

CHEVALIER & SCIALES

MIGRATION OR RELOCATION OF OFFSHORE FUNDS TO LUXEMBOURG



SUMMARY

The Madoff scandal which has led to the quasi-collapse of the banking sector has changed the fund industry landscape. The ability to relocate in Luxembourg opens new horizons to offshore promoters and investors.

The global economic downturn and the perspective of the implementation of the European Directive on Alternative Investment Fund Managers are additional factors which enhance promoters to migrate to Luxembourg.

Confirming such trend, more and more pure offshore funds are already administered via Luxembourg. Having a fund domicile in Luxembourg offers numerous advantages (I), while migrating offshore funds to Luxembourg can be operated in different manners (II).

I. THE KEY ADVANTAGES OF RELOCATING YOUR OFFSHORE FUND(S) TO LUXEMBOURG

The regulatory characteristics of Luxembourg as well as its peculiar environment made Luxembourg the leader of the fund industry in Europe.

(A) 1ST EUROPEAN FUND DOMICILE

Luxembourg became in a few decades one of the leading locations for investment funds, being the first-largest fund services centre in Europe and the second worldwide, after the USA. Since 1959, when the first fund was established, the investment fund industry has hugely expanded. As at 31 December 2009, total assets under management (AUM) of Luxembourg investment funds reached EUR 1,840.993 billion. Over the last twelve months, the volume of AUM increased by around 12%. Luxembourg hosts more than 75 % of UCITS authorized for cross-border distribution in the European Union (EU).

(B) A COMPREHENSIVE REGULATORY FRAMEWORK

Legal structures offered by Luxembourg:

Luxembourg was the first member country to implement the European directive on Undertakings for Collective Investment in Transferable Securities (UCITS) back in the late 1980's and is as of today the leader in the European fund industry offering diversified structures which meet the needs of investors and promoters. The law of 20 December 2002 relating to Undertakings for Collective Investment in Transferable Securities shaped the investment fund market differentiating between the regulated undertakings for collective investments in transferable securities (UCITS Part I or UCITS) and a lighter regulated vehicle, the undertakings for collective investments (Part II Funds), both designed for retail investors. Further to the

enactment in February 2007 of the law on specialized investment funds (SIF), designed for sophisticated investors, Luxembourg offers investors and promoters a broad choice of legal structures to meet their expectations and requirements. The Luxembourg investment funds can be divided into the following three categories:

- UCITS Part I (1843 as at 31 December 2009);
- Part II Funds (649 as at 31 December 2009); and
- SIFs (971 as at 31 December 2009).

UCITS benefit from the European passport which provides them with the possibility of distributing their units within the EU (i.e a benchmark of more than five hundred millions of European consumers) with only having to respect formal compliance in other states whereas offshore funds wishing to distribute their units in the EU at large shall apply in every member state for such distribution. The UCITS IV directive (to be in force in 2011) will also speed up the cross-border distribution of UCITS funds. In contrast, Part II Funds can only market their units in other EU countries after complying with the specific conditions stipulated by the authorities in the relevant country, which make them a less attractive choice as migration vehicle.

UCITS were traditionally limited to investment in long/short equity. Such scope was extended by the UCITS III directive and the eligible assets directive of 2007 which allows UCITS to invest in, inter alia derivatives in general, OTC derivatives (TRS, contracts for difference etc), to adopt synthetic shorting strategies, investments in hedge fund indices, etc always in accordance with the limitations set forth by Luxembourg regulations.

The SIF is a lightly regulated and tax efficient fund, which gives fund promoters an onshore alternative to consider (as compared to traditional offshore jurisdictions such as Cayman and BVI) when deciding on the jurisdiction for setting-up a fund and the type

of fund vehicle to use. The SIF is dedicated to sophisticated investors.

Finally, promoters can choose between two types of legal structure for an investment fund (UCITS, Part II Funds and SIFs): an investment company with variable or fix capital (SICAV / SICAF) or a common contractual fund (FCP). Both vehicles can create sub-funds, each with a different investment policy and which are fully segregated. The choice of whether to create a fund as an FCP or an investment company is mainly based on tax considerations, as an FCP is tax transparent.

The Luxembourg regulatory authority:

The CSSF, which authorizes and monitors all Luxembourg registered funds, is an experienced and pragmatic regulator responding to promoters' needs in insuring rigorous prudential supervision and in implementing the flexible European legal framework responding to nowadays investors' researches of security.

In light of these benefits, inwards re-location to Luxembourg seems to be a pragmatic choice in these times of financial turmoil.

II. STEPS FOR RELOCATING YOUR FUND TO LUXEMBOURG

Relocation of a fund to Luxembourg can mainly be achieved by choosing for one of the following three methods: (A) a contribution in kind of all the assets and, as the case may be, the liabilities to a Luxembourg fund which is open to UCITS, Part II Funds and SIFs whether in the form of SICAVs / SICAFs or FCPs, (B) a re-domiciliation of an offshore fund to Luxembourg which is only open to UCITS, Part II Funds and SIFs in the form of SICAVs or SICAFs or (C) a merger of an offshore fund into a Luxembourg fund which is only open to UCITS, Part II Funds and SIFs in the form of SICAVs or SICAFs. The choice of the type of relocation will depend mainly on the legal structure and not on the specificity of the investments contemplated. The timing of such relocation can consequently vary according to

the vehicle transferred to Luxembourg and the method chosen.

(A) CONTRIBUTION IN KIND BY AN OFFSHORE FUND TO A LUXEMBOURG UCITS, PART II FUND OR SIF

Which Luxembourg investment vehicles can be used:

An offshore fund can contribute all its assets and liabilities at the incorporation of a SICAV or an FCP or to an existing SICAV or FCP. The offshore fund will become a shareholder of the Luxembourg fund. Such contribution does not result in an automatic universal transfer. The assignment of all its assets and, as the case may be, its liabilities shall be made on a case-by-case basis in conformity with the relevant applicable laws.

Main steps:

Such contribution process will only be possible if (i) the legal documentation of the Luxembourg vehicle authorizes (or does not forbid) subscription by contribution in kind and (ii) if the contributed assets can be considered as eligible assets according to Luxembourg laws. Luxembourg entities with variable capital will approve the contribution by a resolution of the management bodies whereas entities with fixed capital will hold a meeting of shareholders resolving on such increase of the capital. In both cases, a valuation report will be issued by an independent Luxembourg auditor in respect of the contributed assets.

(B) TRANSFER OF REGISTERED OFFICE OF AN OFFSHORE FUND TO LUXEMBOURG UCITS, PART II FUND OR SIF

Which Luxembourg investment vehicles can be used:

Re-domiciliation of an offshore fund can only be considered for investment companies (SICAVs and SICAFs) not for FCPs. It is the easiest way to relocate since the offshore fund does

not cease to exist but is merely transferred to Luxembourg, without discontinuation of its legal personality.

According to a commonly accepted interpretation of the Luxembourg law on commercial companies dated 10 August 1915 (the "Company Law"), even if a company has been incorporated abroad, if such company has its central administration in Luxembourg, it shall be considered as a Luxembourg company. However such transfer must be allowed outward and in-ward and it may trigger difficulties with companies incorporated in a common law country whereby a company shall have the nationality of its seat of incorporation.

Main steps:

The migration process will require the amendment of the by-laws and of the prospectus of the fund to be in compliance with Luxembourg law. The offshore fund will need to obtain the approval of the CSSF, which will review the documentation of the fund to check the compliance with Luxembourg law. Backward, you will need to inform the investors of the fund of such re-domiciliation and they will most likely need to approve such a migration (or, as the case may be, withdraw from the fund) according to the law of the originating state. You may have to change the service providers. However, it may be a benefit for investors, as it may trigger fewer costs.

(C) CROSS-BORDER MERGER

Which Luxembourg investment vehicles can be used:

A cross border merger occurs when an offshore fund is absorbed into a Luxembourg fund, its assets and liabilities being transferred to the absorbing Luxembourg investment vehicle (UCITS, Part II Fund or SIF) against the issuance of new units in the Luxembourg investment vehicle to the unitholders of the absorbed offshore fund, which is then dissolved.

For the time being, the UCITS III Directive

solely provides a regulatory framework for merger of investment companies (SICAV) and not for FCPs, it being understood that a cross border merger is only allowed if the legislation of the offshore fund does not prohibit such merger. UCITS IV Directive which will come into force in 2011 will change the landscape of European cross border mergers of funds as it will allow all types of UCITS (SICAVs, FCPs, etc.) to merge into another fund structure. 'In the light of the UCITS IV Directive, a cross-border merger means a merger of UCITS (i) at least two of which are established in different Member States; or (ii) established in the same Member State into a newly constituted UCITS established in another Member State.

Main steps:

The main steps of the merging process are the following: it will usually begin with the approval of both management bodies of the merging companies and the adoption of a common merger project. Such project must then be published according to local laws and will require in most of the cases the approval of the shareholders of each vehicle. A report shall be established by an independent auditor valuing the share exchange ratio. The merger process will be finalized and effective once the general meetings of shareholders of the merging vehicles have given their approval.

III. THE IMPACT OF A RELOCATION TO LUXEMBOURG FOR INVESTORS

A relocation to Luxembourg can in certain circumstances be an advantage from a tax perspective, as a Luxembourg fund, if set-up as an investment company (SICAV) (irrespective whether it is a UCITS, Part II Fund or SIF) can benefit as of this date from 27 double taxation treaties entered into by Luxembourg and third countries. The relocation of a fund to Luxembourg usually does not trigger a capital realization event for existing investors of the offshore fund.

Moreover, a move to Luxembourg has usually a

minimal impact on the investments of investors. Investors may continue to hold the same number of units of the same class of the same sub-fund, as the case may be or will receive in consideration units of the same value in the new Luxembourg fund. The investment objective may remain in most of the cases identical subject to compliance with Luxembourg law. The management of the relocated fund will usually ensure that the fund remains registered in the same countries as they were previously registered for sale. The administrative fees may also be reduced in comparison with offshore legislations which can have a positive impact on the performance of the fund.

FOR FURTHER INFORMATION PLEASE CONTACT:**OLIVIER SCIALES, PARTNER**Email: oliviersciales@cs-avocats.lu**RÉMI CHEVALIER, PARTNER**Email: remichevalier@cs-avocats.luwww.cs-avocats.lu**CHEVALIER & SCIALES****LUXEMBOURG**51, route de Thionville
L-2611 Luxembourg
Luxembourg

Tel : +352 26 25 90 30

Fax : +352 26 25 83 88

DUBAITwin Towers
Bldg. Baniyas Road,
Deira, Dubai,
P.O. Box 4404, Office
#217, 2nd Floor,
United Arab Emirates

Tel: +971 4 2937033

Fax: +971 4 2088699

www.cs-avocats.lu