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UNIVERSIDADE D
COIMBRA

Katy Navega dos Santos

# INVESTMENT FUNDS IN LUXEMBOURG

**Relatório de Estágio no âmbito do Mestrado em Gestão orientado pelo Professor Doutor António José Marques Mendes e pelo Professor Doutor Bruno José Machado de Almeida e apresentado à Faculdade de Economia da Universidade de Coimbra.**

Julho de 2019

Faculdade de Economia da Universidade de Coimbra

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The delivery of this report and its presentation marks the culmination of five years of many experiences, knowledge and learning. As such, I would like to acknowledge and thank all the people that supported me on this amazing journey and who have contributed to make this period so exceptional.

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To all of you my sincere appreciation and gratitude!

You have to dream before your dreams can come true.

A.P.J. Abdul Kalam, *Inspiring Thoughts*.

# ABSTRACT

The following report is part of the Master's degree in Management in the Faculty of Economics of the University of Coimbra, and is related with the curricular internship at PricewaterhouseCoopers in Luxembourg, from the 1st of February to the 7th of June 2019.

The tasks executed in this multinational allowed me to work directly with Investment Funds and triggered my willingness to learn more about the Investment Fund industry, especially in Luxembourg. An Investment Fund is formed by the union of several investors who pool money together to make a financial investment, with the objective of obtaining an expected return. They permit to invest in hundreds of different securities, have low investment costs and have a professional management.

Luxembourg has a political and economic stability and a flexible regulatory framework. By distributing its funds over 70 countries and having achieved approximately 4,000 billion euros of net assets in 2018, Luxembourg is the largest investment center in Europe and the second in the world after the United States.

The objective of this report is to describe the legal structures and forms of Luxembourg's Investment Funds, to highlight the importance of this small country in the Investment fund Industry as well as to compare Luxembourg to its major competitor, Ireland, and to analyze the consequences of Brexit.

In the end, I address the curricular internship, describing the company and the tasks performed, as well as a critical analysis of the knowledge acquired and its relation to the theme chosen.

**Key words**: Investment Funds; Luxembourg; UCITS; Alternative Investment Funds; Brexit.

# RESUMO


O presente relatório foi elaborado como parte integrante do Mestrado em Gestão da Faculdade de Economia da Universidade de Coimbra, no âmbito do estágio curricular desenvolvido na PricewaterhouseCoopers no Luxemburgo, desde o dia 1 de Fevereiro até ao dia 7 de Junho 2019.

As tarefas executadas nesta multinacional permitiram-me o contacto direto com os fundos de investimento, pelo que, neste contexto, surgiu o interesse em aprender mais sobre a indústria dos fundos de investimento, especialmente no Luxemburgo. Um fundo de investimento é formado pela união de vários investidores que se juntam para a realização de um investimento financeiro, tendo como objetivo um retorno esperado. Permitem investir em centenas de títulos diferentes, têm baixos custos de investimento e uma gestão profissional.

Luxemburgo tem uma estabilidade política e económica e um quadro regulamentar flexível. Ao distribuir os seus fundos em mais de 70 países e ter alcançado aproximadamente 4,000 bilhões de euros de ativos líquidos em 2018, Luxemburgo é o maior centro de investimentos da Europa e o segundo a nível mundial depois dos Estados Unidos.

O objetivo deste relatório é descrever as estruturas legais e as formas dos fundos de investimento do Luxemburgo, destacar a importância deste pequeno país na indústria dos fundos de investimento, bem como comparar o Luxemburgo com o seu principal concorrente, a Irlanda, e analisar as consequências do Brexit.

Na parte final, é abordado o estágio curricular realizado, sendo feita uma descrição da entidade e das tarefas realizadas, bem como uma análise crítica aos conhecimentos adquiridos e a sua relação com o tema escolhido.



**Palavras-Chave:** Fundos de Investimento; Luxemburgo; OICVM; Fundos de Investimento Alternativos; Brexit.

# List of Abbreviations

A2C – Assurance to Clients

ABBL – *Association des Banques et Banquiers du Luxembourg*

AE – Audit Efficiency

AIF – Alternative Investment Funds

AIFM – Alternative Investment Fund Manager

AIFMD – Alternative Investment Fund Manager Directive

ALFI – Association of the Luxembourg Fund Industry

CAPS – Custody & Pricing Solutions

CCF – Common Contractual Fund

CLT – Country Leadership Team

CSSF - Commission for the Supervision of the Financial Sector

D4U – Data for you

EC – European Commission

ECB – European Central Bank

EFC – European Fund Classification

ETF – Exchange Traded Funds

EU – European Union

EY – Ernst and Young

FCP – *Fonds Commun de placement*

FRS – Financial Reporting Services

G20 – Group of Twenty

GP – General Partner

ICAV – Irish Collective Asset-Management Vehicle

IFRS – International Financial Reporting Standards

IPO – Initial Public Offering

KIID – Key Investor Information Document

KPMG – Klynveld Peat Marwick Goerdeler

Lux GAAP – Luxembourg Generally Accepted Accounting Principles

ManCo – Management Company

NAV – Net Asset Value

OECD – Organization for Economic Co-operation and Development

OICVM – *Organismos de Investimento Coletivo em Valores Mobiliários*

PwC – PricewaterhouseCoopers

QIAIF – Qualifying Investor Alternative Investment Funds

RAIF – Reserved Alternative Investment Fund

RIAIF – Retail Investor Alternative Investment Funds

SA – Public Limited Company

SARL – Private limited company

SCA – Partnership Limited by Shares

SCOSA – Co-operative in the form of the Public Limited Company

SCS – Limited partnerships

SCSp – Special Limited Partnership

SFTR – Securities Financing Transactions Regulation

SICAF – *Société d'Investissement à Capital Fixe*

SICAR – *Société d'Investissement en Capital à Risque*

SICAV – *Société d'Investissement à Capital Variable*

SIF – Specialized Investment Fund

SNA – Statement of Net Assets

SNC – Unlimited company

SOP – Statement of Operations

SRRI – Synthetic risk and reward indicator

UCI – Undertaking for Collective Investment

UCITS – Undertakings for the Collective Investment in Transferable Securities

VAT – Value Added Tax

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# INTRODUCTION

This report represents the culmination of my academic career in order to obtain my Master's degree in Management. The curricular internship is one of the three ways for a student to complete his graduation's degree from the Faculty of Economics of the University of Coimbra.

Having chosen to complete a curricular internship in the audit area, the challenge was to find an organization that would allow me to grow, both professionally and personally, and thus constitute an opportunity to develop, enrich and practice the knowledge acquired during my academic course.

The Internship took place at PwC (PricewaterhouseCoopers) in Luxembourg with a duration of four months. PwC develops its activity in the areas of Audit, Advisory and Tax and is the largest professional services firm in Luxembourg. As my major function during the internship was the quality review of Investment Funds, I decided to deepen the knowledge obtained and describe the legal structures of Luxembourg's Investment Funds as well as the importance and the role of Luxembourg in this industry. I could have opted to study the Investment Funds available in Portugal, but I decided to focus on Luxembourg because of Luxembourg being the largest Investment center in Europe and because of having completed my internship there.

An Investment Fund (or Undertaking for Collective Investment) is the collective holding of financial assets. The fund is then managed by a team of specialists and invested in equities, bonds and other investment products. Both institutional investors and individuals can invest in a fund and it permits to diversify their portfolio. Luxembourg made it very early to one of the major financial centers worldwide due to its strategic location at the heart of Europe and is today the second largest investment center in the world after the United states.

This internship report is structured into four main chapters, with each of them containing several sub-chapters. The first chapter of this report includes some definitions of Investment Funds from different authors and institutions, it also introduces the first Investment Fund in history as well as the benefits of investing in Funds and finishes with statistical figures in the Euro Area.

The second chapter of the report explains Luxembourg's fund regimes and the legal forms, it also introduces the different Fund structuring options and the regulatory administrative requirements. The third chapter includes a comparison with Luxembourg's direct competitor, Ireland, and the consequences of Brexit in this industry. The last chapter includes a description of the host entity, referring to the historical part of PwC, the services provided and the organizational structure. This part also approaches the main activities developed during the internship and contains a critical analysis of the internship. This report ends with a conclusion on the theme chosen.

# CHAPTER I: INVESTMENT FUNDS

## 1.1. Definition of Investment Funds

Giles, Alexeeva & Buxton (2003) define a fund as:

> … a pool of money contributed by a range of investors who may be individuals or companies or other organizations, which is managed and invested as a whole, on behalf of those investors. Generically such funds are sometimes known as "collective investments" since they collect people's money together (Giles et al., 2003: xvii).

Barger & Irving (1996) define a fund as:

> Funds, also known as collective investment vehicles, are financial structures for pooling and managing the monies of multiple investors. Investors cede significant control over their money to professional managers, who in turn buy either listed securities or private equity stakes in firms (Barger & Irving, 1996: 8).

The Regulation defines an Investment fund as "a collective investment undertaking that invests in financial and non-financial assets, to the extent that its objective is investing capital raised from the public" (ECB, 2007: 4).

To be qualified as an Investment fund however, an investment undertaking must be "collective". Therefore, the European Central Banks states that "an investment undertaking is considered a collective investment undertaking if the document which establishes the undertaking allows for investments from more than one investor" (ECB, 2007: 4).

During the past few decades the collective investment funds have been growing in terms of financial intermediation. As indicated by the OECD (Organization for Economic Co-operation and Development) data, the investment funds assets have been risen strongly as a share of national income and as a share of financial assets in most European countries (OECD, 2005).

The Authors of the 2010 Act defined the UCI (Undertakings for Collective Investment) based on three criteria. A UCI is an investment structure:

> 1) Whose funds have been raised from the public, and are used for collective investment;
>
> 2) The exclusive object of which is the collective investment of savings;
>
> 3) Which invests in assets (transferable securities or other assets) and operates in accordance with the principle of risk- spreading (Kremer & Lebbe, 2014: 1).

While the first of these criteria, the raising of funds from the public, may be dispensed in certain conditions determined by the law, the second and the third ones must always be met.

When the public raises capital it means that, it was raised from a group of investors beyond a “small circle of persons” (Kremer & Lebbe, 2014). The collective investment of savings is defined as the common investment from this group of investors; they may invest in transferable securities or other assets (Kremer & Lebbe, 2014). Finally, the principle of risk spreading prevents the excessive concentration of a UCI’s investments and reduces investment risk (Kremer & Lebbe, 2014).

Since Investment funds are financial intermediaries they perform two main functions.

First, they allow investors to buy securities of companies that they could otherwise not buy because of many factors such as transaction costs, legal restrictions or lack of competence (Barger & Irving, 1996). It gives them the opportunity to invest in a diversified pool of assets with a single purchase of shares or units, to achieve better liquidity and to obtain professional management at a reasonable cost (Barger & Irving, 1996).

Secondly, Investment funds are also a source of funding to entities such as banks or corporations. Firms need external debt and equity financing to grow and invest after they have spent their internal sources (Barger & Irving, 1996).

As Carroll, Kays & Smith (2011) state in their book, the investment industry attracts attention because investment funds are everywhere:

> governments around the world will finance their national economies by selling bonds to bond funds; large financial institutions will enter trades with money market funds; people’s pensions will be invested in equity funds; the shopping centers and malls that people visit to buy everyday goods are often held by real estate funds; the companies where people work may be owned by private equity funds (Carroll et al.,2011: v).

Ultimately, Investment funds are investment products that were created with the intention of collecting investor’s capital and investing it through a portfolio of financial instruments such as stocks, bonds and other securities (EC, n.d).

They are investment solutions for individuals and act as important economical intermediators between investment and savings which makes the investment fund sector highly relevant, economically and socially (Hazenberg, 2012).

## 1.2. First investment fund in history

The history of the investment fund dates back to the second half of the eighteenth century. At that time, the economic situation did not look bright and began with the bankruptcy of the Ayr Bank in Great Britain. This pulled the Dutch Bank Clifford & Co to bankruptcy too and resulted in a crisis that continued to spread.

Amsterdam broker, Abraham van Ketwich, launched in this context a fund in 1774 in the Dutch Republic under the name “Eendragt Maakt Magt” (“unity makes power”).

His objective was to reduce the risk for individual investors through diversification. He defended that the diversification would increase the interests to invest of small investors who owned smaller amounts of money (Hazenberg, 2012).

The diversification rules were established in the offering document by mentioning “ten different categories of bonds across which the investments had to be spread” (Hazenberg, 2012: 16). Those categories consisted of bonds from Austria, Denmark, German Kingdoms, Spain, Sweden, Russia Latin America and the West Indies (Hazenberg, 2012).

To prevent the risk of conflict of interests, Abraham van Ketwich did only the administration of the fund and let two commissioners manage the fund. The fund was structured as a closed end fund but to provide liquidity the shares were traded on the Amsterdam stock exchange. However, due to the Fourth Anglo-Dutch War and to political revolutions in Europe, the fund was not successful and was put into liquidation in 1824.

## 1.3. Benefits of Investment Funds

According to Giles et al. (2003) there are mainly four reasons why investors should invest in funds.

First, by investing in funds, individuals reduce the risk through diversification. If the investors were buying securities directly, it would be difficult to buy holdings in several companies. Moreover, putting their money in only one company does not diversify their risk because if that company goes bankrupt, they loose all their money. So, investing in funds reduces risk because funds generally invest in twenty or more different investments which reduces the systematic risk and the specific risk (Giles et al., 2003). Consequently, a diversified portfolio can obtain good results even if some shares register losses. This reduction of risk through diversification is called risk-spreading (Giles et al., 2003).

Secondly, investing in Investment funds reduces costs through economies of scale. The authors state:

> The individual investor's transactions costs on small purchases or sales are typically much higher as a percentage of the value of each transaction than those for institutional investors dealing in large quantities such as funds. The extent of the cost advantage this gives the fund, will depend on the time for which the investment is held, the extent to which a portfolio is subject to changes, and the total charges levied by the fund (Giles et al., 2003: 6).

Again, diversification is necessary to reduce risk and the greater the diversification the greater will be the transaction costs and the greater will be the advantage of holding an Investment fund with its economies of scale (Giles et al., 2003).

The third benefit of investing in Investment funds is the professional management. Most of the investors don't have the time, skills and expertise to manage their investments. They therefore prefer to elect professional and competent investment fund managers. These managers try to outperform the market, monitor and restructure the portfolio to reach financial goals (Giles et al., 2003).

Finally, investor protection is another advantage of investing in Investment funds. There is a large and extensive regulatory framework in place to safeguard investors (Angela, n.d.). Each investor possesses the prospectus of the fund insuring a high degree of transparency. Investment funds need to respect the laws and the strict rules imposed by the supervision authorities. Moreover, the legal structure and the strict regulations that govern the investment funds permit a very large protection against the fraud and the illegal financial practices (Angela, n.d.).

Furthermore, Hazenberg (2012) defines other benefits of investing in Investment funds such as:

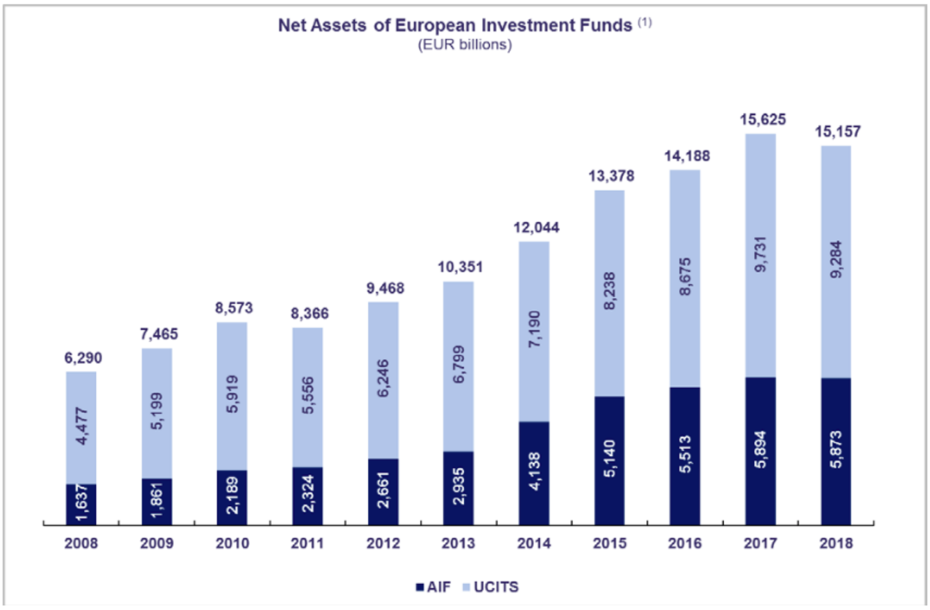
> - "Wide choice, as a result of which it is possible to find funds meeting individual needs and preferences;
> - Flexibility to increase or reduce exposure to certain asset classes;
> - Access to markets that are otherwise not accessible or difficult to invest in;
> - Tax benefits of certain types of fund investments, compared to direct investments;
> - Liquidity" (Hazenberg, 2012: 22).

## 1.4. Statistics

Investment funds are an important part of the euro area financial sector. The investment fund sector has recorded high levels of wealth gains the last years but there were two financial crises. The first one, the "Dot.com crises" in 2011 and the second was in 2007 that had a higher impact. It took approximately eight years for the value of investment fund holdings to reach its pre-crisis level (Euro Area Statistics, 2017).

The European asset management industry had a difficult year in 2018. As shown in figure 1, there was a decrease in the net assets of UCITS (Undertakings for the Collective Investment in Transferable securities) and AIFs (Alternative Investment Funds), from EUR 15,625 billion at the end of 2017 to EUR 15,157 billion at the end of 2018. This was caused by the extreme decrease of the world stock markets (EFAMA, 2019).

*Figure 1: Net Assets of European Investment Funds in billions of euros*




Source: EFAMA. (2019). Trends in the European Investment Fund Industry in the Fourth Quarter of 2018 & Results for the full year of 2018. *Quarterly Statistical Release- March 2019,* n-76. P.3.

Table 1 shows the aggregated national balance sheet of Investment funds in the Euro Area as at June 2019 in billions of euros. Luxembourg recorded more than EUR 4,500 billion in net assets and is therefore the largest investment center in Europe followed by Ireland ( EUR 2,584.7 billion), Germany (EUR 2,341.0 billion) and France (EUR 1,453.6 billion).

*Table 1: Aggregated national balance sheet of euro area Investment funds in billions of euros as at June 2019*

| **Country** | **Assets in EUR billions** |
|---|---|
| Belgium | 170.5 |
| Germany | 2,341.0 |
| Estonia | 1.1 |
| Ireland | 2,584.7 |
| Greece | 6.4 |
| Spain | 303.6 |
| France | 1,453.6 |
| Italy | 389.1 |
| Cyprus | 5.2 |
| Latvia | 0.4 |
| Lithuania | 1.2 |
| Luxembourg | 4,566.2 |
| Malta | 19.7 |
| Netherlands | 905.5 |
| Austria | 183.4 |
| Portugal | 29.0 |
| Slovenia | 2.7 |
| Slovakia | 7.0 |
| Finland | 132.6 |
| Euro Area Total | 13,102.9 |

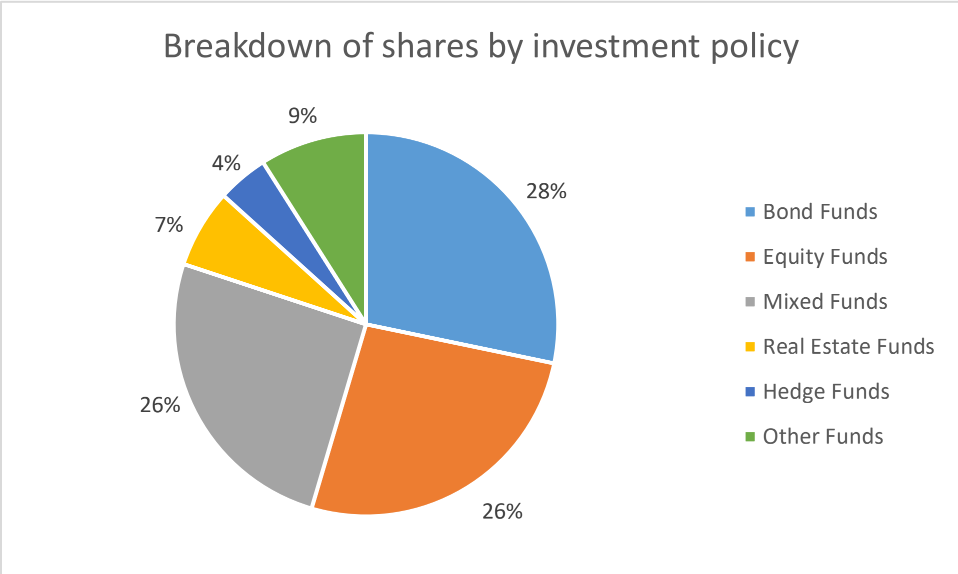
Source: Performed by the author based on the data available on ECB. (2019a). Aggregated national balance sheets of euro area Investment Funds.

The European and national statistics on Investment funds can be classified under six categories, as represented in figure 2, according to the investment policy. These are equity funds, bond funds, mixed funds, real estate funds, hedge funds and other funds. Each sub-category is further broken down to distinguish between open-end and closed-end funds[I] (Euro Area Statistics, 2017).

[I] Please note that these concepts will be explained in detail in sections 2.3, 2.4.6 and 2.8.1.

At the end of December 2018, bond funds accounted for the largest percentage of investment fund shares in the euro area (28%), followed by mixed funds and equity funds (both with 26%), other funds (9%), real estate funds (7%) and hedge funds (4%) (ECB, 2019b).

*Figure 2: Euro Area Investment Funds, breakdown of shares by investment policy as at December 2018.*



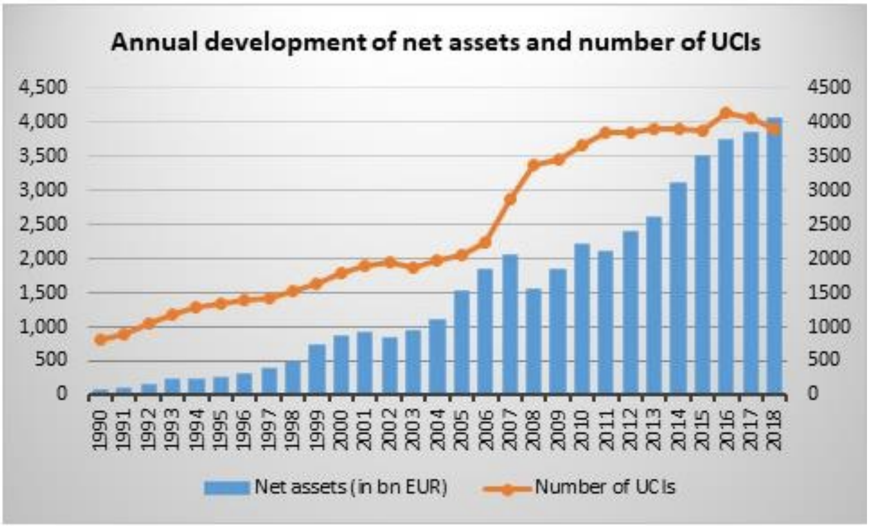

Source: Performed by the author based on the data available on ECB. (2019b). Breakdown by investment policy.

# CHAPTER II: INVESTMENT FUNDS IN LUXEMBOURG

## 2.1. Why Luxembourg?

Luxembourg is the largest Investment fund center in Europe and the second largest in the world after the United States. With its funds offered in more than 70 countries it is also the largest global distribution center for Investment funds. As shown in figure 3, Luxembourg recorded more than EUR 4,000 billion in net assets and had approximately 4,000 Undertakings for Collective Investments in 2018.

*Figure 3: Annual development of net assets and number of UCIs*




Source: CSSF. (2018). Development of Net Assets and Number of UCIs.

As Camille Thommes, General Director of ALFI (Association of the Luxembourg Fund Industry) states: “Luxembourg built these strong positions in the global Investment fund industry based on three concepts: international orientation, excellence and stability” (ALFI, 2017: 3).

Even though Luxembourg is a small country with a limited national market it was a founding member of the European Union and is also a member of most of the principal international organizations. Luxembourg made it very early to one of the major financial centers worldwide due to its strategic location at the heart of Europe and of its openness towards cross-border integration (ALFI, 2017). It has a political and economic stability and a regulatory framework that offers flexible products designed for specific markets and clients’ needs. Moreover, it is a multilingual and multicultural financial center, with a long tradition of financial expertise and a large knowledge of the needs of international clients (ALFI, 2014b).

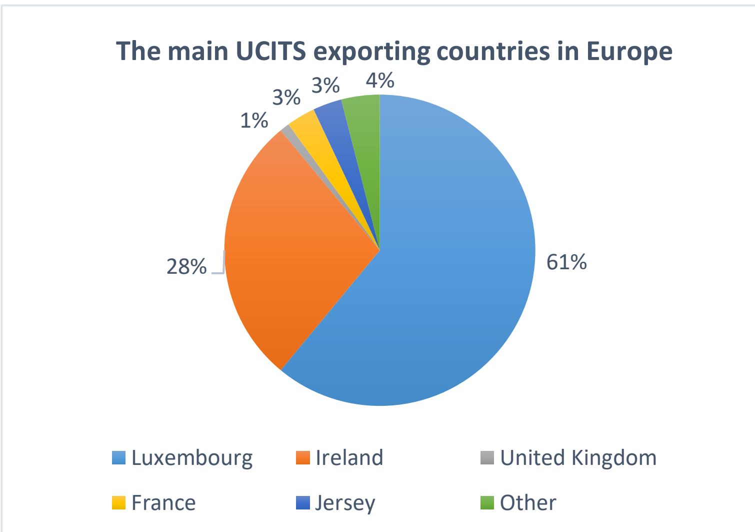
Luxembourg was always capable of "balancing its budgets, in limiting its public debt and in preserving the highest ratings" (ALFI, 2014a: 7). Taxes are the major revenues that allow the State to function. The financial center contributes around one third of the Luxembourg State budget (ALFI, 2014a).

Altogether the success of Luxembourg consists in its competency in most of the sectors. Apart from having a highly diversified banking sector (wealth management, corporate, commercial and depositary banking) and being the European leader in the Investment fund industry Luxembourg has also an important position in insurance and reinsurance, capital markets and in sustainable finance (ALFI, 2014a). The core strengths of Luxembourg are that it is well regulated, stable, diversified and international (ALFI, 2014a). Annex I shows ten reasons why the fund industry chooses Luxembourg according to ALFI.

In the mid-1980s by anticipating again a new opportunity, Luxembourg was once more a pioneer and was the first country to implement the UCITS Directive into national law. This caused promoters to go to Luxembourg to create UCITS Investment funds and to distribute them from there. With this Directive, Luxembourg initiated to market funds across the EU (European Union) and later across the globe (ALFI, 2014a). This is why today Luxembourg is the world's second largest Investment fund center after the United States, and the global leader in terms of offering cross-border funds (ALFI, 2014a).

Currently, as shown in figure 4, 61% of all UCITS registered in at least 3 countries are Luxembourg funds.

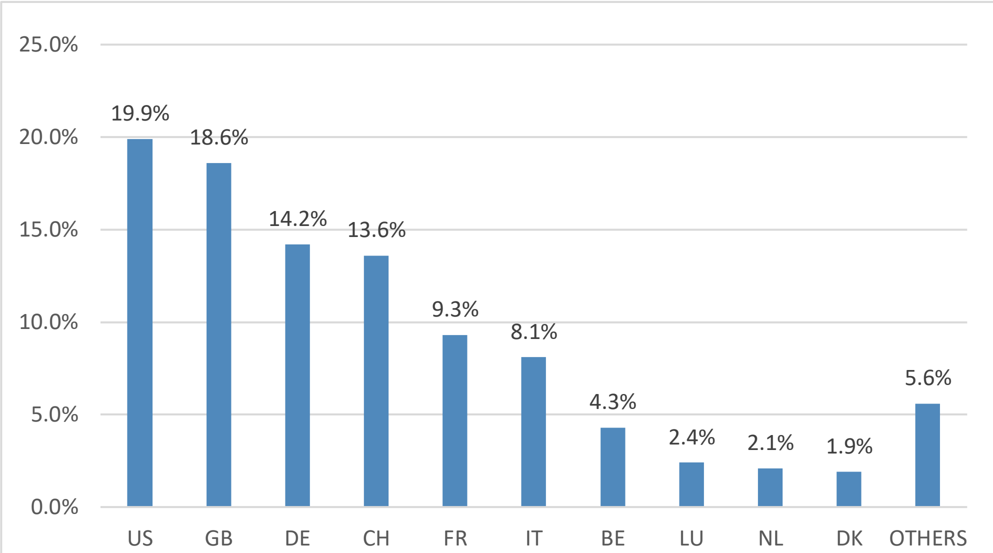
*Figure 4: The main UCITS exporting countries in Europe*




Source: Performed by the author based on PwC (2019b). *Global Fund Distribution.*

Not only was Luxembourg a pioneer with the introduction of the UCITS Directive it also became a growing center for Alternative Investment Funds with the introduction of the Specialized Fund regime. Indeed, the introduction of the EU Alternative Investment Management Directive in 2013 boosted the development of hedge funds, real estate funds and private equity funds. Figure 5 shows Market share (in %) of fund initiators' home countries in terms of assets under management.

*Figure 5: Market share of fund initiator's home countries in terms of assets under management*




Source: Performed by the author based on CSSF. (2019c). Origin of UCI initiators in Luxembourg.

Asset managers from all over the world use Luxembourg as their gateway to the European and the global investment fund market. By basing their funds in Luxembourg, they benefit from the country's reputation as a well-regulated and supervised financial center, and this facilitates global fund distribution. Today, Fund initiators from the United States and the United Kingdom have the highest market shares in terms of assets under management.

## 2.2. Luxembourg’s fund regimes

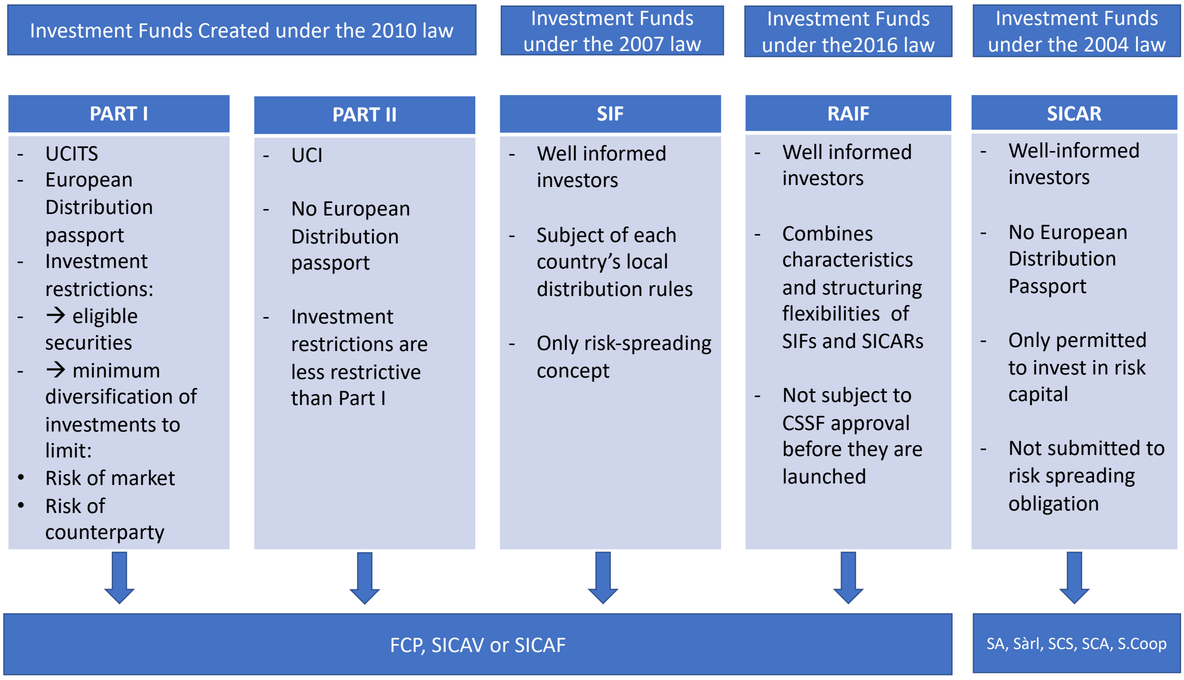
This section introduces the structure of Luxembourg’s Investment funds. These can be regulated on the basis of the Law of 17 December 2010, called the 2010 Law. This law differentiates between Part I that are the Undertakings for Collective Investment in Transferable Securities, the UCITS, and the second part of the Law the Undertakings for Collective Investments. The investment possibilities of UCIs are wider than for UCITS and can include Alternative Investments, such as hedge funds, private equities and real estates. Since UCIs do not benefit from an European passport they can only market their units in the EU and other countries outside of Luxembourg and are therefore subject to the supervision of these countries.

In 2004 and 2007 respectively Luxembourg created the Investment Company in Risk Capital (SICAR- *Société d’Investissement en Capital à Risque*) and the Specialized Investment Fund (SIF) in anticipation of a changing regulatory environment for Alternative Investment Funds. An additional and complementary Alternative Investment Fund regime was introduced in 2016, which is similar to the SIF and the SICAR, the so-called Reserved Alternative Investment Fund (RAIF).

Part I and Part II of the 2010 Law, the SIFs and the RAIFs can be structured in two forms. The first one is the contractual form as a common fund (FCP- *Fonds Commun de Placement*) that is a co-proprietorship whose joint owners are only liable up to the amount they have contributed. The FCP does not have a legal personality and must be managed by a Luxembourg management company. The second is the corporate form as an investment company that can be managed by its Board of Directors. An investment company can have a variable capital (SICAV-*Société d’Investissement à Capital Variable*) or a fixed capital (SICAF-*Société d’Investissement à Capital Fixe*).

Figure 6 summarizes the different types of Investment Funds available in Luxembourg with some of their specificities and characteristics.

*Figure 6: Summary of Luxembourg Fund regimes*




Source: Compiled by the author

Figures 7 and 8 show the breakdown of Luxembourg Investment Funds according to the legal form and part applicable. As at 31 March 2019, the Grand Duchy of Luxembourg had 3,868 Investment funds (table 2); of which 1,805 (47%) were funds governed by Part I of the Law and 2,063 (53%) by Alternative Investment Funds, divided into the three subcategories Part II (7%), SIF (39%) and SICAR (7%). Among these 3,868 Investment funds, there were 2,151 SICAV (56%), 1,406 FCP (36%), 269 SICAR (7%), and 43 other UCI / SIF (1%).

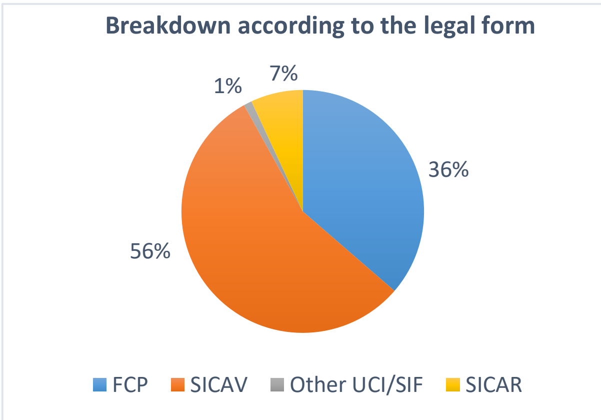
As for the distribution in legal form, the SICAV is the legal form that dominates the sector, in terms of the amount of funds raised and mostly in terms of net assets held. As for the distribution according to the law to which the Investment fund is subject, it is the funds subject to Part I that prevail with little advance on Specialized Investment funds.

*Table 2: Number of Investment Funds by Law and Legal Form as at March 2019*

| **Law/ Part/ Legal Form** | **FCP** | **SICAV** | **Other UCI/SIF** | **SICAR** | **TOTAL** |
|---|---|---|---|---|---|
| **Part I (2010 Law)** | 939 | 866 | 0 | 0 | 1805 |
| **Part II (2010 Law)** | 145 | 144 | 2 | 0 | 291 |
| **SIF** | 322 | 1141 | 40 | 0 | 1503 |
| **SICAR** | 0 | 0 | 0 | 269 | 269 |
| **TOTAL** | 1406 | 2151 | 42 | 29 | 3868 |

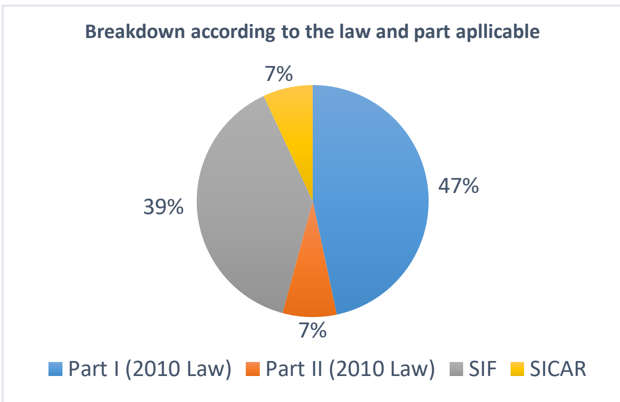
Source: Compiled by the author based on CSSF. (2019b). Number of UCIs.

*Figure 7: Breakdown according to the legal form as at March 2019*




Source: Calculated by the author based on the data available on CSSF. (2019b). Number of UCIs.

*Figure 8: Breakdown according to the law and part applicable as at March 2018*




Source: Calculated by the author based on the data available on CSSF. (2019b). Number of UCIs.

### 2.2.1 Two important entities

Before beginning with the descriptions of Luxembourg's Investment Funds, it is important to introduce two important entities, the Commission for the Supervision of the Financial Sector (CSSF) and the Association of the Luxembourg Fund Industry (ALFI).

#### 2.2.1.1 The CSSF

The « Commission de Surveillance du Secteur Financier » (CSSF) is the Luxembourg regulatory authority which supervises all Luxembourg registered funds. It is a public law body established with legal status by the Luxembourg state.

Its mission is "to control the professionals and products of the Luxembourg financial sector. It supervises, regulates, authorizes, informs and, if necessary sanctions" (CSSF n.d.).

The CSSF controls the UCIs that are established and marketed in Luxembourg, it also supervises management companies as well as the surveillance of the AIFMs once transposed into Luxembourg Law. Its function and engagement depend on whether the UCI's are based in Luxembourg or not and if they have an European passport.

Generally speaking, the CSSF promotes transparency and fairness in the financial products and services, protects the final consumers and fights against money laundering and the financing terrorism.

#### 2.2.1.2 ALFI

The Association of the Luxembourg Fund Industry (ALFI) was founded in 1988 with the purpose to represent the Luxembourg investment fund community. ALFI defines its mission as to "Lead industry efforts to make Luxembourg the most attractive international center" (ALFI, 2014c: 28). Its main objective is to help members capitalize on industry trends, shape regulation, foster dedication to professional standards and quality and to promote the Luxembourg investment fund industry (ALFI, 2014c).

In September 2009 ALFI issued the ALFI Code of Conduct for Luxembourg Investment Funds hereafter the "ALFI Code" which targets especially the role of fund Boards and gives them principles and recommendations for the administration of Luxembourg investment funds. Today, ALFI serves over 1,500 Luxembourg domiciled investment funds, asset management companies and a large range of service providers such as depositary banks, transfer agents, distributors, law firms, accountants and auditors.

## 2.3. UCITS - Part I of the Law of 17 December 2010

UCITS stands for several European Union Directives that created a uniform and regulatory regime for the creation, management and marketing of collective investment vehicles in the EU. UCITS is the acronym of Undertakings for Collective Investment in Transferable Securities and they typically invest in securities listed on public stock exchange and regulated markets (ALFI, n.d.b).

The UCITS Directive was adopted in 1985 with the objective to harmonize the European Union's national laws, to facilitate cross border activities and thereby the creation of a single market for financial services in Europe (Hazenberg, 2013). The Directive established coordinated rules for the Investment funds and their management companies. The EU Member States had then the obligation to transpose the Directive into their national law. On 30 March 1988, Luxembourg was the First Member State to transpose the Directive (Hazenberg, 2013).

Before the introduction of the UCITS Directive, investors were limited to funds only offered in their home countries. Today, investors can invest in any fund that was registered for sale in their country and benefit from a high-level of protection. Investment funds that operate within this regime can be offered all over the EU, the fund has therefore an European passport. The Directive also determines the key features of the funds such as their permitted legal forms, investment and borrowing rules, liquidity requirements, prospectus disclosures and the rules related to annual and semiannual reporting (Kremer & Lebbe, 2014).

Finally, the last amendment of the UCITS Directive was on 28 August 2014. Since 10 May 2016, UCITS V Directive is in place in Luxembourg, thereby implementing Directive 2014/91/EU into the Luxembourg Law. UCITS V brought changes in terms of the duties and liabilities of depositaries of UCITS, remuneration policies of UCITS management companies and the sanctions that the CSSF is empowered to apply (ABBL, n.d.)

Table 3 shows the different requirements and characteristics of an Investment fund under Part I of the 2010 Law.

*Table 3: Characteristics of Investment Funds under Part I*

| | |
|---|---|
| **Eligible investors** | No restriction on the type of investors authorized: they can be sold to the public but also to corporations and institutions. |
| **Authorization** | A UCITS must be authorized by the CSSF before it can start its activities and provide a series of documents and specific information to the CSSF. |
| **Capital requirement** | The net assets for a FCP and for a SICAV/SICAF may not be less than EUR 1,250,000 and must be obtained within six months of authorization. The minimum capital of a self-managed SICAV/SICAF may not be less than EUR 300,000 at the date of authorization. |
| **Central administration** | The central administration must be established in the EU: a Luxembourg UCITS can be managed by a Luxembourg management company or by a management company based in another EU Member State. |
| **Service providers in Luxembourg** | A UCITS set up under Luxembourg law must appoint external auditors and a Luxembourg depositary, which is among other things responsible for the safekeeping of the fund's assets. |
| **Remuneration** | UCITS management companies must put in place remuneration policies and practices for senior management and persons whose professional activities have a material impact on the risk profile of the management company or the UCITS. |
| **Net Asset Value (NAV)** | The fund's NAV must be calculated at least twice a month. |
| **Documents to be established according to laws and regulations** | • Prospectus<br>• Key Investor Information Document (KIID)<br>• Agreements with service providers<br>• Annual audited financial statements<br>• Semi-annual non-audited financial statements<br>• Long Form Report<br>• Description of the risk management procedure |

Sources: ALFI (2018a). *Luxembourg Investment Vehicles: An overview of the legal and regulatory requirements*. P.12-47 and ALFI. (n.d.b). UCITS.

### 2.3.1 Traditional Investment Funds under UCITS

The EFC (European Fund Classification) is a pan-European classification system of Investment funds and classifies four traditional investment funds. These are bond funds, money market funds, equity funds and mixed funds.

#### 2.3.1.1 Bond funds

Lohr defines a bond as: “A bond is a financial product that is used to raise capital for the issuer and earn income for the holder” (Lohr, 2017: 1). The issuer pays interest on the bond at specified intervals and then repays the amount borrowed, on a specified maturity date. There are a wide variety of bonds issued in the global marketplace but the two most common are corporate bonds and government bonds.

The author explains: “Corporate bonds are issued by private companies and are usually fully taxable and secured by a combination of revenues and assets. On the other hand, Government bonds are used to finance public infrastructure, defense, and the full spectrum of government spending” (Lohr, 2017: 1).

Bond funds invest 90 percent of their assets in fixed income securities. Investment in cash and other assets should not exceed 10 percent. Moreover, no equity exposure is allowed (EFAMA, 2008). Bond funds generally pay a higher return than money market funds and their risk is usually lower than that of equity funds. Although a bond is considered a relatively low risk investment, a change in interest rates may result in a decrease in market value. In addition, bonds with particularly attractive yields issued by, for example, governments or companies in developing markets or by companies with low credit ratings present a higher risk of default on the payment of interest or repayment of the initial investment.

#### 2.3.1.2 Money Market Funds

Pan (2008) defines a money market fund as: “a type of mutual fund that invests in low-risk and highly liquid short-term assets such as Treasury bills, bank certificates of deposit, repurchase agreements, and commercial paper. An attractive feature of this type of fund is a constant share price of $1” (Pan, 2008: 20).

Money market funds are generally considered to be safe investment instruments. The explanation for their reputation is their maintenance of $1 NAV (Net Asset Value). Investors expect to purchase shares of money market funds at a stable NAV, generally $1.00 per share. This provides benefits and simplicity in terms of its tax, accounting, and recordkeeping treatment (Brennan, 2009). The excess earning produced through the interest rates on the portfolio holding is distributed to the investors in the form of dividend. Money market funds have low risk but also low-return investment and are therefore not suited for long-term investment goals because they don't offer much capital appreciation (Brennan, 2009).

#### 2.3.1.3 Equity Funds

An equity fund, also called stock fund is a fund that invests in stocks (equities securities). The objective of an equity fund is not only to collect dividends but also the long-term growth through capital appreciation. Since equity funds are exposed to variations in share prices, they are usually more volatile than fixed income funds and mixed funds. They offer to investors higher potential returns but also with higher levels of risk. Equity funds can be actively managed through stock selection and asset allocation or designed to replicate a specific stock index.

According to the EFC an equity fund must invest at least 85% of its assets in equities. The range of assets in which equity funds can invest is very large, which is why each fund will select assets according to three major criteria. They may invest according to the country or region, according to a specific sector such as energy, utilities, financials, healthcare etc., or according to market capitalization (Ernst & Young, 2017).

One of the main advantages of holding stock funds is diversification. Stock funds own many individual stocks across different industries which diminishes the chances that the execution of one single stock or industry impacts the performance of the whole portfolio (Fidelity, n.d.). Not only that, stock funds also offer presentation to the world's biggest value market and this provides to the investors the possibility to possess shares in the most successful organizations (Fidelity, n.d.).

However, there are also a few dangers related to equity funds. One of them is that the performance of each stock fund is dictated by the performance of its stock holdings. In this way, when stocks decrease in price, the value of the investment in the fund will go down in price too so if the investors decide to sell the fund when stock prices are low, they may loose money (Fidelity, n.d.).

#### 2.3.1.4Mixed Funds

Mixed funds, also called multi-asset funds, are defined by the ECB (European Central Bank) as “Investment funds investing in both equity and bonds with no prevalent policy in favor of one or the other instrument” (ECB, 2009: 7).

The main characteristic of mixed funds is that they offer investors exposure to a broader range of assets, sectors, strategies and direct investment exposures (e.g. individual securities, bonds) with greater flexibility (Russel Investments, n.d.).

Through their diversified portfolio allocation, mixed funds permit to investors to also be positioned in the equity markets but with more moderate overall risk and return features (ECB, 2007). Since bond markets are uncertain in terms of the development of interest rates, the investment strategies proposed by mixed funds have therefore become highly interesting to investors (ECB, 2007).

### 2.3.2 Other types of UCITS Funds

#### 2.3.2.1 Exchange Traded Funds

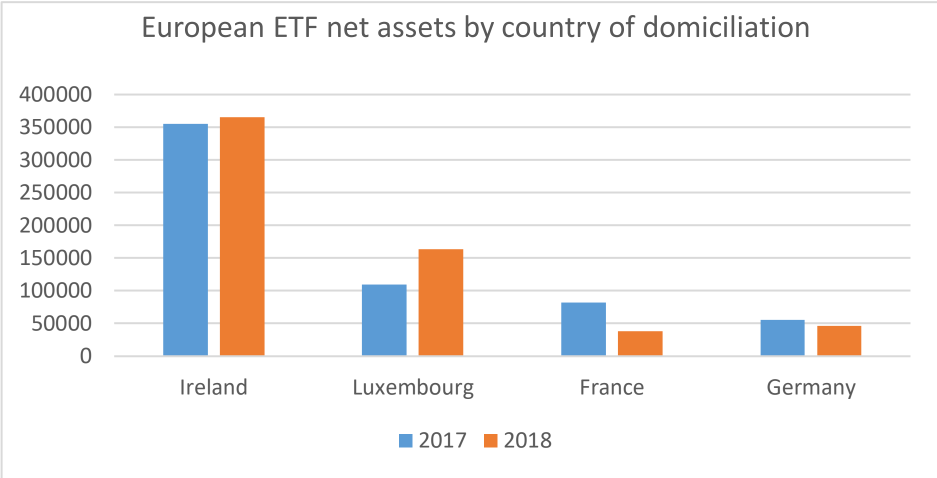
Exchange traded funds are index funds that invest in a basket of securities or commodities with the objective of “replicating the performance of their benchmark indices as closely as possible” (Deville, 2008: 2).

They are listed on the stock exchange which causes their price to vary throughout the day. The benefits of this type of investment funds are the lower costs, tax efficiency and transparency (Deville, 2008). Moreover, ETFs have a passive management. Funds managers intervene very little and are limited to administrative tasks since they don’t develop any strategy to outperform the index. This causes to low management fees and makes ETFs very attractive to investors.

It can be said that ETFs combine advantages of stocks (tradability and liquidity) and of index funds (low costs and diversification) into one product.

As shown in Figure 9, Luxembourg is the second largest domicile for ETFs in Europe after Ireland and has been experiencing impressive growth rates.

*Figure 9: European ETF net assets by country of domiciliation in millions of euros*




Source: Performed by the author based on ALFI. (2019). *Luxembourg your international ETF hub.*

### 2.3.2.2Lifecycle funds

Lifecycle funds, also called target funds, have the characteristic to accompany the lifecycle of their investors and to meet investors' changing needs and risk profiles as they get older. At the beginning, Lifecycle funds invest in funds or assets with high risk and return ratio, such as equities and then move their asset allocation towards a more balanced portfolio of assets by increasing the proportion of fixed-income securities to end with more cautious and conservative funds. Pfau (n.d.) states: "The lifecycle asset allocation strategy involves allocating a high proportion of one's assets to equities during the early period far away from the target date, and gradually shifting to more conservative assets, such as bonds and bills, as the target date approaches" (Pfau, n.d.: 2)

### 2.3.2.3 Guaranteed funds

Guaranteed funds are generally long-term investments and are suitable for cautious investors. Dempster et al. (2007) affirm: "The main feature of these products is a minimum guaranteed return together with exposure to the upside movements of the market" (Dempster et al., 2007: 245).

The income generated from the fund is guaranteed at maturity and therefore offers partial or full capital protection. However, a guaranteed fund implies a formal guarantee from the management company issuing the fund or from a third party, such as a bank or insurance company

#### 2.3.2.4 Funds of funds

"A fund of funds holds a portfolio of other investment funds, providing the investor with an alternative to investing directly into the underlying individual funds" (Matheson, 2018: 28). A fund of funds invests in several other investment funds instead of investing directly in financial assets like shares or bonds. Funds of funds can allocate their assets to diverse funds or geographical fund strategies while others focus on just one or two. This way, funds of funds offer a way of increasing diversification and a way of gaining access to a wider range of fund management skills and specialization through a single investment.

## 2.4. Alternative Investment Funds

Kremer & Leber (2014) define Alternative Investment Funds as: "An Alternative Investment Fund is an Investment Fund other than a UCITS which rises capital from a certain number of investors with a view of investing it in the interests of these investors, in accordance with a defined investment policy" (Kremer & Lebbe, 2014: 2).

In Luxembourg, Part II of the 2010 Law, SIFs, SICARs, RAIFs and non-regulated investment vehicles can be qualified as AIFs.

The Luxembourg UCIs are for most part governed by Directive 2011/61 or, through their managers, the Alternative Investment Fund Managers (AIFM), by the Alternative Investment Fund Manager Directive (AIFMD). An AIFM is a legal person whose regular business is to manage one or more AIFs. As such, the AIFMD regulates the management, administration and marketing of Alternative Investment Funds in the EU. Key issues covered by the AIFMD include authorization and operating conditions for AIFMs, remuneration, conduct of business and valuation requirements, transparency, marketing and rules in relation to third countries (Kremer & Lebbe, 2014).

The definition of an Investment fund under AIFMD is similar to an UCIT but an AIF is not subject to the principle of risk-spreading and secondly, an AIF must always raise capital from a number of investors (Kremer & Lebbe, 2014).

### 2.4.1 The AIFM Law

The AIFMD was approved by the European Parliament on 11 November 2010 and is the result of a G20 (Group of Twenty) consensus as a response to the global financial crisis. The objective of the AIFM Law was first to obtain more regulation of the activities in the

Alternative Investment Fund sector and monitoring of systematic risks, to create harmonized rules for the management and marketing of AIFs and to enhance more transparency for investors (ALFI, 2014c).

Alternative Investment Fund Managers are subject to the rules of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD). Luxembourg has transposed the AIFMD Law into its national law on the 12 July 2013 to strengthen its position as a global investment fund center (ALFI, 2014c).

The AIFM Law contains several principle-biased rules as the one laid down in the UCITS Directive. As an example, an AIFM must "act honestly, with due skill, care and diligence and in the best interest of the AIF or its investors and in the integrity of the market" (ALFI, 2014c: 10).

The AIFMs are obliged to manage three internal control functions such as a permanent compliance function, a risk management function and an internal audit function (ALFI, 2014c).

The AIFM Law applies to Lux/EU AIFMs managing one or more EU AIFs/non-EU AIFs; Non-EU AIFMs managing one or more EU AIFs; Non-EU AIFMs marketing AIFs in the EU (ALFI, 2014c). The only scenario which does not fall within the scope of the AIFM regime is the situation of a non-EU AIFM managing and/or marketing a non-EU AIF outside the EU (ALFI, 2014c).

Authorized AIFMs will be allowed to perform core functions such as portfolio management, risk management, administration, marketing and activities related to the assets of the AIF (ALFI, 2014c).

The main advantage of having an authorized AIFM is that it benefits from a passport for marketing its EU-based AIFs to professional investors in the EU on a cross-border basis. An authorized Luxembourg AIFM may also hold a UCITS ManCo (Management Company) license, and therefore market and manage on a cross-border basis both EU AIFs and UCITS funds (ALFI, 2018a).

### 2.4.2 Part II of the 2010 Law

Non-UCITS that are not subject to a specific product law, like the SIF and the SICAR, can be classified under Part II of the Law as Undertaking for Collective Investments (UCIs).

The main advantages are that this type of fund is highly flexible, subject to expert and flexible supervision and is well known by international investors.

UCIs under Part II are Investment funds that can invest in all types of assets, they are qualified as AIFs and can be sold to all types of investors contrary to the SIFs or RAIFs. They may be constituted as a FCP or as a SICAV/SICAF that might be open or closed-ended.

UCI Part II Funds may either appoint an external AIFM (the management company of the fund or a different entity is appointed as AIFM) or choose to be internally managed. In this case, the UCI Part II fund will itself be considered as the AIFM and will have to follow the requirements of the AIFM Law (Luxembourg for Finance, 2019b).

The minimum capital for a FCP and for a SICAV/SICAF is EUR 1,250,000 that must be reached within 6 months after the authorization. If the SICAV/SICAF is internally managed then it needs to have a capital of EUR 300,000 at the date of authorization (Ernst & Young, 2017).

UCI Part II Funds that have appointed an EU AIFM can market their shares, units or partnership interests via a specific passport to professional investors across the EU.

### 2.4.3 SIF

SIF is the acronym of Specialized Investment Fund and was introduced by the Luxembourg Law of 13 February 2007. The SIF regime was created with the intention of providing to UCIs the possibility to invest in any type of assets with both traditional and alternative strategies (Elvinger Hoss, 2019).

The SIF regime was amended by the law of 12 July 2013 on Alternative Investment Funds Mangers and is therefore divided into two parts. The first one is general provisions applicable to all SIFs, the second one are specific provisions applicable to SIFs that are qualified as AIFs and that must be managed by an authorized AIFM (Elvinger Hoss, 2019). Because of this broad definition of SIF AIFs, most SIFs are entitled as SIF AIFs.

SIFs that are qualified as AIFs must appoint an AIFM, it can be an external AIFM or they can be internally managed. In this case the SIF AIF will itself be considered as the AIFM.

A SIF may take the legal form of a FCP or may be constituted as an investment company SICAV or SICAF that might be open or closed-ended. However, also other legal forms are possible. The minimum capital for a FCP and for a SICAV/SICAF is EUR 1,250,000 that must be reached within 12 months after the authorization (ALFI, n.d.a). If the SICAV/SICAF is internally managed then it needs to have a capital of EUR 300,000 ate the date of authorization (ALFI, n.d.a).

In comparison to UCIs under Part II of the 2010 Law, SIFs are more flexible regarding their investment policy and have a more relaxed regulatory regime. However, SIFs cannot be sold to all types of investors, instead SIFs can only raise capital from well-informed investors that are able to understand and evaluate the risks of investing in that fund. Well-informed investors are:

- Institutional investors
- Professional investors
- Other types of investors who have declared in writing that they are well-informed investors and who either (i) invest a minimum of EUR 125,000 or (ii) have been assessed by a credit institution, an investment firm or a management company which certifies the investors' ability to understand the risks associated with investing in the SIF (Ernst & Young, 2017: 40).

SIFs are subject to the principle of risk diversification and must be established in such a way as to lighten the risk of any conflict of interest.

SIF AIFs are obliged to divulge additional information in their annual reports. "This information includes firstly the total amount of remuneration paid by the AIFM to its staff for the financial year, the number of beneficiaries and where relevant any carried interest paid by the SIF AIF" (Elvinger Hoss, 2019: 14). In addition, the annual reports must include information on the use of Securities Financing Transactions (SFTR) and total return swaps (Elvinger Hoss, 2019).

### 2.4.4 SICAR

SICAR stands for "*Société d'investissement en Capital à Risque*", it is an investment vehicle that was created for investments in private equity and venture capital. The objective is to acquire financial assets in order to sell them at profit.

SICARs are subject to Luxembourg Law of 15 June 2004 (SICAR Law) which was amended in October 2008 and by the AIFM Law of 12 July 2013. The goal of the amended SICAR Law "was to simplify fund-raising and investment in risk-bearing capital" (KPMG, 2014: 1). Also, the objective was to create a vehicle which could handle with the needs of private equity and venture capital projects, benefiting from a light regulatory regime, while still being subject to the supervision of the CSSF (Elvinger Hoss, 2015). In summary, SICARs allow corporate flexibility with recognized supervision and beneficial tax treatment (Elvinger Hoss, 2015).

The SICAR regime can be used by vehicles that have the objective to invest in securities with risk-capital. Risk-capital can be defined as: the direct or indirect contribution of assets to entities in view of their launch, development or listing on a stock exchange" (Elvinger Hoss, 2015: 4).

Contrary to the other fund types that can be set up in a contractual form, the SICAR must always be established as a corporate entity with fixed or variable capital (Luxembourg for Finance, 2019a). However, the abbreviations SICAV or SICAF used in the other fund types set up in corporate form are not applied for SICARs.

A SICAR must adopt one of the corporate forms listed by the Law, i.e. a public company (SA), a partnership limited by shares (SCA), a cooperative in the form of a public limited company (SCoSA), a private limited company (Sàrl), a limited corporate partnership (SCS) or the special limited partnership (SLP).The SICAR may be set up as a single fund or as an umbrella structure with multiple compartments.

The SICAR benefits from an attractive tax regime which varies depending on the legal form adopted. If their income is derived from transferable securities or from cash held for the purpose of a future investment, their income will be also tax exempt, if not, SICARs pay an ordinary income tax of 28.80% (Elvinger Hoss, 2015). SICARs are also exempt from wealth tax and management services provided to a SICAR are exempt from Luxembourg VAT (Value Added Tax) (Elvinger Hoss, 2015).

The minimum subscribed share capital of a SICAR is EUR 1 million that must be obtained within twelve months after the company was authorized (KPMG, 2014). A SICAR that is characterized as an AIF is not obliged to but can be managed by a management company.

### 2.4.5 RAIF

The Luxembourg Law of 23 July 2016 introduced a new type of Luxembourg investment vehicle, the Reserved Alternative Investment Fund (RAIF). This new type of investment vehicle is a combination of the attributes of the SIFs and of the SICARs but with the distinction that RAIFs are not subject to the supervision of the CSSF. Hence, contrary to the

SIFs or SICARs, that are AIF, the RAIF does not need a prior authorization from the CSSF before it can begin its activities, nor to close supervision by the CSSF *(*ALFI, 2016). They can invest in any kind of asset and pursue any kind of investment strategy.

Unlike a SIF that can be non-AIF, a RAIF must always be AIF and are subject to the full AIFMD requirements and must be managed by an authorized external Alternative Investment Fund Manager (AIFM).

The objective of a RAIF is: "the collective investment of the funds raised in assets with the objective of spreading the investment risks and offering investors the benefit of the results of the management of the assets" (Ernst & Young, 2017: 42).

The RAIF regime was introduced in order to enlarge the variety of investment vehicles in Luxembourg and to offer a new alternative to the initiators of Luxembourg AIF projects.

The capital of a RAIF may not be less than EUR 1,250,000 and this amount must be obtained within a period of twelve months after its authorization.

Besides of this, the RAIF has the same characteristics of a SIF and SICAR. First, they are reserved to well-informed investors, they may be set up in the contractual form FCP or corporate form (SICAV/SICAF), they may be established as umbrella funds or as stand-alone funds and the structures may be open-ended or closed-ended for both subscriptions and redemptions *(*ALFI, 2016).

Even though the RAIFs are not subject to the CSSF supervision, the AIFM must ensure that the RAIF obeys to the so called AIFMD rules that includes the appointment of a depositary and an independent auditor *(*ALFI, 2016). Since RAIFs are managed by an AIFM, the RAIF benefits from the marketing passport *(*ALFI, 2016).

### 2.4.6 The different types of Alternative Investment Funds

In its broadest definition, alternative investment assets are those which are not part of traditional asset classes such as cash, stocks, or bonds that retail investors are most familiar with. Even though there is no definitive list of alternative assets the three broadest and largest categories of alternative investments are hedge funds, private equity and real estate.

#### 2.4.6.1 Hedge funds

Zheng et al. (2018) define hedge funds as: “alternative investment vehicles that use pooled funds and sophisticated strategies to generate a positive return on investment, while adjusting their exposure to various macroeconomic and market factors” (Zheng et al., 2018: 147).

As the European Central bank states, a “hedge fund” is defined for statistical purposes as follows:

> any collective investment undertaking, regardless of its legal structure under national laws, which applies relatively unconstrained investment strategies to achieve positive absolute returns, and whose managers, in addition to management fees, are remunerated in relation to the fund’s performance. For that purpose, hedge funds have few restrictions on the types of financial instrument in which they may invest and may therefore flexibly employ a wide variety of financial techniques, involving leverage, short- selling or any other techniques (ECB, 2017: 9).

The success of the hedge funds is due to the main characteristics of this type of funds which are their flexibility in terms of strategy and of financial assets in which they can invest (Di Tommaso & Piluso, 2018).

However and because they engage in speculation, hedge funds are often more risky than the overall market. They are also illiquid and require a high initial investment by accredited investors (Miller, 2018). They are less liquid than traditional funds because customers can only recover their investments for a fixed period of the year. Among the clients of hedge funds, we only find institutional investors. These are, wealthy people, banks or pension funds.

A key attribute of hedge funds is their ability to reach positive absolute returns for their investors under all market conditions (ECB, 2009). This is in opposition to other Investment funds, which usually track a specific market benchmark. Therefore, “hedge funds typically indicate in their prospectus and in their advertising documentation that their performance is de-correlated from market trends” (ECB, 2009:8).

The greatest risk regarding hedge funds is that they are not as much regulated than the other Investment Funds. This lack of regulation also produces a lack of transparency (Mcneil, 2012).

In Luxembourg, the hedge fund sector has grown rapidly in the last years. Luxembourg regulated hedge funds are essentially tax-exempt vehicles, with the exception of registration duty and the annual subscription tax (ALFI, 2018a).

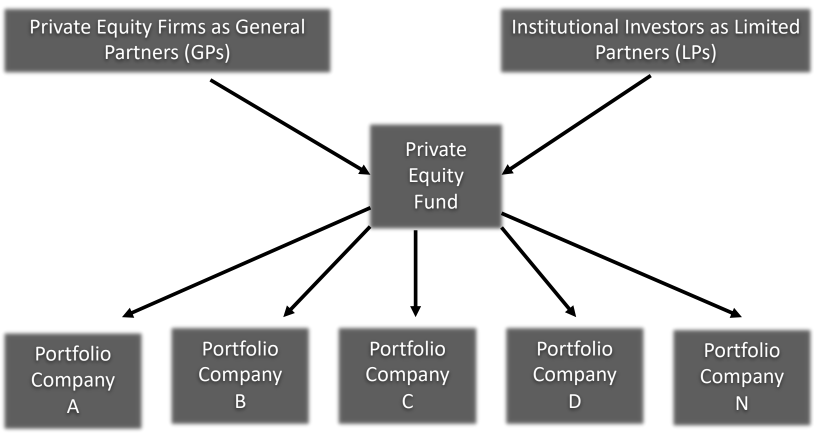
#### 2.4.6.2 Private equity funds

"Private equity generally refers to the acquisition of a company or a stake in a company through a transaction involving privately held equity or other non-public securities by an investor or group of investors" (Ernst & Young, 2017: 434).

The name "private equity" refers to investments in securities which are not usually listed in the public markets (Kim, 2018).

The main difference between hedge funds and private equity funds is essentially the vision of time. Hedge funds focus on short-term gains, while private equity funds focus on the long-term potential of their portfolio. The structure of a private equity fund generally involves several key entities, as follows (figure 10):

*Figure 10: Structure of a Private Equity Fund*




Source*:* Prepared by the author based on Chambers, Black, & Lacey (2018). Alternative Investments: A Primer for Investment Professionals. *CAIA Association.*P.83

A private equity fund is generally a "partnership" between a private equity firm (general partner) and investors in the fund (limited partners) (Ernst & Young, 2017).

GPs (General Partners) typically make a small capital contribution, usually 1% to 5% of the fund's capital, and promise management services in exchange for a "profit" (carried interest) in the partnership and "fees", the management fees (Kim, 2018). Limited partners may become involved in advisory committees, but they play limited roles in managerial activities to keep their liability protections. The GP is the person responsible for the partnership's debts and obligations which cannot be satisfied out of the partnership's assets.

The portfolio companies shown in figure 10 are the ventures selected by the fund managers that receive the invested capital.

Generally, Private Equity Funds are divided into two categories, buyout funds and venture capital funds.

A **venture capital** fund is the most conventional form for a private equity fund. It focuses on young companies with high growth prospects that cannot attract investors through traditional fund raising. Coin & Vacca explain: "For these companies, it is often difficult to borrow from banks, since the early stages of growth of a firm feature a high-risk high-return profile" (Coin & Vacca, 2016: 223). Venture capital funds invest in these higher risk companies with the intention of achieving a higher rate of return (Ernst & Young, 2017). Venture capital funds made early investments in recent successes like Google (in the United States), Skype (in Europe), and Baidu (in Asia) (Metrick, & Yasuda, 2010).

A **leverage buyout** fund will invest primarily in established businesses with significant borrowing capability (Mcneil, 2012). Typically, the fund acquires a controlling interest in the business in order to develop the business and then sell the business at a later date. Generally, the fund creates a corporate acquisition vehicle to obtain then the stock or assets of the portfolio company (Mcneil, 2012).

#### 2.4.6.3 Real Estate Funds

Real estate funds, as indicated by their name, are special shares funds investing in good-quality real estate. The goal of investing in real estate is not only to collect the rental income of the property but above all, the goal is to focus on the appreciation of the property over the long term. There are two main categories of real estate funds, direct real estate funds and indirect real estate funds. Direct real estate funds invest in property assets or structures holding property assets, generally in sectors like retail, offices, residential, industrial premises, leisure (e.g., hotels, leisure parks) and logistics (e.g., warehouses). They generally generate returns from the increases in the value of the assets and from rental income. Generally, diversified direct funds invest in more than one sector.

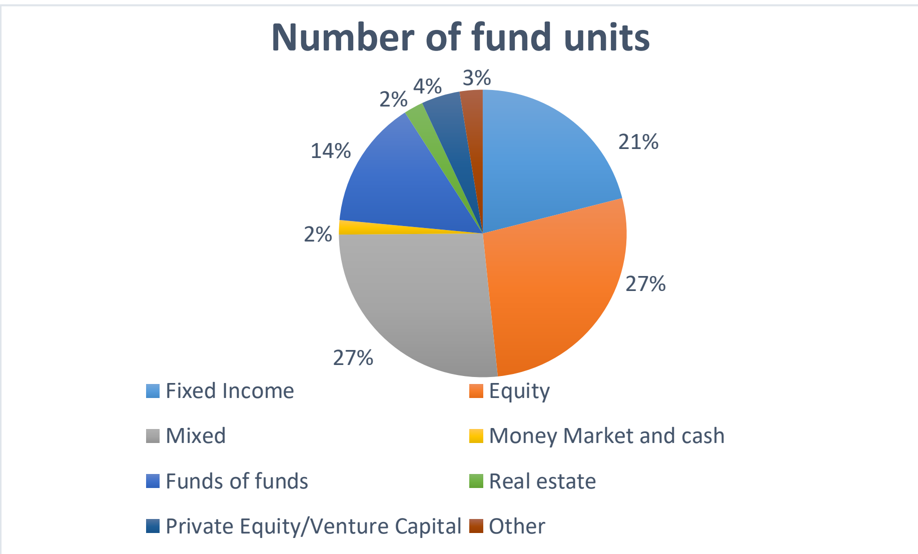
On the other hand, indirect funds invest in listed real estate securities or in other real estate funds.

Luxembourg remains the leading European domicile for vehicles investing in international real estate. The number of real estate fund units has continued to grow during 2018, bringing the total number of real estate fund units domiciled in and operated from Luxembourg to 324 (ALFI, 2018b). Real estate UCIs benefit from the general tax rules applicable to UCIs and are exempt from municipal business tax, corporate income tax and net worth tax but are subject to a fixed registration duty and an annual subscription tax ("*taxe d'abonnement*").

## 2.5. Statistics of UCITS and AIFs

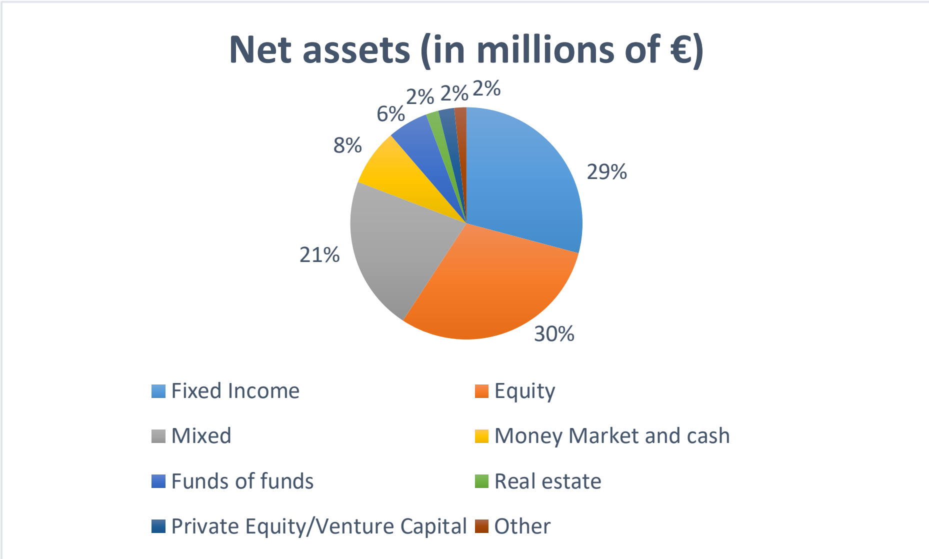
Figures 11 and 12 show the percentage by fund type in terms of number of units and net assets in millions of euros. Taken into account the different types of Investment funds of UCITS and of AIFs explained before, fixed income funds, equity funds and mixed funds are the most popular and used types of funds in terms of net assets and in terms of number of fund units.

*Figure 11: Percentage by Fund Type in terms of Fund units*




Source: Calculated by the author based on the data available on CSSF. (2019a). Investment Policy of UCIs.

*Figure 12: Percentage by Fund Type in terms of net assets in millions of euros*




Source: Calculated by the author based on the data available on CSSF. (2019a). Investment Policy of UCIs.

## 2.6. Legal forms of the Investment Funds

Luxembourg laws and regulations permit the creation of Undertakings for Collective Investment of the contractual type (FCP) and of the corporate type (investment companies). Investment companies may be established either as companies with variable share capital (*Société d'Investissement à Capital Variable* or SICAV) or companies with fixed share capital (*Société d'Investissement à Capital Fixe* or SICAF). A SICAV or SICAF is generally an investment company with legal personality that may benefit from some of Luxembourg's wide network of tax treaties, whereas a FCP is a co-proprietorship of assets without legal personality, which is recognized as transparent for tax purposes.

### 2.6.1 Fonds Commun de Placement (FCP)

Article 5 of the Amended Law of 17 December 2010 on Undertakings for Collective Investment defines a FCP as follows:

> Any undivided collection of transferable securities and/or other liquid financial assets referred shall be regarded as a common fund if it is made up and managed according to the principle of risk spreading on behalf of joint owners who are liable only up to the amount contributed by them and whose rights are represented by units intended for placement with the public by means of a public or private offer. (Luxembourg Stock Exchange, 2017: 6)

"A common fund is a co-proprietorship whose joint owners are only liable up to the amount they have contributed and whose ownership rights are represented by units" (Ernst & Young, 2017: 27). As explained above a common fund has no legal personality. Regardless of whether the common fund is created under the 2010 Law, SIF Law or RAIF Law it must be managed by an authorized management company (Ernst & Young, 2017).

A UCITS common fund must be managed by a Luxembourg management company (Chapter 15 of the 2010 Law) or a management company established in another EU/EEA Member State (Ernst & Young, 2017). An AIF common fund must also be managed by a Luxembourg management company. The management company may either manage the AIF itself or appoint an authorized AIFM in Luxembourg or another EU/EEA Member State (Ernst & Young, 2017). The Board of Directors of this management company and the depositary have total control over the common fund (Ernst & Young, 2017).

### 2.6.2 SICAV/SICAF

Article 25 of the amended Law of 17 December 2010 on Undertakings for Collective Investment defines a SICAV as follows:

> SICAVs shall be taken to mean those companies which have adopted the form of a public limited company governed by Luxembourg law,
>
> -whose sole object is to invest their funds in transferable securities and/or other liquid financial assets in order to spread the investment risks and to ensure for their unitholders the benefit of the result of the management of their assets, and
>
> - whose units are intended to be placed with the public by means of a public or private offer, and
>
> - whose articles of incorporation provide that the amount of the capital shall at all times to be equal to the net asset value of the company (Luxembourg Stock Exchange, 2017: 15)

A SICAV in Luxembourg is an Investment fund in the form of an Investment Company whose share capital is variable. On the other hand, a SICAF Investment Fund in Luxembourg is an Investment Company whose share capital is fixed.

The capital of a SICAV is always equal to its net assets (Ernst & Young, 2017). Their objective is: "the investment of the share capital in securities or in other liquid financial investments in accordance with the principle of diversification" (LCG, n.d.: 3). The shareholders receive the income generated from the management of their assets (LCG, n.d.).

Contrary to the common funds, investment companies have a legal personality and are controlled by their governing body, usually the Board of Directors. The shareholders have ultimate power over the fund.

An investment company may either appoint a management company or AIFM or be internally managed. In this case, the governing body of the UCI plays the role of the management.

The SICAV and SICAF can be formed as a corporation in Luxembourg in the form of:

- Public Limited Company (PLC., Corp./SA);
- Private Limited Company (LLC., Ltd./SARL);
- Partnership Limited by Shares (SCA);
- Co-operative in the form of the Public Limited Company (SCOSA);
- Limited partnerships (SCS);
- Special limited partnership (SCSp), which was introduced by the AIFM Law. It has no legal personality and offers a high degree of contractual flexibility.

In addition, a SICAF may take the form of an unlimited company (SNC - *Société en Nom Collectif*).

The decision to create a UCI as a common fund or as investment company is primarily driven by tax, operational and marketing considerations. Table 4 details the main differences between common funds and investment companies.

*Table 4: Differences between FCP and SICAV/SICAF*

| | Common Fund | Investment Company (SICAV or SICAF) |
|---|---|---|
| Management entity | Luxembourg management company which in the case of an AIF, may appoint an AIFM. | Self-managed investment company: Board of Directors, General Partner or Manager.<br>Managed investment company:<br>-UCITS: a management company<br>-AIF: a management company and/or an AIFM |
| Control | Board of Directors of management company in conjunction with depositary. | Board of Directors, General Partner or Managers(s) and ultimately by investors. |
| Shareholders 'meetings | Unitholders' meetings are not mandatory for a common fund | At least one meeting of shareholders must be held annually |
| Taxable status | Tax transparent (with limited exceptions) | Not tax transparent (with limited exceptions) |
| VAT status (Value added tax) | VaTable person via its management company | VaTable person |

Source*:* Performed by the author based on Ernst & Young. (2017). *Investment Funds in Luxembourg*. P.14

## 2.7. Subscription tax

The subscription tax (“*taxe d'abonnement”*) is a registration fee established on the negotiability of securities in Luxembourg. Table 5 shows the subscription tax applicable for each legal form.

*Table 5: Subscription tax applicable to the different Legal Forms in Luxembourg*

| | |
|---|---|
| Part I | - 0.05% of NAV;<br>- 0.01% of NAV possible for money market funds, cash funds and institutional funds. |
| Part II | - 0.05% of NAV;<br>- 0.01% of NAV possible for money market funds, cash funds and institutional funds. |
| SIF | - 0.01% of NAV;<br>- Tax exemption possible for certain money market pension funds or SIFs investing in other funds already subject to subscription tax. |
| SICAR | - No subscription tax. |
| RAIF | - 0.01% of NAV;<br>- Tax exemption possible for certain money market and pension funds that invest in other funds already subject to subscription tax;<br>- If a RAIF invests entirely in risk capital, then it is subject to the SICAR tax regime and is not subject to the subscription tax. |

Source: Performed by the author based on the data available on ALFI. (2018a). *Luxembourg Investment Vehicles: An overview of the legal and regulatory requirement.* P.44-47

## 2.8. Structuring and Regulatory Administrative Requirements

### 2.8.1 Fund structuring options

#### 2.8.1.1 Closed-end and Open-end funds

Closed-end funds were one of the first specialized financial intermediaries created over a hundred years ago to give to small investors access to a managed and diversified portfolio (Fletcher, 2013).

Tanzer (2010) explains: "When a new closed-end fund is launched, it raises money in an initial public offering-similar to the way a company raises money when it goes public" (Tanzer, 2010: 36). After it goes public, no new capital enters the fund and money flows out only when dividend or capital gains are distributed to shareholders (Tanzer, 2010). After the IPO (Initial Public Offering), the shares of the fund start trading just like any other stock (Tanzer, 2010).

Another characteristic of closed-end funds that differentiates them from other Investment funds is their price structure. While the price of most Investment funds directly shows the value of the individual fund's portfolio of assets, the closed-end fund Net Asset Value usually varies continuously from the stock market's share price (Fletcher, 2013). Since the shares of a closed-end fund are often traded on the stock market based on investor demand, the fund can be traded on the market at a price higher or lower than its NAV.

On the other hand, an open-end fund is a diversified portfolio of pooled investor money that can issue an unlimited number of shares. An open-end Investment fund is a separate asset and does not represent a legal entity (Domgagoj et al., 2010). The money is collected by issuing and selling documents on the fund's share. The fund managers invest then this money in different securities (deposits, bonds, stocks, treasury bills and other) (Domgagoj et al., 2010).

#### 2.8.1.2 Stand-alone funds vs Umbrella Funds

Every fund can be constituted as a "stand-alone" fund or with multiple sub-funds, known as an "umbrella fund". Many Luxembourg-based Investment funds are in the form of umbrella funds. These consist of many sub-funds, which operate as separate investment funds while being part of the same legal entity. This structure makes it possible to create funds with different strategies or designed for different types of investors in the same legal entity, which can, if necessary, reduce their respective costs. It is usually cheaper for investors to move from one fund to another within an umbrella fund.

The sub-funds differ in their investment policy, the currency in which they are denominated or the type of investor to which they are open. These sub-funds, although they act as a separate investment fund, nevertheless remain subject to the same legal regime because they are all in the same legal entity.

Each fund or sub-fund can issue different classes of shares that are distinguished by different structures and levels of commissions. Thus, the actions can be adapted to the preferences of a market or a type of investor.

Since the umbrella forms the legal entity, all sub-funds and share classes in the umbrella are managed by one board and one depositary and are subject to the same tax regime.

#### 2.8.1.3 Master-feeder structures

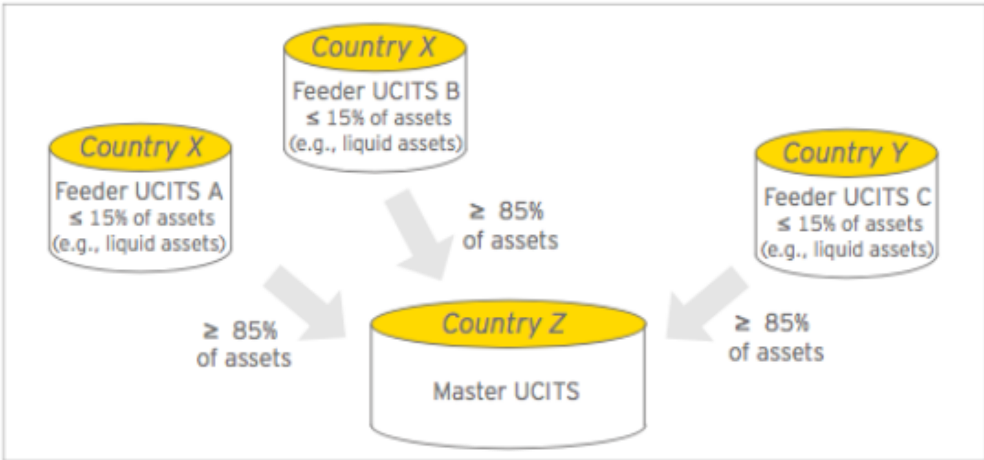
A master-feeder structure allows multiple funds using the same investment strategy to pool their capital and be managed as part of a bigger investment pool. Master-feeder structures may be adopted by asset managers as a distribution mechanism to simplify the access to certain markets (ALFI, 2010).

There are three main steps, first investors invest in Investment funds, then the different funds create a master-feeder and will feed it (Feeder-Funds) and then the assets of the master-Feeder will be invested in the market.

One of the main advantages of the master-feeder structure is efficiency and reduced cost because pooling fund assets with the same investment strategy into master vehicles results in economies of scale, cost efficiency and increased liquidity (ALFI, 2010).

Furthermore, master-feeder structures can be created to suit the needs of different types of investors (ALFI, 2010). This way, promoters and distributors can develop their own brand by offering feeder vehicles that invest in masters and are not subject to the costs associated with creating their own products (ALFI, 2010). Figure 13 shows a possible master-feeder scenario.

*Figure 13: Example of a master-feeder structure*




Source: Ernst & Young. (2017). *Investment Funds in Luxembourg*. P.15

## 2.8.2 Investment fund information

It is mandatory that the fund provides investors with information about the characteristics of the fund. Funds must prepare a prospectus, a Key Investor Information Document and an annual report.

### 2.8.2.1 Fund Prospectus

The fund prospectus is the most important document from the Investment fund and provides information on four main categories.

First the Prospectus explains the investment objective and policy of the fund and what assets and classes it uses to achieve its goals. Often the prospectus indicates benchmark figures such as indices that are used to assess the performance of the fund. It explains what types of risks the fund is subject to, such as interest rates, currency, credit or liquidity. A prospectus may also include information about performance over specific time periods to understand if the fund has met its performance objectives in the past. Finally, the prospectus needs to include information on how the fund is valued, how the NAV is calculated and the terms and conditions for buying or selling the shares.

### 2.8.2.2 Key Investor Information Document

The Key Investor Information Document (KIID) was introduced by the Directive IV of the UCITS and is a short document that informs the investors on how funds operate and what risks they involve. It gives information to investors about past performance, or relevant future performance scenarios, costs and its risk and reward profile (SRRI- synthetic risk and reward indicator) (Kremer & Lebbe, 2014). It is a pre-contractual document that provides information that is easy to understand, accurate, clear and unambiguous to investors or potential investors (Kremer & Lebbe, 2014).

The KIID is intended to be self-sufficient which means that the investor should not have to read the fund's prospectus in order to obtain enough information to decide.

#### 2.8.2.3 Annual report

An annual report presents the fund's movements during a specific period and its financial position. It contains a manager's report that explains the performance of the fund and a discussion of the markets and investments. It shows the assets that the fund holds and the expenses that it has incurred. It includes also an annual audit report that checks and certificates the accuracy of the fund's accounts.

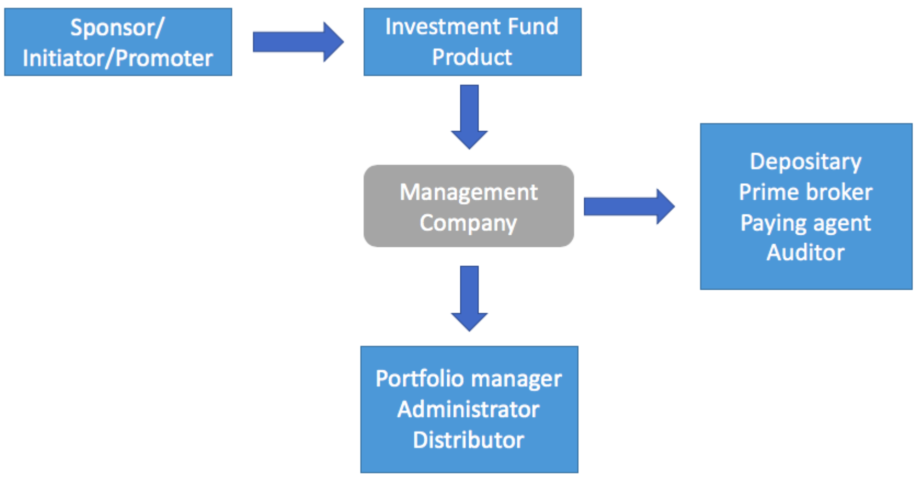
The annual and semi-annual report provide information to investors to help them determine if the fund is managed as promised and if it is still convenient for their investment needs.

An example of an annual report can be found on Annex III.

### 2.8.3 Fund service providers

Funds service providers is the term used to describe the parties providing services to a collective investment scheme. This section outlines the principal duties of the main service providers represented on figure 14.

*Figure 14: The different Service Providers involved in a Collective Investment Scheme*




Source: Performed by the author

1. Sponsor, initiator or promoter

A "sponsor" takes care that the management company respects the applicable prudential requirements. Generally, the "sponsor" is the main shareholder of the management company, or a group entity to which the main shareholder belongs (Ernst & Young, 2017).

The promoter or the initiator in case of the SIFs are the creators of the UCIs and play significant roles in the activity of the UCI. They are the portfolio manager or adviser and play a role in the distribution of the UCI (Ernst & Young, 2017).

2. Management company or AIFM

"Management companies and AIFM are companies that manage UCIs. Management includes, in general, portfolio management, administration and distribution" (Ernst & Young, 2017: 17). An investment company must assign an approved management company in Luxembourg or designate itself as being self-managed. A FCP since it has no legal personality must be managed by a Luxembourg management company and a RAIF must be managed by an authorized AIFM; it cannot manage itself (Ernst & Young, 2017). There are three types of authorized management entities in Luxembourg as shown in table 6.

*Table 6: Summary of the activities of management companies*

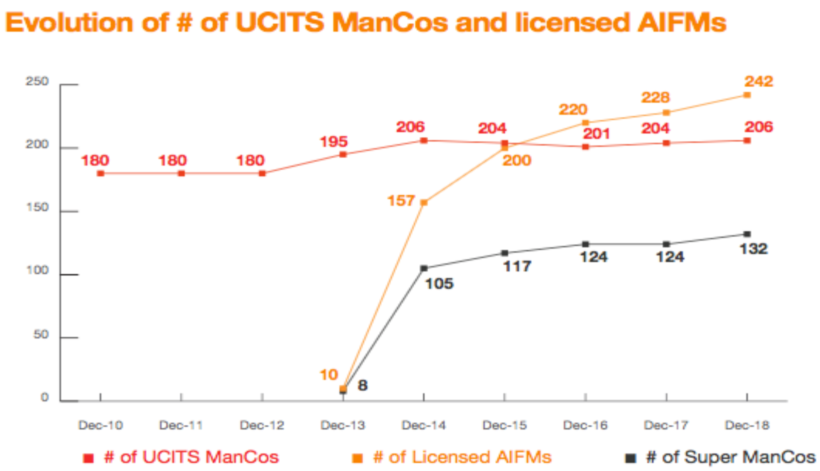
| | Chapter 15 management company | AIFM | Chapter 16 management company |
|---|---|---|---|
| Regular Business | Managing UCITS | Managing AIF | Managing non-UCITS |
| Other possible activities | -Managing other UCIs<br>-Discretionary Portfolio management<br>-Investment advice | -Activities related to the assets of the AIF<br>-Discretionary Portfolio management<br>-Investment advice | -Managing investment vehicles other than AIF |

Source*:* Performed by the author based on Ernst & Young. (2017). *Investment Funds in Luxembourg*. P.148

These companies are often specialized in certain types of financial instruments, certain economic sectors or geographical markets (Europe, Asia, North America). If the fund has more than one sub-fund with different strategies, it is necessary that the management company uses a specialized investment advisor for a specific sub-fund to maximize its return.

Often, these companies also take care of the risk management of the fund. This risk management consists of continuously identifying the various risks to which the fund is exposed and putting systems in place to quantify, manage and monitor them. It is necessary to check whether the investment limits are respected, analyze with attention the risk of derivative products and share all these analyzes concerning the risk position of each sub-fund with the Board of Directors of the fund and propose improvements.

*Figure 15: Evolution of UCITS Management Companies and Licensed AIFMs in Luxembourg*




Source: PwC (2019c*). ManCos Observatory Barometer* [Brochure].

Figure 15 shows the evolution of UCITS Management companies and licensed AIFMs in Luxembourg. As at December 2018, Luxembourg had 242 licensed AIFMs, representing an increase of 14 over a year, 206 UCITS ManCos and 132 Super ManCos. Super ManCos are Management companies that have both UCITS and AIFM licenses.

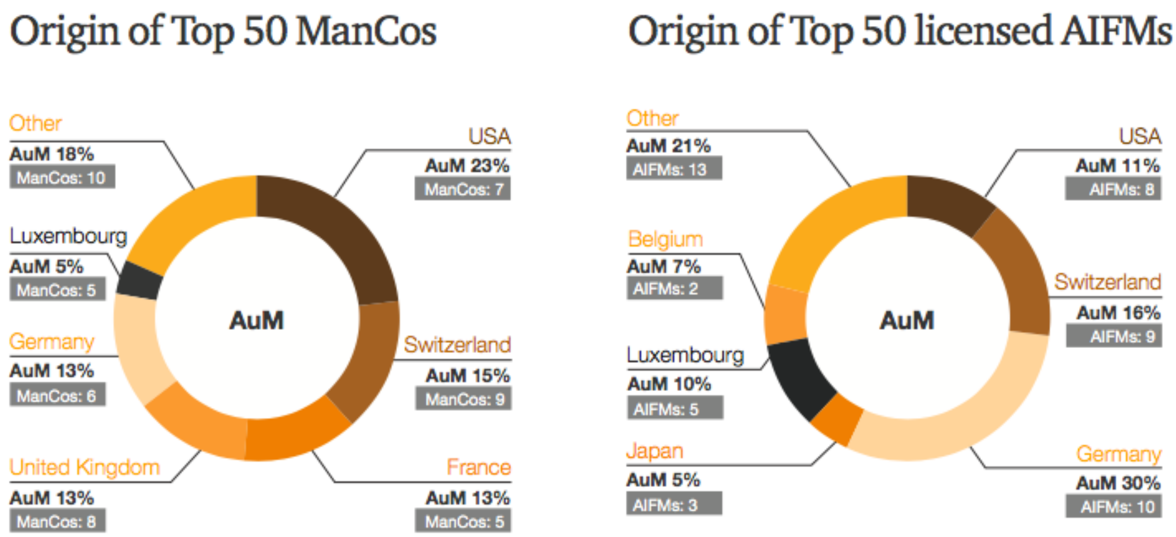
In addition, Luxembourg attracted 19 new entities in 2018, confirming the established position of the country as the preferred Asset Management hub in Europe.

Six of these entities are coming from the United Kingdom which is due to the consequences of the Brexit.

The top 5 ManCos as of 31 December 2018 (in terms of AuM) are:

1) JPMorgan Asset Management (Europe) S.à r.l.
2) DWS Investment S.A.
3) Amundi Luxembourg S.A.
4) BlackRock (Luxembourg) S.A.
5) UBS Fund Management (Luxembourg) S.A.

*Figure 16: Origin of the Top 50 Management Companies and licensed AIFMs*




Source: PwC (2019c). *ManCos Observatory Barometer* [Brochure].

In terms of the origin of Top 50 ManCos (figure 16) we find in second position management companies of Swiss origin (15%), for example UBS Fund Management or Pictet Asset Management. The United States is placed in first position with the giant JP Morgan, which manages 277,363 million euros of net assets and ranks first in the individual ranking (PwC, 2019c).

In terms of top 50 licensed AIFMs (figure 16) we find 30% of German companies such as Universal Investment and Deka International, Switzerland occupies also here the second place with 16%.

Luxembourg is famous worldwide for Investment funds and Switzerland for its management know-how. Switzerland has served as a model in the field of management techniques, particularly in wealth management, and has developed internationally around this specific expertise. Where Luxembourg has specialized in investment vehicles, structuring, administration and distribution skills, Switzerland has developed around its competence and innovation in management. The combination of these favorable environments allows for optimal solutions, such as innovative management by Swiss specialists, assets housed in a structure established in Luxembourg. Today they benefit from unique synergies that allow them to establish their reference positions and to face new markets. In an increasingly competitive market Switzerland and Luxembourg were able to innovate and develop strong partnerships enabling them to put their strengths in front of their customers (Fuchs, 2005).

3. Portfolio manager and Investment adviser

The portfolio manager is a delegate of the UCI or of its management company and is responsible for managing the fund or some of its sub-funds with respect to the investment, divestment and reinvestment of the assets of the UCI (Ernst & Young, 2017).

The investment adviser on his hand advises the portfolio manager but does not make any decisions (Ernst & Young, 2017).

4. Administrator

“The administrator is responsible for keeping the accounting records of the UCI, calculating the NAV, assisting in preparing the financial statements, and acting as a contact with the CSSF and the independent auditor” (Ernst & Young, 2017: 17). The administrator must be located in Luxembourg and will be appointed to carry out the activities of:

- Fund administration: Such as legal and fund management accounting services; customer inquiries; valuation of the portfolio and pricing of the shares or units; distribution of income; contract settlements; record keeping (Ernst & Young, 2017).
- Registrar and transfer agent: The registrar and transfer agent collects the subscription orders and later purchase orders. It is the intermediary between the investors, distributors and the fund. It is responsible for monitoring the transactions of the fund and for identifying suspicious or fraudulent transactions and reporting them immediately to the CSSF (Ernst & Young, 2017).
- Domiciliation agent: The domiciliation agent provides the registered office of the fund and facilities and manages the correspondence and the bills. (Ernst & Young, 2017).

5. Distributor

Distributors are intermediaries that market the shares or units or receive subscription and redemption orders since they are appointed agents of the UCI (Ernst & Young, 2017).

6. Depositary

The depositary is responsible for the safekeeping of the assets of the UCI, and for the administration of the assets (Ernst & Young, 2017).

In general, the depositary of a UCI should perform the following duties:

- The safekeeping of financial instruments and other assets belonging to the UCI;
- Cash flow monitoring;
- Carrying out a number of other monitoring and oversight duties (Ernst & Young, 2017).

The individuals who represent the depositary bank must be of good repute and have sufficient and relevant experience

It takes care of the management of the financial instruments that the fund owns and manages the events related to the possession of these instruments. It is legally liable to the management company and the investors of the fund in case of loss arising from non-compliance with their obligations.

The eligible depositaries are Luxembourg established credit institutions or Luxembourg established investment firms that fulfill certain requirements under the Law of 5 April 1993 (Luxembourg for Finance, 2019a).

7. Prime broker

The prime broker is required to report information to the depositary on a daily basis. Prime brokers' interventions cover both financing and execution and administration services. These are the execution and placing of orders at the customer's depository, the coverage of international positions, clearing and settlement of trades and even custodial services (Ernst & Young, 2017).

The prime broker also carries out a financing activity: securities lending, leverage, line of credit, repo transactions (securities-backed cash loans), etc. They also sell structured finance via derivatives, such as futures and swaps.

Finally, prime brokers provide advisory services in the areas of risk management or regulatory aspects.

8. Paying agent

The paying agent organizes the payments made by the UCI. A paying agent is required in each country where the UCI is distributed (Ernst & Young, 2017).

9. Independent auditor

The financial statements included in the annual report must be audited by a Luxembourg independent auditor ("*réviseur d'entreprises agréé*"). The independent auditor must be approved by the CSSF in accordance with the Law of 23 July 2016 on the audit profession and must have qualified and relevant experience. Auditors are bound by the obligation of professional secrecy (Ernst & Young, 2017).

Today, the auditor's job goes much further than preparing the audit report attached to the financial statements by which the auditor expresses an opinion on the true and fair view of the financial statements. While the certification of accounts used to be a posteriori validation of the numbers at a given date, the current regulations now requires the auditor to also analyze the main processes for establishing the net asset value of the fund and the internal controls of these processes. The objective of this approach is to put in place processes that provide reasonable assurance that possible calculation errors are detected by effective internal controls.

Except for RAIFs which are not directly supervised by the CSSF, the independent auditor is obliged to inform the CSSF of any fact or decision of which it becomes aware while auditing the accounting data contained in a UCI's annual report, in the event that such fact or decision:

• constitutes a material breach of the law or the regulatory provisions adopted for its execution;

• threatens the continuity of operations of the UCI; or

• may lead to a refusal to certify the accounts or to the expression of qualified opinions (Ernst & Young, 2017).

### 2.8.4 Fees and expenses related to Investment funds

There are several fees and expenses related to Investment funds, the two major categories are the formation expenses and the operating expenses.

#### 2.8.4.1 Formation expenses

First, the formation expenses include all the costs necessary to establish and to form an Investment fund such as notary fees, legal fees, advisory fees related to initial structuring, printing of prospectus and CSSF initial authorization fees (Ernst & young, 2017). These formation expenses are carried by the UCI unless the management company or general partner decide to absorb fully or partially the formation expenses.

#### 2.8.4.2 Operating expenses

The second type of expenses are the operating expenses which are the costs related with the execution of the daily management and operation of the Investment fund. This type of expenses includes among others management fees and advisory fees, performance fees, and administration fees.

Management fees cover the costs associated with the management of the investment portfolio, advisory services and distribution services and all funds have these charges. These fees are reflected in the fund's share price and are not directly charged to the investor and the level of the management fee depends on the type of fund. They will be higher when the fund is managed in an active way such as hedge funds. The fees shall be calculated upon the Net Asset Value of the Sub-funds and vary from 0.5% to 3% per year.

For some funds the investment manager is also rewarded with an additional remuneration in the form of a performance fee. They will receive this performance fee when the fund has outperformed its benchmark and if the fund's NAV has increased by a minimum amount and is higher than the previous high value. Performance fees range between 5% to 20%

In addition, another significant expense faced by a Luxembourg UCI is the fee paid for administration including, fund accounting, registrar and transfer agency and domiciliary agency. Account fees may include purchase fees, redemption fees, or exchange fees. The administration fee is based on a specific percentage of net assets and there might be an agreement to provide a minimum fee.

Other operating expenses incurred by a Luxembourg Investment fund can include:

- Depositary fees, transaction fees, and brokerage fees;
- Domiciliation fees;
- Directors fees, insurance, conducting persons fees and management company fees;
- Preparation of financial reports;
- Annual and semi-annual report printing costs;
- Net Asset Value (NAV) or price publication expenses;
- Independent valuation costs;
- Annual registration duty (if applicable);
- CSSF annual fee;
- Legal fees;
- Audit fees;
- Stock exchange maintenance fee;
- Cross-border registration application, authorization, and maintenance fees;
- Cross-border tax compliance fees;
- Distribution costs;
- Annual subscription tax for UCIs;
- Investor communication costs;
- Marketing costs (Ernst & young, 2017).

The percentage of the fees are always defined in the prospectus of the fund and varies from fund to fund.

# Chapter III: Comparison with Ireland and the impact of Brexit

## 3.1 Comparison with Ireland

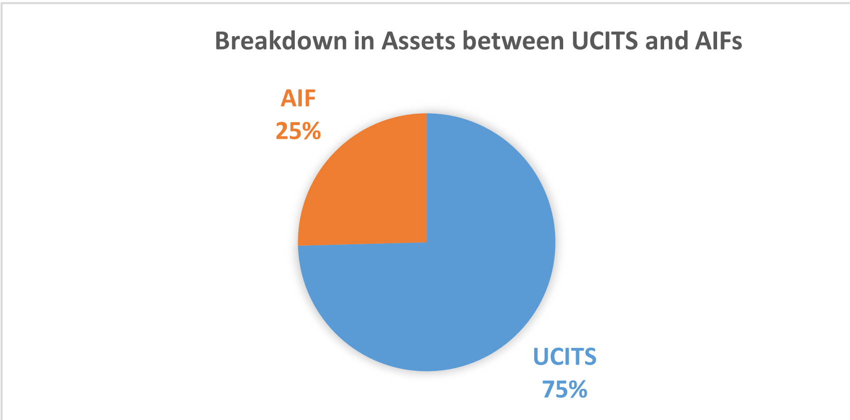
As Ireland is the second largest Investment fund center in Europe (as shown in table 1) after Luxembourg, I found important to introduce the legal structures available in Ireland and to do a comparison between Luxembourg and Ireland.

### 3.1.1 Legal Structures available in Ireland

As at December 2018 Ireland had a total of 13,941 funds which of them 7,920 were Irish domiciled Funds and 6,624 were non-domiciled and it distributes its funds to over ninety countries. It has a large range of fund types, an efficient tax structure and puts priority on investor protection. "Ireland has in its favor; a developed national infrastructure, a highly competent and skilled workforce, political stability, the regulatory system […]" (Lawless & Murray, 2009: 1). The Central Bank is responsible for the approval and supervision of the Investment funds.

It has the same categories of funds as Luxembourg which are the UCITS and the AIFs. Today 75% of Irish domiciled funds are UCITS and 25% are AIFs (figure 17).

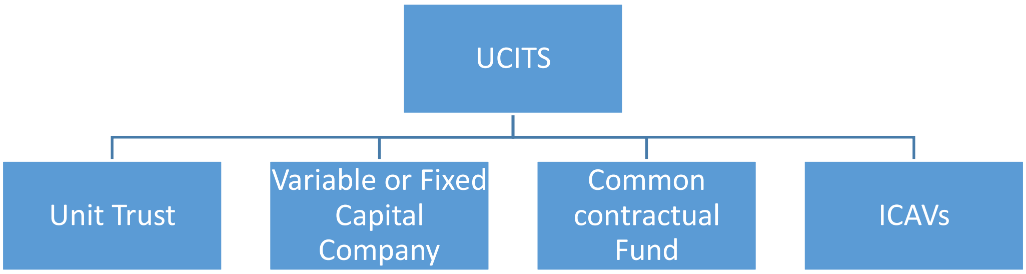
*Figure 17: Breakdown in Assets between UCITS and AIFs in Ireland*




Source: Performed by the author based on If Irish Funds Industry. (2019). Statistics

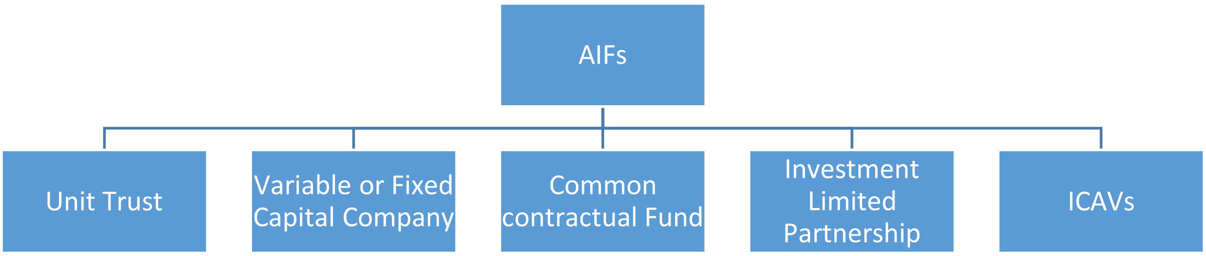
In Ireland, UCITS and AIFs can be established as follows:

*Figure 18: Legal Structures of UCITS in Ireland*




Source: Performed by the author

*Figure 19: Legal Structures of AIFs in Ireland*




Source: Performed by the author

A distinct feature is that AIFs can fall into two categories, RIAIFs (Retail Investor Alternative Investment Funds) and QIAIFs (Qualifying Investor Alternative Investment Funds).

A "RIAIF" is an AIF that is approved by the Central Bank and that can be marketed to retail investors. They have less investment and eligible asset constraints than UCITS but have more regulation than the QIAIF (CBI, n.d.). RIAIFs have no regulatory minimum subscription but do not have the automatic right to market across the EU under the AIFMD marketing passport (CBI, n.d.).They must therefore appoint an authorized AIFM and non-EU managers or registered AIFMs are restrained from managing RIAIFs (CBI, n.d.).

On the other hand, a "QIAIF" is an AIF that is approved by the Central Bank and that can be marketed to Qualifying Investors. These are not subject to large investment or borrowing constraints and can be displayed to professional investors across the EU and the EEA by an authorized AIFM using the AIFMD marketing passport (CBI, n.d.).

There are numerous legal structures available for both UCITS and AIF funds. The choice of legal structure will depend on the fund preferences, market requirements and operational considerations. Table 7 describes the legal structures available in Ireland.

*Table 7: Definitions and characteristics of the legal structures available in Ireland*

| | |
|---|---|
| **Unit Trust** | - Is established under the 1990 Unit Trust Act;<br>- Is a contractual fund structure between the management company and the trustee;<br>- Requires a management company but does not require annual general meetings and non-prejudicial changes to the trust deed can be made without the request of the unit holder. |
| **Investment Company** | - Is a corporate investment fund subject to the Irish company law;<br>- The most common type is the Variable Capital Investment Company (VCC) (which is similar to the SICAV in Luxembourg);<br>- The objective is to collectively invest its funds and spread investment risk. |
| **Common Contractual Fund (CCF)** | - Does not have a legal personality and may therefore only act through the manager;<br>- The investors are co-owners through their contractual agreements, participation and share in the assets of the fund;<br>- The CCF has a similar structure as the FCP in Luxembourg |
| **Investment Limited Partnership** | - Does not have an independent legal personality which means that the partners are responsible for the assets, liabilities, profits and losses;<br>- This structure is not permitted for UCITS funds and the Central Bank obliges at least one Irish General Partner;<br>- Contrary to the Investment company there is no requirement to operate under the principle of risk spreading. |
| **Irish Collective Asset-Management Vehicle (ICAV)** | - Is a new corporate fund structure for Irish Investment funds and was introduced in March 2015;<br>- Is a modernizing and simplifying structure of the Investment company fund structure and was specifically created to attend the needs of investment funds;<br>- Has its own legislative regime and is not required to spread risk. |

Source: Performed by the author

### 3.1.2 Tax framework

Ireland has one of the most developed and favorable tax treaty networks in the world, spanning over 90 countries across the EU, Middle East, Asia and South America.

1. Taxation of Funds

Irish domiciled funds are immune from the Irish tax on income and gains obtained from their investment portfolios and are not subject to any Irish tax on their net asset value. "Irish residents may invest in an Irish domiciled fund without affecting the tax-exempt nature of the fund" (Matheson, 2018: 29).

2. Taxation of Investors

There are no withholding taxes on income distributions or redemption payments made from an Irish Fund to a non-Irish resident investor, under the condition that there are no Irish assets held by a fund. However, exemptions from this withholding tax are available for certain categories of Irish investors such as pension funds, life assurance companies and other Irish domiciled funds (Matheson, 2018). Generally, foreign investors can retain the tax status of their home jurisdiction. For example, an investor with a tax-exempt pension fund can retain the benefits when invested in an Irish fund that is structured as a tax transparent fund.

3. VAT and Transfer Taxes

Management and administration services to an Irish domiciled fund are exempt from Irish VAT. But legal accounting or other services can be subject to the Irish VAT liability for Irish domiciled funds. Also, no capital duty is payable on the issue of fund units (Matheson, 2018).

4. Corporate tax

Finally, fund management companies, investment managers and fund service providers profit from Ireland's 12.5% corporate tax rate.

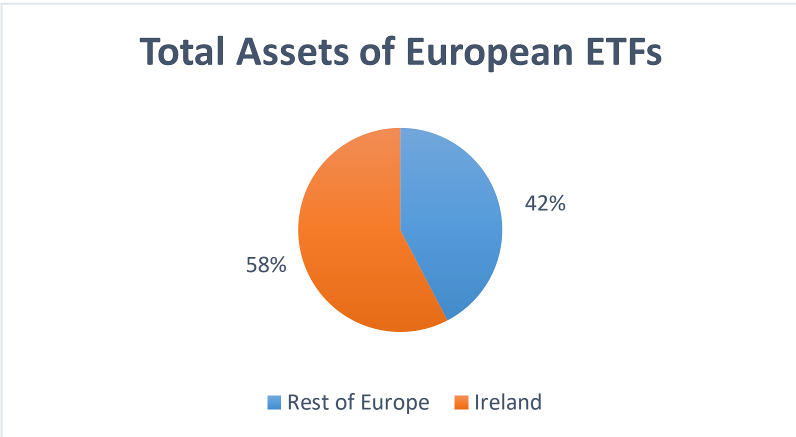
### 3.1.3 Luxembourg versus Ireland

Ireland and Luxembourg are the European domiciles of choice for cross-border fund distribution. Both have a long-standing reputation and are globally recognized as experts in creating and distributing a wide range of funds (Matheson, 2016). They have a strong and competent regulatory framework for Investment funds with a clear process and a wide range of investment structures. However, they also differ in some aspects and this section will illustrate the differences between them.

As showed in figure 4 the main UCITS exporting country in Europe is Luxembourg with a percentage of 61% followed by Ireland with 28%. On the other hand, Ireland is incomparable when it comes to hedge funds. It is the largest hedge fund administration center in the world. Ireland services alternative investment assets representing approximately 40% of global and 63% of European hedge fund assets (Matheson, 2016).

Moreover, Ireland has strengthened its reputation for complex funds, including exchange traded funds and money market funds. As shown in the below figure Irish domiciled ETFs represent approximately 58% of the total European ETF market.

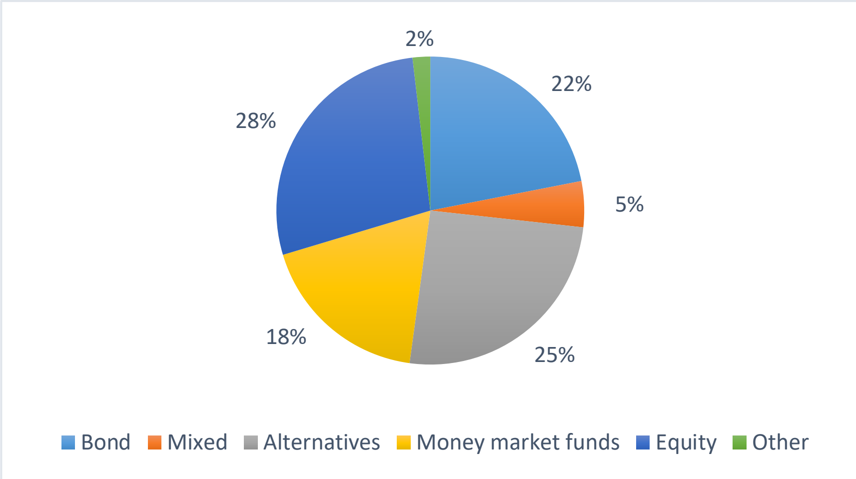
*Figure 20: Total Assets of European ETFs*




Source: Performed by the author based on the data available on If Irish Funds Industry. (2019). Statistics.

In Luxembourg money market funds represent only 8% (figure 12) of the total net assets of Investment funds contrary to 18% in Ireland as shown in figure 21.

*Figure 21: Breakdown by investment policy in Ireland.*




Source: Performed by the author based on the data available on If Irish Funds Industry. (2019). Statistics

Additionally, Ireland has the largest number of stock exchange listed Investment funds, with over 7,000 classes listed (Matheson, 2016).

There is no income tax, subscription tax, redemption tax, corporation tax and Irish funds are exempt from Irish tax on their income or gains, regardless of where investors are located. Also, Ireland does not impose any annual tax comparable to the "*taxe d'abonnement*" in Luxembourg (Matheson, 2016).

Ireland's 12.5% rate of corporation tax is the lowest in the OECD and is more advantageous than the 29.22% proportional rate in Luxembourg.

As a conclusion it can be said that although Luxembourg has also managed to specialize in the Alternative Investment Funds space it dominates the UCITS sector while Ireland dominates the Alternative Investment Funds sector being number one for hedge fund servicing. However, an advantage for Luxembourg is that it has been developed and marketed its financial services for longer and more extensively than Ireland. The fact that Luxembourg was the first country to implement the first UCITS Directive into national law allowed it to attract many international fund promoters very early on. Furthermore, Luxembourg is more competitive in the range of structures and alternative managers it offers (Matheson, 2016). Table 8 summarizes the major differences between Luxembourg and Ireland.

*Table 8: Differences between Ireland and Luxembourg in the Investment Fund Industry*

| | **Luxembourg** | **Ireland** |
|---|---|---|
| **Categories of funds** | UCITS (part I)<br>AIFs:<br>• Part II;<br>• SIF;<br>• SICAR;<br>• RAIF. | UCITS<br>AIFs:<br>• RIAFIs;<br>• QIAIFs. |
| **Legal Structures** | FCP; SICAV; SICAF. | Unit Trust; Investment Company; Common Contractual Fund; Investment Limited Partnership; ICAV. |
| **Supervision** | CSSF | CBI |
| **Taxation** | Income tax;<br>Subscription tax of 0,01% or 0,05% depending on the legal form;<br>No withholding tax except if EU savings directive applies;<br>No capital duty;<br>Value added tax (VAT) for some services;<br>Corporate tax of 29,22%;<br>Double taxation treaties depending on the legal form and structure. | No income tax;<br>No subscription tax;<br>No redemption tax;<br>Irish funds are exempt from Iris tax on their gains and income;<br>No capital duty;<br>Value added tax (VAT) for some services;<br>Corporate tax of 12,5%;<br>Double taxation treaties with over 70 countries. |
| **Specificities** | Largest investment center in Europe;<br>First country to implement the UCITS Directive;<br>Leader in UCITS. | Leader in hedge fund sector;<br>Strong reputation for complex funds such as ETF and money market funds;<br>Largest Stock exchange for investment fund listings, with 7,000 classes listed. |

Source: Performed by the author

## 3.2 The impact of Brexit

On 23 June 2016, the majority of the British population (51.9%) voted for the exit of the United Kingdom from the European Union. Since then Brexit has generated a competition between several major European cities that play an important role in the financial sector. According to the “Brexit sensitivity index” calculated by the rating agency Standard & Poor's the three most exposed European countries at Brexit are, Ireland, Luxembourg and the Netherlands and the least exposed countries are Italy, Austria and Finland (Fort, 2019).

The aim of this section is to describe the consequences of Brexit on the Investment funds industry as well as the major effects it has already caused particularly to Luxembourg and to its direct competitor, Ireland.

The Luxembourg Government has, from the beginning, declared that relations with the UK would remain important. It pointed out that since the internal market is based on four freedoms that it would not be possible for the UK to restrict the free movement of persons while continuing to benefit from the other three freedoms. Prime Minister Xavier Bettel made it clear: "before, they were in and they had many opt-outs; now they want to be with many opt-ins. We're not on Facebook where there's an 'It's complicated status' "(quote from 12 October, 2016, BBC).

The UK is an important partner of Luxembourg since they are both supporters of the economic liberalism. Their partnership is also important in the field of transnational European cooperation.

### 3.2.1 Implications of the loss of the key EU passports for Investment Funds

In the absence of an accord where EU rules would continue to be implemented in the UK, the UCITS and AIFMD regulatory regimes will not be applied in the UK anymore and the UK will be qualified as a “third country” (O’Conner, 2019).

Since UCITS are EU-domiciled funds with EU-domiciled ManCos if there is no agreement nor changes to UCITS legislation, UK UCITS will no longer be UCITS, and UK ManCos will no longer be able to be ManCos for the twenty-seven European UCITS countries.

The UK  will no longer benefit to passport across the EU under the UCITs regime and to continue to be marketed in the EU:

- National private placement regimes will need to be implemented; or
- The fund can be re-established in an EU member state (Mayson Hayes & Curron, n.d.).

Unlike the UCITS Directive, both AIFs and AIFMs may be EU or non-EU. Therefore, the impact of Brexit on AIFs is different than for UCITS. If an UK AIFM manages AIFs, it will continue to be able to manage EU AIFs but they will loose the access to the AIFMD management passport and UK AIFs that are managed by UK AIFM will similarly loose access to the marketing passport. Also, any UK AIFs managed by an EU AIFM will also loose access to the marketing passport (O'Conner, 2019).

This way to continue to be marketed in the EU, the fund could:

- Continue to be marketed by the UK AIFM with no great change if the AIFMD passport is extended to the UK post-Brexit; or
- Appoint an AIFM in an EU member state; or
- Consider re-establishment as a self-managed AIF within an EU member state (Mayson Hayes & Curron, n.d.).

Until agreements and changes in the legislation are not put in place, the UK has created the Temporary Permission regime that allow EU UCITs and AIFs to continue to be sold in the UK.

In Luxemburg, on 28 March 2019, the Chamber of Deputies passed a law, Law n°7426, that permits Investment funds to have a one-year delay to resolve breaches of investment rules and EU passporting problems resulting from a "hard" or "no-deal" Brexit. The purpose of this law is to preserve market stability and protect investors from negative Brexit issues. This law affects UCITS and SIFs.

The one-year delay permits to Luxembourg funds to modify their portfolio composition as well as their investment strategies and prospectuses (Veeckmans, 2019). The law also allows UK Management Companies, authorized as AIFMs, to continue selling their UK UCITS in Luxembourg for maximum one year, until getting a Management Company in the EU. The law will enter into force starting from the date of the UK's departure from the EU (Veeckmans, 2019).

### 3.2.2 Luxembourg or Ireland?

Brexit has led investment managers to decide to open their next fund in Luxembourg or Ireland. Both Ireland and Luxembourg have a solid reputation as Investment fund domiciles and have business friendly tax systems. UK asset managers may appoint a third party AIFM in Luxembourg or in Ireland that would manage their EU-based AIFs to continue to have access to the EU passporting regime.

One major advantage for Luxembourg is the SCSp form that is more attractive in Luxembourg than the current legislation in Ireland. However, Ireland is better positioned since they have a similar culture, the same time zone, a common law legal system and they are English-speaking.

On the other side, Ireland's Investment funds do not benefit from the same flexibility as Luxembourg with the introduction of the new law. UK managers distributing UK Investment funds in Ireland have already started transferring their funds to Irish ManCos, knowing that they will not benefit from a time frame to take the necessary actions (Veeckmans, 2019).

UK funds managers have clear advantages in re-allocating their business to Luxembourg as it is the largest Investment fund center in Europe and has the adequate international human resources and infrastructures. Moreover, most of the UK Fund Managers already have subsidiaries located in Luxembourg.

The reallocation of UK Fund Managers to Luxembourg would increase the attractiveness for multinational companies in Luxembourg. This could also mean for Luxembourg an increase in its population and therefore in the real estate prices, possibly also requiring certain adaptations of the infrastructures.

According to ALFI, 23 asset management companies based in the UK have publicly declared that they will create or strengthen their presence in Luxembourg. Some of them are for example JPMorgan, Blackstone, MJ Hudson, Columbia Threadneedle, M&G Investment Ltd (Di Pillo, 2019).

Since the Brexit referendum EUR 72 billion in capital has been moved to offshore funds by UK investors (Taylor, 2019). Dublin has received EUR 48 billions of net inflows from the UK since June 2016, with Luxembourg receiving only EUR 23 billion (Taylor, 2019).

It can be said that Dublin comes up as the clear winner in terms of attracting business from the UK, with 100 firms choosing the Irish capital as a post-Brexit location. 60 have chosen Luxembourg, 41 Paris, 40 Frankfurt and 32 Amsterdam (Wright et al., 2019).

# CHAPTER IV: DESCRIPTION OF THE INTERNSHIP

## 4.1 Presentation of the host entity

### 4.1.1 PricewaterhouseCoopers

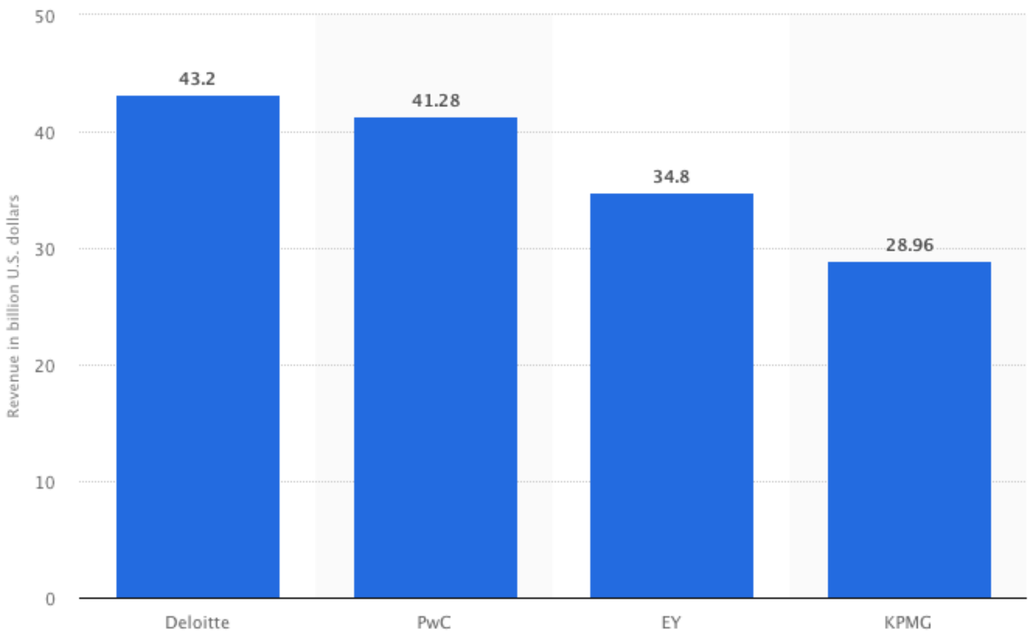
Price Waterhouse and Coopers is a multinational professional services network that is headquartered in London. The company serves clients since the nineteenth century. The firm was founded in 1850 in London by Samuel Price and in 1865 it decided to do a partnership with Edwin Waterhouse due to the increase demand of accounting services. At the end of the 19th century, Price Waterhouse gained a solid reputation in England and in 1980 Price Waterhouse decided to open a new office in New York as the firm mainly dealt with US customers. Then in 1997 the firm merged with another powerful audit firm Coopers & Lybrand which was very present in the United States as well as in Russia and the Eastern European countries. This resulted in a new industry leader in terms of size and revenues, with approximately 13,000 employees and revenues estimated at $12 billion. Following the merger, the company continued to grow while acquiring new companies in Europe.

Today, PwC serves 26 industries and is a network of firms in 158 countries with more than 236,000 people who “deliver quality in assurance, advisory and tax services” (PwC, 2019a).

The PwC world network, also known as PwC International Limited, is a global network of separate firms, operating locally in countries around the world. The companies are members of PricewaterhouseCoopers International Limited and have the right to use the PricewaterhouseCoopers name (PwC 2018a). They share “knowledge, skills and resources” (PwC 2018a: 109). Since they are a member of the PwC network, they also agree to accept certain common policies and keep the standards of the PwC network (PwC 2018a). Annex II shows PwC’s global split of revenues by service line and by geographic region.

It is one of the so called Big Four that refers to the four largest auditing and accounting firms in the world. They are called “Big” because of their “size, reputation and worldwide reach” (Big 4 Career Lab, n.d). The group is made up of PwC, Deloitte, EY (Ernst and Young) and KPMG (Klynveld Peat Marwick Goerdeler). The Big Four have helped to develop a new form of business entity. They have a common code of conduct and are coordinated in terms of “brand, risk, quality, values and ethics” (Shore & Wright, 2018: 310). Figure 22 shows the revenues of the Big Four worldwide in 2018.

*Figure 22: Revenues of the Big Four worldwide in 2018*




Source: Statista. (2019). Revenue of the Big Four accounting / audit firms worldwide in 2018 (in billion U.S. dollars).

Deloitte is the largest of the Big Four firms in terms of revenues and has generated approximately $ 43,2 billion. With a revenue of $ 41,28 billion, PwC is in second position and EY occupies the third place with $ 34,8 billion. KPMG is the smallest of the four with $ 28,96 billion.

### 4.1.2 PricewaterhouseCoopers in Luxembourg

PricewaterhouseCoopers Luxembourg, is a member of PwC International Limited and operates as a "*Société coopérative*" since the first of July 2012. It is registered as an approved audit firm ("*cabinet de révision agréé*") as per the Law of 23 July 2016 on the audit profession (PwC 2018a).

PwC Luxembourg is the largest professional services firm in Luxembourg with 2,850 people employed from 77 different countries. It has a subscribed capital of EUR 857,450 and a total of capital and reserves of EUR 23,216,220.68 at 30 June 2018.

PwC Luxembourg serves seven industries:

1. Asset and wealth management
2. Banking
3. Insurance
4. Operational Companies
5. Private
6. Government and Public Sector
7. Real Estate

They serve all type of clients from large multinationals to small family-run enterprises as well as the public and institutional sectors (PwC, 2018b).

The purpose of the company is to "build trust in society and solve important problems" (PwC, 2018a: 8).

The gross sales in millions of euros were 445,631 in 2018 which is a growth of 10.19% compared to 2017 (PwC, 2018a). Table 9 shows the percentage of the gross revenue of 2018 per service and per industry.

*Table 9: Percentage of Gross Revenues per service and per industry in 2018*

| **% of Gross Revenues 2018 per service** | **% of Gross Revenues 2018 per Industry** |
|---|---|
| Statutory Audit: 36.9% | Public Sector: 6% |
| Other Assurance Services: 5.2% | Private Equity: 12% |
| Tax: 33.2% | Real Estate: 16% |
| Advisory: 24.6% | Financial Services: 47% |
| | Operational Companies: 20% |

Source: Performed by the author based on PwC (2018a). *Annual Review*. P.11

#### 4.1.2.1 Structure

Since PwC Luxembourg is a Partnership it means that Partners execute their work with certain autonomy and entrepreneurship. It is a group of professionals that work together to benefit the firm and clients that are paid on the firm's results.

Partners have assigned the overall responsibility for strategic, business, operational and financial management of the Firm to a Country Leadership Team (CLT). The CLT is composed of the CEO, who is elected for four years by the Partners, a Deputy to the CEO (currently also the Financial Services leader), a Tax leader, an Audit and Assurance leader, an Advisory leader, a Compliance and Risk leader, a Finance and Operations leader, a People leader, a Clients and Markets leader, a Strategy leader and a Chief Transformation Officer (PwC, 2018a: 110). The Firm also has an oversight body (the Supervisory Board). This board is composed of 7 members elected among and by the partners, for a term of four years (PwC, 2018a: 110).

#### 4.1.2.2 Departments

PwC Luxembourg is divided in different departments that provide different services to clients. These are:

1. Tax
2. Advisory
3. Assurance
4. Corporate Services

1. Tax

PwC bases their tax services on three main pillars: (1) Corporate tax compliance and accounting services, (2) Fund tax compliance and (3) Tax consulting (PwC, 2018a).The tax teams help clients to execute their tax obligations, to prepare their annual accounts and give them support in the complex international tax environment (PwC, 2018a).

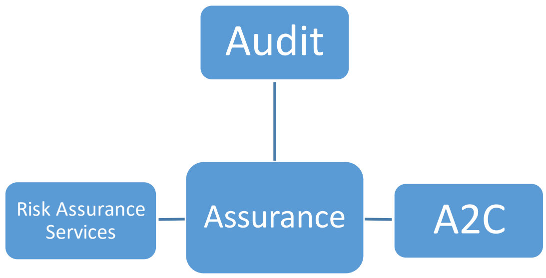
2. Advisory

The advisory teams support organizations with “the challenges of a changing business environment, the sustainability of their business models as social impacts and good governance” (PwC, 2018a: 18). The Advisory department serves the needs of their clients in three market segments namely, financial services, industries and services and the public sector (PwC, 2018a).

3. Assurance

The Assurance group provides assurance on the financial performance and operations of the business and helps to improve external financial reporting and adapt to new regulatory requirements. This department is divided into three sub-departments (figure 23) which are Risk Assurance Services, Audit and A2C (Assurance to Clients).

*Figure 23: Division of the A2C Department into three sub-departments*




Source: Performed by the author

The Risk Assurance team offers to its clients a variety of specific insurance services such as data assurance services, IT assurance and Regulatory services as well as advices about anti-money laundering.

Audit occupies the main part of the assurance work. The objective of an audit is to analyze whether the information presented in the financial report reflects the financial situation of the company at that given date.

The primary goal of the A2C department is to provide an on-going support to engagement teams and to facilitate the transfer of audit and quality comments to the auditors, administrative agents and external providers. Having done my internship in the A2C department it will be explained in detail in section 4.1.2.3.

4. Corporate Services

Finally, the last department provides the necessary support for the other lines of services to operate. Since changes and transformations impact all the sectors, this department establishes robust processes that permit the progress of the company. This department includes:

- Human Capital Committee (Talent acquisition, People Share, Talent and Career Development);
- Operations Committee (Event organization, Business support, Finance, Information Technology, Project Management Office);
- Knowledge Research Marketing Communication;
- Territory team (General Secretary, Office of General Counsel (OGC), Data Protection Office) (PwC, 2018a).

#### 4.1.2.3 A2C Department

The department in which I had the opportunity to do my internship was the “Assurance to Clients” department and more precisely in the service “Financial Reporting Services”.

The department is composed of four different services namely:

- Data for you (D4U);
- Audit Efficiency (AE);
- Custody & Pricing Solutions (CAPS);
- Financial Reporting Services (FRS).

D4U is a group established to better serve the audit teams in the field of Data collection and management. They do the fund accounting data collection, implement and monitor files transfer protocols, and do data quality checks.

The audit efficiency team is in charge of performing, reviewing and documenting audit tests delegated by audit teams. Its main objective is the preparation of audit tests and reports on a centralized basis and with automatization tools. The goal of the team is to achieve greater efficiency in terms of costs and respect of deadlines.

CAPS is a central group that provides an ongoing support function to engagement teams around valuation areas. They have developed specific technologies and softwares to answer all audit requirements in terms of securities pricing and derivatives valuation as well as to facilitate the fund audit process.

FRS is responsible for the quality review and follow-up of the financial statements and annual reports of Investment funds, management companies, insurance and reinsurance companies, banks, operational companies, Private equity, Real Estate entities, Securitization annual accounts and PSF’s annual accounts.

In collaboration with the audit teams, it checks the PwC standards for the production of the financial reports. This goes from the compliance with the law and directives, the general presentation, the internal consistency to the preparation of letters for the end of the audit (No Comment Management Letters and Representation Letters for instance). The department is also responsible of the finalization of the review of these reports within the legal deadline by sending the PDF to the Fund’s Administrative or Fund’s Domiciliary Agents in order for them to easily e-file the reports to the CSSF.

The role of the FRS team is to check the internal consistency and accuracy of figures in the Financial Statements and Annual Accounts as well as performing an initial review for compliance with the specific disclosure requirements of the fund company (Lux GAAP (Luxembourg Generally Accepted Accounting Principles ), IFRS (International Financial Reporting Standards), Laws etc.), prospectus and the completion of appropriate disclosure checklists.

It also manages document changes and comments processing on a centralized basis, identifying for the audit teams, changes since the previous draft and the application of PwC comments. It informs the audit regarding some problems noted that must be solved before the delivery of the audit report. The work is done in French, English, and German.

The service is composed of forty-five people with different backgrounds. There are twenty Associates, thirteen Senior Associates, three Managers, one Senior Manager and one Director as well as trainees during busy seasons. The Associates and trainees are in charge of the quality revue of the financial statements of the Investment funds and other industries. The Senior Associates are employees with more experience who review, correct and validate the work done by the Associates and Trainees.

Today, this service counts approximately 1,300 Investment funds and 49 Administrative agents in Scope.

## 4.2 Tasks Fulfilled

The first day at PwC Luxembourg was marked by a Welcome Day that began with the presentation of the values of the company as well as information about practical and administrative questions. I was also able to have a first contact with the human resource department, other interns and employees that joined the company on that same day.

On the first week of the internship I had some e-learnings to do. Those e-learnings helped me on some basic aspects such as how to use a printer but also taught me some important notions such as the independence notion. Independence in itself means that the Associate does not have the right to have a direct relationship with a client with whom he may have a financial interest. For example, by being a customer of a specific bank or insurance company, the Associate does not have the right to work on the reports of these entities.

After some weeks, I also obtained some trainings that introduced and explained the different steps of the quality review as well as the presentation of the different departments of the company. It also explained the importance and the role of an auditor and how the FRS team assists the audit team.

During the internship, I did the same work as the Associates which was the quality review of the Investment funds. The different steps of the quality review will be explained in detail in the next section. An example of an annual report of an Investment Fund can be found on Annex III.

### 4.2.1 Steps of the Quality review

The quality review is done in different steps. The first time the financial statements are sent from the client to PwC are called Draft 1, this Draft goes through two teams, the FRS team and the audit team.

Both teams analyze and review the financial statements and note some comments of the changes that need to be done by the client. Once the report is modified by the client, PwC receives the second draft and makes sure that the adjustments are correct. This procedure is done until the accounts are considered accurate.

All these steps require a certain amount of time and a lot of concentration with the goal of identifying any inconsistencies in the report. The documents used for the review are saved in a working tool called “Ingenium”.

To start a review, one of my Senior Associates assigned me the tasks through a tool called “WISH” which is a tool that includes all the tasks to be performed by the FRS team as well as the deadline for FRS to provide it as completed. The different steps of the quality review will be now explained.

#### 4.2.1.1Determine the type of the Investment fund

The first step to do when reviewing an annual report is to know what type of Investment fund and which accounting principles we are facing since it will determine the legal requirements and specificities. The information is stated in the notes of the annual report or in the general information.

### 4.2.1.2 Comparison

After having determined the type of Investment fund, I needed to perform a comparison of the new version with the signed version N-1 to check the changes from last year, more precisely to check what the client has added or deleted. The comparison was done by a program called “Power PDF” that bars the items that were deleted and highlights the items added. Thus, the Associate can distinguish the changes and notify them on the Draft with blue color. In addition a tampon is put on the first page to inform the audit team that the comparison was done.


The compare serves also to check if the N-1 figures still present in the N financial statements match. This is the case for example for the net assets of the previous year that is included in the SOP (Statements of Operations) or for the statistical information that shows the values of the net assets, shares outstanding and NAV per share from the two previous years. To show that the numbers were verified it is necessary to put a tick next to each of them.

### 4.2.1.3 Check Prospectus

The check Prospectus is only necessary in two cases, if it is the first year of the Investment fund or if there is a new Prospectus. In these cases, it is necessary to check the different information detailed in the report such as the Administration, General information and the notes to the financial statements. Moreover, the name of the fund and sub-funds, the currency of the fund and sub-funds and the closing date of the fund must also be verified and compared with the Prospectus.

### 4.2.1.4 Recalculation

One of the most important steps is the recalculation of the figures that verifies the financial statements presented in the report. The recalculations are done in an Excel file and the sums obtained must be the same as those in the report.

The recalculation consists of the verification of the SNA (Statements of Net Assets) and SOP, the securities portfolio as well as the calculation of the change of the unrealized result of year N, the performance of the fund, the net asset value per share, the calculation of the derivative instruments and any other calculation presented in the report. All percentages and calculable sums presented in the management report or in the Notes must also be calculated in the Excel file.

If differences are noticed, the Associate leaves a comment to the client that needs to rectify it. If the figures and sums match, then the Associate puts a "tickmark" also known as "footing" next to each verified total to inform the audit team that the figures are correct. Examples of tickmarks are:  and 

Some examples of recalculations that I performed are:

- The performance of a share class with the formula:

  (NAV per share of N – NAV per share of N-1)/(NAV per share of N-1)*100;

- Change of the unrealized result;
- Sums in the schedule of investment: total cost, total market value, total percentage of net assets;
- Number of shares outstanding;
- NAV per share for each class.

#### 4.2.1.5 Consistency Check

a) Cover page

The check of the consistency begins on the cover page that indicates the name of the fund, the closing date as well as the legal structure of the fund. As stated before, these must be checked with the Prospectus of the fund. The cover page also includes the number of the Trade and Companies Register.

For funds of the form of a SICAV, the number is given in the form of R.C.S (for example B4522). For funds in the form of FCP, the number is indicated in R.C.S.K (for example R.C.S.K 4855). Moreover, in case of FCP it is best practice to also indicate the R.C.S number of the management company since it has no legal personality.

The R.C.S number can be checked on the website of the Trade and Companies Register (lbr.lu). The Associate must place a screenshot on the cover page to prove that the information has been verified. By entering the name of the fund, the name of the management company of the fund or the R.C.S number, we can find the following information:

- The name or business name;
- The registration number;
- The legal form; and
- The registered address.

Example:

**Triodos SICAV II**
**B115771**

^ Informations

**Dénomination(s) ou raison(s) sociale(s)**
Triodos SICAV II

**Siège social**
11-13, Boulevard de la Foire
L - 1528 Luxembourg

**Date d'immatriculation**
27/04/2006

**Forme juridique**
Société d'investissement à capital variable

b) Management Report

Since the management report is essential for investors, it is necessary that the data presented is authentic. The data that must be verified by the FRS team is:

- The name of the fund or sub-fund;
- The form;
- The currency used in the accounts;
- The figures;
- The performances; and
- The closing date.

If performances or variations of amounts are expressed in the report and are verifiable, they must be recalculated in the Excel file.

c) Audit Report

The audit report is an opinion prepared by the FRS team and signed by an audit Partner that certifies that the financial statements are transparent and faithful and do not contain any anomalies or on the other hand that the accounting standards are not respected. An example of an audit report can be found in the Annex III. This audit report must be checked by the

Associate that must compare the version available in the annual report with the one available on the template Ingenium. If in the first Draft the Audit Report has not been attached the FRS team is in charge of creating and attaching it.

In particular, the Associate must ensure that the following information is correct:

• Name of the fund or sub-fund;

• Closing date and the date of the audit report;

• Statement of Net Assets, Statement of Operations, Schedule of Investments;

• Consistency with the Template;

• Name of the partner that signs the opinion.

d) Cross-Check

Cross-checks are used to check that the different elements in the report are consistent throughout the report to avoid, for example, spelling mistakes. A Cross-check is illustrated as follows: 

The different elements that need to be cross checked are:

1) Table of contents and page numbers;
2) Name of the fund, sub-funds and share classes: the names need to be written in the same manner in the whole report and identical as in the prospectus;
3) Closing date;
4) Currency of the fund, sub-funds and classes: If the currency of the SNA is in euro, it is mandatory that the SOP is in the same currency and that the currency is mentioned in the notes;
5) Figures: for example the NAV must be the same in the SNA and in the SOP as well as in the schedule of investments;
6) Notes: Check that the notes (number and title of the note) taken from the SNA and SOP correspond to those included in the notes to the accounts;
7) Footnotes: check if the footnotes can be referenced.

e) Other Checks

Other checks done by the Associates include for example the check of the maturity of investments and derivative instruments in the schedule of investment that must be after the closing date of the report.

Also, the Associate needs to check if the fund is managed by an AIFM. This can be done on the CSSF website. By entering the name of the Fund, Investment Manager or Management Company, it is possible to see if the entity is an AIFM authorized or regulated. If it is only regulated it means that it has not been authorized until now and that the AIFM Disclosure is not applicable.

Another analysis is the Illustrative check. The illustrative is an internal PwC document containing all the legal and recommended information that must appear in the financial statements. The Associate uses the illustrative to validate the standard notes according to the type of fund. For example, the annual report of a Fund under Part I must include the Global Risk Exposure and funds under Part I or Part II must include the transaction costs. It also permits to verify that the presentation of derivatives is in a certain format. Here is an example (table 10) of Futures Contracts where the following items must be present.

*Table 10: Example of the headings of Futures Contracts*

| **Futures Contracts** | | | | | |
|---|---|---|---|---|---|
| Currency | Number of contracts bought/sold | Description | Maturity | Notional Value | Unrealized appreciation Or depreciation |

Source: Performed by the author based on Internal PwC Illustrative (confidential document).

6. Checklists

When the quality review is finished, the Associate is responsible for completing two checklists, the Overall Conclusion Analytics and the Disclosure Checklist. These two checklists are confidential and cannot be illustrated in this report.

The Overall Conclusion Analytics considers the Financial Statements and is represented by questions such as: Are there any unusual accounts or inconsistencies in the Statement of Net Assets and the Statement of Operations? Other questions are related with the securities lending, performance fees and derivatives. The Associate responds with a yes, no or not applicable.

The disclosure checklist is a mandatory document that ensures that all required notes and information are in the financial statements, that recommends information that is best practice and checks that all requested tasks have been performed. The disclosure checklist is longer than the Overall Conclusion Analytics and can be answered by Yes, N/A (not applicable) or O/S (states that the information necessary is missing in the report).

At the beginning of the checklist, it is necessary to indicate whether it is an Investment fund under Part I, Part II a SIF or a foreign fund. This is of great importance because the checklist is divided into applicable questions for all legal forms, while some other questions in the checklist are applicable only for some forms of Investment funds. The checklist enables to check that all steps have been completed and that all the provisions have been fulfilled in the report. For funds under Part I of the Law, Part II of the Law, SIFs and RAIFs one of the information that must be presented is the distribution of the fixed and variable remunerations. Therefore, an example of questions in the checklist are:

- Remuneration disclosure: should include a general description relating to the financial and non-financial criteria of the remuneration policies and practices.
  => Total remuneration paid by the Manco to its staff at year-end, split into fixed and variable remuneration.
  => Remuneration of delegates to disclose if delegate located in the EU.
  => Total remuneration of staff in the Manco involved in the UCITS activities.
  => Number of beneficiaries.
  => Carried interest paid by the UCITS, if any.

Example of AIFM provisions questions are:

- When authorized AIFM => overview of investment activities during the year and overview of the AIF's portfolio at year-end.
- When authorized AIFM => overview of AIF performance over the year.
- When authorized AIFM => Remuneration disclosure in Activity Report/other unaudited information,
  -> Total remuneration paid by the AIF and/or the AIFM to the identified staff of the delegates at year end split into fixed and variable remuneration.

-> Total remuneration of the identified staff of the delegates in the AIFM involved in the AIF activities.

-> Number of beneficiaries.

- When authorized AIFM => the AIFM is required to provide investors with information on risk management, liquidity arrangements and leverage on a periodical and regular basis and at a minimum at the same time than the annual report.

After I did all these steps, I needed to validate it on “WISH” and a second review was performed by a Senior Associate or Manager in order to ensure the accuracy and the quality of the review of the financial statements performed and the completion of the disclosure checklists.

## 4.3 Critical Analysis

After four months at PwC I can say that I had the opportunity to develop communication skills, adapt to new environments and new ways of working as well as organization and flexibility. It has also helped me to develop some knowledge such as the access to certain computer tools, a more efficient use of Excel and internal programs of the company.

Audit is a very challenging area in its various aspects. The deadlines set to do the work also introduced the need to deposit a large capacity of time management and therefore resistance to work under pressure.

PwC Luxembourg was my first choice to do my internship. First because it was the opportunity for me to go back to my home country, Luxembourg, and second because I always wanted to know how the work environment in a Big Four is and especially at PwC that is recognized for providing a lot of training and knowledge very quickly.

PwC has a strong team spirit and cooperation between all the employees. I had the chance to work with an excellent team that gave me the knowledge and support that I needed. My team integrated me well and mutual aid and solidarity were always present.

In my opinion my contribution was positive since I learn and work fast, I am efficient and have a strong team spirit. Moreover, since I speak the three official languages of

Luxembourg (French, German and Luxembourgish) I was able to work in all of them and develop them better.

One important point was that the company did not make any distinction between trainees and employees which resulted in autonomy and sense of responsibility. The learning environment was indeed stimulating and provides me with an excellent base for the future.

Since my work was directly related with the Investment Funds in Luxembourg and since this was also the subject of my internship report it definitely helped me to write this report and to understand the complex structure of Luxembourg Investment Funds.

However, there were also some negative points. First a less positive point was that even though when I arrived at PwC I had the chance to be trained by my two Senior Associates from my table, the official training with the other trainees was done one month after I arrived. This training could have benefitted me more at the beginning.

Another negative point to note were the constant "bugs" of the different software's and of Internet that restrained us from working or that made us loose all our work. This in tough times was very stressful and disturbing.

Starting in March the department begins a period called "busy" because there are a lot of funds to review as most funds close on December 31$^{st}$ and this is also why the firm hires trainees to help them. One of the difficulties for me was to adapt to this stressful situation. As I had just started the internship, I had to learn how to handle the stress and to adapt to the amount of work and learn the tasks as quickly as possible to help the team.

Another difficulty encountered at the beginning of the internship was to change between the different languages used in the reports. As explained before, since I worked in German, French and English I had to learn all the expressions and denominations in those three languages. What presented a challenge at the beginning proved to be a good opportunity to deepen my linguistic abilities.

I would definitely recommend PwC as a host entity because I was able to develop many competencies in a very short time such as autonomy, responsibility and team spirit.

In conclusion, internships are an important tool for the development of skills of future professionals allowing a closer contact with the professional reality. As a result, my internship at PwC was an enriching experience both personally and professionally that adds value to my future career prospects.

# CONCLUSION

In a very competitive marketplace, it is essential to combine theory and practice. In this sense, I opted to do an internship as a way of concluding my Master's degree in Management.

The objective of this internship report was to highlight the different structures of Investment Funds available in Luxembourg and the importance of this so small country in the Investment Fund industry.

Luxembourg has succeeded in identifying the expectations of ambitious and cautious investors and incorporated these expectations into appropriate structures. Today, Luxembourg leads the UCITS industry with the result that two out of three UCITS are based in Luxembourg. The fact that Luxembourg was the first country to implement the UCITS Directive into its national law allowed it to attract many international promoters very early on. Moreover, it has also developed in parallel extensive expertise in Alternative Investment Funds. It offers structures for all the main alternative asset classes and investment strategies such as Hedge funds, Private Equity and Real Estate.

Through this work it was possible to describe the different legal forms and structures that Luxembourg offers and that are adapted for different types of investors. Investment funds are one of the best solutions to increase wealth while minimizing risk. They have been growing and are becoming more known by the general public who is looking for an accessible and different product. Investing in Investment Funds permits to benefit from the advantages of working as part of a group. Investors benefit from economies of scale, from a decrease in risk through diversification and from a professional management.

It can be said that Investment Funds are the most successful in countries with a good reputation for regulation and with clear legal systems which is definitely the case in Luxembourg. Giles et al. (2003) states:

> Collective investment funds only develop successfully where legal systems provide for clear and fair mechanism of asset ownership and transfer and for redress if things go wrong, basically where rights can be predictably sustained. In such an environment, people can be reasonably sure that if they hand over their money to someone else for management, that it will be properly looked after and that they will be able to get their money back subject to the terms stated in the contract (Giles et al., 2003: 2).

This report has also permitted to understand the direct competitors of Luxembourg such as Ireland and to talk about the consequences of Brexit as well as the different adjustments that Luxembourg has already implemented. The winner in terms of Investment Funds because of Brexit is still unclear, but it can be said that Luxembourg has already benefitted from it and will continue to benefit.

Since there is not a lot of literature about Luxembourg's Investment Funds it was hard for me to obtain information, this is also why my main resources to write this report were electronic documents from different companies and institutions such as ALFI or the CSSF.

This report enabled me to acquire and deepen my knowledge about the different types of Investment Funds available in Luxembourg and to understand the importance of Luxembourg in the Investment Fund industry.

To conclude, the accomplishment of this internship revealed in a highly valuable and enriching professional experience, provided me with new theoretical and practical knowledge and with new technical and personal skills that would not be possible without the support of the entire FRS team. I now feel prepared to face the professional future with the certainty that I did the right choice about my academic career.

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# ANNEXES

## Annex I: Ten Reasons why the fund industry chooses Luxembourg

1. “It has a stable political and social environment and a strong economy;
2. It is a founding member Union and is situated at Europe, with about 510 million European citizens on its doorstep;
3. Luxembourg’s legal and regulatory framework for investment funds is state-of-the-art and recognized as such by the global asset management community;
4. With more than EUR 4,000 billion in assets under management, Luxembourg is the number one investment fund center in Europe and Number Two in the world after the US;
5. It leads the way in investor protection and has a highly experienced and responsive regulator;
6. It has a unique concentration of investment fund experts specialized in all aspects of product development, administration and distribution;
7. It has established a competitive framework for UCITS (Undertakings for Collective Investment in Transferable Securities), funds “passported” within the EU, and non-UCITS funds;
8. Its fund lawyers, audit firms and tax advisors are highly experienced in cross-border registrations of both UCITS and non-UCITS funds, facilitating fund distribution around the globe;
9. Its laws provide for umbrella funds, which have several compartments under a single legal structure and each can invest in a different asset class;
10. Luxembourg is endowed with an international and multilingual workforce. English is the language of the financial sector, French, German and other European languages are also spoken.”

Source: ALFI. (2017). *Luxembourg: the Global Fund Centre*. P 4-5.

# Annex II: PwC's global split of revenues by service line and by geographic region

PwC's revenues were $ 41,28 billion in 2018, an increase of up 7% on the prior year.

Unlike some of the other Big Four, PwC focuses more heavily on audit services. In fact, almost 41.3% ($ 17,056 billion) of its revenues were from audit related services. Advisory counted for $ 13,7 billion (33.4%) and tax for $ 10,4 billion (25.3%) (PwC Global, 2019).

*Table 11: Split of revenues by service line worldwide in 2017 and 2018 in USD.*

| | 2018 | 2017 |
|---|---|---|
| **Assurance** | 17,056 | 15,965 |
| **Advisory** | 13,779 | 12,253 |
| **Tax** | 10,446 | 9,462 |
| **Revenues** | 41,280 | 37,680 |

Source: Performed by the author based on PwC Global. (2019). Revenues.

In the Americas, revenues grew by 4%, by 6% in Western Europe and in Central and Eastern Europe by 10%. Revenue growth from the Middle East and Africa was impressive at 12%. Across Australasia and the Pacific, revenue growth was 7% while PwC's strongest growth was in Asia where revenues grew 15% (PwC Global, 2019).

*Table 12: Split of revenues worldwide by geographic region in 2017 and 2018 in USD.*

| | 2018 | 2017 |
|---|---|---|
| **Americas** | 17,454 | 16,800 |
| **Asia** | 5,675 | 4,900 |
| **Australasia and Pacific** | 1,810 | 1,650 |
| **Central and Eastern Europe** | 918 | 776 |
| **Western Europe** | 13,864 | 12,192 |
| **Middle East and Africa** | 1,559 | 1,362 |
| **Revenues** | 41,280 | 37,680 |

Source: Performed by the author based on PwC Global. (2019). Revenues.

# Annex III: Example of an Annual Report of an Investment Fund under Part II

Schroders

# Schroder SMBC Global Bond Series

## Audited Annual Report

30 September 2018

Luxembourg

R.C.S. Luxembourg of the Management Company B 37.799 / R.C.S. Number for FCP K 1185

## Schroder SMBC Global Bond Series

Fonds Commun de Placement à Compartiments Multiples (FCP)

# Audited Annual Report

## 30 September 2018

No subscriptions can be received based solely on periodical reports. Subscriptions are valid only if made on the basis of the current prospectus accompanied by the last available audited annual report or unaudited semi-annual report if published thereafter.

Audited annual and unaudited semi-annual reports, the current prospectus and the Management Regulations of Schroder SMBC Global Bond Series (the 'Fund') are available, free of charge, at the Fund's Management Company, 5, rue Höhenhof, L-1736 Senningerberg, Grand Duchy of Luxembourg.

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# Schroder SMBC Global Bond Series

## The Fund

Schroder SMBC Global Bond Series (hereinafter referred to as the 'Fund') is organised in and under the laws of the Grand Duchy of Luxembourg as a mutual investment umbrella fund (Fonds Commun de Placement à Compartiments Multiples). The fund is an unincorporated co-proprietorship of securities and other assets, managed in the interest of its co-owners (hereinafter referred to as the 'Unitholders') by Schroder Investment Management (Europe) S.A. (hereinafter referred to as the 'Management Company'), a company incorporated under the laws of Luxembourg and having its registered office in Luxembourg. The assets of the Fund are segregated from those of the Management Company.

The Fund qualifies as an undertaking for collective investment ('UCI') regulated by the provisions of Part II of the Luxembourg law of 17 December 2010, as amended, regarding undertakings for collective investment (the '2010 Law') and as an Alternative Investment Fund within the meaning of article 1 (39) of the Luxembourg law of 12 July 2013.

This report covers the year from 1 October 2017 up to 30 September 2018. The last day on which prices were calculated was 28 September 2018, the last working day of the financial year under review. The financial statements are prepared in accordance with Luxembourg regulations relating to undertakings for collective investment. At the date of this report, there is one Schroder SMBC Global Bond Series sub-fund (the 'Sub-fund') available for investment.

## The Sub-fund

On 30 September 2018 Schroder Global Bond Open B Distribution (USD) was the only active unit class in the Sub-fund. Further details regarding the investment objectives of the Sub-fund can be found in the Fund's prospectus, which is available free of charge at the Management Company's office, 5, rue Höhenhof, 1736 Senningerberg, Grand Duchy of Luxembourg.

Schroders is a FATCA compliant organisation. The FATCA classification of this entity and its GIIN is as follows: FATCA entity classification: FFI; Sponsoring entity: Schroder Investment Management (Europe) S.A.; Sponsoring entity GIIN: 4RIMT7.00000.SP.442.

## Corporate Governance

The Management Company and the Fund are subject to corporate governance based on:

1. The obligations, in respect of the Fund, as defined by Part II of the Luxembourg law of 17 December 2010, as amended on undertakings for collective investment and the Alternative Investment Fund Managers Directive 2011/61/EU, as implemented in Luxembourg law, which are available for inspection at the registered office of the Management Company at 5, rue Höhenhof, 1736 Senningerberg, Grand Duchy of Luxembourg.
2. The Management Regulations of the Fund, which are available for inspection at the registered office of the Management Company.
3. The obligations in respect of the Management Company, which is subject to the requirements of the Management Company Directive 2010/43/EC and the Alternative Investment Fund Managers Directive 2011/61/EU, as implemented in Luxembourg law.
4. The Association of the Luxembourg Fund Industry ('ALFI') Code of Conduct for Luxembourg Investment Funds, the principles of which the Management Company has voluntarily adopted.

### Internal Control and Risk Management Systems

The Board of Directors of the Management Company is responsible for establishing and maintaining adequate internal control and risk management systems of the Fund in relation to the financial reporting process. Such systems are designed to manage rather than eliminate the risk of error or fraud in achieving the Fund's financial reporting objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Management Company has put procedures in place to ensure all relevant accounting records are properly maintained and are readily available, including the production of annual and semi-annual reports. The annual and semi-annual reports of the Fund are required to be approved by the Board of Directors of the Management Company and filed with the Commission de Surveillance du Secteur Financier ('CSSF'). The annual statutory financial statements are required to be audited by independent auditors who report to the Management Company on their findings.

The Board of the Management Company meets at least four times a year and ensures that the Management Company maintains high standards of integrity and control in its operations and that it possesses adequate governance and means of control as law and regulation demand.

# Board of Directors

## Management Company

**Schroder Investment Management (Europe) S.A.**

5, rue Höhenhof, 1736 Senningerberg
Grand Duchy of Luxembourg

## Board of Directors of the Management Company

### Chairman

- **Carolyn Sims***

**Chief Financial Officer**

Wealth Management Schroder & Co. Limited
1 London Wall Place
London, EC2Y 5AU
United Kingdom

### Directors

- **Nicholas Alter*****

**Head of Technology – Distribution Product & Continental Europe**

Schroder Investment Management (Europe) S.A.
5, rue Höhenhof, 1736 Senningerberg
Grand Duchy of Luxembourg

- **Chris Burkhardt****

**Chief Operating Officer**

Schroder Investment Management (Europe) S.A.
5, rue Höhenhof, 1736 Senningerberg
Grand Duchy of Luxembourg

- **Paul Duncombe*****

**Head of Multi-Asset Product, UK and Europe**

Schroder Investment Management Limited
1 London Wall Place
London, EC2Y 5AU
United Kingdom

- **Vanessa Grueneklee****

**Head of Investment Management and Distribution Services**

Schroder Investment Management (Europe) S.A.
5, rue Höhenhof, 1736 Senningerberg
Grand Duchy of Luxembourg

- **John Hennessey******

**Chief Operating Officer, Distribution**

Schroder Investment Management Limited
1 London Wall Place
London, EC2Y 5AU
United Kingdom

- **Mike Pavey******

**Chief Operating Officer, Portfolio Services**

Schroder Investment Management Limited
1 London Wall Place
London, EC2Y 5AU
United Kingdom

- **Cord Rodewald*****

**Head of Compliance**

Schroder Investment Management (Europe) S.A.
5, rue Höhenhof, 1736 Senningerberg
Grand Duchy of Luxembourg

- **Patrick Stampfli**

**Chief Operating Officer EUROPE**

Schroder Investment Management (Europe) S.A.
5, rue Höhenhof, 1736 Senningerberg
Grand Duchy of Luxembourg

- **Alastair Woodward*****

**Head of Risk, EMEA**

Schroder Investment Management (Europe) S.A.
5, rue Höhenhof, 1736 Senningerberg
Grand Duchy of Luxembourg

*Carolyn Sims was appointed to the Board of Directors on 14 November 2017 and elected Chairman on 16 November 2017.

**Chris Burkhardt and Vanessa Grueneklee were appointed to the Board of Directors on 10 July 2018.

***Nicholas Alter, Paul Duncombe, Cord Rodewald and Alastair Woodward resigned from the Board of Directors on 10 July 2018.

****John Hennessey and Mike Pavey were appointed to the Board of Directors on 14 November 2017.

# Administration

## Principal Paying Agent, Domiciliary Agent, Registrar, Alternative Investment Fund Manager and Transfer Agent

**Schroder Investment Management (Europe) S.A.**

5, rue Höhenhof, 1736 Senningerberg,
Grand Duchy of Luxembourg

## Investment Manager

**Schroder Investment Management Limited**

1 London Wall Place, London,
EC2Y 5AU, United Kingdom

## Custodian and Fund Administrator

**J.P. Morgan Bank Luxembourg S.A.**

European Bank & Business Centre, 6, Route de Trèves,
2633 Senningerberg, Grand Duchy of Luxembourg

## Auditor

**PricewaterhouseCoopers, Société coopérative**

2, rue Gerhard Mercator, 2182 Luxembourg,
Grand Duchy of Luxembourg

## Distributor and Agent Company in Japan

**SMBC Friend Securities Co., Ltd.**

Yamatane Building, 7-12 Nihonbashi-Kabutocho, Chuo-ku,
Tokyo 103-8221, Japan

## Legal Advisers

**In Luxembourg:**

**Elvinger, Hoss & Prussen**

2, place Winston Churchill, 1340 Luxembourg,
Grand Duchy of Luxembourg

**In Japan:**

**Mori Hamada & Matsumoto,**

Marunouchi Park Building
2-6-1 Marunouchi, Chiyoda-ku,
Tokyo 100-8222, Japan

# Directors' Report

## Introduction

The Directors of Schroder Investment Management (Europe) S.A. (the 'Management Company') submit their report and the financial statements in respect of Schroder SMBC Global Bond Series (the 'Fund') for the year ended 30 September 2018.

## Activities during the year

As at 30 September 2018, the total net assets of Schroder SMBC Global Bond Series (the 'Fund') were USD 39,440,434 compared to USD 50,022,647 on 30 September 2017, representing a decrease of 21.15%.

For the year under review, the sub-fund available for investment was Schroder SMBC Global Bond Series - Schroder Global Bond Open, with a B Distribution (USD) Unit class.

We are committed to meeting the needs of our investors and will continue to manage the Fund in their best interests.

**The Board of Directors**
Schroder Investment Management (Europe) S.A.

30 September 2018

The information contained in this report is historical and not necessarily indicative of future performance.

# Investment Manager's Report

## Economic review

The path of US interest rate rises and the prospect of trade wars were dominant concerns for much of the 12-month period. The end of 2017 saw the US pass long-awaited tax reforms, with big permanent cuts for corporations expected to stimulate both growth and inflation. US economic data generally remained robust, with annualised GDP growth of 4.2% in the second quarter of 2018. The unemployment rate hit 3.7% in September 2018, the lowest since December 1969. The Federal Reserve (Fed) raised interest rates four times over the 12 months, taking the policy rate to a target of 2.00-2.25% at the end of September 2018. Trade wars between the US and China were increasingly a focus for markets as 2018 progressed. By the end of the period, the US had imposed tariffs on almost $250 billion of goods from China, around half of total imports, while China retaliated with duties on $110 billion of products from the US, or almost 90% of China's imports from the US.

In Europe, political concerns were a primary consideration. Early 2018 saw Germany form a new government with Angela Merkel remaining as chancellor. Italy's March election saw no overall winner. After months of negotiations, a governing coalition was eventually formed between populist parties, the League and the Five Star Movement. Their spending plans proved a concern for markets, with a proposed 2.4% budget deficit for 2019. Eurozone growth slowed during the period, with expansion of 0.4% in both Q2 and Q1, down from the 0.7% growth rate seen at the end of 2017. The inflation rate moved up to around 2.0% towards the end of the period but core inflation remained closer to 1.0%. The European Central Bank (ECB) announced that it expects to end its quantitative easing (QE) programme in December 2018, and that interest rates will remain at current levels through the summer of 2019.

In the UK, Brexit talks took most of the headlines. Optimism ebbed and flowed as negotiations continued between the UK and European Commission. However, by the end of the period under review the prospect of the UK leaving the EU with no deal appeared to have risen. Some disappointing macroeconomic data in the early part of the year saw the Bank of England (BoE) reduce its 2018 growth forecast to 1.4% from 1.8% previously. However, the BoE did raise interest rates twice over the period, to 0.75%, following a sustained period of above target inflation.

It was a tale of political stability for Japan, with the incumbent LDP winning the October 2017 general election and then Prime Minister Shinzo Abe winning the LDP leadership election in September 2018. This gave enhanced clarity regarding government policy for the forthcoming years. Inflation remained below target and the Bank of Japan made no major changes to its policy framework. The central bank kept the short-term policy rate on hold at -0.1% and the 10-year government bond yield target at "around zero per cent", alongside an unchanged ¥80 trillion annual pace of Japanese government bond purchases.

For emerging markets, the prospect of trade wars dominated the period. As well as imposing tariffs on Chinese products, the US also pushed ahead with plans to revamp the Nafta agreement and confirmed a pact with Mexico towards the end of the period. Meanwhile, Chinese economic growth saw some moderation. The authorities announced a range of targeted economic support measures, including a shift to fiscal stimulus and credit easing. The central bank also re-introduced measures to stabilise the renminbi. Brazil saw an environment of political uncertainty ahead of general elections in October, while a truck driver strike in May paralysed the economy. In South Africa, policy improved following the African National Congress leadership election which was won by anti-corruption candidate Cyril Ramaphosa. Turkey was in focus amid a sharp sell off in the lira. The currency fell as geopolitical tensions with the US exacerbated ongoing concerns over Turkey's wide current account deficit, above-target inflation and central bank independence.

## Fixed income markets

The relatively advanced stage of the US economic cycle became more apparent. Global growth became increasingly US-led, with a series of strong data prints through the middle part of 2018. Europe saw economic activity moderate, back toward trend, after strong growth in 2017.

Global macro risks increased steadily in the form of escalating trade tensions between the US and China and implementation of tariffs, emerging market instability and political risks in Europe.

These factors were reflected in diverging government bond yields. US 10-year Treasury yields rose from 2.33% to 3.06% and two-year yields rose from 1.48% to 2.82%. UK 10-year yields rose from 1.36% to 1.57% and 10-year Bund yields were virtually unchanged at 0.47%.

In Europe, there was volatility in relation to events in Italy. Concerns over potential tensions between the populist coalition government and the European Union (EU) reached a heightened state in late-September as the government announced a larger than expected 2019 fiscal deficit target of 2.4%. Italian 10-year yields rose from 2.11% to 3.15% over the 12 months.

US 10-year yields rose 40 basis points (bps) through January and into early February as growth and inflation expectations shifted higher following the tax reform bill and strong hourly wage growth. Another decisive shift higher in yields came in Q3 amid strong data.

There was significant instability among emerging markets (EM) due to tightening US dollar liquidity and various idiosyncratic factors. Elevated inflation and concerns over public finances led to sharp currency weakness in countries like Argentina and Turkey. Argentina agreed a bailout from the IMF, while Turkey implemented a substantial rate hike. A number of other emerging economies have also begun raising rates.

Global corporate bonds saw a small negative total return, led by the US dollar market, but positive excess returns. Global high yield returned 1.6% as the US dollar and sterling markets performed well. US dollar HY energy returned 5.8%, benefiting from a solid oil price and a substantial improvement in balance sheets within the sector over the past year or so.

*(All data sourced from Bloomberg)*

# Investment Manager's Report (cont)

## Fixed income outlook

Government bond valuations have turned less rich but are still unattractive at current levels. Importantly, US economic data remains relatively robust along with rising inflationary pressures. US Treasuries still look expensive on valuation grounds. For German Bunds, weaker growth has already been priced, but inflation risks have not.

Valuations are unattractive across the credit segments. For US investment grade bonds, valuations are uncompelling and fundamentals are deteriorating. In particular, both merger and acquisitions activity and leverage continue to increase. While corporate fundamentals are in a stronger position in Europe compared to the US, the region is vulnerable to political risk and the withdrawal of QE support.

**The Investment Manager**
Schroder Investment Management Limited

30 September 2018

The information contained in this report is historical and not necessarily indicative of future performance.

# Notes to the Financial Statements as at 30 September 2018

## The Fund

The Fund qualifies as an undertaking for collective investment (UCI) regulated by the provisions of Part II of the Luxembourg law of 17 December 2010, as amended, regarding undertakings for collective investment (the '2010 law') and as an Alternative Investment Fund within the meaning of article 1 (39) of the Luxembourg law of 12 July 2013. The Fund has been established for an undetermined period and may further issue several classes of units in each sub-fund. The financial statements are prepared in accordance with Luxembourg regulations relating to undertakings for collective investments.

## Classes of Units

There was one class of units available for investment as at 30 September 2018:

Schroder Global Bond Open Class B Distribution (USD).

## Initial and Distribution Charges

There are no Initial Charges on B Units*.

The B Units are subject to a Distribution Charge of 1.26% of the Net Asset Value per annum.

No initial charge is paid by an Investor on the acquisition of B Units of the Sub-Fund. Instead a contingent deferred sales charge ('CDSC') may be payable to the Management Company as described in the prospectus of the Fund. Please note that since 1 July 2010, Schroder Investment Management (Europe) S.A. is the commission paying agent for the Fund.

## Minimum Subscription Amount, Minimum Additional Subscription Amount and Minimum Holding Amount

The minimum initial subscription and the minimum holding amount is 100 units. The minimum additional subscription amount is 10 units.

The limits stated above may be waived at the discretion of the Management Company.

## Management Fee

The Management Company is entitled to receive a management fee as remuneration for its services. Such fee is calculated and accrued daily in reference to the net asset value of the portfolio and paid monthly in arrears. The rate for the year under review for B Units was 0.35% of Net Asset Value per annum.

This fee may be waived at the discretion of the Management Company.

## Expense subsidy

The administration fees, custodian fees, distribution fees, management fees and statutory fees are calculated and accrued daily by reference to the Net Asset Value of the Fund and are paid monthly. These fees which were applied to the sub-fund during the year under review, were capped at a maximum rate of 1.78% of the Net Asset Value of the Fund. During the year under review, the Management Company subsidised the Fund in order to comply with the cap on the above mentioned fees.

## Net Asset Value

### Calculation of Net Asset Value per Unit

The Net Asset Value ('NAV') per unit of each class is calculated on each Dealing Day, and expressed in the currency of the relevant sub-fund or class. It is calculated by dividing the NAV attributable to each class, being the proportionate value of its assets less its liabilities (including any provisions considered by the Management Company to be necessary or prudent), by the number of units of such class then in issue. The resulting sum is rounded to the nearest two decimal places. Further details on rules that apply in valuing total assets can be found in the current prospectus.

The assets of each sub-fund are invested for the exclusive benefit of the unitholders of the corresponding sub-fund and the assets of a specific sub-fund are solely accountable for the liabilities, commitments and obligations of that sub-fund.

## Valuation of the Assets of the Fund

The value of any cash in hand or on deposit, bills and demand notes and accounts receivable, prepaid expenses, cash dividends and interest declared or accrued and not yet received shall be deemed to be the full amount thereof, unless in any case the same is unlikely to be paid or received in full, in which case the value thereof shall be arrived at after making such discount as the Management Company may consider appropriate in such case to reflect the true value thereof.

The value of securities, financial derivative instruments and assets is determined on the basis of the last available price on the stock exchange or any other regulated market on which those securities or assets are traded or admitted for trading. Where such securities or other assets are quoted or dealt in on more than one stock exchange or any other regulated market, the Directors of the Management Company shall make regulations for the order of priority in which stock exchanges or other regulated markets shall be used for the provision of prices of securities or other assets.

*Please refer to the related note under the caption, 'Net Asset Value / Valuation of the Assets of the Fund'.

# Notes to the Financial Statements as at 30 September 2018 (cont)

## Valuation of the Assets of the Fund (cont.)

If a security is not traded on or admitted to any official stock exchange or any other regulated market or, in the case of securities so traded or admitted, the last available price does not reflect their true value, the Directors of the Management Company are required to proceed on the basis of their expected sales price, which shall be valued with prudence and in good faith.

Units or shares in open-ended undertakings for collective investment are valued on the basis of the latest available reported Net Asset Value. The latest reported Net Asset Value may be adjusted to reflect market movements since the date of the report in accordance with adjustment methods as determined by the Management Company. Purchases and sales of investments are recognised on the trade date.

For other transferable securities not dealt on a regulated market, the valuation is based on all readily available data, which may involve valuation techniques determined in good faith by the Management Company to reflect the true value of the underlying security, and where applicable in accordance with valuation methods identified by the underlying issuer of such transferable securities.

Any assets or liabilities in currencies other than the base currencies of the Fund will be converted using the relevant spot rate quoted by a bank or other responsible financial institution.

## Realised gains and losses on sales of investments in Securities

Realised gains and losses on sales of investments in securities are determined on the average cost basis and include transactions costs.

## Forward Foreign Exchange Contracts

Outstanding forward foreign exchange contracts were valued at the last available price at NAV calculation day by reference to the forward rate of exchange applicable to the maturity of the contracts. The unrealised appreciations/(depreciations) are shown in the Statement of Net Assets under 'Net unrealised appreciation/(depreciation) on forward foreign exchange contracts'.

## Changes in the sub-fund

A list, specifying the total purchases and sales, which took place during the year under review may be obtained free of charge, upon request, at the registered office of the Management Company.

## Taxation

Under legislation and regulations currently prevailing in Luxembourg each sub-fund is subject to a capital tax on its net assets at an annual rate of 0.05% calculated and payable quarterly.

No capital tax is payable on the portion of the net assets of a sub-fund invested in other Luxembourg undertakings for collective investment. Under present law neither the Fund nor the Unitholders are subject to any Luxembourg tax on income or capital gains nor to any withholding or estate tax.

## Dividends

During the year under review, the Fund made the following dividend distributions:

| Record Date | Ex-dividend Date | Payment Date | Fund | Currency | Dividend per Unit |
|---|---|---|---|---|---|
| 10-Oct-17 | 11-Oct-17 | 16-Oct-17 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 13-Nov-17 | 14-Nov-17 | 17-Nov-17 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 11-Dec-17 | 12-Dec-17 | 15-Dec-17 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 10-Jan-18 | 11-Jan-18 | 16-Jan-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 13-Feb-18 | 14-Feb-18 | 20-Feb-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 12-Mar-18 | 13-Mar-18 | 16-Mar-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 10-Apr-18 | 11-Apr-18 | 16-Apr-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |

# Notes to the Financial Statements as at 30 September 2018 (cont)

| Record Date | Ex-dividend Date | Payment Date | Fund | Currency | Dividend per Unit |
|---|---|---|---|---|---|
| 14-May-18 | 15-May-18 | 18-May-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 11-Jun-18 | 12-Jun-18 | 15-Jun-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 10-Jul-18 | 11-Jul-18 | 17-Jul-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 13-Aug-18 | 14-Aug-18 | 20-Aug-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |
| 10-Sep-18 | 11-Sep-18 | 14-Sep-18 | Schroder SMBC Global Bond Series -Schroder Global Bond Open B Distribution | USD | 0.035 |

## Disclosure of Transaction Costs

The transaction costs are broker commission fees and taxes related to the purchase and sale of transferable securities. As Schroder SMBC Global Bond Series is a bond fund, no additional figure will be disclosed in this paragraph since broker commission fees are included in the spread, which is excluded from the calculation pursuant to Annex I, Schedule B, Chapter V of Directive 2009/65/EC of the European Parliament.

## Subsequent Events

As at the date of the approval of the Financial Statements, there were no significant subsequent events.

# Fund Performance as at 30 September 2018 (Unaudited)

| Sub-Fund* | Class (Currency) | 1 Year % | 2 Years % | 3 Years % | Since Launch % |
|---|---|---|---|---|---|
| Global Bond Series - Schroder Global Bond Open (Launch Date: 30/06/2009) | Class B (USD) | (3.43) | (3.59) | (0.06) | 10.00 |

* All fund performance data are on a NAV to NAV basis (Bid to Bid), adjusted for dividends, net of expenses and gross of taxes. The term "Since Launch" means the launch date of the sub-fund. Past performance is not a reliable indicator of future results, prices of units and the income from them may fall as well as rise and investors may not get back the amount originally invested.

# Audit Report

To the Unitholders of
**Schroder SMBC Global Bond Series**

## *Our opinion*

In our opinion, the accompanying financial statements give a true and fair view of the financial position of Schroder SMBC Global Bond Series (the "Fund") as at 30 September 2018, and of the results of its operations and changes in its net assets for the year then ended in accordance with Luxembourg legal and regulatory requirements relating to the preparation and presentation of the financial statements.

**What we have audited**

The Fund's financial statements comprise:

- the statement of net assets as at 30 September 2018;
- the portfolio of investments as at 30 September 2018;
- the statement of operations for the year then ended;
- the statement of changes in net assets for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

## *Basis for opinion*

We conducted our audit in accordance with the Law of 23 July 2016 on the audit profession (Law of 23 July 2016) and with International Standards on Auditing (ISAs) as adopted for Luxembourg by the "Commission de Surveillance du Secteur Financier" (CSSF). Our responsibilities under those Law and standards are further described in the "Responsibilities of the "Réviseur d'entreprises agréé" for the audit of the financial statements" section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Fund in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) as adopted for Luxembourg by the CSSF together with the ethical requirements that are relevant to our audit of the financial statements. We have fulfilled our other ethical responsibilities under those ethical requirements.

## *Other information*

The Board of Directors of the Management Company is responsible for the other information. The other information comprises the information stated in the annual report but does not include the financial statements and our audit report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## *Responsibilities of the Board of Directors of the Management Company and those charged with governance for the financial statements*

The Board of Directors of the Management Company is responsible for the preparation and fair presentation of the financial statements in accordance with Luxembourg legal and regulatory requirements relating to the preparation and presentation of the financial statements, and for such internal control as the Board of Directors of the Management Company determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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*Cabinet de révision agréé. Expert-comptable (autorisation gouvernementale n°10028256)*
*R.C.S. Luxembourg B 65 477 - TVA LU25482518*

In preparing the financial statements, the Board of Directors of the Management Company is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors of the Management Company either intends to liquidate the Fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Fund's financial reporting process.

### *Responsibilities of the "Reviséur d'entreprises agréé" for the audit of the financial statements*

The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an audit report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Law of 23 July 2016 and with ISAs as adopted for Luxembourg by the CSSF will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the Law of 23 July 2016 and with ISAs as adopted for Luxembourg by the CSSF, we exercise professional judgment and maintain professional scepticism throughout the audit.

We also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors of the Management Company;
- conclude on the appropriateness of the Board of Directors of the Management Company's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our audit report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our audit report. However, future events or conditions may cause the Fund to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

PricewaterhouseCoopers, Société coopérative
Represented by

Luxembourg, 12 December 2018

Valerie Piastrelli

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*Cabinet de révision agréé. Expert-comptable (autorisation gouvernementale n°10028256)*
*R.C.S. Luxembourg B 65 477 - TVA LU25482518*

# Statement of Net Assets as at 30 September 2018

| | | Schroder SMBC Global Bond Series - Schroder Global Bond Open USD |
|---|---|---|
| **ASSETS** | | |
| **Investments** | | |
| Securities at cost | | 39,015,802 |
| Unrealised depreciation* | | (760,155) |
| **Securities at Market Value** | | **38,255,647** |
| Cash at banks | | 1,065,474 |
| Interest receivable | | 330,549 |
| Sundry receivables and prepayments | | 11,260 |
| **TOTAL ASSETS** | | **39,662,930** |
| **LIABILITIES** | | |
| Payables for redemptions | | 37,813 |
| Management fees payable | | 10,719 |
| Other payables and accruals | | 173,964 |
| **TOTAL LIABILITIES** | | **222,496** |
| **TOTAL NET ASSETS** | | **39,440,434** |
| **Net Asset Value** | | |
| as at 30 September 2018 | | 39,440,434 |
| as at 30 September 2017 | | 50,022,647 |
| as at 30 September 2016 | | 59,077,097 |
| **Units Outstanding** | | |
| as at 30 September 2018 | **Class B Distribution (USD)** | 5,475,873 |
| **Net Asset Value per Unit** | | |
| as at 30 September 2018 | **Class B Distribution (USD)** | 7.20 |
| as at 30 September 2017 | **Class B Distribution (USD)** | 7.88 |
| as at 30 September 2016 | **Class B Distribution (USD)** | 8.33 |

| **UNREALISED APPRECIATION/(DEPRECIATION) SPLIT** | |
|---|---|
| Unrealised appreciation on investments | 550,217 |
| Unrealised (depreciation) on investments | (1,310,372) |

* Please refer to the table Unrealised appreciation/(depreciation) for the calculation split.

The notes on pages 13 to 15 form an integral part of these financial statements.

# Statement of Operations for the Year Ended 30 September 2018

| | Schroder SMBC Global Bond Series - Schroder Global Bond Open USD |
|---|---|
| **INCOME** | |
| Bank interest | 3,205 |
| Net Bond interest | 1,228,807 |
| **Total Income** | **1,232,012** |
| **EXPENSES** | |
| Administration fees | 50,663 |
| Management fees | 158,040 |
| Bank and interest charges | 272 |
| Custodian fees | 9,007 |
| Taxe d'abonnement | 22,578 |
| Distribution fees | 568,944 |
| Other Expenses | 4,515 |
| **Total Expenses** | **814,019** |
| Expense Subsidy | 10,001 |
| **NET INVESTMENT INCOME/(LOSS)** | **427,994** |

The notes on pages 13 to 15 form an integral part of these financial statements.

# Statement of Changes in Net Assets for the Year Ended 30 September 2018

| | Schroder SMBC Global Bond Series - Schroder Global Bond Open USD |
|---|---|
| **NET INVESTMENT INCOME/(LOSS)*** | **427,994** |
| **Net realised gains/(losses)**** | |
| on securities sold | (91,686) |
| on forward foreign exchange contracts | (11,684) |
| on foreign exchange on other net assets | (62,665) |
| **NET REALISED PROFIT/(LOSS)** | **(166,035)** |
| **Net change in unrealised appreciation/ (depreciation)** | |
| on investments | (1,743,112) |
| on foreign exchange on other net assets | 99 |
| **NET CHANGE IN UNREALISED APPRECIATION/(DEPRECIATION)** | **(1,743,013)** |
| **NET CHANGE IN TOTAL NET ASSETS AS A RESULT OF OPERATIONS** | **(1,481,054)** |
| Net proceeds from issue of units | 518,128 |
| Payment for units redeemed | (7,118,743) |
| Dividends declared for the year from net investment income | (2,500,544) |
| **Increase/(Decrease) in Net Assets for the Year** | **(10,582,213)** |
| Net Assets at the beginning of the year | 50,022,647 |
| **NET ASSETS AT THE END OF THE YEAR** | **39,440,434** |

| **REALISED GAINS/(LOSSES) SPLIT***** | |
|---|---|
| Realised gains on securities sold | 503,241 |
| Realised (losses) on securities sold | (594,927) |
| Realised gains on forward foreign exchange contracts | 15,871 |
| Realised (losses) on forward foreign exchange contracts | (27,555) |

* Please see the Statement of Operations for the calculation of Net Investment Income/(Loss).
** Please refer to the table Realised gains/(losses) for the calculation split.
*** The realised amounts shown in this table represent the sum of the net realised gains and losses at investment level for the year under review.

The notes on pages 13 to 15 form an integral part of these financial statements.

# Portfolio of Investments as at 30 September 2018

## Schroder SMBC Global Bond Series - Schroder Global Bond Open

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments Admitted to an Official Exchange Listing | Market Value USD | % Net Assets |
|---|---|---|---|
| **Australia** | | **774,287** | **1.96** |
| AUD 577,000 | Australia Government Bond, Reg. S 2.75% 21/10/2019 | 420,180 | 1.06 |
| AUD 310,000 | Australia Government Bond, Reg. S 3% 21/03/2047 | 217,744 | 0.55 |
| EUR 100,000 | BHP Billiton Finance Ltd., Reg. S, FRN 5.625% 22/10/2079 | 136,363 | 0.35 |
| **Czech Republic** | | **589,378** | **1.50** |
| CZK 13,210,000 | Czech Republic Government Bond, Reg. S ZCP 17/07/2019 | 589,378 | 1.50 |
| **Denmark** | | **169,729** | **0.43** |
| DKK 1,010,000 | Denmark Government Bond 1.5% 15/11/2023 | 169,729 | 0.43 |
| **France** | | **2,641,912** | **6.70** |
| EUR 150,000 | Autoroutes du Sud de la France SA, Reg. S 4.125% 13/04/2020 | 184,894 | 0.47 |
| EUR 200,000 | BPCE SFH SA, Reg. S 1% 08/06/2029 | 229,610 | 0.58 |
| EUR 100,000 | Capgemini SE, Reg. S 1.75% 01/07/2020 | 118,980 | 0.30 |
| EUR 17,000 | France Government Bond OAT, Reg. S, 144A 2% 25/05/2048 | 21,322 | 0.05 |
| EUR 141,000 | LVMH Moet Hennessy Louis Vuitton SE, Reg. S 0.375% 26/05/2022 | 164,155 | 0.42 |
| EUR 185,000 | Orange SA 8.125% 28/01/2033 | 372,888 | 0.95 |
| GBP 100,000 | Orange SA, Reg. S, FRN 5.75% Perpetual | 140,635 | 0.36 |
| EUR 100,000 | SANEF SA, Reg. S 1.875% 16/03/2026 | 119,769 | 0.30 |
| EUR 100,000 | Societe Fonciere Lyonnaise SA, REIT, Reg. S 2.25% 16/11/2022 | 122,848 | 0.31 |
| USD 590,000 | Societe Generale SA, 144A 2.5% 08/04/2021 | 575,572 | 1.46 |
| EUR 300,000 | Total Capital International SA, Reg. S 1.023% 04/03/2027 | 348,391 | 0.88 |
| EUR 200,000 | UNEDIC ASSEO, Reg. S 1.25% 28/03/2027 | 242,848 | 0.62 |

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments Admitted to an Official Exchange Listing | Market Value USD | % Net Assets |
|---|---|---|---|
| **Germany** | | **1,005,031** | **2.55** |
| EUR 100,000 | Bayer Capital Corp. BV, Reg. S 0.625% 15/12/2022 | 116,516 | 0.30 |
| EUR 80,000 | Bundesrepublik Deutschland, Reg. S 1.5% 04/09/2022 | 99,230 | 0.25 |
| EUR 251,000 | Bundesrepublik Deutschland, Reg. S 2.5% 15/08/2046 | 394,653 | 1.00 |
| USD 400,000 | Landesbank Baden-Wuerttemberg, Reg. S 2.125% 31/01/2020 | 394,632 | 1.00 |
| **Indonesia** | | **128,615** | **0.33** |
| IDR 2,200,000,000 | Indonesia Treasury 6.125% 15/05/2028 | 128,615 | 0.33 |
| **Ireland** | | **528,676** | **1.34** |
| EUR 103,000 | Bank of Ireland, Reg. S 1.25% 09/04/2020 | 121,528 | 0.31 |
| EUR 300,000 | Ireland Government Bond, Reg. S 3.9% 20/03/2023 | 407,148 | 1.03 |
| **Italy** | | **1,945,804** | **4.93** |
| EUR 100,000 | Assicurazioni Generali SpA, Reg. S, FRN 5.5% 27/10/2047 | 123,336 | 0.31 |
| EUR 1,550,000 | Italy Buoni Poliennali Del Tesoro 1.2% 01/04/2022 | 1,740,268 | 4.41 |
| EUR 77,000 | Italy Buoni Poliennali Del Tesoro 2.05% 01/08/2027 | 82,200 | 0.21 |
| **Mexico** | | **1,717,864** | **4.36** |
| USD 600,000 | America Movil SAB de CV 5% 30/03/2020 | 614,043 | 1.56 |
| MXN 3,200,000 | Mexican Bonos 5.75% 05/03/2026 | 150,558 | 0.38 |
| USD 950,000 | Mexico Government Bond 3.625% 15/03/2022 | 953,263 | 2.42 |
| **Netherlands** | | **118,602** | **0.30** |
| EUR 100,000 | ING Groep NV, Reg. S, FRN 2.5% 15/02/2029 | 118,602 | 0.30 |
| **Norway** | | **881,216** | **2.23** |
| NOK 7,030,000 | Norway Government Bond, Reg. S, 144A 4.5% 22/05/2019 | 881,216 | 2.23 |

The notes on pages 13 to 15 form an integral part of these financial statements.

# Portfolio of Investments as at 30 September 2018 (cont)

## Schroder SMBC Global Bond Series - Schroder Global Bond Open (cont)

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments Admitted to an Official Exchange Listing | Market Value USD | % Net Assets |
|---|---|---|---|
| **Poland** | | **591,646** | **1.50** |
| EUR 500,000 | Poland Government Bond, Reg. S 1.375% 22/10/2027 | 591,646 | 1.50 |
| **Russia** | | **68,449** | **0.17** |
| RUB 4,900,000 | Russian Federal Bond - OFZ 7.05% 19/01/2028 | 68,449 | 0.17 |
| **Singapore** | | **80,806** | **0.21** |
| SGD 110,000 | Singapore Government Bond 2.5% 01/06/2019 | 80,806 | 0.21 |
| **South Korea** | | **643,358** | **1.63** |
| KRW 737,000,000 | Korea Treasury 1.875% 10/06/2026 | 643,358 | 1.63 |
| **Spain** | | **1,211,888** | **3.07** |
| EUR 285,000 | Autonomous Community of Madrid Spain, Reg. S 1.773% 30/04/2028 | 334,473 | 0.85 |
| USD 400,000 | Banco Santander SA 3.848% 12/04/2023 | 391,652 | 0.99 |
| EUR 215,000 | Spain Government Bond, Reg. S, 144A 2.7% 31/10/2048 | 254,289 | 0.64 |
| EUR 200,000 | Telefonica Emisiones SAU, Reg. S 1.495% 11/09/2025 | 231,474 | 0.59 |
| **Supranational** | | **765,574** | **1.94** |
| CAD 1,010,000 | International Bank for Reconstruction & Development 1.125% 11/03/2020 | 765,574 | 1.94 |
| **Sweden** | | **320,717** | **0.81** |
| EUR 100,000 | Essity AB, Reg. S 1.625% 30/03/2027 | 116,801 | 0.29 |
| SEK 1,600,000 | Sweden Government Bond 3.5% 01/06/2022 | 203,916 | 0.52 |
| **United Kingdom** | | **5,223,767** | **13.25** |
| GBP 186,000 | Annington Funding plc, Reg. S 3.184% 12/07/2029 | 240,404 | 0.61 |
| USD 300,000 | Barclays Bank plc 5.14% 14/10/2020 | 307,905 | 0.78 |
| USD 500,000 | Barclays plc 3.684% 10/01/2023 | 486,765 | 1.23 |
| EUR 200,000 | FCE Bank plc, Reg. S 0.869% 13/09/2021 | 232,033 | 0.59 |

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments Admitted to an Official Exchange Listing | Market Value USD | % Net Assets |
|---|---|---|---|
| USD 290,000 | HSBC Holdings plc 6.8% 01/06/2038 | 358,307 | 0.91 |
| GBP 221,000 | HSBC Holdings plc, FRN 2.175% 27/06/2023 | 286,722 | 0.73 |
| USD 467,000 | Lloyds Banking Group plc 4.582% 10/12/2025 | 458,883 | 1.16 |
| EUR 250,000 | Nationwide Building Society, Reg. S 6.75% 22/07/2020 | 322,865 | 0.82 |
| EUR 150,000 | Natwest Markets plc, Reg. S 5.5% 23/03/2020 | 187,531 | 0.48 |
| EUR 300,000 | Natwest Markets plc, Reg. S 0.5% 15/05/2024 | 346,279 | 0.88 |
| GBP 140,000 | NGG Finance plc, Reg. S, FRN 5.625% 18/06/2073 | 200,168 | 0.51 |
| GBP 322,000 | UK Treasury, Reg. S 2.5% 22/07/2065 | 517,861 | 1.31 |
| GBP 450,000 | UK Treasury Bill ZCP 22/10/2018 | 585,939 | 1.49 |
| GBP 260,000 | UK Treasury Bill ZCP 05/11/2018 | 338,432 | 0.86 |
| GBP 163,000 | WM Treasury 2 plc, Reg. S 3.25% 20/10/2048 | 209,641 | 0.53 |
| USD 140,000 | WPP Finance 2010 5.625% 15/11/2043 | 144,032 | 0.36 |
| **United States of America** | | **9,066,597** | **22.99** |
| EUR 133,000 | Allergan Funding SCS 1.25% 01/06/2024 | 152,861 | 0.39 |
| USD 34,000 | Allergan Funding SCS 4.75% 15/03/2045 | 33,363 | 0.08 |
| USD 250,000 | American Tower Corp., REIT 3.375% 15/10/2026 | 233,434 | 0.59 |
| USD 190,000 | AT&T, Inc. 4.75% 15/05/2046 | 174,282 | 0.44 |
| EUR 246,000 | AT&T, Inc., Reg. S 2.35% 05/09/2029 | 287,466 | 0.73 |
| USD 190,000 | Bank of America Corp. 3.5% 19/04/2026 | 183,853 | 0.47 |
| USD 250,000 | Becton Dickinson and Co. 3.363% 06/06/2024 | 241,832 | 0.61 |
| EUR 380,000 | Coca-Cola Co. (The) 1.125% 09/03/2027 | 441,391 | 1.12 |
| USD 350,000 | Dow Chemical Co. (The) 5.25% 15/11/2041 | 371,838 | 0.94 |

The notes on pages 13 to 15 form an integral part of these financial statements.

# Portfolio of Investments as at 30 September 2018 (cont)

## Schroder SMBC Global Bond Series - Schroder Global Bond Open (cont)

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments Admitted to an Official Exchange Listing | Market Value USD | % Net Assets |
|---|---|---|---|
| **United States of America (cont.)** | | | |
| USD 558,000 | Ford Motor Credit Co. LLC 4.14% 15/02/2023 | 549,052 | 1.39 |
| EUR 200,000 | General Electric Co. 1.5% 17/05/2029 | 223,118 | 0.57 |
| USD 505,000 | Goldman Sachs Group, Inc. (The) 2.6% 27/12/2020 | 496,796 | 1.26 |
| EUR 100,000 | Goldman Sachs Group, Inc. (The), Reg. S 1.375% 15/05/2024 | 116,842 | 0.30 |
| USD 500,000 | Hartford Financial Services Group, Inc. (The) 5.5% 30/03/2020 | 515,583 | 1.31 |
| USD 190,000 | JPMorgan Chase & Co. 6.3% 23/04/2019 | 193,807 | 0.49 |
| EUR 245,000 | JPMorgan Chase & Co., Reg. S, FRN 1.638% 18/05/2028 | 285,386 | 0.72 |
| USD 130,000 | Kinder Morgan, Inc. 5.55% 01/06/2045 | 138,366 | 0.35 |
| USD 550,000 | Morgan Stanley 5.625% 23/09/2019 | 563,841 | 1.43 |
| USD 100,000 | S&P Global, Inc. 3.3% 14/08/2020 | 100,061 | 0.25 |
| USD 160,000 | Spectra Energy Partners LP 3.5% 15/03/2025 | 154,085 | 0.39 |
| USD 150,000 | Sunoco Logistics Partners Operations LP 3.9% 15/07/2026 | 142,913 | 0.36 |
| USD 20,000 | US Treasury 1.875% 31/07/2022 | 19,252 | 0.05 |
| USD 340,000 | US Treasury 1.875% 30/09/2022 | 326,666 | 0.83 |
| USD 225,000 | US Treasury 2% 30/11/2022 | 216,896 | 0.55 |
| USD 160,000 | US Treasury 2.75% 31/05/2023 | 158,775 | 0.40 |
| USD 95,000 | US Treasury 2.25% 15/08/2027 | 89,278 | 0.23 |
| USD 190,000 | US Treasury 2.75% 15/02/2028 | 185,680 | 0.47 |
| USD 90,000 | US Treasury 2.875% 15/05/2028 | 88,826 | 0.23 |
| USD 355,300 | US Treasury 2.875% 15/08/2028 | 350,553 | 0.89 |
| USD 130,000 | US Treasury 3% 15/11/2044 | 126,273 | 0.32 |
| USD 193,000 | US Treasury 2.5% 15/02/2046 | 169,538 | 0.43 |
| USD 65,000 | US Treasury 2.25% 15/08/2046 | 54,001 | 0.14 |
| USD 235,000 | US Treasury 2.75% 15/11/2047 | 216,604 | 0.55 |
| USD 1,045,000 | US Treasury Inflation Indexed 0.125% 15/07/2026 | 1,038,129 | 2.63 |
| USD 425,000 | Walmart, Inc. 3.7% 26/06/2028 | 425,956 | 1.08 |
| **Total Transferable securities and money market instruments admitted to an official exchange listing** | | **28,473,916** | **72.20** |

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments dealt on another Regulated Market | Market Value USD | % Net Assets |
|---|---|---|---|
| **Canada** | | **543,251** | **1.38** |
| CAD 545,000 | Province of Quebec Canada 5% 01/12/2041 | 543,251 | 1.38 |
| **France** | | **175,923** | **0.44** |
| USD 180,000 | Electricite de France SA, 144A 6% 22/01/2114 | 175,923 | 0.44 |
| **Italy** | | **275,121** | **0.70** |
| EUR 100,000 | Intesa Sanpaolo SpA, Reg. S 2% 18/06/2021 | 117,804 | 0.30 |
| EUR 143,000 | Italy Buoni Poliennali Del Tesoro, Reg. S, 144A 3.45% 01/03/2048 | 157,317 | 0.40 |
| **Poland** | | **100,418** | **0.25** |
| PLN 332,000 | Poland Government Bond 5.75% 25/10/2021 | 100,418 | 0.25 |
| **Spain** | | **1,045,445** | **2.65** |
| EUR 705,000 | Spain Government Bond, Reg. S, 144A 1.4% 30/04/2028 | 813,864 | 2.06 |
| EUR 195,000 | Spain Government Bond, Reg. S, 144A 1.95% 30/07/2030 | 231,581 | 0.59 |
| **Sweden** | | **291,707** | **0.74** |
| USD 300,000 | Stadshypotek AB, 144A 2.5% 05/04/2022 | 291,707 | 0.74 |

The notes on pages 13 to 15 form an integral part of these financial statements.

# Portfolio of Investments as at 30 September 2018 (cont)

## Schroder SMBC Global Bond Series - Schroder Global Bond Open (cont)

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments dealt on another Regulated Market | Market Value USD | % Net Assets |
|---|---|---|---|
| **United Kingdom** | | **476,124** | **1.21** |
| USD 502,000 | Reckitt Benckiser Treasury Services plc, Reg. S 2.75% 26/06/2024 | 476,124 | 1.21 |
| **United States of America** | | **6,835,628** | **17.33** |
| USD 94,543 | Aegis Asset-Backed Securities Trust, FRN, Series 2005-4 'M1' 2.666% 25/10/2035 | 94,835 | 0.24 |
| USD 7,381 | Ameriquest Mortgage Securities Trust, FRN, Series 2005-R2 'M2' 2.936% 25/04/2035 | 7,387 | 0.02 |
| USD 250,000 | Apple, Inc. 4.45% 06/05/2044 | 264,509 | 0.67 |
| USD 250,000 | Bank of America Corp., FRN 3.705% 24/04/2028 | 240,864 | 0.61 |
| USD 65,348 | Bayview Commercial Asset Trust, FRN, Series 2007-2A 'A1', 144A 2.486% 25/07/2037 | 62,780 | 0.16 |
| USD 8,586 | Bear Stearns ARM Trust, FRN, Series 2004-3 '2A' 4.054% 25/07/2034 | 8,623 | 0.02 |
| USD 285,000 | Citigroup, Inc., FRN 3.887% 10/01/2028 | 276,909 | 0.70 |
| USD 280,000 | Comcast Corp. 6.4% 15/05/2038 | 334,659 | 0.85 |
| USD 13,296 | Encore Credit Receivables Trust, FRN, Series 2005-3 'M2' 2.951% 25/10/2035 | 13,313 | 0.03 |
| USD 90,717 | FHLMC Structured Agency Credit Risk Debt Notes, FRN, Series 2015-DNA2 'M2' 4.816% 25/12/2027 | 92,580 | 0.23 |
| USD 107,375 | FNMA, FRN, Series 2014-C04 '1M2' 6.965% 25/11/2024 | 122,963 | 0.31 |
| USD 493,575 | FNMA AB8897 3% 01/04/2043 | 476,266 | 1.21 |
| USD 111,260 | FNMA AB9341 3% 01/05/2043 | 107,371 | 0.27 |
| USD 322,989 | FNMA AR7218 3% 01/06/2043 | 311,699 | 0.79 |
| USD 264,640 | FNMA AS0203 3% 01/08/2043 | 255,354 | 0.65 |
| USD 396,077 | FNMA AS0205 3% 01/08/2043 | 382,160 | 0.97 |
| USD 460,580 | FNMA AU1628 3% 01/07/2043 | 444,373 | 1.13 |
| USD 35,032 | GNMA 4520 5% 20/08/2039 | 37,315 | 0.09 |
| USD 93,898 | GNMA 4578 5% 20/11/2039 | 100,025 | 0.25 |
| USD 411,832 | GNMA, FRN MA0483 3.125% 20/10/2042 | 422,954 | 1.07 |
| USD 184,957 | GNMA MA1377 4.5% 20/10/2043 | 193,694 | 0.49 |
| USD 22,763 | Impac Secured Assets Trust, FRN, Series 2006-1 '2A2' 2.626% 25/05/2036 | 22,289 | 0.06 |
| USD 13,828 | IndyMac INDX Mortgage Loan Trust, FRN, Series 2007-FLX3 'A1' 2.305% 25/06/2037 | 13,712 | 0.04 |
| USD 240,000 | Kraft Heinz Foods Co. 5.375% 10/02/2020 | 246,974 | 0.63 |
| USD 33,000 | Mastr Asset-Backed Securities Trust, FRN, Series 2005-WMC1 'M4' 3.161% 25/03/2035 | 33,230 | 0.08 |
| USD 310,000 | NBCUniversal Media LLC 5.95% 01/04/2041 | 356,515 | 0.90 |
| USD 20,821 | Structured Asset Investment Loan Trust, FRN, Series 2003-BC4 'M1' 3.416% 25/06/2033 | 20,997 | 0.05 |
| USD 90,197 | Triton Container Finance IV LLC, Series 2017-2A 'A', 144A 3.62% 20/08/2042 | 88,141 | 0.22 |
| USD 700,000 | US Treasury 1.875% 31/01/2022 | 677,414 | 1.72 |
| USD 300,000 | US Treasury 1.875% 28/02/2022 | 290,121 | 0.74 |
| USD 260,000 | US Treasury 1.875% 30/04/2022 | 250,961 | 0.64 |
| USD 350,000 | US Treasury Inflation Indexed 0.375% 15/01/2027 | 349,373 | 0.89 |

The notes on pages 13 to 15 form an integral part of these financial statements.

# Portfolio of Investments as at 30 September 2018 (cont)

## Schroder SMBC Global Bond Series - Schroder Global Bond Open (cont)

| Number of shares or Principal Amount | Transferable Securities and Money Market Instruments dealt on another Regulated Market | Market Value USD | % Net Assets |
|---|---|---|---|
| **United States of America (cont.)** | | | |
| USD 230,217 | WaMu Mortgage Pass-Through Trust, FRN, Series 2004-AR4 'A6' 4.121% 25/06/2034 | 235,268 | 0.60 |
| **Total Transferable Securities and Money Market Instruments dealt on another Regulated Market** | | **9,743,617** | **24.70** |

| Number of shares or Principal Amount | Other Transferable Securities not dealt on another Regulated Market | Market Value USD | % Net Assets |
|---|---|---|---|
| **New Zealand** | | **38,114** | **0.10** |
| NZD 50,000 | New Zealand Government Bond, Reg. S 5.5% 15/04/2023 | 38,114 | 0.10 |
| **Total Other Transferable Securities not dealt on another Regulated Market** | | **38,114** | **0.10** |

| | | | |
|---|---|---|---|
| **Total Investments** | | **38,255,647** | **97.00** |
| **Other Net Assets** | | **1,184,787** | **3.00** |
| **Net Asset Value** | | **39,440,434** | **100.00** |

The notes on pages 13 to 15 form an integral part of these financial statements.

# Appendix I - Total Expense Ratio (the "TER") for the Year Ended 30 September 2018 (Unaudited)

| Sub-Fund Name | Class | TER | TER Cap* |
|---|---|---|---|
| **Schroder SMBC Global Bond Series - Schroder Global Bond Open** | B Distribution | 1.78% | 1.78% |

*Please refer to the Expense subsidy section of the Notes to the Financial Statements for the details of TER Cap.

# Appendix II - AIFM Disclosures (Unaudited)

## 1. Risk Profile and Leverage

The Fund uses a risk management process that allows monitoring the risks of the Sub-funds and ensuring they are being managed in line with their investment policy and risk profile.

Leverage ratios are important risk metrics to represent the current risk profile of the sub-funds and are monitored on a daily basis.

Leverage is a way for the Fund to increase its exposure through the use of financial derivative instruments and/or borrowing of cash or securities where applicable it is expressed as a ratio ('leverage ratio') between the exposure of the Fund and its Net Asset Value.

The leverage ratio is calculated in accordance with two methodologies for calculating the exposure of the Fund, the gross method and the commitment method.

There were no new arrangements for managing the liquidity and no changes to the maximum level of leverage occurred during the year under review.

As required by AIFM rules, the following information is provided to Unitholders:

| Fund Name | Commitment limit | Commitment leverage level | Commitment utilisation | Gross leverage limit | Gross leverage level | Gross leverage utilisation |
|---|---|---|---|---|---|---|
| Schroder SMBC Global Bond Series Fund | 1.10 | 0.99 | 89.91% | 1.20 | 0.99 | 82.42% |

## 2. AIFMD remuneration disclosures for Schroder Investment Management Europe S.A. (SIM Europe) for the year to 31 December 2017

These disclosures form part of the non-audited section of this annual report and accounts and should be read in conjunction with the Schroders plc Remuneration Report on pages 62 to 90 of the 2017 Annual Report & Accounts (available on the Group's website – www.schroders.com/ir), which provides more information on the activities of our Remuneration Committee and our remuneration principles and policies.

The AIF Material Risk Takers ('AIF MRTs') of SIM Europe are individuals whose roles within the Schroders Group can materially affect the risk of SIM Europe or any AIF fund that it manages. These roles are identified in line with the requirements of the AIFMD Directive and guidance issued by the European Securities and Markets Authority.

The Remuneration Committee of Schroders plc established a remuneration policy to ensure the requirements of the AIFMD Directive are met for all AIF MRTs. The Remuneration Committee and the Board of Schroders plc review remuneration strategy at least annually. The directors of SIM Europe are responsible for the adoption of the remuneration policy, for reviewing its general principles at least annually, for overseeing its implementation and for ensuring compliance with relevant local legislation and regulation. During 2017 the Remuneration Policy was reviewed and changes were made to ensure compliance with the UCITS/AIFMD remuneration requirements.

The implementation of the remuneration policy is, at least annually, subject to independent internal review for compliance with the policies and procedures for remuneration adopted by the Board of SIM Europe and the Remuneration Committee. The most recent review found no fundamental issues but resulted in a range of more minor recommendations, principally improvements to process and policy documentation.

The total spend on remuneration is determined based on a profit share ratio, measuring variable remuneration charge against pre-bonus profit, and from a total compensation ratio, measuring total remuneration expense against net income. This ensures that the interests of employees are aligned with Schroders financial performance. In determining the remuneration spend each year, the underlying strength and sustainability of the business is taken into account, along with reports on risk, legal and compliance matters from the heads of those areas.

The remuneration data that follows reflects amounts paid in respect of performance during 2017.

- The total amount of remuneration paid by SIM Europe to its 259 staff was €27.5 million of which €21.2 was fixed remuneration (e.g. salaries, benefits in kind) and €6.3 was variable remuneration (e.g. annual bonus awards or deferred bonus awards). Employees of other Schroders Group entities who serve as Directors of SIM Europe receive no additional fees in respect of their role on the Board of SIM Europe.
- The following disclosures relate to AIF MRTs of SIM Europe. Most of those AIF MRTs were employed by and provided services to other Schroders group companies and clients. As a result, only a portion of remuneration for those individuals is included in the aggregate remuneration figures that follow, based on an objective apportionment to reflect the balance of each role using relevant regulated AUM as a proportion of the total AUM within the scope of each role. The aggregate total remuneration paid to the 106 AIF MRTs of SIM Europe in respect of the financial year ended 31 December 2017, and attributed to SIM Europe or the AIF funds that it manages, is €1.7 million, of which €0.8 million was paid to senior management, €0.8 million was paid to MRTs deemed to be taking risk on behalf of SIM Europe or the AIF funds that it manages and €0.1 million was paid to other AIF MRTs.

For additional qualitative information on remuneration policies and practices see www.schroders.com/rem-disclosures.

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