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## Circular 24/856 on investor protection in the event of a NAV calculation error, non-compliance with investment rules and other errors

On March 29, 2024, the Commission de Surveillance du Secteur Financier (“CSSF”) issued a new circular that has significant implications for the administration and management of Undertakings for Collective Investment (“UCIs”), replacing the existing Circular CSSF 02/77 as from 1 January 2025 (the “Circular”)<sup>1</sup>.

The Circular addresses errors related to the calculation of the net asset value (“NAV”), non-compliance with the investment rules applicable to UCIs, as well as other errors at the level of a UCI as further specified by the Circular. The Circular applies to Undertakings for Collective Investment in Transferable Securities (“UCITS”), UCI Part II<sup>2</sup>, SIFs<sup>3</sup>, and SICARs<sup>4</sup>, as well as ELTIF<sup>5</sup>, MMF<sup>6</sup>, EuVECA<sup>7</sup>, and EuSEF<sup>8</sup>, for which CSSF is the competent authority.

The Circular does not directly apply to unregulated alternative investment funds such as RAIFs. However, in cases where unregulated alternative investment funds- such as RAIFs- qualify as ELTIFs and the CSSF is the competent authority under the applicable legislation, certain sections of the Circular will apply.

<sup>1</sup> The French version of the Circular can be accessed at: <https://www.cssf.lu/en/Document/circular-cssf-24-856/>

<sup>2</sup> An Undertaking for Collective Investment subject to Part II of the *Law of 17 December 2010 relating to undertakings for collective investment*.

<sup>3</sup> A Specialized Investment Fund withing the meaning of *the Law of 13 February 2007 relating to specialised investment funds*.

<sup>4</sup> “*Société d'Investissement en Capital à Risque*” which translates to “Investment Company in Risk Capital”. It is a type of investment company in Luxembourg designed for risk capital investments, often used for venture capital and private equity purposes.

<sup>5</sup> European Long Term Investment Fund.

<sup>6</sup> Money Market Fund is a type of mutual fund that invests in short-term, low-risk securities such as government bonds, treasury bills, and commercial paper.

<sup>7</sup> European Venture Capital Fund is a regulatory framework established by the European Union to encourage investment in small and medium-sized enterprises (SMEs) by facilitating the operation of venture capital funds.

<sup>8</sup> European Social Entrepreneurship Fund, similar to EuVECA, EuSEF is a regulatory framework developed by the European Union to support investment in social enterprises.

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## 1. Roles and Responsibilities

The Circular is addressed in particular to: (i) the governing body of the UCI or the AIFM, such as the board of directors, (ii) the AIFM (whether or not established in Luxembourg), (iii) the UCI administrator and (iv) the depositary.

According to the CSSF, it is primarily the responsibility of UCI managers or AIFM, to establish effective organizational measures to minimize errors or non-compliance within a UCI. Should errors or non-compliance occur despite preventive measures, these managers are obligated to adhere to the guidelines outlined in the Circular for addressing such issues. Additionally, they must ensure that arrangements with service providers involved in UCI operations are adequately structured according to the Circular's guidelines.

## 2. Types of Errors

The Circular expands the scope of errors beyond NAV calculation errors and investment rule breaches to other errors such as payment of costs/fees, swing pricing) that may occur.

- (i) Significant NAV calculation errors (Section 4 of the Circular)

The Circular outlines what constitutes a significant NAV calculation error by setting out the materiality thresholds and outlines the measures to be taken. Compared to Circular CSSF 02/77, new tolerance thresholds are defined. The different thresholds depend on the investment strategy of the UCI.

- (ii) Non-compliance with investment rules (Section 5 of the Circular)

The Circular introduces the concept of passive and active non-compliance and two correction methods.

- (iii) Incorrect application of swing pricing (Section 6.1 of the Circular)

In the case of errors relating to swing pricing and other anti-dilution measures, the UCI must be compensated for the losses caused by the error. According to the Circular, the UCI is only obliged to compensate investors for losses incurred upon subscription or redemption of units if the applicable materiality threshold has been exceeded.

- (i) Non-compliance with costs and charges (Section 6.2 of the Circular)

The Circular outlines that in the event that an UCI has paid an amount of costs/fees (e.g. to an AIFM, to service providers) that is too high compared to the amount provided for in the constitutive documents and/or the prospectus, this constitutes an error that must be corrected and for which the UCI must be compensated.

If the UCI has paid less fees or expenses than it should have paid, the Circular aims to protect investors from the late payment of these fees or expenses either by requiring the losses of the UCI to be borne

by the party causing the error or, if the amount is charged to the UCI, by recalculating the NAVs affected by the error without applying the materiality thresholds.

- (ii) Incorrect application of Cut-Off Periods (Section 6.3 of the Circular)

According to the Circular, investors should be compensated for damages caused by the incorrect application of Cut-Off Periods. The constitutional documents and/or the prospectus of a UCI open to subscriptions and/or redemptions specify the cut-off time limits and periods which apply to capital transactions which investors may carry out on the basis of a given NAV (“**Cut-Off Periods**”). If the Cut-Off Periods provided for in the constitutional documents and/or prospectus are not respected, subscription and/or redemption orders duly submitted by investors may be executed on the basis of a NAV which is earlier or later than the NAV which the investors would have obtained if the cut-off times provided for in the constitutional documents and/or prospectus had been respected.

- (iii) Investment allocation errors (Section 6.4 of the Circular)

The Circular furthermore describes errors that might occur in the allocation of UCI investments such as a security being allocated to a different compartment of the same umbrella, or operations being allocated to the wrong share classes. If the error negatively impacted the portfolio, the UCI, the relevant compartment or class must be indemnified for the damage caused by the wrong allocation.

### **3. Guidelines for Protecting Investors**

Implementation of these guidelines by UCIs, investment fund managers, and stakeholders will contribute to maintaining investor confidence in collective portfolio management and investment professionals operating in Luxembourg. The updated regime will enable CSSF to further develop risk-based supervision of UCIs.

### **4. Entry into Force**

Circular CSSF 24/856 comes into force on January 1, 2025, with Circular CSSF 02/77 being repealed. An English version of the circular will be published soon.