

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

CSSF Regulation N° 12-01 laying down detailed rules for the application of Article 42a of the law of 13 February 2007 relating to specialised investment funds concerning the requirements regarding risk management and conflicts of interest

(Mémorial A – No. 192 of 6 September 2012)

The Executive Board of the Commission for the Supervision of the Financial Sector,

Considering Article 108a of the Constitution;

Considering the Law of 23 December 1998 establishing the Commission for the Supervision of the Financial Sector and especially its Article 9(2);

Considering the Law of 13 February 2007 relating to specialised investment funds;

CHAPTER I

SUBJECT MATTER, SCOPE AND DEFINITIONS

Article 1

Subject matter

This regulation lays down detailed rules for the application of Article 42a, paragraphs (1) and (2) of the law of 13 February 2007 relating to specialised investment funds;

1) concerning the appropriate risk management systems referred to in Article 42a, paragraph (1) of the law of 13 February 2007 relating to specialised investment funds and in particular the criteria for assessing the adequacy of the risk management systems used by the specialised investment funds;

2) concerning the organisational structures and requirements referred to in Article 42a, paragraph (2) of the law of 13 February 2007 relating to specialised investment funds whose objective is to minimise the risk of conflicts of interest.

Article 2

Scope

This regulation shall apply to specialised investment funds within the meaning of Article 1 of the law of 13 February 2007 relating to specialised investment funds.

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Article 3

Definitions

For the purpose of this regulation, the following definitions shall apply in addition to those set down in the law of 13 February 2007 relating to specialised investment funds:

(1) "counterparty risk" shall mean the risk of loss for the specialised investment fund resulting from the fact that the counterparty to a transaction may default on its obligations prior to the final settlement of the transaction's cash flow;

(2) "liquidity risk" shall mean the risk that a position in the portfolio of the specialised investment fund cannot be sold, liquidated or closed at a limited cost in a sufficiently short time frame and that the ability of the specialised investment fund to comply at any time with the terms and forms of redemption laid down in the management regulations or in the articles of incorporation in accordance with Articles 8 and 28, paragraph (2) of the law of 13 February 2007 in relation to specialised investment funds is thereby compromised;

(3) "market risk" shall mean the risk of loss for the specialised investment fund resulting from fluctuation in the market value of positions in its portfolio attributable to changes in market variables such as interest rates, exchange rates, equity and commodity prices, or an issuer's creditworthiness;

(4) "operational risk" shall mean the risk of loss for the specialised investment fund resulting from the inadequate internal processes and failures in relation to people and systems, or resulting from external events, and includes legal and documentation risk, and risk resulting from trading, settlement and valuation procedures executed on behalf of the specialised investment fund;

(5) "managers" shall mean the persons within the meaning of Article 42, paragraph (3) of the law of 13 February 2007 relating to specialised investment funds;

(6) "relevant person" shall mean any person involved in the activities of the specialised investment fund or any person directly or indirectly linked to the specialised investment fund.

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CHAPTER II

RISK MANAGEMENT

Article 4

Organisation of the risk management system

1. Specialised investment funds shall establish and maintain a risk management function.

2. The risk management function referred to in paragraph (1) shall be hierarchically and functionally independent from operating units.

However, the CSSF may allow a specialised investment fund to derogate from this obligation of independence where this derogation is appropriate and proportionate in view of the nature, scale and complexity of the activities, and the structure of the specialised investment fund.

A specialised investment fund shall be able to demonstrate that appropriate safeguards against conflicts of interests have been adopted, so as to allow the independent performance of risk management activities, and that its risk management system fulfils the requirements of Article 42a, paragraph (1) of the law of 13 February 2007 relating to specialised investment funds.

3. The risk management function shall have the necessary authority and access to all relevant information which is necessary for the performance of its tasks.

4. Specialised investment funds may delegate all or part of the activities of the risk management function to third parties, provided that the third party has the necessary competence and capacity to exercise the activities of the risk management function in a reliable, professional and efficient manner in accordance with the applicable legal and regulatory requirements.

The delegation shall not in any circumstance exonerate the managers of the specialised investment fund from their responsibility in relation to the adequacy and efficiency of the risk management system nor from the monitoring of risks linked to the specialised investment fund activities referred to in Article 5 of this regulation.

5. The managers shall adopt the risk management system of the specialised investment fund and, subsequently, have it reviewed and documented on a regular basis.

6. Specialised investment funds shall provide a description of the risk management system to the CSSF as part of their application for authorisation. Any subsequent major change to their risk management system shall be notified to the CSSF.

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Article 5

Risk management function

1. The risk management function shall:
 - (a) implement and maintain an appropriate and documented risk management policy that allows an adequate detection, measurement, management and monitoring of exposure to market, liquidity and counterparty risks, as well as of exposure to all other risks, including operational risk, which may be significant in the context of the activities of the specialised investment fund;
 - (b) ensure compliance with the risk limitation system of the specialised investment fund.

2. For the purpose of paragraph (1), specialised investment funds shall consider the nature, scale and complexity of the activities, as well as the structure of the specialised investment fund.

CHAPTER III

CONFLICTS OF INTEREST

Article 6

Criteria for the identification of conflicts of interest

1. For the purpose of identifying the types of conflicts of interest that arise in the course of providing services and activities and whose existence may damage the interests of the specialised investment fund, specialised investment funds shall take into account, by way of minimum criteria, the question of whether a relevant person is in any of the following situations, whether as a result of providing collective portfolio management or otherwise:
 - (a) that person is likely to make a financial gain, or avoid a financial loss, at the expense of the specialised investment fund;
 - (b) that person has an interest in the outcome of a service provided to the specialised investment fund or to another client or of an activity carried out for their benefit, or of a transaction carried out on behalf of the specialised investment fund or of another client, which is distinct from the interest of the specialised investment fund in that outcome;
 - (c) that person has a financial or other incentive to favour the interests of another client or group of clients over the interests of the specialised investment fund;
 - (d) that person carries on the same activities for the specialised investment fund as for one or several clients that are not specialised investment funds;
 - (e) that person receives or will receive from a person other than the specialised investment fund an inducement in relation to the collective portfolio management activities performed for the benefit of the specialised investment fund, in the form of monies, goods or services, other than the standard commission or fee for that service.

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2. When identifying the types of conflicts of interest, specialised investment funds shall take into account the interests of the specialised investment fund, including those derived from their membership of a group or from the performance of services or activities, the interests of the clients and the obligations of the specialised investment fund towards its unitholders.

Article 7

Conflicts of interest policy

1. Specialised investment funds shall establish, implement and maintain an effective conflicts of interest policy. This policy shall be set out in writing and be appropriate to the size and organisation of the specialised investment fund and the nature, scale and complexity of its business.

In addition, specialised investment funds shall establish, implement and maintain a policy to prevent any relevant person from entering into personal transactions that may give rise to a conflict of interest.

Specialised investment funds shall set up an adequate policy aiming to prevent or manage any conflict of interest resulting from the exercise of voting rights attached to instruments held.

Where the specialised investment fund is a member of a group, the policy shall also take into account any circumstances which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

2. The conflicts of interest policy established in accordance with paragraph (1) shall in particular:

(a) identify, with reference to the activities of collective portfolio management carried out by or on behalf of the specialised investment fund, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of the specialised investment fund;

(b) define procedures to be followed and measures to be adopted in order to manage such conflicts.

3. Specialised investment funds shall, as part of their authorisation file, confirm to the CSSF that they have set up a conflicts of interest policy.

Article 8

Independence with regard to conflict management

1. The procedures and measures provided for in Article 7, paragraph (2), point b) of this regulation shall ensure that relevant persons engaged in different business activities involving a conflict of interest carry on those activities at a level of independence

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appropriate to the size and activities of the specialised investment fund and of the group to which it belongs, and to the extent of the risk of damage to the interests of the specialised investment fund.

2. The procedures to be followed and measures to be adopted in accordance with Article 7, paragraph (2), point b) of this regulation shall include the following where necessary and appropriate for the specialised investment fund to ensure the requisite degree of independence:

(a) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities of collective portfolio management involving a risk of a conflict of interest where the exchange of that information may harm the interests of the specialised investment fund;

(b) the separate supervision of relevant persons whose principal functions involve carrying on activities of collective portfolio management on behalf of, or providing services to, clients or investors whose interests may conflict, or where these clients represent different interests that may conflict with the interests of the specialised investment fund;

(c) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

(d) measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out collective portfolio management activities;

(e) measures to prevent or control the simultaneous or sequential involvement of a relevant person in several distinct collective portfolio management activities where such involvement may impair the proper management of conflicts of interest.

If the adoption or the implementation of one or more of those measures and procedures does not ensure the requisite degree of independence, specialised investment funds shall adopt such alternative or additional measures and procedures as will be necessary and appropriate for that purpose.

Article 9

Management of activities giving rise to a detrimental conflict of interest

1. Specialised investment funds shall keep and regularly update a record of the types of collective portfolio management activities carried out by or on behalf of the specialised investment fund in which a conflict of interest entailing a material risk of damage to the interests of the specialised investment fund has arisen, or, in the case of an ongoing collective portfolio management activity, may arise.

2. Where the organisational or administrative arrangements made by the specialised investment fund to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that the risk of damage to the interests of the specialised investment fund or of its unitholders will be prevented, the managers shall be promptly informed so as to be able to take any measure necessary to ensure that the specialised

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investment fund will always act in the best interests of the specialised investment fund and its unitholders.

3. Specialised investment funds shall inform the investors of the situations referred to in paragraph (2) by means of any appropriate durable medium and provide the reasons for their decision.

Article 10

Publication

This regulation shall be published in the *Mémorial* and on the CSSF's website.

The regulation shall enter into force on the first day of the month following its publication in the *Mémorial*.

Specialised investment funds existing upon entry into force of this regulation shall have until 31 December 2012 at the latest to comply with the provisions of this regulation.

Luxembourg, 13 August 2012

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

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