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The Reserved Alternative Investment Fund **RAIF**

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The Reserved Alternative Investment Fund **RAIF**

The introduction of a new alternative investment fund (**AIF**) regime, the “reserved alternative investment fund” (**RAIF**) or “*fonds d’investissement alternatif réservé*” (*FIAR*) by the law of 23 July 2016 relating to reserved alternative investment funds (the **RAIF Law**) is another step towards increasing the attractiveness of the Luxembourg investment fund and asset management environment, following the implementation of Directive 2011/61/EU on alternative investment funds managers (**AIFMD**).

Purpose of the RAIF introduction

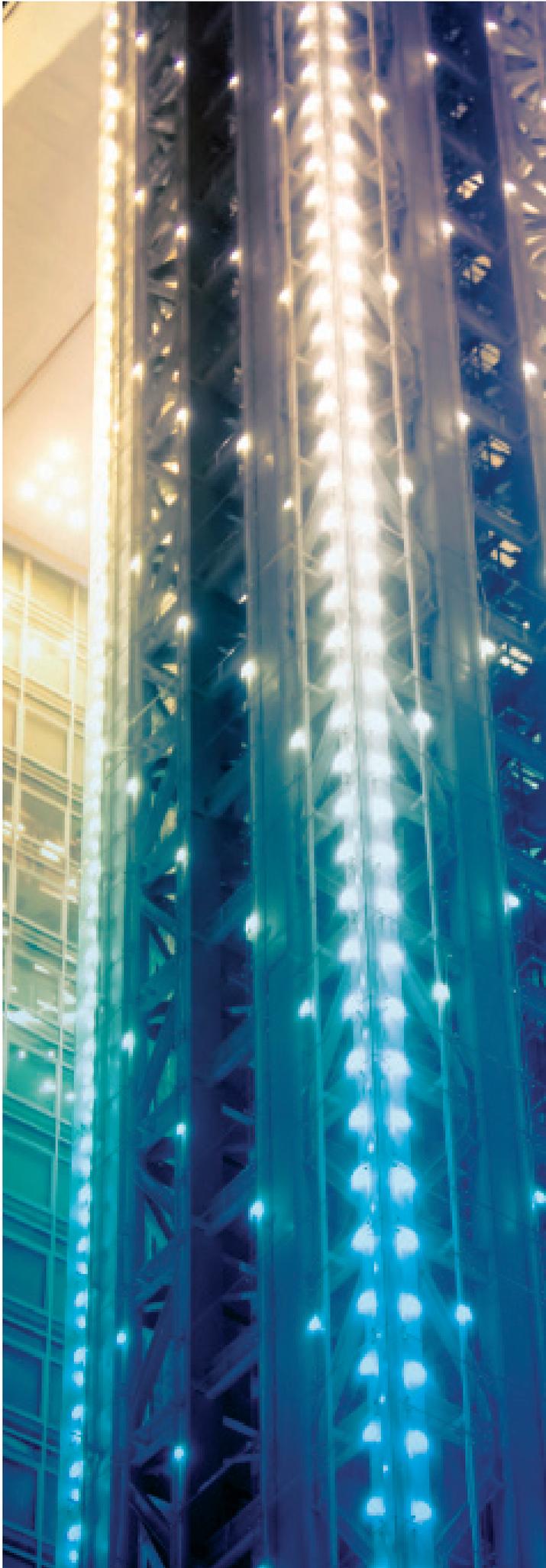
The RAIF Law creates a new flagship regime responding to the needs of AIF managers and investors alike for light establishment and flexible corporate/operating rules. Overall, not only will initiators be able to set up the RAIF without CSSF approval, but they will also benefit from the attractive structuring features which at present are only available to regulated AIFs (umbrella structure, variable capital, specific tax regime). In addition, access to the much sought-after AIFMD marketing passport will be available, and investors’ protection will be ensured by the full application of the AIFMD regime at manager level. With the RAIF Law therefore come many novelties as compared to the current regulated and unregulated fund regimes.

By simplifying the regulatory burden on alternative investment fund managers (AIFM) to set up AIFs, the RAIF Law significantly reduces “time to market”. At present, AIFs regulated as SIFs,¹ SICARs² or Part II UCIs³ generally go through a double layer of regulatory approval (for the AIFM and the fund-level SIF/SICAR/Part II licences, respectively). The hiring of third party AIFMs has often simplified this process by allowing AIF initiators to outsource AIFM services. Market access could still be delayed, however, pending CSSF approval to be obtained at fund level.

1 Specialised investment funds (SIFs) subject to the law of 13 February 2007 on specialised investment funds, as amended (**SIF Law**).

2 Investment companies in risk capital (SICARs) subject to the law of 15 June 2004 on investment companies in risk capital, as amended.

3 Undertaking for collective investments subject to part II of the law of 17 December 2010 on undertakings for collective investments, as amended.



The RAIF Law also provides corporate flexibility for unregulated fund structures. Limited partnerships established as special limited partnerships (SCSp) or common limited partnerships (SCS) have proven to be very successful so far, but the market calls for having the ability to set up umbrella structures in an unregulated fund context. This possibility, so far only available to regulated AIFs, will now be offered to RAIFs, together with more flexibility as regards capital increases/reductions and share redemptions.

Eligibility requirements

In order to be set up as a RAIF, the envisaged fund must (i) qualify as an AIF within the meaning of the AIFMD, (ii) be managed by an external authorised AIFM, (iii) offer its shares, units or partnership interests to well-informed investors only, and (iv) pursue a diversified investment policy, unless it will exclusively target investments in risk capital assets. Its constitutive documents must specify that the fund is subject to the provisions of the RAIF Law. These four conditions are analysed below.

Alternative investment fund

The RAIF regime will only be eligible to AIFs within the meaning of the Luxembourg law of 12 July 2013 which implemented the AIFMD in Luxembourg law (AIFM Law), i.e. “*collective investment undertakings, including investment compartments thereof, which (i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) do not require authorisation pursuant to article 5 of Directive 2009/65/EC (the UCITS Directive)*”.

Authorised AIFM

RAIFs may only be managed by an authorised external AIFM. The AIFM may be established in Luxembourg, any other member state of the European Union or any other third country, provided that the third country AIFM holds the requisite AIFM licence. This option is not yet available as the extension of the AIFM management/marketing passport to third countries is subject to an EU Commission Delegated Regulation, which has not yet been issued. Nor is the RAIF regime available for

internally managed AIFs or AIFs managed by registered AIFMs benefiting from the de minimis exemption (i.e. not reaching the applicable threshold of assets under management triggering the AIFM licence requirement under the AIFMD)⁴.

Some entities will, however, be allowed to establish RAIFs without having to appoint an external authorised AIFM. These entities are listed in the AIFM Law (for instance, supranational institutions including the European Central Bank, the European Investment Bank, the European Stability Mechanism, the World Bank or other similar international organisations and national central banks), provided that the RAIFs managed by those institutions act in the public interest.

If the external AIFM loses its authorisation or is deprived of or resigns from its mandate, the governing body of the RAIF must appoint a replacing external AIFM within two months following the withdrawal of the original AIFM. If this deadline is not respected, the RAIF's governing body must file a request with the competent Luxembourg district court to have the RAIF dissolved and liquidated.

Well-informed investors

The shares, units or partnership interests of a RAIF may only be offered to "well-informed investors" as defined in the SIF Law,⁵ i.e. any institutional investor, professional investor or other investor who has stated in writing that it adheres to the status of a 'well-informed' investor and who invests a minimum of EUR 125,000 in the RAIF, or who has been subject to an assessment by a credit institution, investment firm, management company or authorised AIFM to confirm its expertise, knowledge and experience for correctly appraising an investment in the RAIF. RAIFs must have the necessary means to ensure ongoing compliance with these conditions.

Eligible assets and diversification

Like the SIF regime, the RAIF may invest in any kind of assets which may be legally acquired. Any type of investment strategy is permitted without any restriction whatsoever, provided that the RAIF's manager aims to spread the investment risks. The RAIF Law itself is silent on the scope and meaning of this diversification requirement, but the legislative explanatory notes refer to the SIF regime and the related Circular CSSF 07/309 with respect to risk-spreading by SIFs. Taking these as guidance, the following principles should be considered as applicable to RAIFs:

- (i) A RAIF may not invest more than 30% of its assets or commitments in securities of the same type issued by the same issuer. For the application of this restriction, every sub-fund of a target umbrella undertaking for collective investment is to be considered as a separate issuer, provided that the principle of segregation of liabilities among the various sub-funds vis-à-vis third parties is ensured.
- (ii) Short sales must not result in the RAIF holding a short position in securities of the same type issued by the same issuer, which represents more than 30% of the RAIF's assets.
- (iii) When using financial derivative instruments, the RAIF must ensure a similar level of risk-spreading, via appropriate diversification of the underlying assets. Similarly, the counterparty risk in an over-the-counter transaction must, where applicable, be limited according to the quality and qualification of the counterparty.

⁴ EUR 100 million (including any assets acquired through use of leverage) or EUR 500 million when the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF.

⁵ See footnote 1 above.

The RAIF regime offers the choice of waiving the diversification regime if the RAIF's sole objective is to invest in securities representing risk capital and if it opts for the specific related tax regime (see the tax regime section below). The notion of risk capital has been defined as the direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange. The aim of this exception is to partially reproduce the SICAR regime in the unregulated fund context.

Operational aspects

No CSSF approval

RAIFs are not subject to a direct supervision by the CSSF, but the RAIF needs to appoint an external authorised AIFM which is supervised by its supervisory authority. The CSSF will supervise the external AIFM if it is established in Luxembourg.

Overview of available legal forms

The RAIF Law provides for the whole range of legal forms available for Luxembourg regulated RAIFs. A RAIF may be established under either a contractual 'common fund' form (FCP), a corporate legal form like a public or private limited liability company (S.A. or S.à r.l.), a corporate partnership limited by shares (SCA) or a partnership form (SCS or SCSp), either with variable or fixed capital (SICAV or SICAF). In all cases, the designation of the fund must be completed by the words "reserved alternative investment fund" or the abbreviated form "RAIF". The RAIF Law provides that the RAIF's net assets should reach a minimum of EUR 1,250,000 within twelve months following its establishment. The different legal forms are described below.

- Common fund (FCP)

A RAIF may be structured as an FCP (*fonds commun de placement or common fund* – FCP RAIF), a co-ownership of assets governed by management regulations and managed by a CSSF regulated management company. The RAIF Law largely reproduces the SIF Law concerning the management company. A management company which is either authorised as an AIFM itself or designates an external AIFM (in Luxembourg or another EU Member State) must be appointed. The issue/redemption of units, and the distribution rules will only be subject to the rules contained in the management regulations (provided the minimum capital requirement of EUR 1,250,000 is at all times met).

- Corporate legal form - Investment company with variable capital (SICAV)

A RAIF may also be structured as a SICAV (*société d'investissement à capital variable* or investment company with variable capital – SICAV RAIF) organised under any of the available corporate forms: private limited liability company (*société à responsabilité limitée* – S.à r.l.), public limited liability company (*société anonyme* – S.A.), corporate partnership limited by shares (*société en commandite par actions* – S.C.A.), common limited partnership (*société en commandite simple* – S.C.S.), special limited partnership (*société en commandite spéciale* – S.C.Sp) or cooperative company in the form of a public limited liability company (*société coopérative sous forme de société anonyme* – Coop. S.A.). Here again, the RAIF Law mirrors the SIF Law.

Irrespective of the legal form chosen, the SICAV RAIF will benefit from flexible corporate rules in terms of profit distributions and the issue or redemption of shares. The distribution of annual or interim dividends will not be subject to any legal

restrictions other than those freely determined in the RAIF's constitutive documents and the ongoing minimum capital requirement of EUR 1,250,000. Provided that at least 5% of the issue price is paid up upon issuance, the issue and redemption rules for shares may also be freely chosen in the SICAV RAIF's constitutive documents.

SICAV RAIFs established as limited partnerships (SCS/SCSp) will benefit from enhanced flexibility, as both voting and transfer rules may be freely chosen in their constitutive documents. In addition, both the SCS and SCSp may issue partnership interests associated with capital accounts (*compte d'associés*).

- Other forms of RAIF

In addition to the FCP or SICAV structures permitted under Luxembourg law, RAIFs may adopt any other form, including but not limited to, the corporate forms established by the law of 10 August 1915 on commercial companies, in which case they will be referred to as SICAF (*société d'investissement à capital fixe* or investment company with fixed capital – SICAF RAIF).

Umbrella and sub-funds

Irrespective of the legal form chosen, a RAIF may be established as an umbrella structure with one or more compartments, each comprising a distinct portfolio of assets and liabilities. This is quite a novelty for an unregulated fund structure under Luxembourg law, as, save for securitisation vehicles, only Luxembourg regulated funds such as SIFs, SICARs or Part II UCIs could previously be established with several sub-funds. The sub-fund specifications in the RAIF's issuing document should lay down each respective sub-fund's investment policy and may freely choose its operating terms (issue/redemption of securities/interests rules; distribution rules; fee structure; eligible investors, etc. – all those terms may differ from one sub-fund to another). The liquidation of one sub-fund will not trigger the winding-up of the umbrella structure as a whole (unless no other active sub-fund remains). As for SIFs, creditors' rights in relation to a specific compartment will be limited to the assets of that compartment only, unless the RAIF's constitutive documents provide otherwise, and cross-investments between sub-funds will also be allowed under certain conditions.

Establishment formalities

Establishment formalities for RAIFs will be limited, but require the involvement of a notary at all times. For RAIFs organised as a SICAV/F in the form of an S.A., S.à r.l. or S.C.A., the articles of association will have to be adopted by a notarial deed. In all other instances, i.e. if the RAIF is established as an FCP, an SCS or an SCSp, a notarial record confirming that the entity has been duly established must be drawn up within five business days from the formation of the RAIF.

The RAIF's establishment must be filed with the Luxembourg Register of Commerce and Companies (**RCS**) for publication in the RESA (*Recueil Electronique des Sociétés et Associations*), the official electronic platform of central publication regarding companies and associations. The publication will include the name of the external AIFM appointed to manage



the RAIF. The RAIF will also be registered on an official list maintained by the RCS within twenty business days from the signature of the notarial deed.

Service providers

Depositary

A Luxembourg-based depositary must be appointed. The depositary should prove that it has appropriate professional experience to perform this function. It will be deemed eligible if the depositary has already been approved by the CSSF to act as the depositary for other Luxembourg-regulated funds such as SIFs, SICARs, Part II UCIs or UCITS.⁶ The tasks and liabilities of a RAIF's depositary are those laid down in the AIFM Law.

Auditor

Accounting information provided in the RAIF's annual report must be audited by an independent auditor (*réviseur d'entreprises agréé*). Like the depositary, the independent auditor must prove that it has appropriate professional experience. This condition will be considered as fulfilled if it has already been approved by the CSSF as the auditor of other Luxembourg regulated funds.

Others

RAIFs may organise their central administration in Luxembourg internally, or, where necessary, with the involvement of, for instance, a Luxembourg-based regulated service provider acting as the central administrative agent.

The appointment of an investment manager (or sub-investment manager) will be permitted, subject to compliance with the delegation provisions in the AIFMD; i.e. will be subject to the approval of the home regulator of the AIFM.

Investor information

In terms of disclosure to investors, the RAIF regime will mirror the SIF Law by requiring an issuing document to be prepared, and the AIFM Law as regards the minimum information to be disclosed to investors prior to any investment, and the contents of the annual report.

⁶ Undertakings for collective investment in transferable securities (UCITS) subject to Part 1 of the law of 17 December 2010 on undertakings for collective investments, as amended.

Issuing document

The issuing document must include all the information necessary for investors to be able to make an informed judgement in relation to the investment offered to them, in particular the associated risks. It must be kept up to date, especially when new investors are admitted to the RAIF. It must be supplied to subscribers upon request.

All disclosure requirements laid down under article 23 of the AIFMD will generally be contained in the issuing document, which will thus contain all the information to which investors should have access (a description of the RAIF's investment strategies and objectives, the types of assets in which it may invest and the procedures by which it may change its investment strategy or investment policy; the identity of the AIFM, the depositary, the auditor and any other service provider; a description of the RAIF's valuation procedure and the pricing methodology for valuing assets, etc.).

The front page of the issuing document must clearly state that the RAIF is not subject to CSSF supervision. The RAIF Law expressly allows separate issuing documents to be drawn up for each sub-fund, in accordance with a well-established practice for umbrella SIFs and SICARs. In this case each sub-fund's issuing document should clearly state that the RAIF is an umbrella structure which may be composed of one or more compartments.

Annual report

Each RAIF must publish an annual report to be provided to investors within six months after the end of the period to which it relates. The rules in article 22 of the AIFMD apply in full to the contents of this annual report. The RAIF Law further provides that a separate set of accounts may be prepared for each sub-fund when a sub-fund's annual accounts also contain consolidated financial information concerning any other sub-fund in the umbrella. Again, this confirms a practice already adopted by the CSSF for umbrella SIFs and SICARs.

Tax regime

Default tax regime

The default tax regime applicable to RAIFs mirrors the SIF regime. This means that the RAIF will only be subject, at fund level, to an annual subscription tax levied at a rate of 0.01% of its net assets (calculated on the last day of each quarter). Depending on the investment assets, some exemptions from subscription tax apply, in order to avoid a duplication of this tax. Irrespective of the legal form chosen for the RAIF, it is not subject to corporate income tax, municipal business tax or net wealth tax, and distributions of profits by the RAIF do not give rise to a withholding tax.

Optional regime for risk capital RAIFs

As an alternative to the default regime, a RAIF which does not take the legal form of an FCP may choose to be taxed according to the same tax rules as those applicable to SICARs. To benefit from this optional regime, the RAIF's constitutive documents must provide that (i) its sole object will be to invest in risk capital assets, and (ii) it is subject to article 48 of the RAIF Law (which provides for the possibility to apply for the optional regime)). At the end of the relevant financial year the auditor must confirm that the RAIF has complied with the risk capital investment policy. This report must be filed with the competent tax authorities.

The choice between the default tax regime or this optional tax regime must be made at the umbrella level, meaning that within a single umbrella structure it will not be possible to have some sub-funds subject to the default tax regime and others to the optional SICAR-like tax regime.

Under these SICAR-mirroring tax rules, a RAIF which takes a corporate legal form (like the S.A., S.à r.l. or S.C.A.) will be a normally taxable entity for corporate income tax and municipal business tax purposes, but with an exemption from its taxable basis for any profits and gains derived from securities (*valeurs mobilières*) invested in risk capital, or from funds reserved for investment and actually having been invested within twelve months. As a normally taxable entity, it should have access to the extensive network of double tax treaties signed by Luxembourg with other jurisdictions (subject to acceptance by the relevant source countries). Other than this liability for corporate income tax and municipal business tax, with a wide exemption, there should be no other liability for direct taxes. The RAIF will be exempt from net wealth tax (except for a minimum net wealth tax set at EUR 4,815, in principle). In line with the tax rules applying to SICARs, distributions of profits by the RAIF do not give rise to withholding tax.

A risk capital RAIF which takes the form of a partnership (the SCS or SCSp) will be deemed to be transparent for corporate income tax and net wealth tax purposes. In addition, it is deemed not to conduct a business and therefore is not liable to municipal business tax. The profits and gains of such a RAIF will therefore not be liable to corporate income tax and municipal business tax at either the level of the RAIF or the level of its non-resident partners (not having a Luxembourg permanent establishment to which its interest in the RAIF is allocable), nor is it subject to net wealth tax. Its distributions of profits should not give rise to any withholding tax.

VAT

By qualifying as an AIF, RAIFs should benefit from the VAT exemption on AIF management services under the same conditions and restrictions as that applicable to AIFs.

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