What CSSF Circular 24/856 means for alternative fund managers

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1. The alternatives industry falls within the Circular’s scope for the first time

2. It covers NAV calculation errors and non-compliance with investment rules

3. Below we detail what managers and their stakeholders need to be aware of

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After more than 20 years in Luxembourg Law, Circular CSSF 02/77 has been replaced by a new, broader rule to protect investors. Angel Ramon Martinez Bastida and Francesca Raffa explain what it means for private market fund managers and their fund administrators.

Circular CSSF 24/856, which clarifies rules on NAV calculation errors and non-compliance with investment rules, is replacing Circular CSSF 02/77 – a law which has been in force for 22 years. Crucially, the updated circular extends its scope to the alternatives industry, making this a revolutionary change for private markets.

This new Circular covers many structures used in the alternatives industry, including Luxembourg specific vehicles SIFs and SICARs, as well as alternative investment funds including: ELTIF (European Long-Term Investment Fund), EuSEF (European Social Entrepreneurship Funds), or EuVECA (European Venture Capital Fund). This means that private market managers and their fund administrators will see an increase in their exposure to these rules.

To meet the requirements of the Circular, the management body of the fund, the AIFM, the fund administrator, and the depositary will need to become familiar with their roles and responsibilities in the prevention and treatment of NAV calculation errors and non-compliance with investment rules.

Listed below are the changes that the different stakeholders need to be aware of and the main impacts they should expect in their operations:

NAV calculation errors and tolerance thresholds

Tolerance thresholds for alternative investment funds must be fixed by the management body of the investment fund, taking into consideration criteria such as if the fund is open or closed, the valuation procedure, the risk profile of the fund or the usual investment policy.

The threshold can be up to 5% for alternative investment funds, following a decision from the management body of the investment fund based on a documented analysis. When funds opt for higher tolerance thresholds, these need to be communicated to the investors either through the inclusion in the offering documentation or through specific communications.

For both closed-ended and open-ended funds in scope of the Circular, the CSSF expects that the calculation of the NAV will be as reliable as possible and in accordance with the regulatory framework and the statutory and contractual documents of the investment fund. Policies and procedures should be in place to ensure this. Furthermore, for open-ended funds, for which subscriptions are made based on the last calculated NAV, tolerance thresholds will determine the margin of error during the NAV calculation process, above which a NAV calculation error is considered significant and must be corrected (and notified to the CSSF in certain cases).

Non-compliance with investment rules

Investment rules, such as rules on eligible assets, portfolio management techniques and investment restrictions set out by the regulatory framework applicable to the investment fund, are now listed in the Circular. When these are not respected, the Circular clarifies and codifies the difference between “passive breaches” occurring for reasons beyond the control of the UCI, or as a result of the exercise of subscription rights, and “active breaches” corresponding to voluntary actions/operations or absence of actions/operations leading to an investment breach.

Only active breaches are subject to the specific corrective measures prescribed by the Circular and must be notified to the CSSF in certain cases, while passive breaches do not need to be notified to the CSSF but need to be corrected by taking due account of the interests of the investors.

Other types of errors

In addition to NAV errors and non-compliance with investment rules, the Circular specifically identifies four additional types of errors, and describes the remedial measures to be taken:

- incorrect application of the swing pricing mechanism,
- non-compliant payment of costs/fees,
- incorrect application of the cut-off rules, and
- investment allocation errors.

More generally, it also states that, even in the absence of specific guidance, a fund should evaluate for any type of error that may arise in relation to its operations and activities, whether regularisation and indemnification are required.

The future private markets' investor

The Circular aims to protect investors more comprehensively, especially considering changes in technology such as tokenisation, which open up private markets to more retail investors. Expanding regulation to cover investment vehicles that had previously only been the preserve of professional or eligible investors to allow for the increase in retail investors is a trend that is likely to continue and fund managers will need to prepare for the potential increase in back-office administration.

The expertise of a knowledgeable partner

Private fund managers being exposed to the rules regarding NAV calculation errors and investment compliance breaches might find it difficult to be compliant with the requirements set out by the Circular. Choosing an experienced and knowledgeable partner like the Aztec Group will help you to ensure that your operations are fully aligned to the requirements set out by the Circular.

If you want to further discuss the requirements of the Circular, how these will affect your operations and how the Aztec Group can assist with the changes, please do not hesitate to contact Angel Ramon or Francesca.