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The investment policy of SIF-like RAIFs and SICAR-like RAIFs[1]

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Introduction

"Reserved Alternative Investment Funds" or "**RAIFs**" have conquered the market since their "birth" in the summer 2016. They are a specific type of unregulated alternative investment funds similar in its attributes to the renown Luxembourg regulated specialised investment funds (the "**SIFs**") and risk capital investment companies (the "**SICARs**"). RAIFs are therefore not subject to the direct supervision of the Luxembourg financial supervisory authority (*Commission de Surveillance du Secteur Financier* or "**CSSF**"). This allows for fund promoters using RAIFs to improve substantially the time-to-market of their new fund products while reducing their set-up and running costs and benefitting from umbrella structures with tax efficient features.

This article will focus on RAIFs' investment policies namely whether they (i) comply with the light risk diversification rules without any limitation on eligible assets (*i.e.* in principle that none of its assets may represent more than 30% of its portfolio) (the "**SIF-like RAIFs**"), or (ii) adopt a risk capital investment policy, which means that they must invest in private equity/venture capital-like assets following a private equity/venture capital-like strategy without being compelled to comply with any risk diversification requirement (the "**SICAR-like RAIFs**").

We will therefore delve into the following aspects of RAIFs' investment policies:

- ➢ In what assets can a RAIF invest?
- ➢ Is a RAIF always subject to risk diversification requirements?
- ➢ What are the risk diversification requirements applicable to SIF-like RAIFs?
- ➢ Can a RAIF borrow money and if so, is there a limit?
- ➢ Can a RAIF lend money and/or buy debt assets comprising revolving credit facilities?

(1) In what assets can a RAIF invest?

A. SIF-like RAIFs

The use of the expression "assets" under Article 1 of the "**RAIF Law**"[2] indicates that almost any type of investment is eligible for SIF-like RAIFs.

This statement is reinforced by the commentary on "**Bill n°6936**"[3] aiming at amending namely the SIF Law and the SICAR Law. The commentary mentions that once Bill n°6936 is passed into law, and the CSSF issues a CSSF-regulation on eligible assets for SIFs, SIFs investing in "atypical assets" will only be accessible to "**Professional Investors**"[4] whereas RAIFs will remain able to invest in both "traditional assets" but also "atypical assets" while offering their "**Shares**"[5] to any "**Well-Informed Investors**"[6].

Therefore, SIF-like RAIFs may invest in:

traditional assets such as private equity, real estate, infrastructure, derivative products, underlying funds, listed equity/bond, some credit funds, etc; and

atypical assets such as wine, diamonds, insurance policies, financial rights linked to soccer players, art works, horses.

B. SICAR-like RAIFs

On the other hand, SICAR-like RAIFs may only invest in securities representing risk capital *i.e.* "*direct or indirect contribution of assets to entities for the purpose of their start up, development or IPO*" (see Article 48(1) of the RAIF Law).

In this respect the RAIF Bill[7] mentions that RAIFs and/or their legal counsels / auditors may base themselves on CSSF Circular 06/241[8] to interpret the investment in securities representing risk capital notion.

● General principles

According to CSSF Circular 06/241 a SICAR must demonstrate (i) an intention to contribute to the development of portfolio companies; (ii) an increased level of risk linked to the contemplated investments; and (iii) an exit strategy. The below explanation will apply the above concepts to SICAR-like RAIFs:

• Development of the underlying

The development concept is construed broadly: it means that the SICAR-like RAIF's business plan and/or investment policy/strategy should explain by which means it intends to generate added value in the portfolio company(ies).

This value creation can take different forms. In general, investments may consist of injecting additional capital into existing portfolio companies or enabling the acquisition on the secondary market of shares representing risk capital. This is why the role of the SICAR-like RAIF as an investor cannot be limited to a passive holding of the participations but must, in principle, involve the active management of the portfolio companies notably via an advisory activity or a representation in the managing bodies of the portfolio company. In this context, it is necessary to describe the restructuring, modernisation or other measures intended to be taken with the aim to lead to a better distribution of the portfolio companies' resources.

This being said an active intervention of the SICAR-like RAIF to create value in the portfolio companies is not required in every case, as other elements may establish the risk capital characteristics, such as the financing mode used or the type of participants, or their remuneration. However, where the SICAR-like RAIF or a compartment thereof invests into a sole portfolio company, the active management element is important.

- *Risk investments*

The SICAR-like RAIF's business plan and/or investment policy/strategy must also include a description of the general risk linked to the investment in risk capital as well as a description of the particular risk linked with the development project.

Regarding the different forms of investments in risk capital or the objective pursued by these investments are concerned, the parliamentary works for the SICAR Law specified that the scope of the SICAR Law covers all types of private equity investments. Private equity risk capital investments may notably take the form of transactions of the buy-offs, leveraged buyouts, management buyout and management buy-in type. Venture capital investments may take the form of start-up and early stage investments.

In principle, all financing modes are eligible, be it by way of an equity contribution, bond issuance, bridge finance or similar financing, mezzanine-type financing, convertible debt, subject to the financing being a "risk capital" type of contribution.

- *Exit strategy*

The SICAR-like RAIF's declared intention must be to acquire financial assets in order to sell them with a profit, as opposed to a holding company which acquires to hold. In this respect, the holding duration – as indirectly reflected in the duration of the SICAR-like RAIF or the relevant compartment thereof – is an important criterion to determine whether an investment policy is acceptable or not.

The SICAR-like RAIF's issuing document must include information on the exit strategy in the framework of its investments and show a non-exhaustive list of the possibilities by which the SICAR-like RAIF contemplates to divest from its underlying and by indicating a predictable holding period, be it via an over-the-counter sale, or via an IPO, or in any other manner. The management of the SICAR-like RAIF will have to determine the most appropriate legal and fiscal way to proceed with the divestments.

Particular rules related to some categories of investments

- *Real estate investments*

A SICAR-like RAIF cannot directly hold real estate. However, the indirect investment via entities that hold or invest in real estate assets representing risk capital characteristics (private equity real estate), as well as the contribution of capital to real estate companies, is possible.

The situation of the real estate referred to in the SICAR-like RAIF's investment policy must be such that the indirect investment made by the SICAR-like RAIF contributes to change its existing condition and, thus, increases its value. The value creation may adopt several forms, such as the enhancement of the real estate through renovation, renegotiation of contracts, renewal of tenants or restructuring of the portfolio of the real estate company.

In addition, the real estate objects must present a particular risk above the normal real estate development risk on a given market. The sole geographical location of a real estate which might present a certain political risk is not sufficient to establish the risk capital characteristics of the investment in the absence of any development element.

- *Infrastructure investments*

Investment in infrastructure projects may be eligible for a SICAR-like RAIF, provided that the underlying assets represent risk capital as described under the "General principles" section above.

- *Distressed debt securities*

The policy which provides for a direct or indirect investment in distressed debt securities is in principle acceptable.

For this type of investment, the activity of the SICAR-like RAIF cannot however be limited to the sole possession of claims, but the investment must allow the SICAR-like RAIF to intervene in the restructuring of the debt of the issuing companies and to contribute to the development of these companies. To this end, it is essential that the issuing document describes in sufficient detail the type of development projects of portfolio companies as well as the particular risk attached to these investments.

- *Loan origination*[9]

The structuring of the loan origination operations may vary based on shadow banking considerations and the type of loan to be granted. It should be remembered first of all that contrary to SIFs and SICARs, RAIFs do not benefit from a general exemption from the "**FS Law**"[10]. This means in short that an analysis should be performed for RAIFs to make sure that they do not fall within the regulated scope of activities as mentioned under the "**PFS FAQ**"[11]. The analysis will deal namely with the questions of the number of loans to be issued, their size, the type of borrowers, the pre-existing relationship with borrowers and/or if such origination activities carried out directly or indirectly by the RAIF is only for a short duration prior to its conversion into a SIF or a SICAR.

– Loan origination directly by the SICAR-like RAIF

Where the SICAR-like RAIF originates a loan directly to a target entity without the target entity being owned by the SICAR-like RAIF, the loan granted must comply with the risk/development/exit requirements abovementioned. This means for instance that the loan granted to a target will have to be used by the target for the purpose of expanding its business or building a new property but not as a revolving credit facility to finance the payment of the salaries incumbent upon the target.

– Loan origination indirectly by the SICAR-like RAIF through a target entity

A SICAR-like RAIF may also invest into a target entity whose business is to originate loans. The SICAR-like RAIF's investment into the target entity would then aim at meeting the risk/development/exit requirements abovementioned at the level of the target i.e. for instance by assisting it in expanding its portfolio of clients, improving the due diligence, performance tracking and/or debt recovery processes, reshuffling its credit portfolio, etc. The loans originated could take the form for instance of a purchase of bonds, granting of revolving credit facilities and/or term loans.

● *Fund-of-fund / master-feeder strategy*

Where the SICAR-like RAIF invests in one or several target fund(s), the development element must be present at the level of this or these target fund(s).

● *Listed securities investments*

Investment in listed securities by a SICAR-like RAIF is acceptable provided that these listed assets represent investment in risk capital. Securities listed on a stock exchange not complying with the requirements applicable to regulated markets within the meaning of MiFID[12] or securities which, even though they are listed on a regulated market, are issued by an entity representing risk capital within the meaning of the RAIF Law and "General principles" section above are likely to fulfil these conditions.

As regards regulated markets within the meaning of MiFID, investment in certain securities listed on these markets may notably be eligible when this investment is associated to a particular development project of the portfolio company or aims at a delisting of the securities and thus these securities represent risk capital.

Listed small caps for instance may constitute eligible investments for a SICAR-like RAIF, so the listing of these companies does not necessarily need to put an end to the investment.

● *Derivative instruments investments*

SICAR-like RAIFs may only use derivative financial instruments for hedging purposes. Investment in derivative financial instruments cannot constitute the object of the investment policy.

In case the issuing document provides for hedging of risks, it must be mentioned that this hedging only refers to interest rate and foreign exchange risks excluding investment risks.

● *Commodities investments*

The acceptability of a SICAR-like RAIF's policy of investments in commodities is assessed in compliance with the criteria developed above under the "real estate investments" sub-section. A SICAR-like RAIF cannot directly invest in commodities. However, an indirect investment via the risk associated to investments in companies exploiting commodities is possible. In any case, the risk and development criteria shall be identifiable at the level of portfolio companies.

● *ABS, CDO investments*

Investments in ABS, CDOs and other similar securities are, in principle, not eligible for SICAR-like RAIFs.

● *Accessory investment policy not compliant with the risk capital notion*

The investment policy of a SICAR-like RAIF cannot allow the investment in assets which are not representative of risk capital, even to a negligible extent, except on a temporary. As a consequence, the management of funds awaiting investment, reinvestment and distribution must be made in accordance with the prudent person rule aiming to preserve the capital for the amounts invested on a temporary basis. The awaiting liquidity may only be invested in assets with no market risk, particularly, investment in shares (even blue chip) is prohibited.

● *Investments through "**IIVs**"[13] or "**SPVs**"[14]*

A SICAR-like RAIF may make indirect investments through:

IIVs: in this case, the IIV's policy must be in line with the investment policy of the RAIF. In order to be eligible, an IIV must qualify as private equity or venture capital fund.

SPVs: in this case, an SPV must have a policy which guarantees an exclusive investment in assets representing risk capital within the meaning of the RAIF Law and the "General principles" section above.

(2) Is a RAIF always subject to risk diversification requirements?

No as long as the RAIF is of the SICAR type (for further information on SICAR-like RAIFs please see the commentary under point B of question (1) above).

As long as the SICAR-like RAIF complies with the below requirements – by way of derogation from the provisions of Article 1 of the RAIF Law – the SICAR-like RAIF and its compartments are not obliged to spread the investment risks:

● *A priori requirements*

To achieve this treatment the SICAR-like RAIF's constitutive documents must state that

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(i) its exclusive object is the investment of its funds in securities representing risk capital, and that (ii) the provisions of Article 48 of the RAIF Law are applicable to it (see Article 48(1) of the RAIF Law).

● *A posteriori requirements*

The SICAR-like RAIF's statutory auditor must also (i) establish every financial year a report to certify that during the past financial year the SICAR-like RAIF has complied with the risk capital investment policy, and (ii) pass on this report to the Luxembourg Direct Taxation Authority.

The RAIF Bill also clarifies that it is not possible for an umbrella RAIF to have some compartments of the SIF type and other of the SICAR type. Should an AIFM[15] want to follow both strategies which are subject to a different tax treatment, it will have to set-up two separate (umbrella) RAIFs.

(3) What are the risk diversification requirements applicable to SIF-like RAIFs?

Similar to the technique adopted by the legislator for SICAR-like RAIFs, the RAIF Bill mentions that RAIFs and/or their legal counsels / auditors may base themselves on CSSF Circular 07/309[16] to interpret the risk spreading requirement that SIF-like RAIFs have to comply with.

In accordance with CSSF Circular 07/309 a SIF-like RAIF's issuing document must include quantifiable restrictions evidencing the fulfilment of the principle of risk-spreading.

● *General notion – the 30% principle*

In accordance with CSSF Circular 07/309, a SIF-like RAIF should be seen as complying with the risk-spreading principle if it does not invest more than "*30% of its assets or commitments to subscribe securities of the same type issued by the same issuer*".

The following clarifications should also be made – based on the CSSF regulatory practice which has developed over time in relation to SIFs and the 30% principle – as those accepted principles should apply as well to SIF-like RAIFs:

• *Securities of the same type notion*

The regulatory practice interpreted the wording "*securities of the same type issued by the same issuer*" as contained under CSSF Circular 07/309 by clarifying that a SIF (or in this instance, a SIF-like RAIF) could not invest more than 30% of its assets or commitments in securities (*i.e.* equity, debt or hybrid) issued by the same issuer.

• *Same issuer notion*

The regulatory practice also clarified that the risk diversification requirement dealt not only with direct counterparty risk but also indirect counterparty risk. For instance, a SIF-like RAIF investing in real estate assets across the globe but where a single tenant (*e.g.* a banking group) would lease more than 30% of the SIF-like RAIF's real estate portfolio would not be compliant with the 30% rule and a derogation would have to be obtained. This being said, derogations (*e.g.* 35% instead of the 30% maximum) in this respect in a SIF context can sometimes be obtained from the CSSF depending namely on the basis of the corporate debt rating of the renter, or the level of rents collected from other renters (*e.g.* where the renter representing more than 30% of the SIF portfolio would only represent 20% or 25% of the rents collected overall).

• *30% of the GAV[17]/NAV[18] notion*

In relation to SIFs and inasmuch as the relevant basis is inserted in the issuing document, the CSSF accepts that the 30% principle applies to the assets of the SIF including leverage (if applicable). Such flexibility should also be applied to SIF-like RAIFs.

• *Investments in more than one compartment of an underlying umbrella fund*

For the purpose of the application of this 30% principle, every compartment of a target umbrella fund is to be considered as a separate issuer provided that the principle of segregation of liabilities among the various compartments vis-à-vis third parties is ensured.

• *Transitional period notion – ramp-up phase*

In relation to SIFs and inasmuch as the relevant clause is inserted in the issuing document, the CSSF accepts a transitional period oscillating between 6 months (for liquid assets) and 3-4 years (for illiquid assets) counting from the final closing during which the SIF is not required to comply with the 30% principle. Such flexibility should also be applied to SIF-like RAIFs.

• *Transitional period notion – ramp-down phase*

Upon the RAIF entering into its winding down phase or liquidation phase or upon some or all of the investments having been fully repaid, the CSSF accepts that the 30% principle no longer applies, as the disposal of or the maturing of the SIF's assets will have an impact on the weightings between assets. Such flexibility should also be applied to SIF-like RAIFs.

• *Passive breaches*

Should a SIF-like RAIF be in a passive breach of the 30% principle for reasons beyond its reasonable control – (i) after the transitional period abovementioned, and (ii) after the SIF-like RAIF has complied with such threshold by the end of the transitional period – due namely to a change in the market value of its portfolio, the SIF-like RAIF should use reasonable efforts to come back within its investment powers and restrictions except where its reasonably believes that this would be prejudicial to the interests of its investors. It is recommended that a provision along those lines be included in the SIF-like RAIF's issuing document to clarify this principle vis-à-vis the auditor and the SIF-like RAIF's investors.

• *Look-through approach - SPVs*

If the SIF-like RAIF invests through one or more SPVs which it controls, the 30% principle will be applied on a look-through basis i.e. the SPV is disregarded as if the SIF-like RAIF held the position directly in the underlying investment(s). In this manner, a SIF-like RAIF can hold for instance 2 or more real estate assets under the same SPV, such assets representing in aggregate more than 30% of the SIF-like RAIF's portfolio.

• *Look-through approach - IIVs*

If the SIF-like RAIF invests through one or more IIVs which it does not control, the 30% principle should be analysed as follows:

– IIVs subject by law to risk-spreading requirements at least comparable to those applicable to SIF-like RAIFs

  The SIF-like RAIF may then invest 100% or less of its assets into such IIV.

– IIVs subject by contractual arrangements to risk-spreading requirements at least comparable to those applicable to SIF-like RAIFs

  The SIF-like RAIF may invest 100% or less of its assets into such IIV provided that the contractual arrangement (either based on a side letter between the manager of the IIV and the SIF-like RAIF or based on the issuing document of the IIV) is enforceable.

– IIVs not subject to risk-spreading requirements at least comparable to those applicable to SIF-like RAIFs

  The SIF-like RAIF cannot then apply the look-through approach and has to apply the 30% principle at the level of the IIV.

• *Cash holdings*

For the avoidance of doubt, no SIF-like RAIF will hold more than 30% of its net asset value (or gross asset value if it uses leverage for investment purposes) in liquid assets with the same credit institution. This is especially important in case of temporary holdings.

• *Short positions*

Short sales may not in principle result in the SIF-like RAIF holding a short position in securities of the same type issued by the same issuer representing more than 30% of its assets.

• *Derivative instruments*

When using financial derivative instruments, the SIF-like RAIF must ensure, via appropriate diversification of the underlying assets, a similar level of risk-spreading and complying with the 30% principle. Similarly, the counterparty risk in an OTC transaction must, where applicable, be limited having regard to the quality and qualification of the counterparty.

• *Compartment per compartment approach*

The 30% principle applies with respect to umbrella SIF-like RAIFs on a compartment per compartment basis, i.e. an asset which would represent more than 30% of a compartment's portfolio could be purchased by two or more compartments (inasmuch as their investment policy allows for it and potential conflicts of interests are dealt with appropriately).

Investments made by SIF-like RAIFs representing more than 30% of their portfolio.

• *"T-bill" exception*

According to CSSF Circular 07/309 the 30% principle does not apply to investments in securities issued or guaranteed by an OECD Member State or its regional or local authorities or by EU, regional or global supranational institutions and bodies. As a consequence, SIF-like RAIFs can invest up to 100% of their portfolio in such assets.

• *Investments in infrastructure assets*

In line with the flexibility offered under CSSF Circular 07/309, the CSSF granted an exception to the 30% principle for SIFs investing in infrastructure allowing them to invest up to 75% of their portfolio in one infrastructure assets provided that:

– the targeted investments of the SIF must clearly qualify as "Infrastructure" investments and should be described as such in the issuing document;

– the investment policy of the SIF must be built for the major part on a portfolio of Infrastructure investments;

– appropriate risk disclaimers must be included in the issuing document in order to draw the attention of investors to the risks linked to the limited level of diversification of their portfolio;

– the issuing document of the SIF must provide that the targeted risk diversification will be performed on a best efforts basis; and

– the issuing document of the SIF must include a description of the conditions under which the shares or units in the SIF are redeemable.

Such flexibility should also be applied to SIF-like RAIFs.

(4) Can a RAIF borrow money and if so, is there a limit?

Yes, and the RAIF Law does not provide for any limit.

(5) Can a RAIF lend money and/or buy debt assets comprising revolving credit facilities?

A RAIF can lend money. In this framework, the only limits are those dictated by the FS Law and interpretations given by the CSSF. Indeed, unlike SIFs, SICARs, Part II Funds and Lux securitisation vehicles, a RAIF is not part of the list of exempted entities under the FS Law. Therefore, one should take into account the shadow banking considerations mentioned by the CSSF in its PFS FAQ before a RAIF granting loans or purchasing debt assets comprising revolving credit facilities or loans not fully drawn.

Pursuant to point 51 of the PFS FAQ, the following exemptions are possible:

● *One-off transactions*

RAIFs performing a unique or one-off lending operation to non-group entities are exempted from shadow banking considerations.

● *Group exception*

RAIFs granting loans exclusively to one or several companies held by it are also exempted from shadow banking considerations.

● *Loans not granted to the "public"*

The CSSF is of the view that a RAIF can grant loans (secured or not) to a "limited circle of previously known persons" and those persons are "known" (*i.e.* existing business relationships or existing contacts) by the entity (the board, GP or AIFM of the RAIF) that holds or controls the RAIF or its SPVs carrying out the lending operations.

CSSF may grant on a case-by-case basis, negative clearances to undertakings carrying out lending operations which (i) would not go beyond a certain number of transactions, (ii) would not go below a certain EUR amount, and/or (iii) exclude some types of borrowers not considered to fall within the "public" notion. Such clearances are important for AIFMs in general (as well as financial institutions that would be contacted to ask for a leverage) because of the criminal sanctions applicable against those granting loans to the public without being either exempted specifically by the FS Law or cleared by the CSSF.

Conclusion

As shown in this article, RAIFs' investment policies are extremely flexible. The chosen investment policy may impact the type of RAIF to be set-up (i.e. SIF-like or SICAR-like RAIF) as well as its tax treatment. Due to this flexibility, it is no wonder why fund promoters seeking well-tailored quick-to-market solutions in an unregulated umbrella structure subscribe to the idea of RAIFs.

Notes

1 The views expressed in this article reflect some of the author's experience to date on the subject matter. As the Luxembourg fund market continues to develop – namely in relation to RAIFs – these views may and will most likely continue to evolve in one way or another. This article should in no wise be construed as legal advice rendered by the author or by NautaDutilh Avocat Luxembourg S.à r.l., nor should it be interpreted as reflecting the views of NautaDutilh Avocat Luxembourg S.à r.l.

2 means the law of 23 July 2016 relating to reserved alternative investment funds, as amended.

3 means the Bill aiming at amending the law of 15 June 2004 relating to the investment company in risk capital (the "**SICAR Law**"), the law of 13 February 2007 relating to specialised investment funds (the "**SIF Law**"), the law of 17 December 2010 relating to undertakings for collective investment, and the law of 12 July 2013 relating to alternative investment fund managers, as amended (the "**AIFM Law**").

4 means any Per Se Professional Investor and Opt-In Professional Investor.

"***Per Se Professional Investor***" means any investor which may fall within one of the following 4 main categories:

– Entities having to be authorised or regulated to operate on financial markets, such as credit institutions, investment firms, other authorised or regulated financial institutions, insurance undertakings and reinsurance undertakings, UCIs and their management companies, pension funds and management companies of such funds, commodity and commodity derivatives dealers, and other institutional investors;

– Large undertakings meeting two of the following size requirements on a company basis: (i) a total balance sheet of at least EUR 20 million; (ii) a net turnover of at least EUR 40 million; (iii) equity of at least EUR 2 million;

– Public sector bodies namely national and regional governments, public bodies that manage public debt, Central Banks, international and supranational institutions such as the World Bank, the IMF, the ECB, the EIB and other similar international organisations; and

– Other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

"***Opt-In Professional Investor***" means any investor that is not a Per Se Professional Investor that may opt-in in order to be treated as a Professional Investor provided (i) the criteria, and (ii) the procedure requirements laid out below are met:

– Criteria

  A credit institution or investment firm must conduct an adequate assessment of the expertise, experience and knowledge of the investor concerned, to reasonably ensure, in light of the nature of the transactions envisaged, that the investor is capable of making his own investment decisions and understanding the risks involved.

  In the course of the above assessment, as a minimum, two of the following criteria should be satisfied:

  – the investor has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;

  – the size of the investor's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds EUR 500,000;

  – the investor works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

– Please note that:

  – the fitness test applied to managers and directors of entities licensed under European Directives in the financial field could be regarded as an example of the assessment of expertise and knowledge; and

  – in the case of small entities, the person subject to the assessment should be the person authorised to carry out transactions on behalf of the entity.

– Procedure

The following procedure must be followed:

  – the investor must state in writing to the credit institution or investment firm that it wishes to be treated as a Professional Investor, either generally or in respect of a particular investment transaction, or type of transaction or product;

  – the credit institution or investment firm must give to the investor a clear written warning of the protections and investor compensation rights it may lose; and

  – the investor must state in writing, in a separate document from the contract, that it is aware of the consequences of losing such protections.

5 means the shares, units or partnership interests (as the case may be) issued by the RAIF (in relation to the relevant compartment in case of an umbrella RAIF).

6 means any Institutional Investor, Professional Investor, and Other Well-Informed Investor.

Regarding the "**Institutional Investor**" notion, the RAIF Law is mute on it and the other fund related laws – such as the SIF Law upon which the RAIF Law is largely based – uses the same concept without elaborating on this notion.

Some indications can however be found in the "UCITS III law" parliamentary documents which referred to the law of 19 July 1991 on institutional undertakings for collective investments which was repealed by the SIF Law (the "**1991 Law**") and provided some clarifications on the concept of "institutional investors". Institutional investors are referred to as companies and organisations "managing moneys and large amounts" (*gérant des fonds et des valeurs importantes*) and shall notably include "professionals of the financial sector" (*professionels du secteur financier*).

The CSSF in its 1999 annual report also provided further guidance on the interpretation of the concept of "institutional investors" in the context of the 1991 Law. According to the CSSF (which switched from a restrictive to a more liberal approach as stated therein), it is not necessary that the client for which a credit institution will act is itself an institutional investor. The CSSF further commented that (i) the moneys invested for the client should be on the basis of a "discretionary management agreement" entered into with the relevant Luxembourg or foreign financial institution subscribing in the fund, and (ii) the end-client cannot have a recourse right (droit de revendication) vis-à-vis the fund (which right should only belong to the financial institution vis-à-vis the fund).

Although the comment made by the CSSF was in the context of the 1991 Law, we believe that this position can also be applied to RAIFs. The consequence of that interpretation is that (regulated) financial institutions may invest in a RAIF (i) in their own name and own account, or (ii) in their own name but on behalf of retail clients having entered into a discretionary management agreement with them and provided that such clients do not have any recourse right against the RAIF.

In its 1999 annual report, the CSSF did not specify any minimum amount to be invested pursuant to such discretionary management agreement and we understand that the characterisation of an institutional investors will merely depend on the fact that (i) the financial institution / professional of the financial sector invests in its own name and behalf, or (ii) the financial institution / professional of the financial sector investing in its own name but on behalf of its clients does so on the basis of a discretionary management agreement concluded between such institution and its client.

- Discretionary management agreements versus nominee arrangements

For a subscription in the RAIF with retail client moneys to be viewed as a subscription made by an "Institutional Investor", all moneys invested by that institution acting in its name but on behalf of one or more retail clients be done on the basis of written discretionary management agreements concluded prior to the investment of the relevant moneys into the RAIF.

For the avoidance of doubt, the subscribing institution should in particular be careful not to subscribe as a mere nominee. In an investment fund context, a nominee is an intermediary which is interposed between a fund and an end-investor and where the end-investor retains in principle the ability to invest directly into the fund upon his/her request. Our view is that a mere nominee type of arrangement whereby a financial institution would subscribe for shares in a RAIF is insufficient to qualify as an Institutional Investor and therefore each retail client behind the investment made by the financial institution into the RAIF should qualify either as an Opt-In Professional Investor or as an Other Well-Informed Investor.

- Non-recourse

It is also recommended to ensure that the end-investor – whose money has been invested pursuant to a discretionary management agreement – has no recourse against the RAIF in which the financial institution invests.

This could be further clarified in the discretionary management agreement itself (although probably implied by the nature of such an agreement) along with the fact that the relevant subscription documents and shareholder register should refer to the financial institution as the legal owner of the Shares in the RAIF (*i.e.* acting in its own name but pursuant to one or more discretionary management agreements).

Regarding the "**Other Well-Informed Investor**" notion, it means any investor who is neither (i) an Institutional Investor, nor a Professional Investor, and who: a) has confirmed in writing that he adheres to the status of well-informed investor, and b) (i) he invests a minimum of EUR 125,000 in the RAIF, or (ii) he has been the subject of an assessment made by a credit institution within the meaning of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, by an investment firm within the meaning of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, or by a management company within the meaning of 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 UCITS, or by an authorised AIFM within the meaning of the AIFMD certifying his expertise, his experience and his knowledge in adequately apprising an investment in the RAIF.

7 means the Bill n°6929 relating to reserved alternative investment funds.

8 means the CSSF circular letter dated 5 April 2006 on the concept of risk capital under the Law of 15 June 2004 relating to the investment company in risk capital (SICAR).

9 for further information on the matter, please see the answer to question (5) below.

10 means the law of 5 April 1993 relating to the financial sector, as amended.

11 means the Part II questions and answers on the statuses of "PFS" issued by the CSSF and last update on 30 November 2015.

12 means Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

13 means intermediary investment vehicles.

14 means special purpose vehicles.

15 means an alternative investment fund manager within the meaning of Article 1(46) of the AIFM Law.

16 means the CSSF circular letter dated 3 August 2007 on risk-spreading in the context of specialised investment funds (SIF).

17 means the gross asset value of the SIF or the relevant compartment thereof.

18 means the net asset value of the SIF or the relevant compartment thereof.

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