, the IFMs with one or several branches must communicate not only the version "L" of the periodic accounting tables (only figures of the head office established in Luxembourg), but also versions "N" (overall figures including figures of the head office and of all branches) and "S" (figures of each branch separately), as detailed in Section B of the document FAQ – Submission of closing documents and financial information by managers.

13. Section XI – General remarks

The "General Information" section includes the information that is generated when making available the reports to IFMs in CISERO, which may explain that certain information included do not reflect an up-to-date situation. This could be the case, for example, for an AIFM holding a ManCo15 and AIFM authorisation until 15/12/N and having renounced its ManCo15 authorisation as of that date. If the reports were made available to the IFM on 10/12/N, they will state that the IFM holds both authorisations. As the information is not updated dynamically, it will be updated during the next financial year.