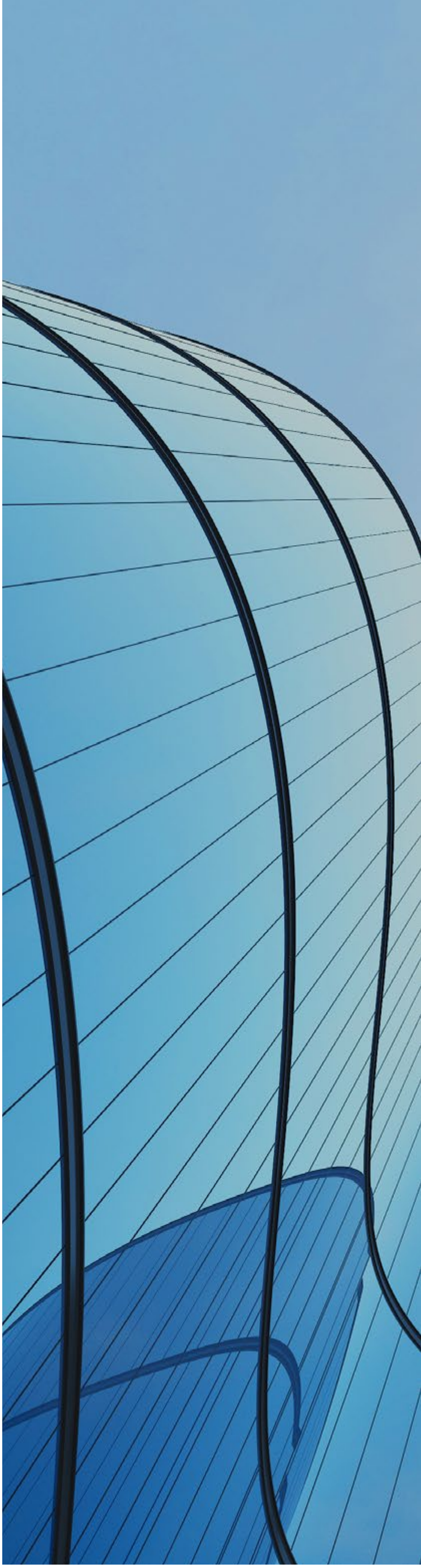
2024

Considerations for the boardroom

Fourth edition

October 2024

Content



Executive summary

We're delighted to share our fourth edition of "Considerations for the boardroom", a toolkit of the hottest boardroom topics for the asset management and alternative investment industries. We believe this guide will boost the quality of your boardroom discussions.

Alongside a brisk overview of the leading boardroom topics, we've also included questions to help you uncover the fund's status regarding these crucial matters.

We will regularly update this toolkit to capture the evolving regulatory agenda and our market insights.

We wish you a pleasant and insightful read.

KPMG

The EU's AML Package is finally here

In July 2021, the European Commission presented an ambitious suite of legislative proposals to strengthen the EU's anti-money laundering (AML) and countering the financing of terrorism (CFT) rules, commonly known as **"the AML Package".** After more than two years of negotiations, the European Parliament adopted the AML Package on 24 April 2024.

The AML Package consists of three legislative instruments[1]:

- The EU Single Rulebook Regulation **(AMLR)**
- The Anti-Money Laundering Authority Regulation **(AMLAR)**
- The sixth Anti-Money Laundering Directive **(AMLD 6)**

The AML Package's key developments include:

- **The AMLR** (currently in effect and applies as of July 2027)
- This single rulebook legislation aims to harmonize approaches across EU Member States. Unlike a directive, the regulation directly applies to Member States and does not require transposition.
- It enforces EU-wide rules on:
    - Scope of obliged entities
    - Internal policies, controls and procedures of obliged entities
    - Customer due diligence
    - Beneficial ownership transparency
    - Reporting obligations
    - Record retention
    - Measures to mitigate risks deriving from anonymous instruments.
- The threshold to determine beneficial ownership in corporate entities has been set at 25%. However, Member States may identify categories of higher-risk corporate entities and propose a lower threshold, which should not fall below 15%.
- **The AMLAR** (currently in effect and applies as of July 2025)

1. The recast of the Transfer of Funds Regulation, initially part of the AML Package, was uncoupled and adopted separately in June 2023.

The AMLAR establishes an AML competent authority at the EU level known as the Anti-Money Laundering Authority (AMLA).

AMLA will be:

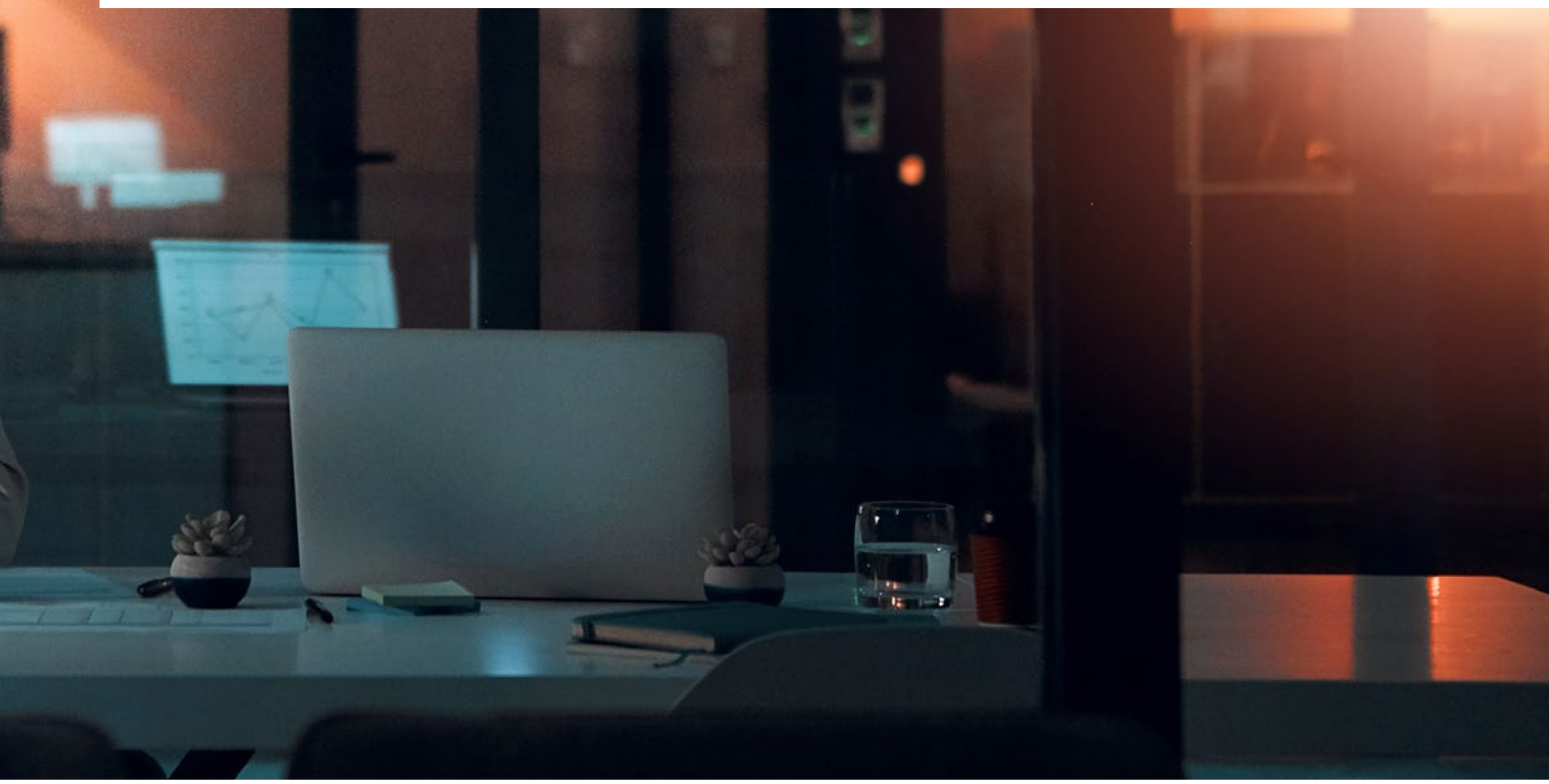
- Seated in Frankfurt am Main, Germany
- Accountable to the European Parliament and the Council for the AMLAR's implementation.

From 2028, one of AMLA's key roles will be to directly supervise at least 40 selected obliged entities and indirectly supervise non-selected obliged entities.

- **The AMLD 6** (currently in effect and must be transposed into Member States' legislation by 10 July 2027)

The directive sets, amongst others, enhanced rules regarding beneficial ownership information and its recording in Central Registers.

While the AMLR will only apply from July 2027 and the AMLD 6 still requires transposition, financial institutions should assess this package's impact on their operations and start preparing. KPMG's dedicated team of AML and CFT specialists is ready to support you in this journey.



The rising cost of financial crime compliance

A LexisNexis Risk Solutions study revealed that financial crime compliance costs increased for an overwhelming 98% of EMEA financial institutions in 2023, who collectively spend over US$85 billion annually on these efforts[2].

Significant increase in technology-related costs

Technology costs regarding networks, systems, and remote work have risen at 70% of organizations located in EMEA and 67% located in Europe. Most of these costs were for compliance and know-your-customer (KYC) software.

Emerging risk of cryptocurrencies, digital payments and artificial intelligence (AI) technologies

Twenty-nine percent of financial institutions indicated that evolving criminal threats were the most significant factor driving an increase in financial crime compliance costs. This is surpassed only by the costs related to rising financial crime regulations and regulatory expectations (38%), and the growing requirement for automation, data and tools (32%).

Increasing labor costs

Seventy-two percent of organizations' labor costs related to full-time employees and part-time salaries have risen over the past 12 months.

2. LexisNexis Risk Solutions, True Cost of Financial Crime Compliance Global Study, 2023, 2024.

Since January 2024, the CSSF's total cost of administrative sanctions was estimated at €3.2 million, of which €3 million involved a credit institution's non-compliance with AML and CFT professional obligations.

Source: CSSF

In July 2023, the US Federal Reserve imposed a US$186 million fine on Deutsche Bank and its US affiliates for inadequately addressing AML control deficiencies, following previous regulatory concerns.

Source: Reuters

In February 2024, the US federal judge approved a plea deal by one of the world's largest cryptocurrency exchanges to pay more than US$4.3 billion in fines and restitution, after pleading guilty to breaking AML laws and violating sanctions.

Source: Bloomberg

It's important to remember that in addition to direct expenditures like staffing and screening, monitoring and reporting technology, the true cost of compliance also includes potential administrative fines from regulators. As the old saying goes: if you think compliance is expensive, wait and see how much non-compliance will cost you.

Out of the Commission de Surveillance du Secteur Financier's (CSSF) 29 administrative sanctions published in the first half of 2024, more than a third were regarding non-compliance with AML and CFT obligations. While the severity of the penalties varied from reprimands and official warnings to a EUR3 million fine, the asset management and alternative investments sectors' sanctions fell at the lower end of the spectrum, with one investment firm being fined EUR785,000.

In comparison, foreign regulators' administrative sanctions, particularly those in the US, often surpass the CSSF's, with fines reaching several billion in exceptional cases.

While these figures alone are noteworthy, the costs of associated remediation programs, external monitors and supplementary inspections can often surpass the penalty itself.

Finally, there's a cost that can be harder to quantify — the one of lost opportunities. Lengthy onboarding processes and unnecessarily blocked accounts and transactions can lead to a poor customer experience and missed business opportunities.

The most suitable way to control financial crime costs depends on the organization's business and operational model, existing AML/CFT framework and risk appetite. Popular solutions include automation and technology, first-time-right strategies, lean processes, and outsourcing and co-sourcing.

Don't hesitate to reach out to KPMG to discuss your unique needs. We offer cost-effective, technology-driven solutions that shrink turnaround time, coupled with experienced resources in a wide range of financial crime matters.

Questions that may be raised

01 Have we prepared for the changes of the EU's AML Package?

02 Are we considering a cost-effective and technology-driven solution that reduces turnaround time?

03 Do we have a growing backlog of due diligence files to review?

04 Do we lack inhouse AML and CFT expertise or resources?

05 Are we struggling to meet our deadlines regarding initial and ongoing due diligence cycles?

06 Are our procedures adequate and in line with AML and CFT requirements?

By
Giovanna Giardina,
Partner, Advisory - Forensic and AML.
E: giovanna.giardina@kpmg.lu

Michal Pochec,
Director, Advisory - Forensic and AML.
E: michal.pochec@kpmg.lu

CSSF thematic inspection approach

The CSSF's regulatory inspections have grown more sophisticated and meticulous over the past year.

Historically, the CSSF's inspections have mainly focused on broad, holistic topics like governance arrangements and AML practices. However, the regulator has recently been delving into more detailed and specialized areas during its thematic reviews.

For example, the CSSF significantly ramped up its scrutiny of environmental, social and governance (ESG) reporting and control frameworks in 2023. The number of ESG inspections doubled compared to 2022, highlighting the regulator's commitment to sustainability and responsible investment practices.

Another focal point is information and communications technology (ICT) outsourcing, reflecting the financial sector's increased use of technology and third-party service providers. While a new inspection area is scrutinizing compliance with the Markets in Financial Instruments Directive (MiFID), which aims to ensure investor protection and market transparency.

The number of branch inspections has also tripled since last year. This underscores the CSSF's proactive stance in maintaining robust oversight across all financial institutions' operational units, as well as Management Companies (ManCos) expanding their European footprint through new branches. Costs and charges are also under the spotlight to ensure that financial institutions' fee structures stay transparent and fair.

The CSSF's efforts go beyond ensuring compliance with existing regulations. The regulator also tests how financial institutions have implemented regulatory principles, including a thorough examination of policies and procedures as well as sample testing.

Questions that may be raised

01 Are we adequately prepared for an upcoming CSSF inspection?

02 Are there any blind spots in our operations that a thematic CSSF inspection may expose?

03 Can we evidence a systematic oversight control framework for our branches' activities?

By
Jean Christophe Cabilin,
Partner, Advisory – Risk Consulting.
E: jeanchristophe.cabilin@kpmg.lu

CSSF Circular 24/856: NAV calculation errors, non-compliance with investment rules and other errors

On 29 March 2024, the CSSF had published the new Circular 24/856 on protection of investors in case of a net asset value (NAV) calculation error, an instance of non-compliance with the investment rules and other errors at the Undertaking for Collective Investment (UCI) level (the “new Circular”). It will replace Circular 02/77 from 1 January 2025.

Scope extension

Along with Undertakings for the Collective Investment in Transferable Securities (UCITS) and UCIs Part II, the new Circular broadens the scope of Circular 02/77 to include the following entities:

- Specialized investment funds (SIFs) and investment companies in risk capital (SICARs)
- Money-market funds (MMFs), European long-term investment funds (ELTIFs), European venture capital funds (EuVECAs) and European social entrepreneurship funds (EuSEFs) under the UCITS, UCIs Part II, SIFs or SICARs fund forms
- ELTIFs not under the above fund forms like non-authorized Luxembourg AIFs, including ELTIF reserved alternative investment funds (RAIFs).

Different stakeholder roles

The new Circular clarifies various stakeholders' roles and responsibilities for treating errors or non-compliance instances, such as the UCI's directors and administrators, investment fund manager (IFM) and depositary, especially those in charge of the UCI's and IFM's governance.

The general principles are:

- To ensure sound organization and governance are in place to prevent errors and non-compliance instances at the UCI level
- To ensure compliance with the Circular's rules regarding the treatment of errors and non-compliance instances
- That the party responsible for the errors and non-compliance instances must ensure remediation and compensation
- That the UCI directors and IFM must ensure the errors and non-compliance instances are remedied and the resulting loss is compensated (if any).

NAV calculation error

Tolerance thresholds

The new Circular determines the tolerance thresholds based on a normative or qualitative approach, depending on the fund's form and profile.

Normative approach

The normative approach applies to MMFs, UCITS, UCIs Part II and ELTIFs with retail investors. This reduces the threshold for MMF UCIs to 0.20% while the thresholds for bond, mixed and equity UCIs remain the same as Circular 02/77.

The new Circular also allows UCITS investing primarily in "other eligible assets" and UCIs investing primarily in "other assets" to have a 1% tolerance threshold, and defines these asset types.

These thresholds apply to Luxembourg UCITS distributed in the EU. If the Luxembourg UCITS is also distributed outside of the EU (e.g. Hong Kong), the (more restrictive) local provisions should be considered when determining tolerance thresholds.

Qualitative approach

The qualitative approach is applied to the following fund forms:

- UCIs Part II and ELTIFs with retail investors, which invest primarily in other (eligible) assets
- UCIs Part II and ELTIFs reserved for professional and well-informed investors
- SIFs, SICARs, EuVECAs and EuSEFs.

Under the qualitative approach, the new Circular allows UCIs to apply a higher threshold than the normative approach subject to the following five strict conditions:

1. The UCI's tolerance thresholds must be determined by the UCI's directors, in interaction with the IFM.
2. The UCI must consider specific criteria, such as:
   - Open versus closed-ended characteristics
   - Investment policy as per the prospectus
   - Listed assets versus non-listed assets
   - Fund risk profile (liquidity, credit and market risk)
   - The robustness of the valuation process in accordance with the UCI's characteristics, investment policy and planned investments.
3. The UCI must consider the normative approach's tolerance thresholds.
4. The selected threshold should not exceed 5% and should be based on a documented assessment considering the criteria of condition 2.
5. The UCI must transparently communicate the use of thresholds other than those of the normative approach to investors.

Correction and indemnification process and financial impact calculation

In the event of a material NAV calculation error, the new Circular outlines the correction and indemnification process as well as the financial impact calculation in sections 4.3 and 4.4.

The UCI should not bear the costs of remedial and corrective actions.

Compensation

The party responsible for the errors or non-compliance instances must ensure remediation and compensation are carried out without delay. The compensation payment cannot be deferred or offset against future remuneration.

The new Circular keeps Circular 02/77's "de minimis" rule and the option to distribute additional shares to shareholders.

Despite all necessary actions taken, if the UCI, IFM or both are unable to compensate the investors, these amounts should be deposited at the "Caisse de Consignation."

Financial intermediaries

If investors have subscribed to the UCI through financial intermediaries, the new Circular offers two compensation approaches:

Look-through approach

- The UCI ensures the final beneficiaries are compensated by making the necessary arrangements with the financial intermediaries to move up the intermediation chain.

No look-through approach

- The UCI ensures the financial intermediaries that act on other investors' behalf have all the necessary information to pay the compensation.
- This approach has a vital transparency requirement — UCIs must inform the final beneficiaries that using financial intermediaries may impact their compensation rights. The UCI must include this information in the next prospectus update.

Non-compliance with investment rules

Ongoing compliance

The legal and contractual rules, including the ESG-related ones, must be continuously complied with until the UCI's dissolution or liquidation date, except for the UCI Law's six-month- period exemption and the specified ramp-up or disinvestment periods of AIFs. The investment rules must also be complied with at each NAV date and between two NAVs.

To ensure ongoing compliance, the new Circular reiterates that adequate pre-trade and post-trade controls must be in place at the UCI or IFM level.

Classification

The new Circular also provides more details on the classification of active and passive breaches:

- A passive breach is an event that occurs beyond the UCI's control.
- An active breach is a voluntary act or a lack of action when the breach was predictable and avoidable.

The new Circular also covers specific non-compliance instances, such as closely linked simultaneous breaches and breaches resulting in a material NAV error.

The CSSF has also updated Question 4 of Circular 02/77's FAQ to provide additional guidance on non-compliance instances resulting from different settlement cycles, particularly given the US, Canada and Mexico's switch to the T+1 settlement cycle in May 2024.

Remedial process

The new Circular requires that an internal policy for treating breaches exists as of the UCI's launch, and that the correction methods for the financial impact calculation (accounting versus economic) should be consistently applied over time. Any change in the correction method must be:

- duly justified in the shareholders' interest
- approved by the UCI/IFM directors and
- applied in the next breach instance.

Active breach corrections for all UCI types must be determined without delay, and the new Circular provides examples of corrective actions that may be considered. The remediation plan's implementation period depends on the investments' liquidity profile.

Passive breaches must be corrected within a reasonable period, considering the investors' interests.

UCIs (other than UCITS) investing in less liquid assets could keep the position that caused the passive breach in the portfolio if it's:

- duly justified and documented internally and
- in the investors' interest.

Other errors

The new Circular provides further guidance on four other errors that may occur at the UCI level and relevant corrective actions.

Other errors	Corrective actions
Swing pricing errors	Depending on the type of incorrect application, the UCI is indemnified if a loss occurs, and the investors are indemnified as per the material NAV error procedure.
Fee and cost errors	In cases of overpayment, the UCI is compensated without regard to the tolerance thresholds. In cases of underpayment, there are two possible approaches: **1.** No retroactive deduction from the UCI's assets, requiring those responsible for the error to cover the amount **2.** Retroactive deduction and correction of NAV errors without regard to the tolerance thresholds.
Incorrect application of cut-off rules	• If the error results in a gain: the investor retains the gain, and the UCI is compensated. • If the error results in a loss: the investor is compensated by cash or additional shares without regard to tolerance thresholds.
Investment allocation errors	• If the error results in a profit: the UCI retains the profit. • If the error results in a loss: the UCI is compensated without regard to the tolerance thresholds.

Notifying the CSSF and other competent authorities

The CSSF must be notified via the usual communication channel within four to eight weeks from the date the active breaches, material NAV calculation errors, or other errors were detected using an updated notification form.

National competent authorities should also be notified where the UCI is marketed according to local requirements.

Passive breaches do not require a notification.

While close-ended funds' NAV calculation errors do not require a notification, they must have appropriate valuation policies and procedures in place for the NAV calculation and ensure compliance on an ongoing basis.

External auditor intervention

External auditor reviews regarding errors and non-compliance instances are risk-based and performed through the:

1. Separate report (based on Circular 21/790) on a sample basis
2. Special report (only for UCITS and UCIs Part II) depending on whether the compensation amounts are above:
    - EUR50,000 in total and/or
    - EUR5,000 per investor.

The special report must be submitted to the CSSF within three months of the CSSF notification date.

Reviews should be performed according to the new Circular as from the year-end 1 January 2025.

Questions that may be raised

01 Has the fund a formalized policy in place for treating material NAV errors and investment breaches, which also covers alternative investment funds (AIFs) investing in less liquid assets? Have the policies been updated according to the new Circular?

02 Are there adequate arrangements with service providers to prevent, mitigate and treat material NAV errors and investment breaches?

03 Have we determined an approach for compensating investors that subscribe through financial intermediaries? Has the prospectus been updated with the adopted approach for transparency purposes?

04 Does the fund's country of distribution have more restrictive local provisions for determining tolerance thresholds?

05 Is there a formally documented assessment for determining tolerance thresholds above 1% based on a qualitative approach? Has the analysis and assessment been consistently applied to other similar fund ranges?

06 Has the fund determined the costs and fees that may fall under "other errors", such as overpayment and underpayment errors? What's the fund's corrective approach regarding cost and fee underpayment?

07 Have we implemented adequate pre-trade and post-trade controls to ensure ongoing compliance with legal and contractual rules, including ESG-related ones?

By

Sabrina Benyagoub,
Director, Advisory - Risk Consulting.
E: sabrina.benyagoub@kpmg.lu

Nasroullah Auliar,
Director, Audit - Private and Public Asset Management.
E: nasroullah.auliar@kpmg.lu

AIFMD 2.0

On 26 March 2024, the final text of the second Alternative Investment Fund Managers Directive (AIFMD 2.0) was published in the Official Journal of the European Union. Member States must transpose the directive into national law before it takes effect on 16 April 2026.

The AIFMD 2.0's aim is to harmonize:

- Regulatory standards between the AIFMD and the UCITS Directive, especially regarding regulatory reporting requirements.
- Regulatory initiatives by national supervisory authorities (e.g. CSSF Circular 18/698) to ensure a level playing field across Europe.

Overview of key amendments:

Loan-originating funds

Amended texts

- Loan-originating AIFs can enjoy EU AIFMs' passporting rights on lending.
- They must respect:
  - 20% of aggregate concentration limits
  - 175% of leverage limits for open-ended AIFs and 300% for closed-ended AIFs
  - 5% of retention of each loan's notional value.

Key impact
AIFMs and AIFs, whose investment strategy is mainly to **originate loans**

Authorization of AIFM and depositary appointment

Amended texts

- Further clarification on permissible activities by AIFMs, as well as information to be provided for AIFM authorization requests, notably regarding detailed explanations and evidence for **conflicts of interest** and for the substance of the AIFM.
- AIFMs can appoint a **depositary** established in a different Member State or a third country.

Key impact
New AIFM applicants and **existing AIFMs** that wish to extend their activity scope

Liquidity management tools

Amended texts

Open-ended and semi-open-ended AIFs must:

- Select at least two liquidity management tools (LMTs) and assess their suitability
- Implement **procedures and policies** for LMT activation and deactivation
- Follow specific requirements for redemption in kind and temporary suspensions.

Key impact
Open-ended and semi-open-ended / evergreen AIFs

Disclosure to investors

Amended texts

- AIFMs must perform:
  - Periodic disclosures of the originated **loan portfolio's** composition
  - Annual disclosures of the **fees and charges** directly or indirectly borne by investors
  - Pre-contractual disclosures of their **LMT framework** to investors.

Key impact
All AIFMs. Main impact regarding **fee and charges disclosures**

Delegatio

Amended texts

The directive imposes new requirements for qualifying delegates and enhanced responsibilities on delegate supervision.

No fundamental changes compared to CSSF Circular 18/698.

Key impact
All AIFMs

Supervisory reporting

Amended texts

AIFMs' reporting will expand to cover all the markets, instruments and exposures of each AIF they manage. They will need to regularly **report data on liquidity management, risk profile and stress test results.**

Key impact
All AIFMs

Questions that may be raised

01 Have we performed a gap and impact analysis of the AIFMD 2.0's updated rules and requirements?

02 Do we currently manage private debt funds classified as loan-originating funds, and do they meet the AIFMD 2.0's new requirements?

03 Have we recently reviewed our governance arrangements regarding LMT, including swing pricing?

04 Have we defined a clear process for identifying and allocating costs and fees charged to the funds and the AIFM?

By
Alan Picone,
Partner, Head of Consulting Asset Management & Alternatives.
E: alan.picone@kpmg.lu

Markets in Crypto-Assets Regulation (MiCA)

The Markets in Crypto-Assets (MiCA) Regulation, part of the EU Digital Finance Package, promotes uniform market rules for crypto assets across the EU. Bolstered by regulatory technical standards (RTS), MiCA establishes the EU's first comprehensive framework for issuing, offering and admitting crypto assets to trading, while also protecting consumers and providing legal certainty and financial stability.

MiCA enables the passporting of crypto asset services across EU Member States, allowing both traditional institutions and new players to enter this emerging market. It will fully apply as of 30 December 2024, although its rules for issuers of asset-referenced tokens (ARTs) and e-money tokens (EMTs) have applied since 30 June 2024.

Categorization of crypto assets

MiCA defines three types of crypto assets, which are subject to different requirements depending on their associated risks:

1. **EMTs**, which maintain a stable value by mirroring an official currency.
2. **ARTs,** which maintain a stable value through one or several underlying liquid asset(s).
3. **Crypto assets that are not considered ARTs or EMTs,** a catch-all category that includes utility tokens and fungible tokens issued by a legal person.

Non-fungible tokens (NFTs) and assets that provide access to goods or services, work with a limited network of merchants or have no identifiable user remain out of scope of MiCA.

Crypto-asset services

Under MiCA, IFMs may provide crypto-asset services for the activities they are authorized to perform. They must notify their competent authority 40 days before the date they plan to provide the following services:

- **Receiving and transmitting crypto-asset orders** on behalf of clients
- Crypto-asset **advice**
- **Crypto-asset portfolio management.**

For custody and administration, IFMs must mandate an entity that is authorized to provide these services.

Investing in crypto assets

Under the Luxembourgish AML/CFT regulation, UCITS addressing non-professional customers and pension funds cannot directly or indirectly invest in virtual assets. AIFs can do so if their units are only marketed to professional investors.

It's important to note that the volatility, liquidity and technological risk of virtual assets can significantly affect investment vehicles' risk profiles and require adequate internal controls. Given the wide range of virtual assets available, investment managers must perform a case-by-case assessment of these investments' impact based on the investment fund's risk profile.

IFMs interested in managing an AIF that directly or indirectly invests in virtual assets must obtain prior CSSF authorization by describing the project and the different service providers and delegates involved.

When the AIF invests more than 20% of its NAV in virtual assets through one or several target funds (TF), CSSF authorization is required. The IFM must assess the TF's manager to identify and manage the risks of virtual asset investments. When a virtual asset investment through one or several TF(s) amounts to an indirect investment (over 20% of its NAV), it remains the relevant IFM's responsibility to determine if the TF has virtual assets as its main exposure.

AML/CFT considerations

When making an investment, IFMs and investment funds must perform an AML/CFT risk assessment of the asset and an AML/CFT due diligence in line with the associated risk, following the local regulatory regime. They must consider:

- The type of investment: direct or indirect
- The type of virtual asset: cryptocurrency, utility token, or other
- The acquisition method: an exchange platform, initial token offering (ITO), initial coin offering (ICO), or other.

This due diligence aims to understand where the virtual assets come from and where they're going to mitigate the risk of abuse.

Questions that may be raised

01 Do we meet the conditions to provide crypto-asset services and investments?

02 Are our clients interested in investing in a crypto-asset fund?

03 Do we have partners that can fulfil crypto-asset custody and administration services for clients?

By
Thor-Hagen Scheller,
Director, Advisory - Risk Consulting.
E: thor-hagen.scheller@kpmg.lu

EMIR Refit

Twelve years after the European Market Infrastructure Regulation (EMIR) was adopted, derivative trading is still undergoing significant regulatory changes. On 29 April 2024, the EMIR Refit entered into force, a large-scale update to enhance the reporting quality of over-the-counter derivatives (OTCs) and exchange-traded derivatives (ETDs).

EU entities involved in derivative trading must report every transaction execution, modification, early termination, and valuation (including collateral) to an authorized trade repository no later than the next business day.

While the market is still digesting the EMIR Refit's new rules, more changes are on the horizon due to next year's "EMIR 3.0" update.

01 Reporting under new validation rules

- EMIR Refit adopts a new end-to-end, XML-based reporting common to all trade repositories, containing new fields, format changes and modifications to the reported values.
- The 89 new reporting data fields bring the total number of reportable fields to 203.

02 Mandatory delegation reporting

- As the "Entity Responsible for Reporting", any IFM is responsible for reporting the details of the transactions entered by their funds.
- When a financial counterparty (FC) deals with a non-financial counterparty (NFC-), the FC is responsible and legally liable for reporting on the NFC's behalf. This is particularly significant in the AIF industry, which leverages special purpose vehicles (SPV) and other corporate structures.

03 Notification to the regulator for significant reporting issues

The IFM must proactively notify the regulator of any:

- Significant misreporting and reporting errors
- Obstacles that may prevent reporting within the deadline.

04 New trade repository controls and feedback messages

- Trade repositories check the reports they receive and reconcile any outstanding ones.
- They provide feedback reports concerning rejections, reconciliations and data quality, which the IFM is expected to monitor even in cases of delegation.

Data quality monitoring

The change of reporting rules is accompanied by an increased supervision on the side of the regulator, making data quality monitoring essential. The CSSF's new targeted, results-based data quality approach is based on 19 data quality indicators and an unlimited number of annual data quality exercises. Each entity's EMIR reporting quality will be considered as a sign of its regulatory health.

Therefore, IFMs must adequately oversee this reporting, even in cases of delegation, through independent access to the data and controls on the reporting's accuracy, completeness and timeliness.

The level of ongoing monitoring must be adapted to the IFM's resources, capabilities and risk appetite. It can range from sample testing to defining the key performance indicators (KPIs) that IFMs receive from their delegates.

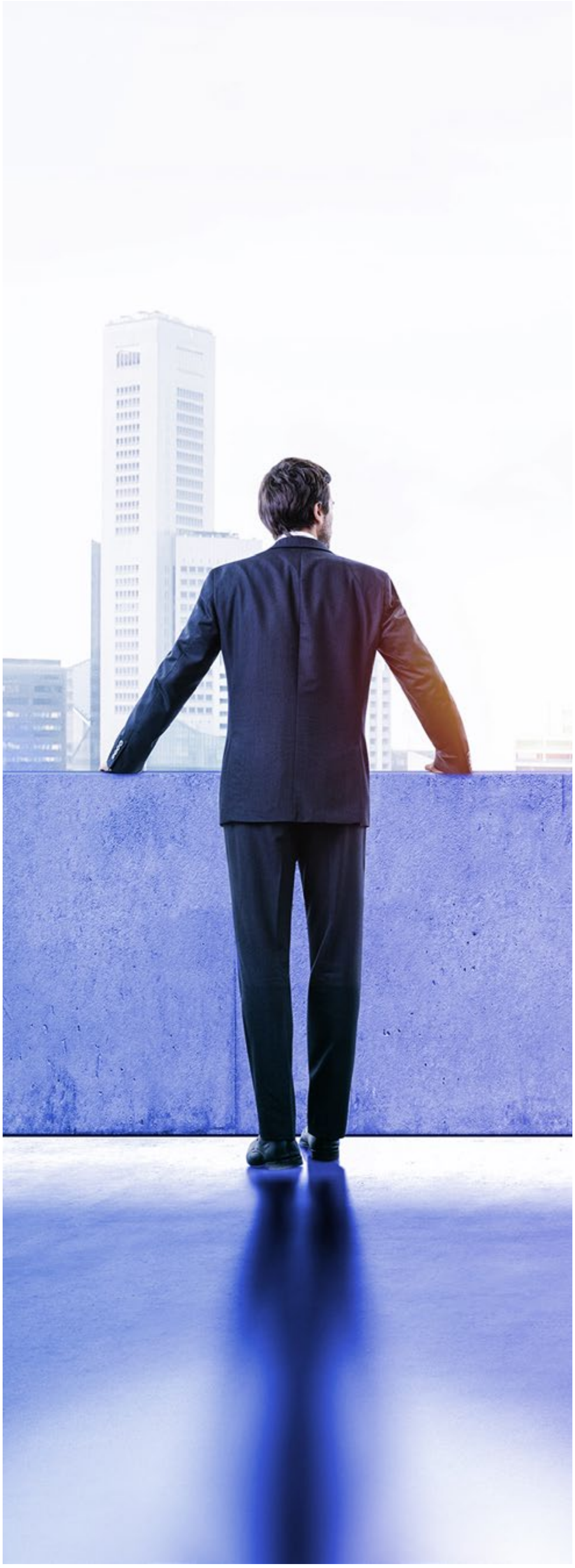
Delegation contracts, initial and ongoing due diligence and EMIR procedures must be adapted to reflect the EMIR Refit's changes.

Current challenges

- The question for IFMs is how to ensure adequate oversight of the derivatives their managed funds are trading and of any reporting they've delegated, without cannibalizing the efficiency gains of delegation.
- Other major challenges include access to data, resource constraints, attribution of costs, and regulatory uncertainty about how these rules will apply to IFMs.
- Notification requirements to the CSSF remain a struggle, especially regarding the calculation of significance on the IFM, sub-fund and counterparty level.

EMIR 3.0.

Concerned entities must also keep EMIR 3.0. in mind, which is expected to go live in mid-2025. Although EMIR 3.0's major changes affect certain entities' obligation to have active accounts at EU central clearing counterparties, it will also introduce changes to procedures and due diligence checks for EMIR data quality.



Questions that may be raised

01 Have we established and adapted an EMIR framework that meets the EMIR Refit's requirements and the CSSF's increased expectations?

02 In cases of delegation, has an appropriate EMIR oversight framework been implemented?

03 Does senior management receive frequent KPIs on EMIR compliance?

04 Have initial obstacles to implementing the EMIR Refit made a CSSF notification necessary?

By
Thor-Hagen Scheller,
Director, Advisory - Risk Consulting.
E: thor-hagen.scheller@kpmg.lu

Pillar 2 and alternative investment funds

The Pillar 2 Directive aims to ensure large multinationals pay a minimum level of tax on the income generated in each jurisdiction where they operate. Alternative investment structures may also be impacted despite the available carve-out.

What's Pillar 2 about?

Pillar 2 is arising from the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) initiative.

The Pillar 2 Directive was adopted at the EU level on 14 December 2022 and transposed in Luxembourg on 20 December 2023.

It introduces a 15% global minimum tax on certain consolidated groups with a revenue of more than €750 million (in at least two out of the four preceding years).

If a jurisdiction's effective tax rate falls below 15%, the Pillar 2 Directive's specific provisions determine the amount of top-up tax for each constituent entity in this jurisdiction. Generally, this is done by applying the Income Inclusion Rule (IRR) and the Undertaxed Profit Rule (UTPR), which can increase the group's tax burden.

When does it apply?

The Pillar 2 Directive applies as from fiscal years starting on or after 31 December 2023.

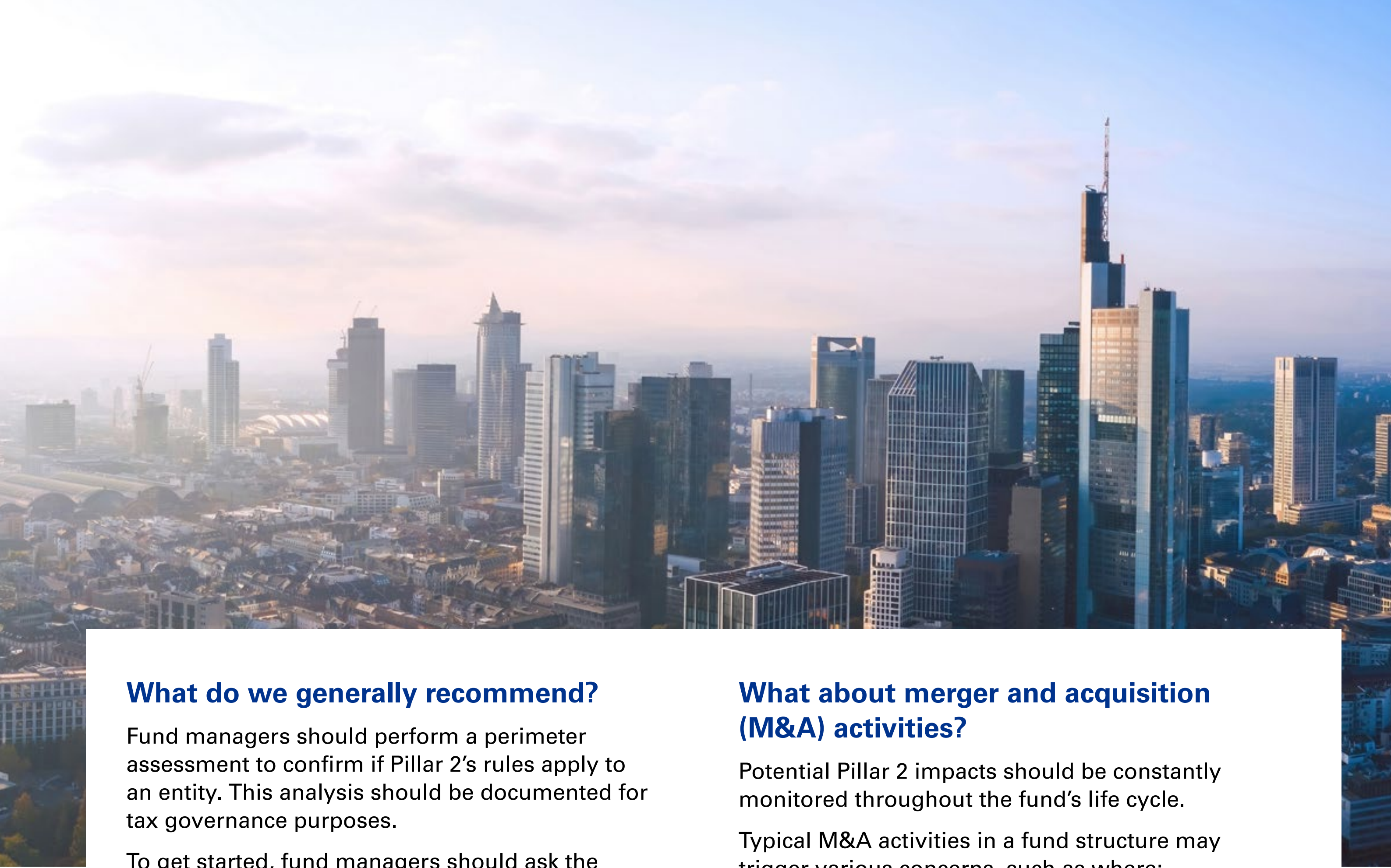
What's at stake for the alternative industry?

While initially targeting multinational corporations, alternative investment funds and their underlying SPV structures may also fall within the Pillar 2 Directive's scope if, for example:

- A given investor consolidates an entity or find vehicle from an accounting perspective.
- A fund's entity is required to consolidate its underlying investment(s) from an accounting perspective while reaching the €750 million revenue threshold.

The Pillar 2 Directive also foresees certain exemptions for investment funds and real estate investment vehicles under very specific conditions. These exemptions may also be extended to SPVs owned by these excluded entities.

However, the exemption conditions may not be necessarily met in all situations. In this case, potential in-scope entities will need to be identified.



What do we generally recommend?

Fund managers should perform a perimeter assessment to confirm if Pillar 2's rules apply to an entity. This analysis should be documented for tax governance purposes.

To get started, fund managers should ask the following questions for each entity of a given fund structure:

1. Is the entity consolidated by its investor?
2. Is the entity required to consolidate from an accounting perspective, or does a local consolidation exemption apply?
3. In the case of a local accounting consolidation, is the entity an excluded entity that benefits from a carve-out? Or if a local accounting consolidation exemption applies, could the entity be brought back into Pillar 2's scope through the so-called deemed consolidation rules?
4. Has the €750 million threshold been reached?

This analysis should also include foreign entities and not be limited to Luxembourg. This is especially relevant to Luxembourg investment funds holding foreign portfolio entities, which themselves could potentially have consolidated more than €750 million of revenue.

If the Pillar 2 rules apply in a given jurisdiction, the next step is to assess whether a top-up tax may apply and through which mechanism.

Please note that the Pillar 2 rules may require certain disclosures in the notes to the annual accounts. In addition, a specific tax return for the in-scope entity will need to be filed with the respective local tax authorities.

What about merger and acquisition (M&A) activities?

Potential Pillar 2 impacts should be constantly monitored throughout the fund's life cycle.

Typical M&A activities in a fund structure may trigger various concerns, such as where:

- Funds acquire or dispose of assets, which impacts the consolidated revenue threshold in a given year.
- There are different accounting consolidation rules applying to a buyer/seller, leading to different Pillar 2 outcomes.
- A given transaction triggers pricing deviations for the same target when modeling Pillar 2 for buyers/sellers with different Pillar 2 profiles.

M&A transactions may also require discussions regarding the relevant information that a buyer should obtain from the seller to fully onboard the target into Pillar 2's scope. Similarly, a specific contractual protection should be negotiated in the share purchase agreement (SPA) regarding the Pillar 2 tax risk.

These considerations should not be underestimated and must be monitored.

And finally, what about data?

More generally, the Pillar 2 Directive will require asset managers to implement various procedures to source and process the necessary data in all jurisdictions where a structure operates.

As gathering and processing this data could materially challenge unprepared organizations, we recommend that asset managers explore specific digital solutions that are emerging on the market.

Questions that may be raised

01 Do we have Pillar 2 oversight in-house, and are we considering potential (local) Pillar 2 positions at the level of the underlying portfolio entities?

02 Does our fund structure or any of its underlying SPVs or portfolio entities fall within the Pillar 2 Directive's scope?

03 Has this analysis been properly documented?

04 Can we effectively manage the Pillar 2 Directive's data collection and processing requirements?

05 How could potential M&A activities trigger Pillar 2 implications, and which precautions must be taken during transactions to mitigate any associated tax risks?

By

Benjamin Toussaint,

Partner, Tax – Alternative Investments.

E: benjamin.toussaint@kpmg.lu

Digital Operational Resilience Act (DORA)

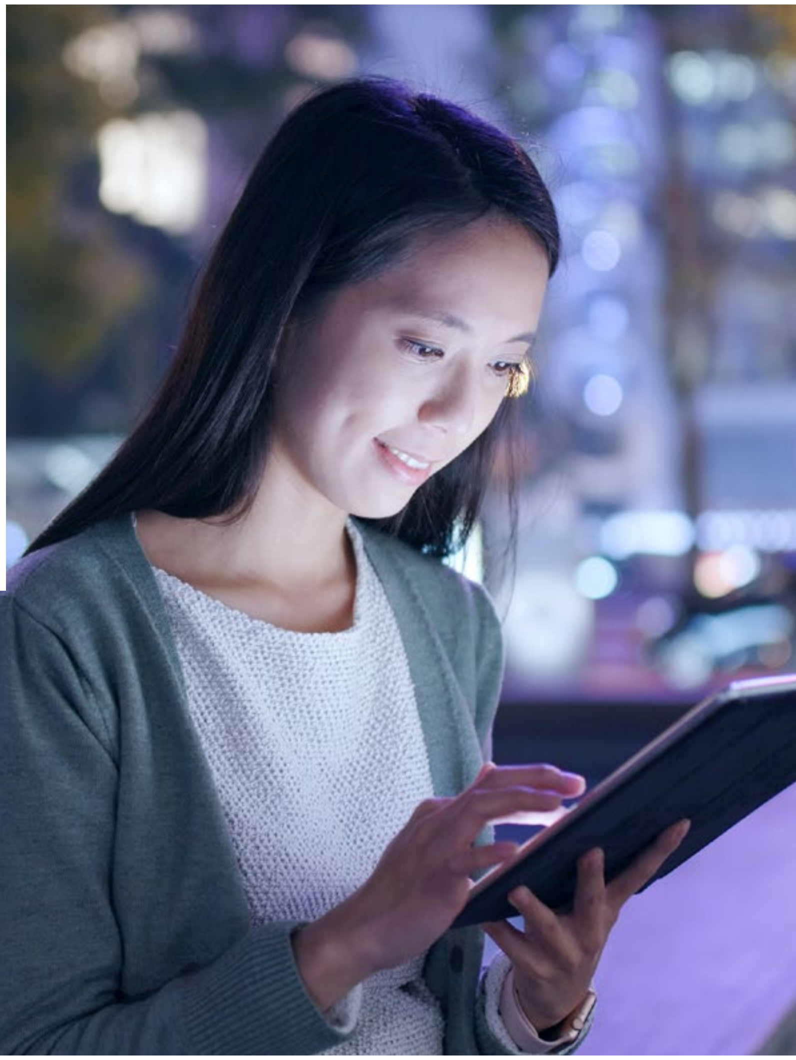
The EU's Digital Operational Resilience Act (DORA) became effective in January 2023. As a regulatory framework for managing ICT and supplier risks, it aims to improve the financial sector's ability to withstand and recover from disruptions and threats.

A crucial component of the European Commission's digital financial package, DORA's primary objective is to ensure that financial market participants can maintain safe and reliable operations, even in the face of significant ICT disruptions.

Financial institutions, including banks, ManCos and AIFMs, have been granted a transition period until **17 January 2025 to achieve full compliance.**

In Luxembourg, the CSSF is actively preparing the market for DORA in several ways, including:

- **Legal developments**: Luxembourg's "DORA law", published on 1 July 2024 and effective from 17 January 2025, amends national financial sector laws to align with the EU's DORA Regulation, empowering national authorities with necessary supervisory and investigative powers.
- **Regulatory developments:** CSSF Circular 24/847 introduces a new ICT-related incident reporting framework to tackle the growth of ICT and security risks in a highly interconnected global financial system. It aims to gain an improved and more structured overview of the nature, frequency, significance and impact of ICT-related incidents, with its requirements partially overlapping with DORA's.
- **Raising awareness:** the CSSF has already given several presentations on DORA, including to professional associations and in other market forums.



What is required?

DORA sets out a comprehensive framework for managing risks linked to the financial sector's growing digitalization and the dynamic cyber threat landscape. So, what do financial entities need to do to establish a resilient digital operational framework?

Governance and organization

- Create a **comprehensive ICT risk management framework** to ensure resiliency, enabling the identification, assessment, management and monitoring of ICT risks
- Ensure **the management body is ultimately responsible** for achieving digital operational resilience.

Digital operational resilience testing

- Create a risk-based digital **operational resilience testing program** as an integral part of the ICT risk management framework
- Perform advanced testing based on threat-led penetration testing (TLPT)
- Implement requirements for testers carrying out the TLPT.

ICT risk management framework

- Ensure all sources of ICT risks are identified, assessed, managed and monitored
- Protect ICT systems and detect anomalous activities
- Implement response and recovery plans and procedures.

Managing third-party risk

- Establish ICT third-party risk as an **integral part of** the ICT risk management framework
- Create a strategy for ICT third-party risk
- Establish a **register of information**
- Perform pre-contracting analyses over ICT services
- Promote standard contractual clauses.

ICT-related incident management, classification, and reporting

- **Implement** an incident management process and **monitor** ICT-related incidents
- **Classify** ICT-related incidents and cyber threats
- **Report** major ICT-related incidents to authorities.

Information-sharing arrangements

- Reinforce the legal grounds for information sharing arrangements on cyber threat information and intelligence.

Questions that may be raised

01 Have we defined a digital operational resilience (DOR) strategy that's integrated with other strategic documents, such as the IT and outsourcing strategy?

02 Have we conducted a gap analysis against DORA's requirements?

03 What challenges could we face when implementing DORA's requirements, including sufficient understanding and mobilization at the group level?

04 Do we comprehensively understand our ICT dependencies, including all ICT assets and any direct or indirect ICT third-party service providers?

05 Has a budget been allocated for DORA compliance?

06 Has a person or team been designated to follow the evolution of future RTS, implementing technical standards (ITS) and guidelines underpinning DORA?

By
Onur Ozdemir,
Partner, Tech & Cyber Risk Consulting.
E: onur.ozdemir@kpmg.lu

Ashish Bedi,
Director, Tech & Cyber Risk Consulting.
E: ashish.bedi@kpmg.lu

Sustainable finance — Evolving regulatory framework and disclosures

The sustainable finance journey goes beyond regulatory requirements
Here are the main ESG and sustainability challenges that market players are still facing, and the questions to tackle them:

Put my ESG strategy into motion

How can I define an ESG strategy and put it into practice?

Adapt my operating model to address ESG opportunities

How should I update my operating model to comply with the integrated ESG regulatory framework and create value?

Reporting according to final Regulatory Technical Standards (RTS)

How should I address the reporting requirements of the final RTS?

Additional ESG focus:

How can I avoid greenwashing risks and use the correct terms in fund names?

How can I enhance my reporting and risk management in the face of increased ESG scrutiny?

Developing an ESG strategy

ESG is a long-term trend that's here to stay. It requires a fund-level, future-proof product strategy that:

- Ensures a better long-term risk management approach, including sustainability risk
- Offers a diversified portfolio with environmental and social contributions
- Meets a new generation of investor expectations

To develop a successful ESG strategy, market players must define their ambitions, assess their current capabilities, and set out an action plan.

Defining your ESG data model for SFDR readiness

Since 1 January 2023, the Sustainable Finance Disclosure Regulation (SFDR) has required financial market participants to report additional information in their pre-contractual documents, websites and periodic reports.

To meet these reporting obligations, financial market participants must:

- Assess the impact on ESG data along their operation's value chain
- Identify the ESG data needs based on their assets under management
- Qualify ESG data from investment decisions to reporting requirements
- Train and educate employees to address these ESG data needs
- Adapt the IT systems to integrate the ESG data model
- Assess current ESG due diligence process for integrating SFDR obligations
- Update risk management processes, compliance checks and internal audits to ensure data accuracy and reliability
- Convert the RTS templates into business requirements
- Adapt their technology or seek external parties to provide support with producing reports.

EU's integrated sustainable finance framework

To channel capital towards sustainable economic activities, the sustainable finance regulatory framework aims to enhance transparency, accountability, and the integration of ESG criteria in investment practices.

Asset managers must navigate the complexities of this evolving framework and ensure compliance while maintaining transparent and comprehensive reporting.

Reporting according to final RTS requirements

Both the SFDR and the EU Taxonomy Regulation mandate that market players disclose ESG information through their prospectuses, annual reports and websites. The SFDR's final RTS elaborated on the required information and its prescribed format through mandatory templates, which entered into force on 1 January 2023.

On 4 December 2023, the European Supervisory Authorities (ESAs) released their Final Report on the SFDR's draft RTS concerning the principal adverse impact (PAI) and financial product disclosures. This report recommended stricter requirements for the PAI disclosure framework, suggested improvements to financial product templates, and mandated the disclosure of financial products' decarbonization targets.

This presents significant challenges for asset managers, who must now adapt to stricter disclosure standards and incorporate decarbonization targets into their reporting processes. To address these challenges, the ESAs developed practical application responses to SFDR questions and coordinated competent authorities' supervision of SFDR disclosures as of 25 July 2024.

Naming ESG funds according to ESMA guidelines

On 14 May 2024, the European Securities and Markets Authority (ESMA) issued its final guidelines on naming funds that use ESG or sustainability-related terms. To protect investors from greenwashing, these guidelines set minimum standards and thresholds for funds marketed in the EU with ESG-specific names, enhancing the transparency and reliability of investment product labels and disclosures.

These new rules pose challenges and opportunities for asset managers, who need to grasp the implications and adjust their investment strategies accordingly.

ESMA opinion

On 24 July 2024, ESMA published its opinion on the functioning of the integrated regulatory framework. Given that the developing EU Taxonomy is to become the framework's sole and common reference, it recommended that the SFDR's approach to defining "environmental sustainability" be phased out.

This move will prevent financial market players from using their own definitions when building products, applying weak "do no significant harm" (DNSH) tests to portfolio holdings, and setting an overly generic sustainable objective at the fund level.

The CSRD

The Corporate Sustainability Reporting Directive (CSRD) extends the SFDR's disclosure requirements from the product and entity levels to the corporate level, aiming to enhance transparency in sustainability reporting. Starting from fiscal year 2025, large companies that meet at least two of the following criteria will need to report according to the European Sustainability Reporting Standards (ESRS):

1. Over 250 employees
2. €50 million in net turnover
3. €25 million in assets.

However, subsidiaries can be exempted from the CSRD if their parent companies include them in consolidated reports.

The European Financial Reporting Advisory Group (EFRAG) has provided non-binding guidance to aid implementation and ensure the ESRS is compatible with other standards, such as the Task Force on Nature-related Financial Disclosures (TNFD) and the International Sustainability Standards Board (ISSB).

For asset managers, the CSRD's requirements will lead to more reliable ESG data from investee companies, supporting SFDR compliance and promoting more sustainable investment practices.

The CSDDD

The Corporate Sustainability Due Diligence Directive (CSDDD) requires companies to produce annual reports on human rights and environmental due diligence. To avoid double disclosure, companies within the CSRD's scope can include this information in their CSRD reports. The CSDDD will take effect in July 2027 and is expected to apply to approximately 5,500 companies by 2029.

The EU's regulatory framework for sustainable finance is significantly reshaping asset management practices. The SFDR, CSRD, CSDDD and other regulations and initiatives jointly ensure more consistent and reliable sustainability data, enhancing asset managers' ability to effectively evaluate and manage ESG risks and opportunities.

ESG — Don't forget the disclosure requirement!

Who is impacted and when?

- Articles 8, 9, 10 and 11 of the SFDR impose disclosure requirements for financial market participants — including management companies and AIFMs, whether authorized or registered — that offer financial products referred to in Article 8(1) or Article 9(1), (2) or (3). These obligations apply to any fund, whether self-managed or managed by a chapter 15 ManCo or AIFM.
- As these requirements applied from 1 January 2022, it's implied that periodic reports published since then should already contain the relevant disclosures. In addition, from 1 January 2023, prospectuses, websites and periodic reports needed to comply with further reporting obligations and dedicated templates.

What needs to be disclosed?

The disclosure requirements are contained in Articles 8, 9, 10 and 11 of SFDR and have been subsequently complemented by the EU Taxonomy's provisions in its Articles 5, 6 and 7. A Level 2 delegated regulation shares further details on the disclosures and templates to ensure consistency amongst market players.

The content and extent of the disclosures depend on:

- The fund's classification (under Articles 6, 8 and 9)
- The characteristics it promotes (social and environmental) for Article 8 funds
- Its sustainable objective (social and environmental) for Article 9 funds.

	SFDR product periodic disclosure	SFDR entity's PAI disclosure
Content	• Fund's ESG performance • Alignment with EU Taxonomy Regulation	• Entity's ESG impact
Process	• Recurring report to be included in the annual report • Ongoing monitoring is optional	• Recurring report to be disclosed on the client's website (annually) • Quarterly monitoring is required
Scope	• SFDR Article 8 funds • SFDR Article 9 funds	• All direct and indirect investments at the entity level
Deadline	• Any annual report published after 1 July 2022 must comply with SFDR Level 1 requirements • SFDR Level 2 (RTS) entered into force on 1 January 2023	• 30 June 2023 for the 2022 reference period (1 January 2022 to 31 December 2022)

What main challenges have we identified in the market?

IFMs have faced several challenges when preparing their SFDR disclosures.

- The classification of the fund is not always clearly available from the prospectus.
- It's difficult to assess the level of detail and the related data breakdown that's required in the disclosures.
- It's unclear from where the information should be collected, or who is responsible for drafting the disclosures' content.
- The description of the fund's objectives is not sufficiently detailed in the prospectus, so it is difficult to meet the disclosure requirements.

The CSSF's supervisory priorities in s ustainable finance and ESMA CSA

To ensure AIFMs and ManCos' compliance with the SFDR, the SFDR RTS and EU Taxonomy, the CSSF will continue to monitor their organizational arrangements, pre-contractual and periodic disclosures, fund documentation consistency, website disclosures, and portfolio analysis.

The CSSF will also inspect entities to ensure their risk management functions are adequately monitoring their sustainability risk, ESG investment strategies and the binding characteristics communicated in the pre-contractual disclosure.

Additionally, regulators will leverage ESMA's guidelines on fund names related to ESG and sustainability to ensure portfolio holdings align with the fund's name, investment objectives, strategy, and characteristics as communicated to investors.

On 6 September 2023, the CSSF announced the launch of a two-stage ESMA Common Supervisory Action (CSA) on sustainability risks and disclosures in the investment fund sector. The CSA's first stage focused on greenwashing risks and has already been completed. The second stage, launched in March 2024, will address organizational arrangements and disclosure transparency at the IFM and product levels. It will follow ESMA guidelines and incorporate recent updates, including the Thematic Review report of August 2023 and the CSA on greenwashing and sustainability risks of July 2023.

Questions that may be raised

01 As board members, what is our collective level of understanding of sustainable finance to engage in credible discussions?

02 Have we received any investor or regulator feedback on the information published on our website, and in our prospectuses and periodic report? If yes, what action was taken?

03 Have we identified our ESG ambitions? Should existing products be adapted, and are there opportunities for new products?

04 What are the fund's main sustainability risks? Is the fund's sustainability risk monitoring robust enough to keep tabs on these risks?

05 Have we identified the disclosure information that was required as of January 2023? Are there any difficulties foreseen? Were we able to produce all related information?

06 How are we addressing any additional information requests from the CSSF? Are we prepared for any potential ESG site inspections?

07 Have we identified the information required or disclosures published from January 2023 onwards? Are there any expected difficulties?

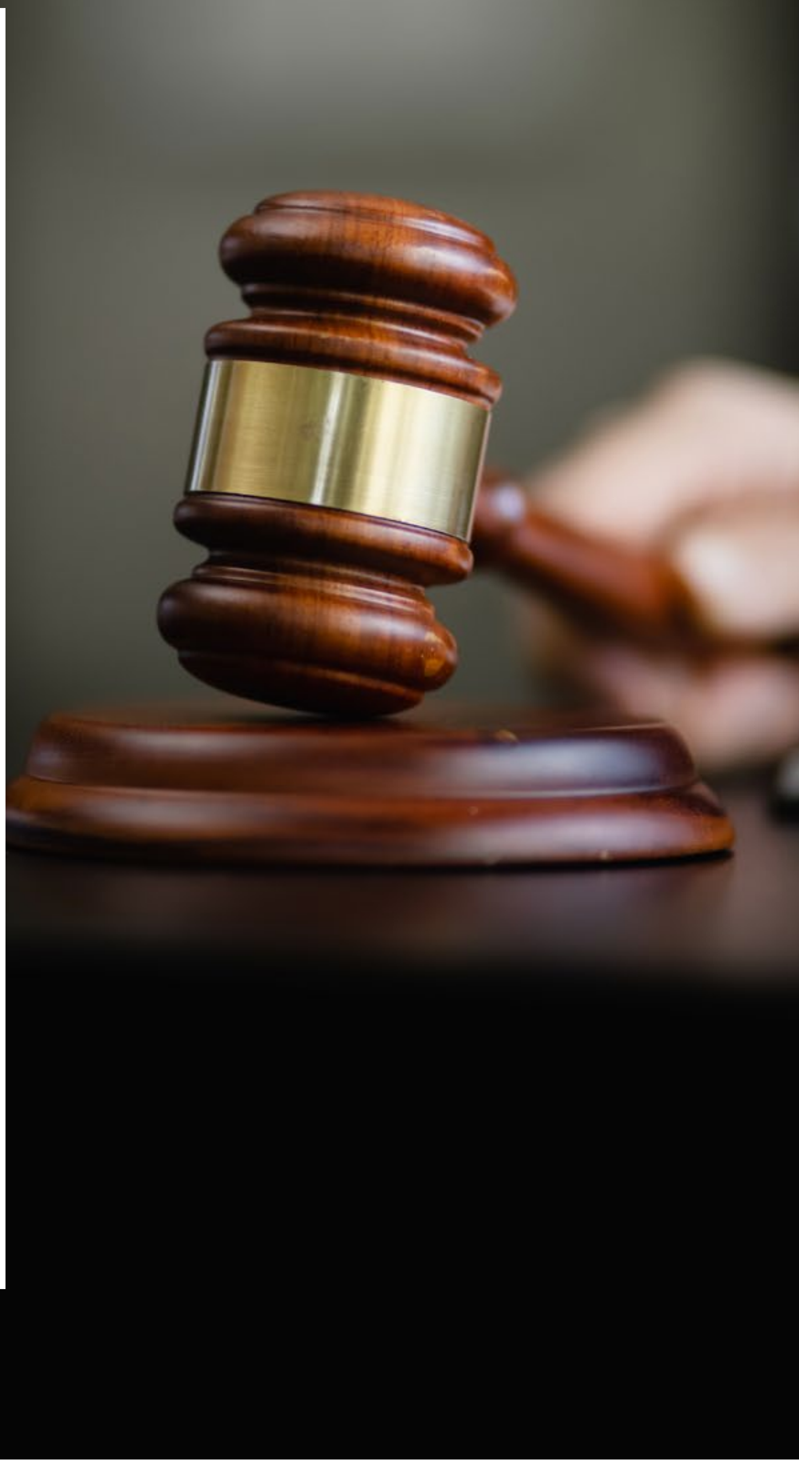
08 Have discussions been engaged with the investment manager to ensure that they will provide the necessary information and data to prepare the disclosure, or will they prepare the disclosure themselves?

09 Are the responsibilities for preparing and validating the disclosures clearly set out?

10 Is there a project plan to ensure the various steps are in place, from collecting the information to preparing the reports?

By
Julie Castiaux,
Partner, Sustainability Lead.
E: julie.castiaux@kpmg.lu

Reduced subscription tax on environmentally sustainable investments



What does the law say?

- As part of its 2021 Budget law, the Luxembourg government enacted to grant a reduction of the annual subscription tax rate of UCIs (Part I and Part II funds), and compartments of UCIs, that invest in any kind of economic activities qualifying as environmentally sustainable as per the EU's Taxonomy Regulation.
- The subscription rate decreases to 0.01% and 0.04% depending on the total net assets invested in environmentally sustainable activities — i.e. any economic activity that qualifies under Article 3 of the EU Taxonomy Regulation.
- To benefit from the reduced tax rate, the fund needs to calculate its percentage of investments in environmentally sustainable activities and include this percentage in its annual report or an assurance report.
- The fund's auditor then issues a certificate with the percentage disclosed in the annual report/assurance report, to be filed with the immediately following quarterly subscription tax declaration. The reduced rate will be fixed for the next four quarters, and will apply the total net assets invested in environmentally sustainable activities as calculated at the end of each quarter.

The certificate of the auditor must confirm the percentage of the assets invested in activities aligned with Article 3 of the EU Taxonomy Regulation as disclosed in the financial statement or the external reasonable assurance report.

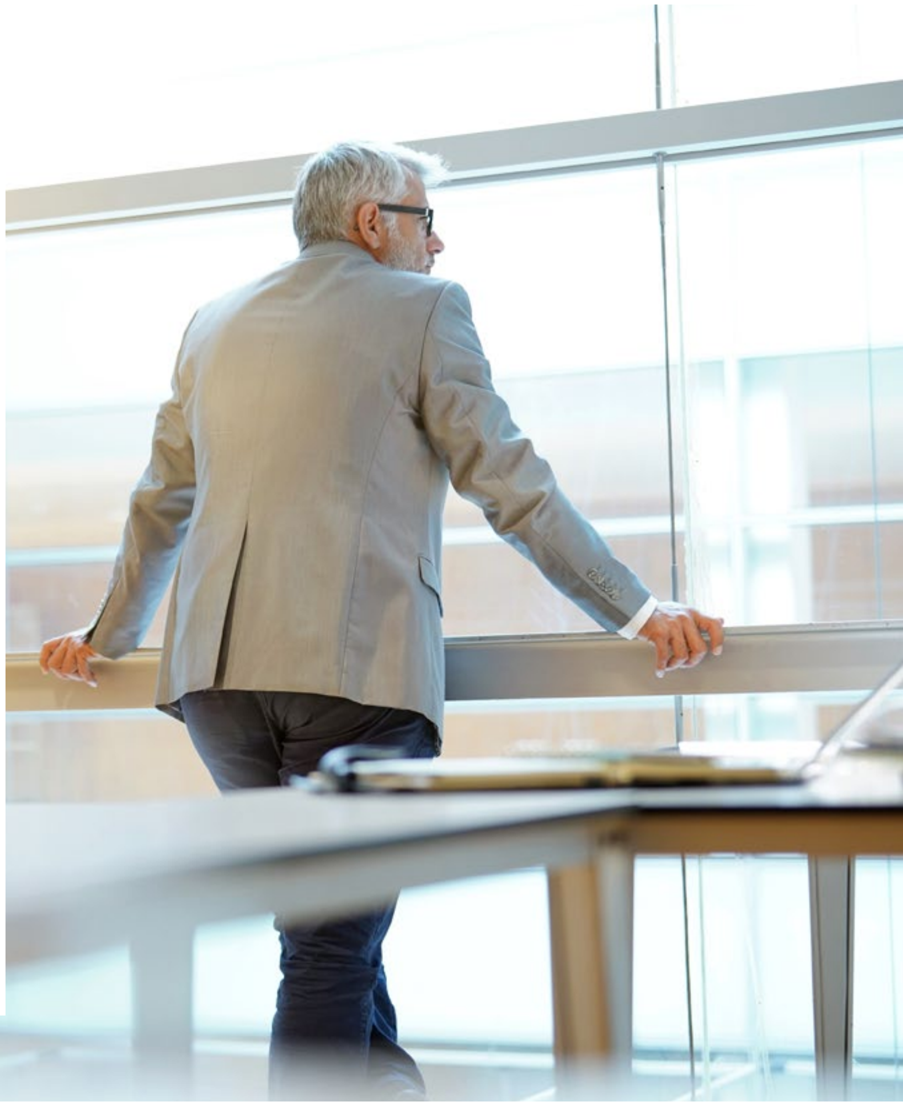
Certificate from the Auditor

- Percentage of assets as disclosed in the annual report or in the assurance report
- A reference to Article 3 of the EU Taxonomy Regulation
- Signature of the auditor

Agreed upon procedures

What is the current implementation status?

- To date, only very few funds have been able to file a request for the reduced subscription tax. As indicated above, the legislation requires that the fund provides a certification from an auditor of the percentage of environmentally sustainable investments. To calculate the percentage of environmentally sustainable investments, the fund must gather data from its underlying investments on their EU Taxonomy alignment.
- However, the EU Taxonomy Regulation didn't require this alignment disclosure before 1 January 2022 for its first two objectives (climate change mitigation and climate change adaptation) and disclosure of the other four objectives was not required until 1 January 2023. As a result, the data is generally not yet available to determine the required percentage of environmentally sustainable investments.



Questions that may be raised

01 Has the fund/ManCo considered the potential of obtaining the reduced subscription tax on environmentally sustainable investments?

02 Is the process for obtaining this reduced tax rate clear? If not, what actions are being taken to obtain clarifications?

03 When will the fund/ManCo be in a position to benefit from the reduced tax rate?

04 Are the processes in place to obtain the necessary data to calculate the percentage of environmentally sustainable investments? If not, who is responsible for implementing these processes, and what is the implementation timeframe?

05 Who will be responsible for the quarterly determination of the percentage of environmentally sustainable investments (central administration, manager, etc.)?

06 Has an auditor been approached and/or appointed to prepare the assurance report?

By
Julie Castiaux,
Partner, Sustainability Lead.
E: julie.castiaux@kpmg.lu

Olivier Schneider,
Partner, Tax – Financial Services.
E: olivier.schneider@kpmg.lu

From anti-money laundering to anti-tax crime laundering: Can you manage your tax risk?

When the scope of AML widens to tax crime, compliance officers need to hit the tax books. And when the financial regulator also comes into play, the topic is a must for the boardroom.

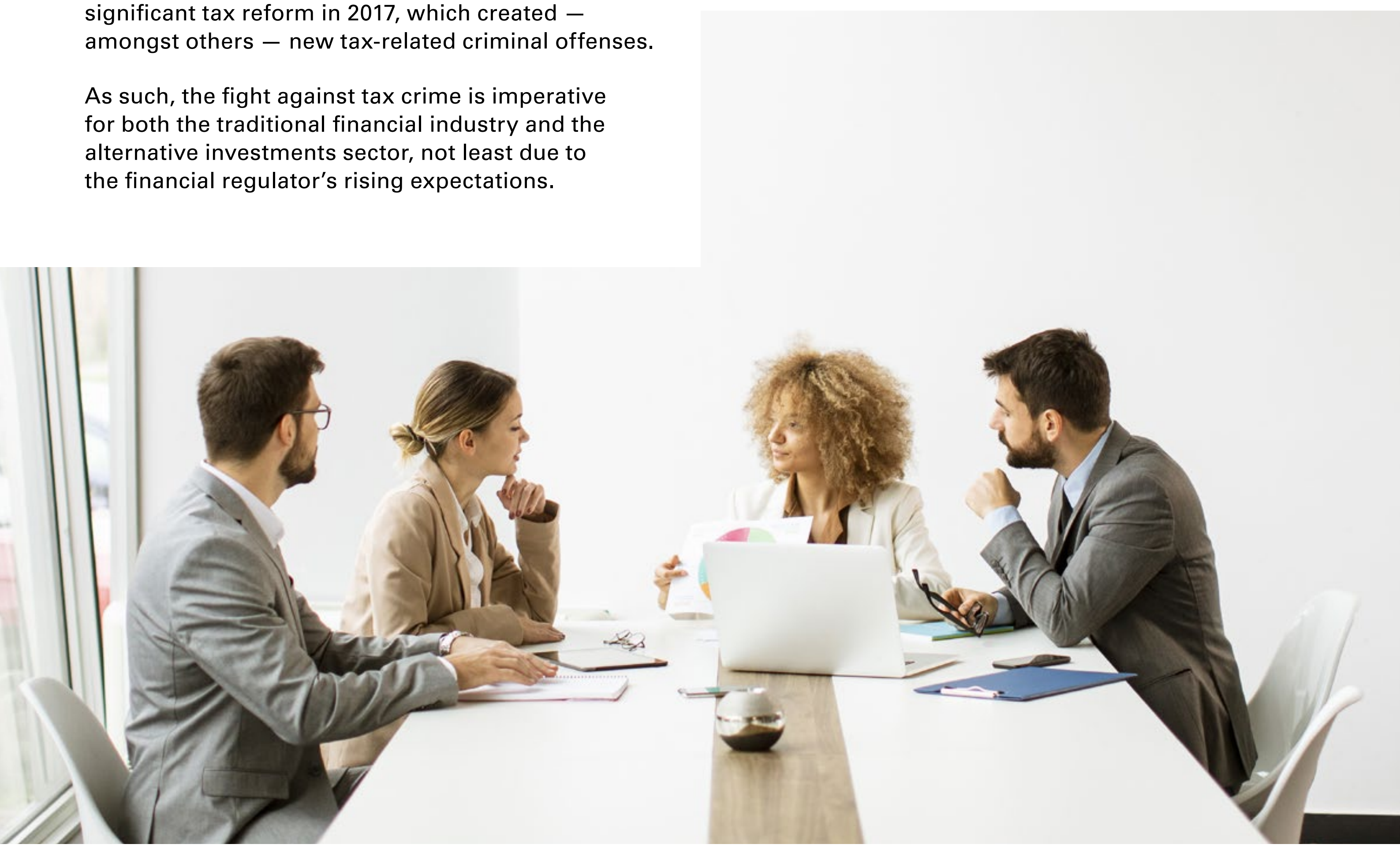
Today's tax landscape is driven by heightening tax obligations, with a shift towards increasing tax transparency and enhancing tax conformity for financial services and professionals supervised by the CSSF. As a result, Luxembourg underwent a significant tax reform in 2017, which created — amongst others — new tax-related criminal offenses.

As such, the fight against tax crime is imperative for both the traditional financial industry and the alternative investments sector, not least due to the financial regulator's rising expectations.

One example is CSSF Circular 20/744, which introduced nine tax indicators to identify potential tax crimes in July 2020, on top of the 21 tax indicators already presented in Circular 17/650.

In its thematic review, the CSSF emphasized that these nine tax indicators must be implemented by all professionals from the asset management sector directly supervised by the CSSF.

To mitigate their exposure to these potential tax risks, professionals must adapt their tax compliance policies and AML frameworks by integrating these indicators into their risk assessment processes.



The nine indicators: At a glance

01	**Complex investment structuring**
02	**Tax base erosion**
03	**Investment transactions** Lack of AEOI/CRS/FATCA procedures
04	**Investment transactions** Lack of economic rationale
05	**Investment transactions** Frequent transactions resulting in losses
06	**Efficient portfolio management techniques**
07	**SICAR**
08	**Subscription tax**
09	**Investor tax reporting**

CSSF audits

After Circular 20/744 was published, the CSSF included these new indicators in the scope of its 2021 audits and began sending specific observations in December 2021 requesting dedicated procedures on the Circular.

Going forward, the circulars and their implementation will be a key consideration of the CSSF.

What are the risks of non-compliance?

- If you don't include the Circular's nine tax indicators in your internal procedures, you could be considered non-compliant with your AML obligations.
- In case of a breach, the CSSF could impose (public) administrative sanctions, ranging from a warning or an administrative fine up to withdrawing or suspending your registration or authorization.
- In a worst-case scenario, you could be considered a money laundering accomplice, resulting in criminal fines and up to 5 years of imprisonment.

Questions that may be raised

01 Are we directly supervised by the CSSF?

02 Have we performed an impact assessment of Circular 20/744 on our business?

03 If yes, have all the assessment's issues been addressed by implementing the necessary mitigating measures?

04 Have we properly implemented the Circular's requirements in our procedures and policies?

05 How robust is our oversight of third-party delegates, funds, and service providers?

06 Has the portfolio/investment manager provided sufficient assurance that its asset due diligence procedures are adequate and in line with the Circular?

07 Has the CSSF already requested an AML/CFT on-site inspection? Are we prepared for such an inspection?

By
Daniel Rech,
Partner, Tax – Financial Services.
E: daniel.rech@kpmg.lu

FATCA and CRS

Background

All Luxembourg financial institutions (including investment funds and ManCos) must comply with the Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS).

The FATCA and CRS law of 18 June 2020 hasn't just heightened the already heavy burden of compliance — it's also reinforced the Luxembourg tax authorities' powers to carry out audits a 10-year time limit.

Given the increased risk of falling under the tax authorities' spotlight, now more than ever, financial institutions must make sure that appropriate policies, controls, procedures and IT systems are in place to meet their reporting and due diligence obligations.

Luxembourg reporting financial institutions (FIs) should also maintain a so-called "Register of Actions", which describes the FI's actions to comply with FATCA and CRS and the roles and responsibilities within the organization.

If a Luxembourg CRS or FATCA audit uncovers non-compliance with due diligence procedures, the maximum penalty of EUR250,000 may apply. And, if the audit finds reportable accounts that are unreported or under-reported, an additional maximum penalty of 0.5% of the non-reported amount could apply.

What will these audits look like?

- As suggested by the OECD, jurisdictions like Luxembourg have several options available when designing and implementing a compliance review procedure. One logical starting point is to review the financial institution's internal control framework regarding its compliance with CRS and FATCA. The Luxembourg tax authorities have already started conducting these audits.
- Another approach is to review a sample of accounts, or combine both methodologies in a multi-phase compliance review using the risk-based approach.

Questions that may be raised

01 Was the FATCA and CRS entity classification of the investment funds under management reviewed?

02 Are there adequate FATCA and CRS procedures in place at the fund or ManCo level?

03 Have internal audits been carried out to ensure the procedures and processes are adequately followed?

04 Do we have training in place to educate all personnel on their FATCA and CRS responsibilities?

05 Is our FATCA/CRS reporting solution efficient and adequate?

By
Jean Kizito,
Partner, Tax – Financial Services.
E: jean.kizito@kpmg.lu

Navigating transfer pricing in the world of asset management

Background

- Historically, transfer pricing for asset management was largely limited to analyzing and pricing transactions between the fund's ManCo and its overseas subsidiaries/affiliates that provide services to the ManCo, like distribution, portfolio management, or investment management.
- While intercompany arrangements regarding ManCos are still a key concern, there are three evolving trends:

01 The rising controversy risk on:

- Related-party financing transactions, especially at the fund level, where shareholder loans/financing can arise due to structuring asset acquisition (debt quantum, interest rate, interbank offered rate [IBOR] transition, etc.)
- Substance, especially when high-value functions are split over different locations and/or in branches
- Transfer pricing documentation, a key element in transfer pricing audits to defend the ManCo's filing position.

02 Changing business models with a direct impact on transfer pricing:

- New value chains where technology plays a larger role and the growing digitalization of capital raising and distribution
- Innovative investment management
- Tools that enhance the investor experience
- Reimagined back and middle offices (changing cost base and allocation keys).

03 The regulatory intersection:

- The AIFMD reform discussions have suggested that transfer pricing is a good indicator of regulatory "substance" in the EU.
- For US groups, the Securities and Exchange Commission (SEC) has long focused on cost and fee allocations, especially in the alternative investment space. Examples include management and monitoring fees, and charges to portfolio companies. Similarly, the EU's MiFID II seeks to identify and attribute fees to specific functions. Investors have also taken notice.
- Asset management regulations are concerned with the seniority and expertise of key personnel that is dedicated and present in key jurisdictions.
- One of the nine tax indicators in the CSSF's Circular 20/744 refers to tax base erosion derived from cross- border transfers of financial flows (e.g. management fees, service fees, marketing commissions, etc.) and (intangible) assets. This triggers questions regarding compliance with Luxembourg transfer pricing rules.

What are the risks?

If transfer prices applied on intercompany transactions don't reflect arm's length prices or haven't evolved in line with the group's business model and the latest transfer pricing trends, Luxembourg or foreign tax authorities are highly likely to impose transfer pricing adjustments and even penalties. These adjustments usually lead to double taxation that can reach very material amounts.

Questions that may be raised

01 Does the group have a transfer pricing policy that our ManCo effectively applies?

02 Are all intercompany transactions supported by legal arrangements?

03 Are intercompany prices regularly benchmarked in transfer pricing documentation according to Luxembourg regulations and OECD Guidelines?

04 What transfer pricing methods have we used (commonly cost plus or fee/profit split), and have we recently reviewed whether they are aligned with the group entities' current business model and functional profile?

05 Do we have supporting documentation for headquarters allocations and, more globally, cost allocation within the group?

06 Have we considered technology's role in the value chain and its transfer pricing consequences (allocation of costs, royalties, profit share, etc.)?

07 Have we revisited any related party financing considering the 2020 OECD Guidelines on financial transactions and/or the IBOR transition?

08 Do we have branches where profit allocations are not documented?

09 Have we ensured our transfer pricing model aligns with the regulatory framework?

Unveil trends and more insights with our survey:
Transfer Pricing Asset Management Survey

By
Sophie Boulanger,
Partner, Tax – Transfer Pricing.
E: sophie.boulanger@kpmg.lu

ELTIF 2.0 — where we stand and what's next

The second European Long-Term Investment Funds (ELTIF 2.0) Regulation, introduced in January 2024, addresses several key weaknesses of the previous regulation and introduces a range of new features to enhance ELTIFs' attractiveness to both retail and professional investors. One of ELTIF 2.0's notable changes is the broadening of the investment universe.

Main changes introduced by ELTIF 2.0

Simplification of distribution rules:

- As ELTIF 2.0 now refers to MiFID II's product governance and suitability provisions, all other due diligence requirements will be eradicated, including the suitability tests and the collection of information specific to ELTIF investors.
- The EUR10,000 minimum investment threshold and the 10% total wealth in investments in ELTIF limit will be removed.

More flexible investment rules:

- The minimum investment in eligible long-term assets will be reduced from 70% to 55%.
- Fund of funds investment strategies will be introduced, subject to the eligibility of the underlying funds' investment in certain assets and of master-feeder structures.
- The EUR10 million minimum investment in real assets will be abolished.
- The value of market capitalization of eligible assets quoted on a regulated market will be increased from EUR500,000,000 to EUR1,500,000,000 (at the time of the investment).
- The borrowing of cash will increase from 30% to 50% of the ELTIF net assets (and even 100% for ELTIFs distributed only to professional investors).
- Portfolio composition, diversification and concentration rules are less stringent and may be disapplied for ELTIFs that are only marketed to professional investors.
- Last but not least, open-ended structures will be allowed. Some constraints will tough limit the redemptions.
- The Luxembourg Parliament recently adopted a new law introducing a subscription tax exemption for Part II funds and SIFs authorized as ELTIFs. This law also reduces the minimum investment amount required from a well-informed investor from EUR125,000 to EUR100,000.

On 19 July 2024, the European Commission published its RTS for ELTIF 2.0. The document clarifies and specifies several technical points, including:

- Circumstances when derivatives can be used to hedge the risks of the ELTIF's other investments
- Requirements for an ELTIF's redemption policy and LMTs
- Circumstances for matching transfer requests of the ELTIF's units or shares
- Criteria for disposing ELTIF assets
- Requirements for cost disclosures.

How did the market react to ELTIF 2.0?

After a sluggish response to the original regulation, most asset managers and private equity firms have reacted positively to ELTIF 2.0's simplifications and increased flexibility.

However, while the number of ELTIFs in the EU rose to 127 as at end of July 2024 compared to 65 as at 31 December 2021, the capital raised remains modest compared to the industry's total capital raised.

What are the main hurdles to reaching individual investors?

While ELTIF 2.0 significantly improves the structuring of funds open to individual investors, several challenges remain to fully unlock their potential:

- **Enhancing the efficiency** of private equity operations and distribution processes to handle the volume and complexity surge that comes with democratization
- **Improving information sharing** between all stakeholders, including private banks, asset managers, service providers, and private equity houses
- **Optimizing servicing costs** to make investments more accessible and competitive
- **Understanding individual and retail investors' expectations** to effectively tailor products and services
- **Provide the necessary financial education** to intermediaries and the retail end-investor regarding alternative investment strategies.

What's next after ELTIF 2.0?

Alongside other fintech initiatives to digitalize the alternative investments industry and deploy tokenization and stablecoins, ELTIF 2.0 is expected to help catalyze the democratization of the private equity industry for family offices and high-net-worth individuals (HNWI) and, eventually, for retail investors.

Questions that may be raised

01 Have we assessed the new potential of ELTIFs, based on the legislation's revision?

02 Is our retail investor base interested in a product providing access to the private equity market?

03 Do we have the necessary competencies in our fund value chain to onboard an ELTIF project?

By

Alexandre Hector,
Partner, Audit.
E: alexandre.hector@kpmg.lu

Jean Christophe Cabilin,
Partner, Advisory.
E: jeanchristophe.cabilin@kpmg.lu

Tax governance and substance for alternative players

The AIF tax environment is becoming increasingly complex. This escalation requires robust tax governance to ensure operating models can meet the challenges of both today and tomorrow.

Substance and tax governance has become critical for asset managers operating AIF structures in Luxembourg.

What have we observed?

Historically, the best practice for investment funds has been to implement some sort of sound decision-making process in Luxembourg.

Generally, this meant rationalizing the board of directors of the Luxembourg SPV structure below the fund (i.e. board composition, type of board members, level of authority and decisions) and recruiting a certain number of full-time employees to perform certain tasks on the ground.

Over the last couple of years, our annual substance surveys have uncovered an evolution in this operating model due to a combination of different factors:

- Local authorities' increasing scrutiny on substance and beneficial ownership requirements
- An avalanche of EU, domestic and international tax reforms
- Changes in funds' regulatory landscape.

The main trends we identified were the following:

- Multiple alternative players have finally implemented governance manuals to:
  - (i) create a tax substance framework consistent with most EU jurisdictions' requirements; and
  - (ii) ensure that Luxembourg was systematically included in the wider governance of asset managers[3].
- A tax role is appointed in Luxembourg.
- More and more functions (including AIFM functions) are being moved to Luxembourg, thus increasing the weight of Luxembourg compared to the wider organization.
- Tax substance is directly leveraging regulatory substance.

Finally, tax and regulatory are now becoming one single topic. As an example, Luxembourg players operating under AIFMs must also comply with CSSF Circular 20/744 of 3 July 2020[4], which requires a risk assessment exercise with nine specific tax indicators.

Overall, we are transitioning from a focus on tax substance to a broader emphasis on tax governance.

Going forward

The significance of tax governance will only continue to grow given the rising complexity of tax rules, including Pillar 2, the third European Anti-Tax Avoidance Directive (ATAD 3) and the "Securing the Activity Framework of Enablers" (SAFE) initiative, as well as the increase in local tax challenges.

Organizations will need to monitor these developments closely, as a successful challenge by a local tax authority may significantly impact the internal rate of return (IRR) of investment structures. They must implement robust controls and regularly review tax governance and substance points.

We believe technology (including AI) should play a major role when implementing and monitoring tax governance in fund structures, whether to handle tax rules' growing complexity or manage costs.

3. We have observed different solutions being implemented in practice, such as the necessary participation of certain key Luxembourg staff in the investment committee, the implementation of certain guidelines with regards to the level or type of information to be shared with the SPV's board, dos and don'ts when deciding on or signing a document, etc.

4. CSSF Circular 20/744 introduced nine tax indicators specifically designed for the Luxembourg fund industry that notably apply to Luxembourg AIFMs.

Questions that may be raised

01 Is there someone responsible for tax matters within my organization?

02 Is my current tax governance framework robust enough to meet the evolving tax and regulatory requirements in the jurisdictions where the investment fund is operating?

03 How is Luxembourg connected to the wider decision-making process within the organization?

04 What step should I take to integrate technology to enhance my tax governance processes and reduce the risk of non-compliance?

By
Benjamin Toussaint,
Partner, Tax – Alternative Investments.
E: benjamin.toussaint@kpmg.lu

Rationalization of fund administration

The historical best-of-breed approach for selecting fund administration services has often resulted in a diverse array of service providers tailored to specific needs. However, the evolution and repositioning of Luxembourg ManCos have prompted a reassessment of their fund administration arrangements to achieve leaner and more efficient operating models.

Historically, many players have worked with multiple fund administrators due to legacy systems, as well as leveraging different administrators for each alternative strategy. The fragmentation of different service providers has often increased oversight burdens and hindered standardization.

Nowadays, some fund administrators are expanding their capabilities and expertise to offer services spanning different strategies, such as liquid AIFs and real estate in the same house.

According to KPMG's 2024 Large-scale ManCo Survey, 43% of market players with at least four fund administrators are seeking to rationalize this number to unlock operational efficiencies.[5] Several alternative players connected to US groups are leveraging their internal capabilities to perform fund accounting tasks.

These rationalization efforts are driving a shift towards more streamlined operations, boosting efficiency, reducing oversight burdens and enhancing standardization across fund administration processes. As market players consolidate their fund administration services, the resulting cohesive and integrated approach is delivering performance gains and service quality while reducing costs.

5. KPMG, KPMG Large-scale ManCo & AIFM Survey 2024, 2024.

Questions that may be raised

01 Is our current fund administration setup efficient and scalable?

02 Do our fund administrators effectively help us execute our required ManCo oversight controls?

03 Is our control framework standardized across our various fund administrators?

04 Are there variations in the service quality across our different fund administrators?

05 Does our current fund administration setup require our oversight team to be more involved than necessary in certain situations (i.e. exception-based involvement versus systematic involvement)?

By
Jean Christophe Cabilin,
Partner, Advisory –
Risk Consulting.
E: jeanchristophe.cabilin@kpmg.lu

Operating model evolution: core versus non-core

Many AIFMs are reevaluating their operating models to streamline their value chain and operations. A key focus is identifying non-core activities for outsourcing, such as reporting and controls execution.

Finding the right balance between outsourced and insourced functions is a challenge for ManCos and AIFMs. While so-called non-core functions are already heavily outsourced, such as transfer agency, fund administration and portfolio management, so-called core functions must be performed either fully or partially inhouse, such as oversight, risk management, AML and internal audit.

Examining which functions to keep inhouse or outsource requires players to analyze costs, their existing staff's skills, technology and strategic considerations. The level of outsourcing also amplifies other challenges. As the number of functions handled by a provider increases, so do the operational risks — along with the need for proper oversight, which must often be demonstrated to supervisory authorities.

Recently, we've observed that asset managers in Luxembourg are increasingly struggling with a lack of talent for some core functions, along with rising costs.

Questions that may be raised

01 Are we focusing on our core activities?

02 In the areas where we're challenged regarding skills and costs, can we partially or fully outsource with sufficient oversight?

By
Said Fihri,
Partner, Advisory.
E: said.fihri@kpmg.lu

New investment tax credit

On 19 December 2023, the Luxembourg Parliament approved bill n° 8276, substantially modifying the investment tax credit (ITC) regime that taxpayers could claim against their corporate income tax. This new regime, which took effect on 1 January 2024, increases the tax incentive for eligible projects in digital, transformation or ecological and energy transition.

Background

Under the old regime, companies could benefit from two types of investment tax credits under Article 152bis of the Luxembourg Income Tax Law (LITL):

- A tax credit for **"global investment"** in specified property of **8%** of the qualifying assets' total acquisition price up to the first €150,000 and **2%** for the portion exceeding €150,000.
- A tax credit for **"additional investment"** in certain tangible property of **13%** of the additional investment in a given year.

On 13 July 2023, Bill n° 8276 was introduced to reshape the previous ITC regime for companies. Alongside increasing the existing global ITC rate from 8% to 12%, the new regime creates a new ITC incentive covering Luxembourg businesses' investments and expenses in their digital transformation, as well as ecological and energy transition.

The new regime defines digital transformation and ecological and energy transition as follows:

Digital transformation

Achieving a process or organizational innovation by implementing and using digital technologies, such as:

- Redefining production processes to increase productivity or resource efficiency
- Implementing an innovative business model to create new value for stakeholders
- Significantly redefining the delivery of services to create new value for stakeholders
- Modernizing the company's organization to create new value for stakeholders
- Improving digital security.

Ecological and energy transition

Defined as "any change that reduces the environmental impact of the production or consumption of energy or the use of resources", such as:

- Improving a production process' energy efficiency, and/or material efficiency and/or significantly reducing its carbon emissions
- Enabling the self-consumption of produced energy or the storing of energy from renewable, non-fossil sources
- Reducing air pollution from production sites
- Promoting the extension of products through re-use.

Overview of the new regime

The new ITC regime can be summarized as follows:

New ITC of 18% for investments

- In digital transformation or ecological and energy transition projects
- Taking into account not only investments but also operating expenses (e.g. personal expenses and third-party costs)

18%

New tax relief for investments in digital transformation or ecological and energy transition

12% for global investment

- Increases the global investment tax relief rate from 8% to 12%
- Abolishes the previous EUR150,000 investment tranche

Increase to

12%

for global ITC

14% for investments qualifying for Article 32bis LITL

- For tangible depreciable assets with special amortization
- For example, investments in assets to reduce water use, eliminate or reduce water, air or noise pollution, and reduce waste

14%

for investments qualifying for article 32bis LITLenergy transition

6% for investments in tangible depreciable assets and software

- 6% considering that these assets are expected to benefit from the 12% tax credit for global investment
- Otherwise, the tax relief is 18%

6% / 18%

for investments in tangible depreciable assets and software transition

To benefit from the 18% ITC, a specific procedure must be followed: new attestation and certification process:

1. Eligibility attestation

The company files an eligibility application with the Ministry of Economy, which includes the following information about the project, among others:

- Name, location and description of the project,
- Objective and a description justifying how the project may achieve its goals
- Start and end dates of the project.

Only investments and operating expenses made or incurred after the application is submitted can be covered by the certificate. The Ministry of Economy will grant or refuse the application within three months of receipt.

2. Annual certificate

The company includes an annual certificate issued by the Ministry of Economy when filing its corporate tax return (CTR) with form 800. Companies must request this annual certificate two months after the year-end that the new ITC was claimed, and the Ministry of Economy will issue the certificate within nine months of that year-end.

The certificate will only cover investments and operating expenses made or incurred after the eligibility application was submitted.

KPMG can help you identify whether your new projects can benefit from this 18% tax incentive.

Our approach:

Questions that may be raised

01 Have we considered the tax incentive that we could receive if we perform a digital transformation project?

02 Do we have existing digital projects which should start soon and/or have already started recently?

03 Do we have a project governance in place to have an ITC eligibility from project inception and to ensure an efficient collection of information?

By
Edouard Fort,
Parner, Tax - Financial Services.
E: edouard.fort@kpmg.lu

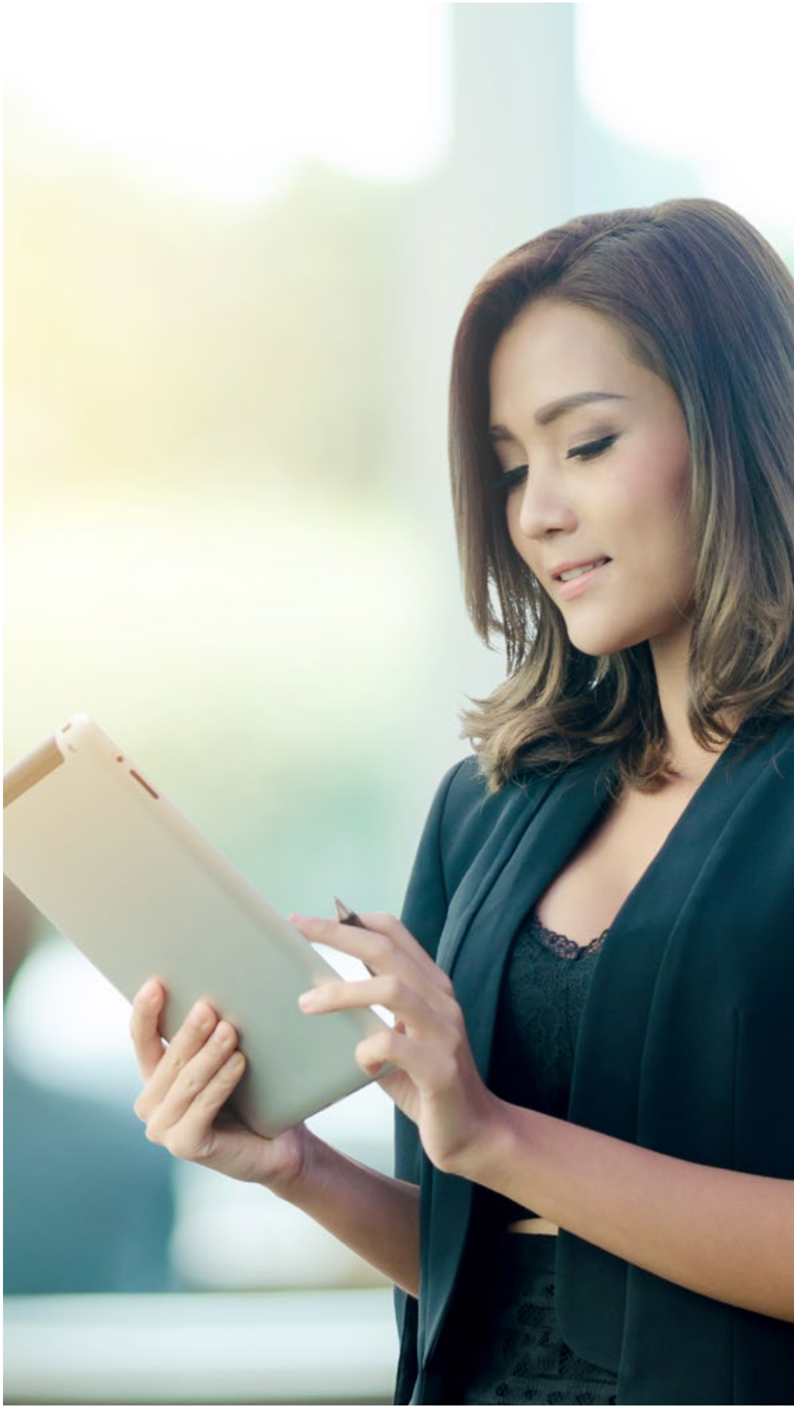
Unlocking the future of asset management with modern data platforms

Data plays a pivotal role in the asset management sector, forming the bedrock for informed decision-making and strategic planning. It's an integral part of the investment lifecycle and essential for operational efficiency.

However, managing data processes is becoming increasingly complex. When engaging with third-party service providers, asset managers need to integrate disparate systems, ensure smooth data exchange, maintain data integrity across diverse platforms and navigate varying data standards and compliance requirements. A compelling example is the variety of formats and naming conventions property managers use to structure and communicate financial and other data to asset managers.

In asset management, modern data platforms serve a diverse range of data consumers, including finance and legal functions, administrators, auditors and other servicing business units. These platforms provide versatile solutions for asset and investment management companies seeking to enhance efficiencies, streamline operations, and facilitate seamless data exchange among stakeholders.

They also provide a single source of truth, simplifying data management by eliminating multiple copies stored across various systems. This ensures decisions are based on accurate and unified data, enhancing data integrity and reliability.



Benefits of modern data platforms

- Data democratization: this improves data accessibility and quality and fosters collaboration across organizations and third-party service providers.
- Cost management: modern data platforms optimize resource management and planning with consumption-based pricing models that enable seamless scalability.
- Connected enterprise: these platforms unlock connectivity with the organization's other systems and platforms, whether internal or external.
- Advanced analytics: companies enjoy data-driven insights and visualizations, paving the way for the transformative impact of Artificial Intelligence in asset management.

Embarking on the journey to implement modern data platforms in asset and investment management requires clear objectives, a cross-functional team, experienced partners, and prioritized projects. Robust data governance, the right technology, and a data-driven culture are essential for long-term success.

There is no one-size-fits-all data platform, particularly in the complex environment of asset management with its diverse asset classes and operating models. Whether using Snowflake, AWS, Azure, or other solutions, custom software engineering and orchestration are essential to tailor the platform to your specific strategy and operational requirements.

Key takeaways

- Data is critical to the asset management sector's investment lifecycle and decision-making.
- However, the industry's diverse systems, asset classes, operating models and regulatory requirements make data management particularly challenging.
- Data management platforms can seamlessly exchange data between the industry's disparate stakeholders and ensure data quality and integrity.
- A custom engineering project is essential to tailor the data platform to your specific strategy and operational requirements.

Questions that may be raised

01 How often do we encounter data quality issues, and how do they impact operations?

02 Can we integrate data from various sources and smoothly incorporate new data into existing systems?

03 How effectively do we manage our data across different functions and departments?

04 How do we handle data access for third-party service providers or collaborators?

05 How much time do our teams spend on data-related tasks that could be automated?

06 Can we generate reports quickly and accurately for internal and external stakeholders?

07 Can our current data infrastructure scale with our business growth?

08 How do we ensure data integrity and compliance across different jurisdictions?

09 Are we missing opportunities to gain a competitive edge due to data limitations?

10 How well does our current data strategy align with our overall business goals?

By
Dimitrios Kampas,
Head of Data and Analytics.
E: dimitrios.kampas@kpmg.lu

Optimizing your digital document strategy

Luxembourg's archiving law of 25 July 2015 allows a digital copy to keep the legal value of its original physical document, but only if a PSDC provider performs the dematerialization process.

When an organization transitions from paper to fully digital documents, management must implement and maintain flexible archiving strategies that comply with the General Data Protection Regulation (GDPR) and other laws, while ensuring the availability and legal value of constitutive, contractual and AML - and KYC related documentation.

Luxembourg's archiving law, which complements the EU's Electronic Identification and Trust Services (eIDAS) Regulation, allows Luxembourg companies to transform their paper documents into digital documents with the same legal value, significantly reducing their physical storage and costs.

However, strict requirements apply to ensure the highest integrity and security of these dematerialized and stored documents. Consequently, this process can only be performed by a certified dematerialization and archiving service provider with a "Prestataires de Services de Dématérialisation ou de Conservation", (PSDC) license. This is granted by Luxembourg's Institute of Standardization, Accreditation, Safety and Quality of Products and Services (ILNAS).

As part of our multidisciplinary service offering, KPMG is licensed by ILNAS to perform a company's full dematerialization and scanning process and handle a document's entire lifecycle until its destruction.

Our systems, including the KPMG Vault, ensure easy integration, that all data is securely managed and stored to guarantee companies' full access to their data. Companies can request proof at any time for every document stored in our systems and we implement various roles and rights to limit who can access the different documents, upload them or even visualize KPIs.

To support GDPR compliance, we can also help companies manage their data retention requirements and implement retention policies. By archiving data in the KPMG Vault, we can directly implement specific data retention rules to ensure each document is kept for the proper time period and then automatically deleted. KPMG's offer is modular, which allows the implementation of a solution perfectly adapted to our client's needs, while allowing transparent management of costs.

Questions that may be raised

01 Do we have a strategy in place for going paperless?

02 Which data retention period should be applied to each document type, and how is it tracked?

03 Do our digital copies need to retain the same legal value as the original paper documents?

04 Can our digital documents be easily accessed following the dematerialization process?

05 Does this process apply to international group companies, and under which regulation?

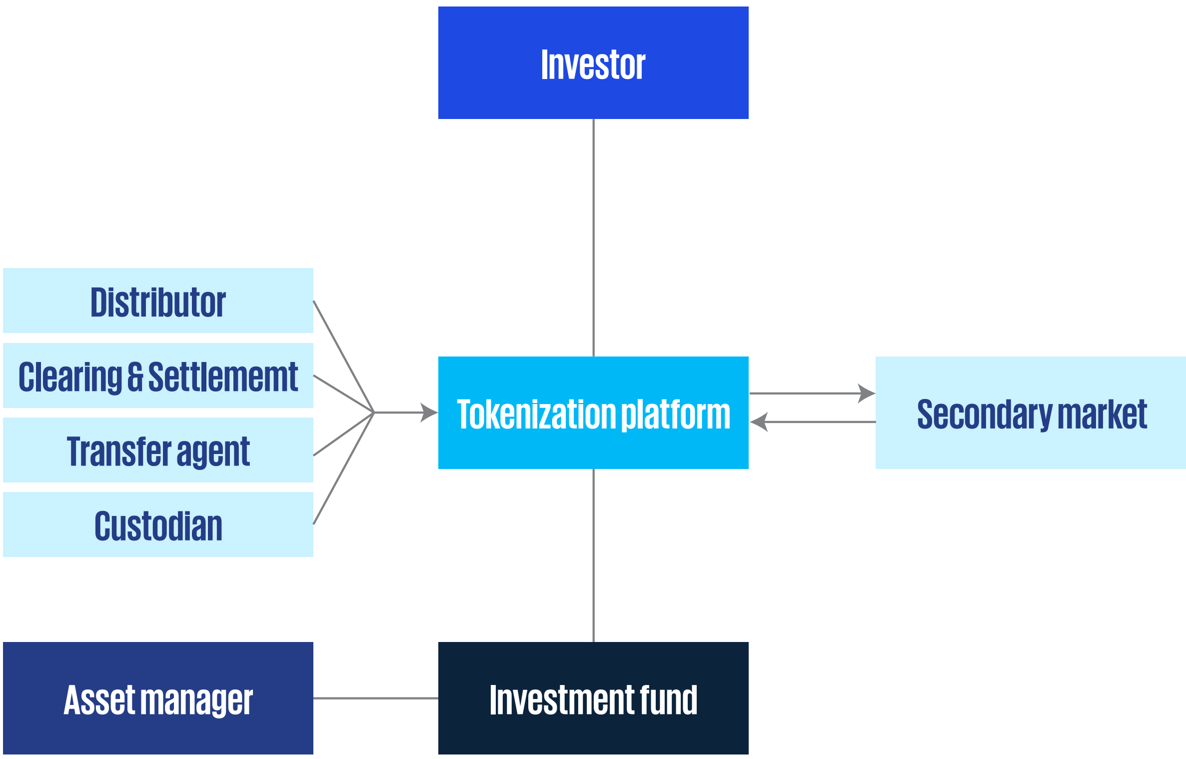
By
Natalie Ebert,
Partner, Fund
Administration Services.
E: natalie.ebert@kpmg.lu

Tokenization as a value chain disruptor

The use of tokenized assets like securities and the technology behind them have the potential to create more efficient markets by optimizing the way assets and services are exchanged. The blockchain can revolutionize asset managers' entire value chain, with processes made leaner or even completely disappearing thanks to the automation of activities. This disruptive nature means asset managers must fundamentally rethink the value chain and the associated processes and business models.

While traditional investments involve multiple intermediaries, high costs and poor liquidity, tokenization tackles these challenges by:

- Allowing economies of scale with disintermediation by performing the distribution, clearing and settlement, transfer agent and custody functions.
- Increasing liquidity from an asset management and fund distribution standpoint by creating secondary markets, facilitating exit and entry strategies as a result.
- Allowing the management of larger investor pools through automation powered by smart contracts.



Questions that may be raised

01 How might blockchain technology impact my industry?

02 To what extent could tokenization benefit the organization and transform the business model?

03 What level of transformation is required for the infrastructure, and what are the costs?

By
Said Fihri,
Partner, Advisory.
E: said.fihri@kpmg.lu

Insights from the KPMG Large-Scale ManCo & AIFM Survey 2024

The fourth edition of our Large-Scale ManCo & AIFM survey attracted a record number of respondents, covering 22 ManCos and 19 AIFMs. The evolution and transformation of these market players' operating models persist to achieve efficient and streamlined processes.

The following points emerged from our survey discussions:

The ManCo operating model evolution continues

Our survey shows that the transformation agenda has evolved from defining operating model design principles to refining and consolidating processes and workflows. Over 80% of market players consider their current operating model to be evolving, highlighting that the transformation agenda isn't stopping anytime soon.

Cultural shift: the new service provider mindset

Market players increasingly see their Luxembourg entity as a center of excellence or service center embedded within the group organization. This requires significant mobilization by the Luxembourg ManCo to build sufficient expertise and capabilities to provide this extended service beyond regulatory ManCo obligations. In fact, 54% of ManCos and AIFMs have at least one senior management member in Luxembourg who carries a global responsibility.

Continued appetite for alternative investment strategies

Market players continue to explore opportunities in the alternative investment space to expand their business volume and product offering. In particular, 21% of market players see alternative investments as their primary growth path, especially regarding infrastructure, private debt and private equity strategies.

Caution around ESG: carefully navigating its complexities and impact

The past few years have seen ESG adoption surge, driven by investor demands and industry direction. However, rising regulatory scrutiny and high operational requirements have triggered a deceleration in this ESG adoption, with some players reclassifying their SFDR Article 9 funds.

Protecting core value as the operating model centerpiece

ManCos and AIFMs are increasingly emphasizing core value protection and scalability through a strategic shift towards a "core versus non-core" approach. This involves identifying and prioritizing the functions essential to their value proposition while streamlining other activities. Twenty-eight percent of ManCos and AIFMs are currently revisiting their outsourcing models — either looking to insource activities regarded as core in their value chain or strategically outsource volume-driven activities.

The branchification phenomena continues

ManCos and AIFMs continue to expand their reach and service offering through their branches. Seventy-six percent of ManCos have at least one branch compared to 55% two years ago. Branches are also increasingly viewed as a form of "near shoring". Originally established for marketing and distribution, the spectrum of activities performed in branches is broadening, in particular discretionary portfolio management (DPM), investment advice, second-line-of-defense support and the internalization of portfolio management.

To discover the full insights of our survey, please visit:
KPMG Large-scale ManCo & AIFM Survey 2024

By
Alan Picone,
Head of Consulting,
Asset Management & Alternative Investments.
E: alan.picone@kpmg.lu

ATAD 3 and its impact on non-executive directors

Although the EU's legislative proposal to fight the misuse of shell entities (the "Unshell Directive" or ATAD 3) has not yet been agreed on at the EU level, potential developments should be closely watched.

Despite multiple attempts to reach a compromise text, EU Member States have yet to agree on the final shape of ATAD 3 and how to harmonize substance and related board composition requirements across the EU.

However, the fight against the misuse of shell entities will undoubtedly remain the EU's key focus in the future.

Once EU Member States agree on the way forward, we expect industry players to perform gap analyses and potentially discuss changing or upgrading their business models.

Background

The initial December 2021 ATAD 3 draft introduced three features, or "gateways", to identify entities at risk of lacking substance.

- High-risk entities — meeting all three gateways based on a self-assessment and not benefiting from a carve-out — would be required to report on their substance through their annual tax return and presumed to be shell entities if they don't meet specific substance indicators.
- These shell entities would also lose certain tax benefits under EU tax directives or double tax treaties, impacting funds' IRR as a result.
- The initial proposal's definition of high-risk entities includes those with passive income earned or paid out via cross-border transactions that outsource their day-to-day operations and decision-making.

Recent developments

Since the initial December 2021 draft, the European Commission has issued several amended proposals due to Member States' lack of consensus. However, none of them were passed.

While nothing official has been communicated, recent feedback from EU discussions indicates that the draft ATAD 3 may be streamlined to become a simple reporting instrument with an exchange of information obligation.

In the absence of any tangible information, we believe that ATAD 3's initial gateways may still be a good indicator of the Directive's final scope and setup:

- The operating model and delegation mock-up of Luxembourg SPVs is likely to still be a key factor in the ATAD 3 reasoning.
- A key indicator was the presence of one or more qualifying directors who:
  - Are tax resident in Luxembourg or a neighboring country.
  - Are qualified and authorized to manage and take decisions independently.
  - Do not actively perform the director function in multiple non-associated enterprises.
- A potential limitation of the number of mandates performed by directors in non-associated enterprises seems to have been previously raised during the legislative process.

While ATAD 3's exact scope still needs to be agreed on, independent directors should keep a close eye on this topic alongside domestic substance requirements.

We expect this potential future legislation will be carefully analyzed in boardrooms.

By
Benjamin Toussaint,
Partner, Tax – Alternative Investments.

E: benjamin.toussaint@kpmg.lu

Contact

Chrystelle Veeckmans
Partner
Head of Asset Management EMEA Region
KPMG Luxembourg
chrystelle.veeckmans@kpmg.lu
+352621876244

Alan Picone
Partner
Asset Management Market Leader
KPMG Luxembourg
alan.picone@kpmg.lu
+352621877239

Benjamin Toussaint
Partner
Alternative Investments Market Leader
KPMG Luxembourg
benjamin.toussaint@kpmg.lu
+352621875339

Mickael Tabart
Partner
Private Equity Market Leader
KPMG Luxembourg
mickael.tabart@kpmg.lu
+352621876738

Joseph De Souza
Partner
Real Estate Market Leader
KPMG Luxembourg
joseph.desouza@kpmg.lu
+352621876722

kpmg.lu
home.kpmg/socialmedia