

LEGAL DUE DILIGENCE FOR INVESTING IN LUXEMBOURG ALTERNATIVE INVESTMENT FUND STRUCTURES

With the increasing popularity of alternative investments, in particular in the areas of private equity, private debt and real estate, we have witnessed that there is more demand in realising such investments via Luxembourg alternative investment fund structures (the “AIFs”) by international eligible investors. In the EU, AIFs were introduced by the Alternative Investment Fund Manager Directive (Directive 2011/61/EU, the “AIFM Directive”), which regulates managers of funds other than those under the Undertakings for Collective Investments in Transferable Securities Directive (Directive 2009/65/EC).

The purpose of this article is to introduce the particular points to be examined during the legal due diligence for investing in a Luxembourg AIF structure.

1. Incorporation and existence of the AIF

Under Luxembourg law, an AIF may be regulated or unregulated and may be set up either in a contractual form (fonds commun de placement) or a corporate form (limited liability company or limited partnership etc.). Given the various options to structure a Luxembourg AIF, the incorporation and existence of the AIF shall be carefully examined as first step of the legal due diligence.

As to the constitutive documents of the AIF, depending on its legal form, the investors shall review the deed of incorporation (which includes the articles of association), the limited partnership agreement or the management regulation of the AIF as applicable. As to the public registration, the AIF shall always be registered with the Luxembourg Trade and Commerce Register (the “RCSL”) upon its incorporation. Such registration process could take up to approximately one month after the incorporation, during which period the information of the AIF will not be published or accessible on the RCSL but the AIF is already capable of entering into legal documents.

In case the AIF is subject to direct regulation of the Luxembourg financial sector regulator Commission de Surveillance du Secteur (the “CSSF”), upon the CSSF’s approval it shall be registered with the official list of the CSSF and published on the CSSF’s website. This applies to e.g. undertakings for



collective investment subject to Part II of the Luxembourg law of 17 December 2010 (UCI Part II funds), specialised investment funds under the Luxembourg law of 13 February 2007 (SIFs) and investments company in risk capital société d’investissement en capital à risque under the Luxembourg law of 15 June 2004 (SICARs).

In case the AIF qualifies as a reserved alternative investment fund under the Luxembourg law of 23 July 2016 (RAIFs), upon incorporation it shall be registered with the RAIF list as maintained and published by the RCSL.

2. Sub-funds

Certain types of Luxembourg AIFs may be structured as an umbrella structure with the possibility to create multiple sub-funds (also known as “compartments”) within the same structure, such as UCI Part II funds, SIFs, SICARs and RAIFs. In general, assets and liabilities of a sub-fund are segregated from those of other sub-funds of the same AIF. Hence it is utmost important to identify whether the investment is made to a single AIF or rather one of the sub-funds of an AIF.

3. Alternative Investment Fund Manager (the “AIFM”)

The AIF shall appoint an AIFM in accordance with the Luxembourg law of 12 July 2013 (the “AIFM Law”), except that such requirement is exempted under certain circumstances. The AIFM carries out, among others, the discretionary portfolio management function of the AIF, if not yet delegated to

another discretionary investment manager. During the legal due diligence in respect of the AIFM, it is crucial to clarify the identity of the AIFM, in particular whether the AIFM is (i) an affiliate to the initiator of the AIF or (ii) a third-party service provider engaged by the initiator.

In case of scenario (i), the priority should be usually to clarify whether the AIFM is authorised by the CSSF or registered with the CSSF. The former is subject to the complete authorisation process of the CSSF and its direct regulation while the latter only requires a simplified registration with the CSSF and is exempted from most of the legal requirements that are applicable to an authorised AIFM as provided by the law.

Scenario (ii) are usually preferred by the initiators not having sufficient substance in the EU. In such case, the legal due diligence should rather focus on how the AIF's internal investment procedures is structured to ensure that the key persons of the initiator may direct the investment activities sufficiently. It is commonly seen that such third-party AIFM would delegate the portfolio management function to a non-EU discretionary investment manager controlled by the initiator and maintain the other functions, e.g. risk management and marketing.

4. Other service providers

In addition to the AIFM, other service providers engaged by the Luxembourg AIF shall be duly verified as well, in particular its depositary bank and transfer and registrar agent as applicable, as these concern respectively the safekeeping of the assets or onboarding and drawdown procedures. The fund documents of the AIF shall describe in a transparent manner the identities of and the functions to be assumed by the respective service providers.

5. Disclosure under the AIFM Directive and the AIFM Law

Article 21 of the AIFM Law transposing article 23 of the AIFM Directive provides for the obligations to disclose certain information to investors of an AIF, which enable them to obtain more visibility on the essential terms of the AIF, e.g. the investment strategy and objectives of the AIF, usage of leverage, fees, charges and expenses and the maximum amounts thereof etc.

The market practice to fulfil these disclosure obligations is to present the required information in constitutive documents or issuing documents but it is also common for investors to receive a separate statement presenting such information from the AIF. In the latter case, investors would need to pay extra attention to the information that is not disclosed in the constitutive document or issuing document of the AIF.

6. Other aspects

Other aspects of the Luxembourg AIF than those listed out above usually also apply to the legal due diligence of an AIF in other jurisdictions, as the Luxembourg structures are flexible enough to implement common practices in the investment funds industry. The following extra aspects shall be considered for the legal due diligence in most cases:

- Terms and periods of the AIF, e.g. overall term of the AIF, final closing date and investment period;
- Open-ended or closed-ended AIF and if open-ended, the redemption policy;
- Mechanisms of re-investment, return of distribution, claw-back of carried interest;
- Distribution waterfall; and
- Amendment procedures of fund documents.



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