FAQ on Circular CSSF 24/856

Version 1 – 24 December 2024

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TABLE OF CONTENTS

Update information ... 2

Context ... 5

Chapter I – Scope of application of Circular CSSF 24/856 ... 6

Q1. Does Circular CSSF 24/856 apply to Reserved Alternative Investment Funds ("RAIFs") subject to the Law of 23 July 2016 and other UCIs not authorised by the CSSF? ... 6

Chapter II – NAV calculation errors at UCI level ... 6

Q1. In case of a significant NAV calculation error for which there were no subscriptions and redemptions during the NAV calculation error period and thus no compensation amounts to be paid to the UCI and/or the investors, what are the remedial actions required and should a "Notification" as laid down in Circular CSSF 24/856 be prepared and provided to the CSSF? ... 6

Q2. In case the tolerance threshold applied to the UCI for a NAV calculation error, in accordance to the internally approved policy, is lower than the tolerance threshold foreseen by Circular CSSF 24/856, do the corresponding NAV calculation errors have to be notified to the CSSF in accordance with that lower threshold? ... 6

Q3. Closed-ended UCIs are not subject to Chapter 4 of Circular CSSF 24/856 and are consequently not required to define a tolerance threshold in accordance with the circular. What are the guidelines applicable to closed-ended UCIs? Should closed-ended UCIs nonetheless consider defining a tolerance threshold? ... 7

Chapter III - Non-compliance with the UCI investment rules ... 7

Q1. Should the following situations be treated as an instance of active non-compliance by a UCITS of the 20% deposit limit of article 43(1) of the 2010 Law in accordance with the provisions of the Circular CSSF 24/856? ... 7

Q2. What are the elements that UCITS have to consider from an investment compliance perspective in the context of the US T+1 move? ... 9

Q3. In case of an active non-compliance by a UCITS of the cumulative investment rule of Article 43 (2) of the 2010 Law (i.e. 5/40%), which securities should be sold to remediate the non-compliance and what are the acceptable methods for calculating the related financial impacts? ... 10

Q4. In case of an active non-compliance by a UCITS of the 20% deposit limit of Article 43(1) of the 2010 Law where the deposit returns a negative interest to the UCITS, can the UCITS calculate the financial impact of the non-compliance by using a method which consists in comparing the interest rate return borne by the UCITS to the interest rate return of an equivalent deposit made with another credit institution? ... 11

Q5. Is it possible, within the same UCI, to use the accounting method to calculate the compensation amount for certain active instances of investment non-compliance (e.g. Article 50(2) of the 2010 Law) and to use an economic method to calculate the compensation amount for other types of active instances of investment non-compliance (e.g. diversification limits of the 2010 Law)?......... 12

Q6. Should a UCITS that exceeds the level of leverage as disclosed to investors in the UCI prospectus in accordance with box 24 of the CESR guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR-10/788 dated 28/07/2010) for UCITS, respectively should a regulated AIF that exceeds the leverage limits as disclosed to investors in accordance with Article 21 (1) (a) of the Law of 12 July 2013 , notify such situation to the CSSF in the context of the provisions of Circular CSSF 24/856?. 12

Chapter IV - Other errors at UCI level.. 12

Q1. Do the following situations qualify, in accordance with Section 6.2. of Circular CSSF 24/856, as "non-compliant payment of costs/fees error" at UCI level?..... 12

Chapter V – General guidelines in relation to the correction of errors/instances of non-compliance... 13

Q1. When the UCI makes use of the "de minimis" amount for compensating the investors who are financially impacted in the context of a significant NAV calculation error or another error, should the UCI seek prior approval from the CSSF?.. 13

Context

Please find hereafter a list of questions/answers in relation to the Circular CSSF 24/856 concerning the protection of investors in case of an NAV calculation error, an instance of non-compliance with the investment rules and other errors at the level of the Undertaking for Collective Investment ("UCI").

The CSSF FAQ on Circular CSSF 24/856 applies in accordance with the scope of application as set out in section 2.1 of Chapter 1 "Scope of application and legal basis" as from 1 January 2025 (i.e. date of entry into force of Circular CSSF 24/856).

This document will be updated when necessary and the CSSF reserves the right to adapt its approach to any matter covered by the Q&A at any time. You should regularly check the website of the CSSF in relation to any matter of importance to you to see if questions have been added and/or positions have been adapted.

Chapter I – Scope of application of Circular CSSF 24/856

Q1. Does Circular CSSF 24/856 apply to Reserved Alternative Investment Funds ("RAIFs") subject to the Law of 23 July 2016 and other UCIs not authorised by the CSSF?

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RAIFs are not in the scope of Circular CSSF 24/856, except if they fall in the categories of UCIs mentioned in Section 2.1. ("Scope of application") of the circular (e.g. Luxembourg ELTIFs), for which the CSSF is the competent authority in accordance with the applicable regulations.

The modalities of application of the Circular CSSF 24/856 for UCIs, which are not UCITS, UCIs Part II, SIFs or SICARs, are set out in points 2 to 4 of Section 2.1. of the circular and relate to ELTIFs, MMFs and EuVECAs/EuSEFs.

Chapter II – NAV calculation errors at UCI level

Q1. In case of a significant NAV calculation error for which there were no subscriptions and redemptions during the NAV calculation error period and thus no compensation amounts to be paid to the UCI and/or the investors, what are the remedial actions required and should a "Notification" as laid down in Circular CSSF 24/856 be prepared and provided to the CSSF?

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In this case, it is expected that the source of the error is determined and corrected so as to ensure that the next NAVs are correctly calculated. The necessary corrective actions (e.g. strengthening of internal controls) should also be taken in order to avoid such errors in the future.

A notification should be provided to the CSSF including also information about the source of the error. In accordance with the notification form, UCIs should include therein the corrective measures taken in order to avoid the reoccurrence of the same kind of significant NAV calculation error in the future.

Q2. In case the tolerance threshold applied to the UCI for a NAV calculation error, in accordance with the internally approved policy, is lower than the tolerance threshold foreseen by Circular CSSF 24/856, do the corresponding NAV calculation errors have to be notified to the CSSF in accordance with that lower threshold?

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Yes.

In that case, all provisions of Circular CSSF 24/856 have to be applied based on the lower threshold as determined for the UCI.

Q3. Closed-ended UCIs are not subject to Chapter 4 of Circular CSSF 24/856 and are consequently not required to define a tolerance threshold in accordance with the circular. What are the guidelines applicable to closed-ended UCIs? Should closed-ended UCIs nonetheless consider defining a tolerance threshold?

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According to point 27 of the Circular CSSF 24/856, closed-ended UCIs, as defined in Chapter 1 ("Definitions and abbreviations"), are not in the scope of Chapter 4 of the circular. As a consequence, the requirements concerning the tolerance threshold of Section 4.2. do not apply to closed-ended UCIs.

Closed-ended UCIs or the Investment Fund Manager ("IFM"), where applicable, have however, in accordance with point 26 and the first paragraph of point 27 of the circular, to ensure that:

- the NAV calculation rules provided for by the law, the constitutive documents and/or the prospectus of the closed-ended UCIs are complied with on an ongoing basis;

- the policies and procedures in place (i) ensure that the assets and liabilities of the closed-ended UCIs are valued in a reliable way and that the NAV is calculated in accordance with the law, the constitutive documents and/or the prospectus and (ii) allow limiting, as much as possible, the risk of NAV calculation errors and detecting the errors that occur.

Closed-ended UCIs or its IFM, where applicable, must further ensure in accordance with the third paragraph of point 27 of the circular that corrective measures are taken to correct, where appropriate, any NAV calculation error. For that purpose, the CSSF recommends that a tolerance threshold is defined for closed-ended UCIs in order to identify any significant NAV calculation error that needs being corrected. Closed-ended UCIs having defined such a tolerance threshold for internal purposes, remain outside of the scope of Chapter 9 of Circular CSSF 24/856 and consequently are not required to submit a notification to the CSSF in case of occurrence of a NAV calculation error exceeding the internally defined tolerance threshold.

Chapter III - Non-compliance with the UCI investment rules

Q1. Should the following situations be treated as an instance of active non-compliance by a UCITS of the 20% deposit limit of article 43(1) of the 2010 Law in accordance with the provisions of the Circular CSSF 24/856?

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a) Generally speaking, the internal organisation of a UCI should provide for a prompt and timely information to the IFM about subscription and/or redemption requests, especially in case of larger capital transactions, allowing the IFM to anticipate as much as possible UCI dealings and related payment flows (in accordance with the settlement cycle of the UCITS) and to take on that basis the necessary measures for ensuring that the portfolio transactions to be carried out as a result

of these capital transactions (with their corresponding settlement cycle) allow an ongoing compliance of the UCITS with the applicable investment rules.

Take the example of a UCI where, due to a settlement date mismatch between the capital activity and the portfolio transactions, the 20% deposit limit of Article 43 of the 2010 Law is exceeded. More particularly, a UCI with regular capital transactions from investors has on T a 18% deposit with a single counterparty. For that UCI a 5% redemption that settles on T+3 and a corresponding 5% securities sale instructed by the IFM for settlement on T+1 lead to a deposit position above 20% with the same counterparty during two days.

In that context and given the characteristics of the UCI, the IFM should have taken the necessary measures for handling possible excess deposits with a given counterparty and should have anticipated on T that the UCI will be non-compliant with the 20% deposit limit. The resulting non-compliance from such anticipated subscriptions/redemptions is avoidable and thus not beyond the control of the UCITS. The non-compliance is considered active.

b) On the same trade date, purchase transactions and sales transactions of securities with different settlement dates are concluded.

   For example, a 5% purchase of security A that settles on T+2 and a 5% sale of security B that settles on T+1 lead to a deposit position above 20% with the same counterparty during one day.

   The cash inflow in relation to the sale of security B causes the deposit limit to be exceeded between T+1 and T+2.

   As the settlement date mismatch is predictable/avoidable and thus not beyond the control of the UCITS, the non-compliance is considered active.

c) In relation to the maturity of a security held in the UCITS portfolio, a cash inflow is generated and leads to an increase of the deposit position above 20% with the same counterparty.

   For example, a 5% position in a bond matures that leads to a deposit position above 20% with the same counterparty. As the expiry of a bond is a predictable/avoidable event and thus not beyond the control of the UCITS, the non-compliance is considered active.

Generally speaking, the CSSF expects that the organisation of the portfolio management by the IFM at the level of the UCITS (i.e. the investment operations, the cash management and the subscription/redemption flows) should provide for an ongoing compliance of the 20% limit on deposits made with a single body.

Nevertheless, even if a UCITS has taken the necessary steps to ensure ongoing compliance with the 20% deposit limit and the settlement date mismatch is predictable, it might under certain justified exceptional circumstances face a temporary non-compliance which cannot reasonably be avoided and thus is beyond the control of the UCI ("passive non-compliance").

The CSSF expects such UCITS to be able to justify the "passive" character of the non-compliance and to document it accordingly while, in accordance with Article 49(2) of the 2010 Law, adopting as a priority objective for its sales transactions the remedying of that situation, taking due account of the interests of its investors.

Q2. What are the elements that UCITS have to consider from an investment compliance perspective in the context of the US T+1 move?

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The Central Securities Depositories Regulation (CSDR) of 23 July 2014 on improving securities settlement in the European Union and central securities depositories introduced the requirement in the EU that all transactions in transferable securities, which are executed on trading venues, are settled by no later than the second business day after their trade date ("T+2" settlement cycle). With effect from end of May 2024, most securities transactions in the United States, as well as other jurisdictions (Canada and Mexico), have moved from a standard settlement cycle of T+2 to T+1.

The applicable settlement cycles and related developments have an impact on the operations of UCITS (and other investment funds). A particular attention in this context relates to the interaction between the settlement cycles of securities transactions (asset side) and fund dealings (subscriptions/redemptions - liability side). When determining the settlement cycle for the fund dealings, UCITS shall notably consider the target markets of their investment policy and their distribution set-up (e.g. local distribution, international distribution), including the parties/intermediaries involved in the related processes. The settlement cycle of UCITS is generally T+2 or T+3, with deviations relating to the individual features and operating model of the fund. The T+3 cycle is typically applied in cases of cross-border distribution with time zone differences.

UCITS have already in the past (i.e. before the move in the US to shorten the settlement cycle to T+1) been confronted with timing gaps between the settlement cycles of their securities transactions and their fund dealings. Such timing gaps, subject to further increase in the absence of any change in the settlement cycle of UCITS dealings as a result of the developments in the US, might give rise under certain circumstances to operational challenges, including from an investment compliance perspective. More particularly, in relation to subscriptions/redemptions transactions, UCITS could face under certain circumstances investment compliance issues concerning the deposit limit laid down in Article 43(1) of the Law of 17 December 2010 relating to undertakings for collective investment ("2010 Law"), ancillary liquid assets laid down in Article 41(2) of the 2010 Law and the temporary borrowing limit set forth in Article 50(2) of the 2010 Law.

The generally applicable principle is that UCITS adhere on an ongoing basis to the applicable investment rules.

As a result, UCITS should in their activities, including in case of subscriptions / redemptions and related securities purchase/sales transactions, take the appropriate measures to ensure their ongoing compliance with the applicable investment rules. Compliance checks on a pre-trade basis should consider settlement cycles so as to avoid non-compliance with applicable investment rules.

With regard to timing gaps in settlement cycles from a general perspective and the recent move in the US to T+1 in particular, UCITS can avail themselves of measures/tools for managing these timing gaps. Subject to a feasibility/impact assessment to be led by the UCITS and the consideration of investors' interests, these measures/tools include, for instance, the following:

- A shortening of the settlement cycle of the UCITS dealings in order to ensure a better alignment with the settlement cycle(s) applicable to the securities transactions operated by the UCITS. The feasibility/impact assessment should notably consider the securities markets (with the applicable settlement cycle) in which a UCITS operates as a result of its investment policy as well as its distribution policy, including related operational constraints.
- The operation of cash management solutions such as so-called "cash sweep" programs. Under "cash sweep" programs, cash balances are moved, at the end of the day, to other banks or are

invested in cash-like instruments (e.g. money market funds) to ensure that the UCITS adheres to the 20% deposit limit per single body, respectively the 20% limit on ancillary liquid assets.

- The diversification of bank relationships by opening an additional bank account for the UCITS with another counterparty.
- Temporary borrowings, limited to 10% in accordance with Article 50 of the 2010 Law, may permit, under certain circumstances and when deemed in the best interest of investors, to bridge the timing gap between incoming payments from subscriptions (e.g. on T+3 for UCITS operating such a settlement cycle) and outgoing payments for related securities purchases (e.g. on T+1 for securities dealt on US markets).
- The use of extended settlement periods, when possible and in the best interest of investors, that broker-dealers can offer to IFMs / portfolio managers under certain conditions (see SEC.gov | Shortening the Securities Transaction Settlement Cycle).

UCITS should also consider the timing of the investments of the incoming payments from subscriptions in securities markets, considering elements such as for example the settlement cycles, the subscription amounts, investment compliance (notably also temporary borrowing limit), borrowing costs, dilution effects.

Before the US T+1 move, UCITS had already to manage in a proactive manner settlement timing gaps between fund dealings and securities markets operations.

In this context, the CSSF acknowledges that UCITS, having well considered the abovementioned principles, the possibilities given for managing timing gaps and the best interests of investors, might under certain exceptional circumstances face temporary non-compliances with the investment rules that could reasonably not be avoided (so-called "passive instances of non-compliance").

Such passive instances of non-compliance should, in principle, resolve themselves upon final settlement of the fund dealings or securities transactions. In case of a non-compliance qualifying as beyond the control, UCITS have, in accordance with Article 49(2) of the 2010 Law, to adopt as a priority objective for its sales transactions the remedying of that situation, taking due account of the interests of its investors.

The CSSF expects UCITS to be able to justify the "passive" character of instances of non-compliance. Cases of active non-compliance as a result of timing gaps in settlement cycles have to be dealt with and corrected in accordance with the provisions of Circular CSSF 24/856.

Q3. In case of an active non-compliance by a UCITS of the cumulative investment rule of Article 43 (2) of the 2010 Law (i.e. 5/40%), which securities should be sold to remediate the non-compliance and what are the acceptable methods for calculating the related financial impacts?

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The 2010 Law foresees in relation to the 5/40% investment rule for UCITS the following:

"The total value of the transferable securities and money market instruments held by a UCITS in the issuing bodies in each of which it invests more than 5% of its assets shall not exceed 40% of the value of its assets".

In case of an active non-compliance with that investment rule, the UCITS does not necessarily have to sell the securities that caused the non-compliance.

It is rather the responsibility of the UCITS to determine, in accordance with the rules outlined below, which security should be sold in order to remediate promptly the active non-compliance.

Example: Following the 9% of total net assets (hereafter "TNA") purchase of a position on Equity A, the portfolio is notably composed as follows:

- 9% of TNA of Equity A
- 8% of TNA of Equity B
- 8% of TNA of Equity C
- 9% of TNA of Equity D
- 9% of TNA of Equity E

The portfolio composition in this case is in non-compliance of the 5/40% rule as the sum of the securities with positions greater than 5% of TNA equals 43%.

Rather than selling the excess position on Equity A, the UCITS remediates the non-compliance through the sale of the excess position on Equity B.

For the financial impact calculation, three methods are acceptable:

a) calculate the impact by reference to the security that caused the non-compliance by applying the accounting method in proportion to the amount in non-compliance (i.e. impact calculated on the excess position on Equity A);

b) calculate the impact by reference to the security that has been sold by applying the accounting method in proportion to the amount in non-compliance (i.e. impact calculated on the excess position on Equity B);

c) calculate the impact by using the economic method in proportion to the amount in non-compliance i.e. impact being calculated by comparing the performance of the reference of the portfolio to the average performance of the securities having positions above 5% or to the performance of the securities that generated the non-compliance) with a consistent use of the method over time.

In case the internal policy of the IFM, does not lay down in writing the method to be used, the CSSF considers that method a) should be applied by default.

Q4. In case of an active non-compliance by a UCITS of the 20% deposit limit of Article 43(1) of the 2010 Law where the deposit returns a negative interest to the UCITS, can the UCITS calculate the financial impact of the non-compliance by using a method which consists in comparing the interest rate return borne by the UCITS to the interest rate return of an equivalent deposit made with another credit institution?

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No.

The CSSF considers that a UCITS should be indemnified in relation to the interest rate and other charges borne by the UCITS as a result of the excess deposit position.

As a consequence, the application of a method that consists in comparing the interest rates between different bank accounts to determine the financial impact is not allowed.

Furthermore, the CSSF considers that the impact calculation of this type of active non-compliance related to the 20% deposit limit of article 43(1) of the 2010 Law should be performed by using the accounting method, unless the conditions allowing the use of the economic method to determine the financial impact caused in the case of an active non-compliance with the UCI investment rules, as set out in paragraph 5.5.3.2 of CSSF Circular 24/856 are observed.

Q5. Is it possible, within the same UCI, to use the accounting method to calculate the compensation amount for certain active instances of investment non-compliance (e.g. Article 50(2) of the 2010 Law) and to use an economic method to calculate the compensation amount for other types of active instances of investment non-compliance (e.g. diversification limits of the 2010 Law)?

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Yes, if this is formally laid down in the internal policy of the IFM and applied on a consistent basis.

Q6. Should a UCITS that exceeds the level of leverage as disclosed to investors in the UCI prospectus in accordance with box 24 of the CESR guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR-10/788 dated 28/07/2010) for UCITS, respectively should a regulated AIF that exceeds the leverage limits as disclosed to investors in accordance with Article 21 (1) (a) of the Law of 12 July 2013 , notify such situation to the CSSF in the context of the provisions of Circular CSSF 24/856?

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No.

However, the CSSF expects that such non-compliance is adequately monitored and corrected in accordance with applicable internal procedures (escalation, etc.).

Chapter IV - Other errors at UCI level

Q1. Do the following situations qualify, in accordance with Section 6.2. of Circular CSSF 24/856, as "non-compliant payment of costs/fees error" at UCI level?

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Example 1:

The estimation by the REA of the audit fees relating to the statutory audit work for the financial exercise was booked in the accounting records of the UCI.

The accrued audit fees reveal later being insufficient as additional audit work, which was not expected at the time of the start of the audit, had to be carried out by the REA causing the audit

fees to be higher. The UCI pays the invoice received by the REA and reverses the accounting accruals recorded.

This situation is not a "non-compliant payment of costs/fees at UCI level" as the UCI accrued the audit fees timely on the basis of reliable information and in good faith.

Example 2:

According to the prospectus of a UCI, an IFM is entitled to a management fee of 2% payable on a quarterly basis by the UCI. The UCI administrator booked an incorrect fee accrual of 1.8% over the first quarter of 2025, with the incorrect booking being detected during the month of March 2025. At that moment, the fee accruals were corrected and set at 2%. The management fee error had no significant impact on the NAV of the UCI.

As there was no incorrect payment of costs/fees, Section 6.2. Circular CSSF 24/856 does not apply. Further, the accrual of the management fee since the beginning of the first quarter was incorrect and generated a NAV calculation error during the quarter. Nevertheless, as the applicable tolerance threshold for a significant NAV calculation error was not exceeded, Chapter 4 of Circular CSSF 24/856 does not apply either.

Example 3:

According to the prospectus of a UCI, an IFM is entitled to a management fee of 2% payable on a quarterly basis by the UCI. The fee is wrongly set up in the accounting system.

As a result, the UCI administrator booked an incorrect fee accrual of 1.8% over the first quarter 2025. At quarter-end, the fee accrual error caused the UCI to pay an insufficient amount of management fees to the IFM for the first quarter 2025. After quarter-end the incorrect payment is detected.

The IFM requested the retroactive payment of the insufficiently paid management fees for the first quarter 2025.

The management fee of 2% was set out in the prospectus of the UCI and was not reflected adequately in the NAVs of the UCI resulting in an underpayment of the management fee.

In this case, Section 6.2 of the circular applies, and the UCI may correct the insufficient payment by using one of the two correction methods described under point 105 of the circular.

Chapter V – General guidelines in relation to the correction of errors/instances of non-compliance

Q1. When the UCI makes use of the "de minimis" amount for compensating the investors who are financially impacted in the context of a significant NAV calculation error or another error, should the UCI seek prior approval from the CSSF?

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No.

The CSSF can, however, ask the UCI to justify on an ex-post basis the level of the “de minimis” amount applied and to provide documentary evidence that such amount represents the bank charges necessary to transfer the compensation amounts to investors (notably where the “de minimis” amount exceeds EUR 25).

In addition, the internal policy of the IFM should provide for the use and the level of the “de minimis” amount in relation to NAV calculation errors.