

**COMMISSION de SURVEILLANCE
du SECTEUR FINANCIER**

In case of discrepancies between the French and the English text, the French text shall prevail

Luxembourg, 15 April 2011

To all Luxembourg management companies subject to Chapter 15 of the Law of 17 December 2010 relating to undertakings for collective investment and to SIAGs within the meaning of Article 27 of the Law of 17 December 2010 regarding undertakings for collective investment.

CSSF CIRCULAR 11/508

Concerns: New provisions applicable to Luxembourg management companies subject to Chapter 15 of the Law of 17 December 2010 relating to undertakings for collective investment and to investment companies which have not designated a management company within the meaning of Article 27 of the Law of 17 December 2010 relating to undertakings for collective investment

Ladies and Gentlemen,

The purpose of this Circular is to clarify the main adjustments that each management company currently subject to Chapter 13 of the Law of 20 December 2002 regarding undertakings for collective investment (hereafter the "2002 Law") shall comply with in order to comply by 1 July 2011 with Chapter 15 of the Law of 17 December 2010 relating to undertakings for collective investment (hereafter the "2010 Law") and CSSF Regulation N° 10-4 transposing Commission Directive 2010/43/EC of 1 July 2010 (hereafter the "Regulation 10-4").

In this context, the Commission for the Supervision of the Financial Sector (hereafter the "CSSF") requests each management company to submit until **1 June 2011 at the latest**, an update of its authorisation file completed with the new requirements under the 2010 Law and Regulation 10-4. **The documents and information to be provided to the CSSF by each management company in the context of the update of its authorisation file are set out in more detail in annex 1.**

The provisions of this Circular apply to the activity of a management company subject to Chapter 15 of the 2010 Law, irrespective of the type of UCIs (UCITS, UCI, SIF, etc.) it manages.

This Circular is also applicable to investment companies which have not designated a management company within the meaning of Article 27 of the Law of 17 December 2010 regarding undertakings for collective investment (hereafter "SIAG"). In the same manner as management companies, they have to complete their authorisation file by **1 June 2011 at the latest**, by providing the information specified in annex 1.

I. General remarks

The purpose of this Circular is to provide clarifications on the new requirements to be complied with and the arrangements a management company shall put in place in order to comply with the new regulatory requirements.

In particular, it should be noted that pursuant to Regulation 10-4 each management company currently subject to Chapter 13 of the 2002 Law is required to proceed to a number of adjustments which mainly relate to the following matters:

- organisational requirements (item II);
- conflicts of interest (item III);
- rules of conduct (item IV); and
- risk management (item V).

Items II to V of this Circular provide some explanations regarding the consequences and the means of implementation of the four items aforementioned.

II. Organisational requirements

II.1. Head office of a management company (Article 102 (1) e) of the 2010 Law)

The head office of a management company shall be located in Luxembourg. This requirement implies that the management company cannot only have a registered or a statutory office in Luxembourg. As a consequence, there shall be at the registered office of the management company an infrastructure which permits to have a centralised view on the activities of the management company and, where applicable, its delegates. To that effect, the company shall:

- have human and technical resources available, which are necessary and sufficient to undertake and control its activities, and
- have IT access to, and/or hold, the complete documentation relating to its operations and those undertaken by its delegates for account of the management company.

II.2. General requirements on procedures and organisation (Article 5 of Regulation 10-4)

Each management company shall establish a precise and clear procedures manual which describes more specifically its internal functioning, the allocation of tasks amongst its staff, hierarchical lines, and, where applicable, the procedures for exchanging information with and controls undertaken on delegates. This procedures

manual shall be available at the registered office of the management company and accessible to its staff.

A management company shall also maintain adequate and orderly records of its business and its internal organisation.

In case of delegation of certain of its functions, the management company shall ensure that the delegate has an internal organisation and internal procedures which enable easy access to all necessary information permitting an efficient control by the management company over such delegate.

The additional information to be provided by the management company pursuant to this item II.2 is set out in more detail in annex 1.

II.3. Resources (Article 6 of Regulation 10-4)

The management company must be able to show that it has enough skilled staff members with the necessary knowledge and expertise for the discharge of the tasks it performs, and for an efficient monitoring of the delegated activities.

II.4. Complaints handling (Article 7 of Regulation 10-4)

Each management company shall implement and maintain effective and transparent procedures for the reasonable and prompt handling of complaints received from investors. The information regarding those procedures shall be made available to investors free of charge.

The management company shall designate amongst its staff one person responsible for the handling, centralisation and follow up of complaints. A specific mandate for the handling of complaints can be given to a specialised third party established in Luxembourg or abroad. Furthermore, the activity plan shall comprise a description of the complaint handling procedures established by the management company.

The management company shall communicate to the CSSF a list of third parties authorised to handle complaints and an annual report indicating the number of complaints filed by investors, the reason for such complaints and the progress made in handling them.

II.5. Electronic data processing and accounting procedures (Articles 8, 9, 15 and 16 of Regulation 10-4)

The management company shall, amongst others, have suitable electronic systems so as to permit a timely and proper recording of each portfolio transaction or subscription or redemption order. In case of delegation of functions included in the activity of collective portfolio management, the authorisation file shall describe the procedures put in place by the management company to monitor that each delegate has suitable electronic systems.

In addition, each management company shall establish accounting procedures in accordance with the accounting rules of the home member states of the UCITS it

manages and which permit the maintenance of separate accounts for each compartment in case of a UCITS with multiple compartments. Likewise, a management company shall establish adequate procedures so as to ensure that all assets and liabilities of the UCITS or, where applicable, its compartments, can be identified and valued in a correct and precise manner. In case the administration of the UCITS it manages is undertaken by a specialised third party, the management company shall monitor that the third party complies with these requirements.

The management company shall appoint amongst its staff a "responsible for the accounting administration".

Finally, the CSSF shall be informed beforehand about any delegation or sub-delegation as regards the administration of UCITS.

II.6. Permanent compliance function and internal audit function (Articles 11 and 12 of Regulation 10-4)

In accordance with Regulation 10-4, management companies shall establish and maintain a permanent function of compliance and internal audit.

Circular CSSF 04/155 (relating to the compliance function) and Circular IML 98/143 (relating to internal control and internal audit) are applicable to management companies.

However, item bd)¹ of Chapter VIII of Circular CSSF 04/155 is not applicable to management companies whose activity is limited to collective portfolio management.

It should be noted that the compliance function and the internal audit function cannot be undertaken concurrently by the same physical person.

In addition, it should be remembered that pursuant to the two aforementioned Circulars the compliance function and the internal control functions shall both submit annual reports to the CSSF.

Finally, a management company can apply the principle of proportionality outlined in Chapter VII below for the organisation of its compliance and internal audit functions.

a) The compliance function

A management company shall have its own compliance function in Luxembourg which shall be organised in accordance with the provisions of Circular CSSF 04/155.

The compliance function shall operate independently and in compliance with the separation of tasks in order to identify any risk of non compliance of the management company with the 2010 Law, Regulation 10-4 and all other regulations applicable to management companies.

¹ The compliance function shall not be outsourced to third parties. This principle shall not preclude the possibility to use the expertise or technical means of third parties [...] or to establish, if appropriate, a functional link with the compliance function of the group [...].

A management company whose authorisation is limited to collective portfolio management may, subject to a specific prior request for derogation based on an adequate justification, delegate the compliance function to a third party in accordance with Article 10 (2) c) of Regulation 10-4.

However, a management company providing, in addition to collective portfolio management, one or more other services as referred to in Article 101 (3) of the 2010 Law may not delegate the compliance function.

The management company shall communicate to the CSSF the name of its "Compliance Officer" together with his/her curriculum vitae.

b) The internal audit function

A management company shall have its own internal audit function in Luxembourg which shall be organised in accordance with the provisions of Circular IML 98/143.

The internal audit function shall operate independently and in compliance with the separation of tasks in order to identify any risk of non-compliance of the management company with the 2010 Law, Regulation 10-4 and all other regulations applicable to management companies.

In accordance with item 5.4.9. a) of Circular IML 98/143, the internal audit function may be delegated to an external expert specialised in internal audit. Where applicable, the name of the third party so mandated shall be communicated to the CSSF together with a description of its competences and internal organisation.

It should be remembered that, in accordance with item 5.4.9. f) of Circular IML 98/143, a management company having one or more branches is not authorized to use an external expert specialised in internal audit. This management company shall therefore have its own internal audit department on a permanent basis.

The management company shall communicate to the CSSF the name of the person responsible for the internal audit function together with his/her curriculum vitae and, in case of delegation of the internal audit function, the name of a person, who may or may not be part of the management, having sufficient knowledge in the area of audit to monitor the work performed by the external expert.

II.7. Permanent risk management function (Article 13 of Regulation 10-4)

In accordance with Regulation 10-4, a management company shall establish and maintain a permanent risk management function.

The permanent risk management function shall be hierarchically and functionally independent from operating units.

However, the CSSF may allow a management company to derogate from that requirement where such derogation is appropriate and proportionate in view of the nature, scale and complexity of the management company's business and of the UCITS it manages.

This function shall, amongst others:

- a) implement the risk management policy and procedures;
- b) ensure compliance with the UCITS' risk limitation system, including statutory limits concerning global exposure and counterparty risk in accordance with Articles 46, 47 and 48 of Regulation 10-4;
- c) provide advice to the board of directors as regards the identification of the risk profile of each managed UCITS;
- d) review and support, where appropriate, the arrangements and procedures for the valuation of OTC derivatives;
- e) provide regular reports to the board of directors and, where it exists, to the supervisory function and to the senior management of the management company on the items listed under Article 13 (3) d) and e) of Regulation 10-4.

In accordance with Article 10 (2) d), the risk management function may be delegated by contract to a specialised third party. The contract and the name of the mandated third part(y)(ies), together with, where applicable, a description of the competences and the internal organisation of this/those third part(y)(ies) shall be communicated to the CSSF. The delegation does in no case release the management company from its responsibility to ensure an appropriate follow-up on the risks of the UCITS.

Without prejudice to the operating model chosen, each management company shall designate amongst its staff a person responsible for risk management having appropriate experience in this area. The name of such person together with his/her curriculum vitae shall be communicated to the CSSF.

Regular reports to be established by the permanent risk management function shall be submitted to the CSSF at least once a year.

It should be noted that the permanent risk management function and the compliance function cannot be undertaken concurrently by the same physical person.

II.8. Personal transactions (article 13 of Regulation 10-4)

A management company shall establish written procedures regarding personal transactions. A list of all personal transactions notified to or identified by the management company shall be available at its registered office in Luxembourg.

III. Conflicts of interest

III.1. Conflicts of interest policy (Articles 18 to 22 of Regulation 10-4)

Management companies shall establish, implement and maintain an effective conflicts of interest policy. This policy shall be in writing and shall be appropriate in relation to the size and organisation of the management company and the nature, scale and complexity of its business. This policy shall identify in particular the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of

damage to the interests of the UCITS, taking also into account the relationships with other members of the group. Likewise, the policy shall include procedures to be followed and measures to be adopted in order to manage such conflicts of interest.

In accordance with Article 22, paragraph 1, of Regulation 10-4, the management company shall keep at its registered office and regularly update a record of the types of the situations which may give rise to a conflict of interest.

In accordance with Article 22, paragraph 3 of Regulation 10-4 the management company shall inform investors about the situations where the organisational or administrative arrangements made by the management company to manage conflicts of interest have not been sufficient to ensure, with reasonable confidence, that risks of damage to the interests of the UCITS or its unitholders will be prevented. The transmission of such information shall be made by any durable medium considered appropriate. In addition, the management company shall indicate to investors the reasons for its decision.

III.2. Strategies for the exercise of voting rights (Article 23 of Regulation 10-4)

The management company shall, amongst 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, so that the exercise is to the exclusive benefit of the UCITS concerned.

An investment company that has designated a management company but has not specifically mandated the management company to exercise the voting rights attached to the instruments held in its portfolio, shall develop its own strategy for the exercise of voting rights.

A brief description of this strategy shall be made available to investors, in particular by way of a website.

IV. Rules of conduct (Articles 25 to 32 of Regulation 10-4)

Regulation 10-4 specifies the content of certain rules of conduct provided for in Article 111 of the 2010 Law.

On the basis of the details provided for in Regulation 10-4, a management company shall establish procedures, arrangements and policies which permit to ensure, amongst others:

- that it acts in the best interests of the UCITS and their unitholders;
- that it executes the investment decisions taken for account of the UCITS in accordance with the objectives, the investment strategy and the risk limitations of such UCITS;
- that it takes all reasonable measures to directly execute all orders itself to obtain the best possible result or alternatively that it ensures that orders placed with other entities for execution, are executed to obtain the best possible result. Contracts for execution of orders concluded with third parties shall take this obligation into account;

- that it executes rapidly and equitably portfolio transactions on behalf of the UCITS it manages.

V. Risk management (Articles 42 to 50 of Regulation 10-4)

Circular CSSF 07/308 relating to the use of a method for the management of risks has introduced the requirement for each management company to communicate to the CSSF a clear and precise procedure for the management of risks.

Article 43 (1) of Regulation 10-4 specifies, amongst others, that the risk management policy shall cover not only market and counterparty risks but also operational and liquidity risks as well as any other risk that may be material for the UCITS it manages.

Furthermore, Article 46 (2) provides that management companies shall calculate the UCITS' global exposure at least on a daily basis.

As a result, each management company shall update its risk management procedure, taking into account not only the provisions of Circular CSSF 07/308 but also the requirements of Articles 42 to 50 of Regulation 10-4 and the guidelines of the European Securities and Markets Authority (hereafter "ESMA") as set forth in the document "CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (ref.: CESR/10-788)" (hereafter "ESMA Guidelines").

VI. The right of establishment/freedom to provide services (Articles 113,114,115,116 and 117 of the 2010 Law)

Each management company which currently pursues activities or which provides services within the territory of another member State through a branch or under the freedom to provide services, shall submit to the CSSF **by 1 June 2011 at the latest** its programme of operations completed in particular by a description of the risk management process which it has established as well the procedures and arrangements established as regards complaints handling.

If a management company intends to manage from 1 July 2011 a UCITS in a member State on a cross-border basis, it shall also provide to the competent authorities of the UCITS home member State the written agreement with the depositary and information on delegation arrangements regarding functions of investment management and administration referred to in annex II of the 2010 Law.

It should be clarified that pursuant to Article 113 of the 2010 Law, where a Luxembourg management company, without establishing a branch, only markets units of UCITS in a member State other than the UCITS' home member State, such marketing is not subject to the provisions regarding the right of establishment of a management company. As a result, a management company that has previously undertaken a notification exclusively for marketing activities is not required to update its notification.

VII. Principle of proportionality

A management company can apply the principle of proportionality in the application of certain requirements set forth in Regulation 10-4 taking into account the nature, scale and complexity of its activities.

On this basis, a management company may be authorised to apply, subject to a prior and duly motivated application, the principle of proportionality in the organisation of its compliance (Chapter II.6.), internal audit (Chapter II.6.) and risk management (Chapter II.7.) functions.

VIII. The investment company that has not designated a management company within the meaning of Article 27 of the Law of 17 December 2010 regarding undertakings for collective investment (hereafter "SIAG")

Items II.4., II.7., III, IV and V set forth here above are applicable to SIAGs.

As regards the risk management function (item II.7.), a SIAG may be authorised, on the basis of a duly motivated application, to apply the principle of proportionality.

Yours sincerely.

COMMISSION FOR THE SUPERVISION OF THE FINANCIAL SECTOR

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Annex 1: Minimum additional information which the application for authorisation to be provided to the CSSF for 1 June 2011 shall contain

A) Management companies

1. Organisational rules

- a confirmation relating to the establishment of a procedures manual;
- a description of the internal reporting guidelines, including the exchange of information with all delegates;
- a description of the systems and procedures put in place by the management company and, where applicable, by the delegates to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information concerned;
- a description of the business continuity plan put in place by the management company and, where applicable, by the delegates;
- the name of the person responsible at the management company who can provide, upon request from the CSSF, information on the financial situation of the management company.

2. Resources

- the management company shall demonstrate that it has the necessary resources in Luxembourg to discharge its obligations.

3. Complaints handling

- a description of the procedures for the handling of complaints put in place by the management company;
- the designation of a person responsible for the handling of complaints.

4. Electronic data processing and accounting procedures

- a description of the IT systems put in place at the level of the management company and of the procedures put in place by the management company to monitor that each delegate has suitable IT systems;
- the name of the "responsible for the accounting administration";
- where applicable, a description of the delegations and sub-delegations undertaken by the management company as regards the administration of UCITS.

5. Permanent compliance and internal audit functions

- a description of the compliance function and the internal audit function put in place by the management company;
- the name of the persons in charge of the compliance function and the internal audit function at the management company;
- where applicable, the name of third parties to which the compliance function and the internal audit function have been delegated.

6. Permanent risk management function

- a description of the risk management function put in place by the management company;
- the name of the person responsible for the risk management function at the management company.

7. Personal transactions

- a confirmation on the establishment of written procedures regarding personal transactions.

8. Conflicts of interest

- a confirmation on the establishment of written procedures regarding conflicts of interest.

9. Strategy for the exercise of voting rights

- a confirmation on the establishment of an appropriate and effective strategy which permits the exercise of the voting rights attached to the instruments held in the portfolios in the exclusive interests of the UCITS concerned.

10. Rules of conduct

- a confirmation on the establishment of procedures, arrangements and policies as regards the rules of conduct.

11. Risk management

- a risk management procedure covering all UCITS managed by the management company completed by the provisions of Regulation 10-4 and the ESMA Guidelines.

12. Right of establishment/freedom to provide services

- where applicable, an updated notification completed, in particular, by a description of the risk management process and the procedures and arrangements put in place as regards complaints handling.

B) Investment companies which have not designated a management company

The update of the program of activity of SIAGs shall contain, at least the information relating to items 3, 6, 8, 9, 10 and 11 of this annex 1.