



Global ambitions

Developed in Luxembourg, SICAVs are well-suited to most investment strategies and many pension schemes globally, writes Kevin Mudd

For protestors at global financial summits, globalisation is a bad thing, but for the rest of us it is a fact of modern life and a largely positive force. It's certainly true that different parts of the global economy are closely linked; witness the effect of the US housing market on the lives of millions around the world, as the sub-prime crisis spread across the financial system. Consequently, it is not surprising that investors increasingly have a global perspective. Few large pension funds invest entirely in domestic assets and high net worth investors will now consider a wide range of asset classes and regions in their search for good returns and diversification.

To facilitate this trend, new investment structures – such as the Luxembourg-based SICAV (Société d'Investissement À Capital Variable) Specialised Investment Funds – are now available. But to understand how and why this new structure is with us, some background information is necessary.

Firstly, the European Union's UCITS (Undertaking for Collective Investment in Transferable Securities) directives, which started in 1988 with UCITS I, have made cross-border investing possible by introducing a passport at fund level. Over the years the UCITS rules have been refined and they have now become a standard for cross-border investment. This means that a fund can be effectively managed in London, then domiciled for regulatory and taxation purposes in Luxembourg or Dublin, and marketed around the world.

SICAVs and OEICs (Open-Ended Investment Companies) are now widely used as the fund vehicles for cross-border investing under the UCITS regulations. UK investors will be familiar with OEICs, also known as ICVCs (Investment Companies with Variable Capital). In Continental Europe, SICAVs fulfil the same role and are broadly used in Luxembourg, Switzerland, Italy, Spain, Belgium and France. Cross-border SICAVs are closely linked with Luxembourg, which is the largest cross-border fund domicile in Europe and indeed the World, with an estimated EUR1571 billion in assets. This growth started in the 1960s with the emergence of the Eurobond market which enabled investors to trade bonds outside their home markets and it was built on Luxembourg's history of providing private banking for highly-taxed individuals in France and Germany.

The Luxembourg hub

With the creation of the UCITS regime, Luxembourg took off as an international financial centre and its government, together with the regulator CSSF (Commission de Surveillance du Secteur Financier), has taken a proactive role in ensuring that the Grand Duchy maintains that status. One pillar of this is Luxembourg's tax neutrality. SICAVs domiciled there are free of all income, capital gains and transaction taxes incurring only a subscription tax of up to five basis points.

Compared to OEICs and unit trusts based in the UK, SICAVs do not have to pay distributions which are subject to withholding tax, but can roll up capital gains tax-free.

In contrast to some other financial regulators, the CSSF has not 'gold-plated' the UCITS directives with additional regulations, but has allowed a relatively liberal interpretation. This approach, together with the existing infrastructure of expertise in fund administration, custody, law, auditing and other services, and the presence of a skilled, multi-lingual workforce, has greatly benefited Luxembourg as a base for cross-border funds. This was highlighted in a report by the Investment Management Association, the trade body for the UK fund management industry, in December 2006. It found that the increasing complexity of the tax environment in the UK was hampering London as a financial centre. Global investors tend to prefer either Luxembourg or Dublin as fund domiciles because they are easier places to do business with fewer tax restrictions.

This is not to say that Luxembourg is in any sense a 'soft touch' from a regulatory point of view. Investor protection has always been a priority and it is significant that following calls for stronger regulation of the hedge fund industry, and frauds such as the Madoff affair, a number of asset managers that previously used the Bahamas and the Cayman Islands as a domicile are relocating to Luxembourg. In all, of the 25 largest asset managers in Europe, 20 have based their fund families in Luxembourg.

A new investment vehicle

With investors increasingly widening their horizons in the search for returns and diversification, Specialised Investment Funds (SIFs) have added a new investment vehicle to their armoury. SIFs were created by new legislation in Luxembourg in February 2007 and have seen rapid growth with approximately 700 funds launched in the first 18 months. A SIF can invest in any underlying asset, from shipping to forestry, works of art, private equity, real estate or in a myriad of hedge fund strategies. They can also be set up without prior approval from the CSSF, but must apply for authorisation in the month following launch and must appoint a Luxembourg custodian to supervise the assets. In terms of taxation, a SIF is exempt from distribution, withholding, capital gains, corporate and wealth taxes.

By being outside of the scope of UCITS, a SICAV SIF permits virtually unbridled asset choice with few investment restrictions, yet still manages to fulfil around 90 per cent of the requirements of Luxembourg's UCITS regulations. Where a retail fund is not required, it is an excellent choice for most investment strategies and well-suited to many pension schemes globally.

In the individual investor market, a SICAV SIF can be distributed to 'well-informed investors.' These are investors whose advisers can state that they understand what the fund does, what its risks are and what the investment strategy is. In absence of this, there is a minimum investment of EUR125,000. The wide range of assets makes this new vehicle particularly attractive to high net worth and institutional investors who want access to areas such as private equity and real estate, together with the security and other benefits of a SICAV.

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In the UK, new regulations due to be introduced by HM Treasury in October should make it easier for British investors and their advisers to use Luxembourg-based funds. Under the proposed regulation, all funds not domiciled in the UK will be regarded as offshore by the Treasury, but a new Reporting Fund status can be applied for, which will replace the current Distributing Fund regime. This will be easier to administer and will do away with much uncertainty for investors. As a consequence, UK independent financial advisers should feel more comfortable recommending SICAV SIFs to well-informed investors without any regulatory concerns. Over time, as investors and advisers become more familiar with the concept and structure of a SICAV SIF, it is likely that acceptance and usage will increase, particularly as they seek returns from increasingly diverse and uncorrelated assets.

A wide appeal

Because it can hold a wide range of assets, a SICAV SIF is a suitable wrapper for modern, multi-asset pension funds. As trustees have to provide for an aging pensioner population, rising longevity and ravaged fund returns, more flexible investment structures will be needed. There has also been much talk about pan-European pensions, for multi-nationals with employees in various locations. Here, the use of a cross-border investment vehicle, such as a SICAV SIF, could simplify investment and reduce duplication and needless extra expense in creating different investment funds for different countries.

Hedge fund managers may also find the SICAV SIF a useful investment vehicle, as leverage and shorting are permitted. Its Luxembourg domicile gives investors the comfort of an independent custodian, making it more robust than funds based in the Cayman Islands, for example, where there is usually no requirement for an independent custodian or administrator.

With the growing trends towards globalisation and cross-border investing, pension funds and other investors are increasingly seeking structures that best suit their taxation and investment objectives. As a consequence, Luxembourg has come to the fore with its robust regulation, tax neutrality and investment flexibility. Modern fund vehicles, such as Luxembourg's SICAV SIF, can soundly answer the questions, "which structure" and "which location."

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