

FMA Guideline 2015/2

Publication:	FMA website
Title:	Guideline on the Code of Conduct for the Liechtenstein Fund Centre

Pursuant to Article 20 of the UCITS Act in conjunction with Articles 25-33 of the UCITS Ordinance and Article 35 of the AIFM Act in conjunction with Articles 42-54 of the AIFM Ordinance (especially Article 15(2), Article 17(3), Article 20(1)(a), Article 32(4), and Article 56(3) of the AIFM Ordinance), the Financial Market Authority (FMA) issues this Code of Conduct, which must be complied with on a continuous basis.

Objectives

The objective of the Code of Conduct is to contribute to the protection of investors, to strengthen confidence in the Liechtenstein fund centre, and to secure and promote the integrity of the Liechtenstein financial market at home and abroad. The scope of application of this Code of Conduct extends to the following laws and ordinances:

- Law on Certain Undertakings for Collective Investment in Transferable Securities (UCITS Act) and the associated ordinance (UCITS Ordinance)
- Law on Alternative Investment Fund Managers (AIFM) and the associated ordinance (AIFM Ordinance)

Purpose

The Code of Conduct serves to further specify the laws and associated ordinances enumerated above. The Code of Conduct may be drawn upon to interpret rights and duties, it ensures open and transparent information for investors, and it serves as a basis for the equal treatment of investors.

The Code of Conduct is addressed to the following:

- Management companies under the UCITS Act
- AIFMs under the AIFM Act
- Depositaries under the UCITS Act and AIFM Act
- Administrators under the AIFM Act
- Distributors under the AIFM Act
- Risk managers under the AIFM Act
- Asset managers and other delegated third parties under the UCITS Act and AIFM Act

- Investment companies and other legal forms under the UCITS Act and AIFM Act

The appointed auditors apply and verify compliance with this Code of Conduct when performing their audits.

Other requirements arising from the laws or ordinances take precedence over this Code of Conduct and remain unaffected.

Content

1.	Fiduciary duty and due diligence	4
1.1	Management of the fund assets	4
1.2	Securities transactions and other trading operations/trading in units	4
1.3	Cooperation with the depositary and delegated third parties	5
2.	Organisation.....	5
3.	Conflicts of interest	6
3.1	Organisational and personnel measures.....	6
3.2	Exercise of membership and creditor rights	7
4.	Information and transparency	7
4.1	Investment principles and investment rules	7
4.2	Historical performance	7
4.3	Cost transparency.....	7
5.	Dealing with valuation errors and investment limit violations.....	8
5.1	Valuation errors.....	8
5.1.1	Significance thresholds.....	8
5.1.2	Consequences of significant valuation errors.....	9
5.1.3	Compensation procedure in the event of significant valuation errors	10
5.2	Investment limit violations.....	10
5.2.1	Consequences of active investment limit violations	11
5.2.2	Compensation procedure in the event of active investment limit violations.....	11
5.3	Responsibilities of the auditor.....	12
5.4	Simplified procedure	12

1. Fiduciary duty and due diligence

1.1 Management of the fund assets

Fund assets shall be managed exclusively in the best interest of the funds, the investors, and market integrity. The investment policy and the character of the investment set out in the constitutive documents must be complied with on a continuous basis, unless otherwise provided by law.

In regard to the managed funds and their investors, licence holders shall respect the principle of equal treatment. An exception from the principle of equal treatment may arise if permissible differentiating criteria are defined with respect to different classes of units.

Conduct must be on behalf of the integrity of the market. Licence holders shall in particular refrain from acting in a way that could interfere with transparent and market-based pricing on the securities markets. Moreover, they shall take precautions so that they cannot be misused for money laundering or terrorist financing.¹

1.2 Securities transactions and other trading operations/trading in units

Securities transactions and other trading operations (e.g., securities lending) for funds must always be conducted in accordance with the terms of the market. Practices must be refrained from that would be at the expense of a fund and its investors.

Orders shall be placed only with carefully selected counterparties who guarantee that the securities transactions and other trading operations are conducted in accordance with terms that are in conformity with the market. From an overall perspective, the orders shall represent best execution.

It must be ensured that reimbursements, trailer fees, and other payments in connection with the purchase, the portfolio, and the sale of investments of the fund directly or indirectly benefit the fund. Soft commissions (e.g., for financial analyses, market and price information systems) are permissible unless they harm the interests of investors.

It must be prevented that investors purchase or return fund units at prices that are already known. As a rule, the principle of forward pricing applies.² The management company must ensure compliance

¹ In principle, the Due Diligence Act (DDA) shall apply pursuant to Article 3(1)(c) DDA to management companies/AIFMs with authorization pursuant to the Law on Certain Undertakings for Collective Investment in Transferable Securities or the Law on Alternative Investment Fund Managers. However, an exception applies to management companies or AIFMs pursuant to Article 4(b) DDA, according to which such entities are exempt from the scope of application if they do not issue physical units or keep unit accounts and thus do not themselves accept any assets.

² Forward pricing is the internationally applied standard for the periodic valuation of funds. As a rule, the following principles must be complied with:

- The constitutive documents must specify a precisely defined cut-off time.
- To the extent possible, the cut-off time shall be defined so that the majority of the markets where the fund is traded are still open or have not yet opened.
- Fund units are as a rule valued on the basis of closing prices/market prices that are available only after the cut-off.
- Orders to issue and redeem units that are received after the cut-off are no longer executed effective that day, but rather effective the following valuation day

This ensures that the investor neither knows nor can estimate the value of the fund unit at the time the order is placed to issue or redeem units. In particular, this prevents late trading/market timing.

Example: Cut-off 12 p.m., valuation is on the basis of prices at 5 p.m., the agreed NAV is based on that valuation.

with forward pricing. Likewise, the necessary precautions must be taken when valuing units to prevent the exploitation of arbitrage transactions and late trading.

1.3 Cooperation with the depositary and delegated third parties

The management company/AIFM shall work together exclusively with depositaries and delegated third parties that are continuously qualified for sound and proper fulfilment of their legal and contractual duties.

Where duties are delegated, compliance with the sections of the Code of Conduct relevant to the delegated parties must be specified in writing in the delegation contract. The parties delegating the duties shall also ensure that they are contractually accorded the requisite rights of examination, instruction, and control.

When notifying the FMA of the delegation of duties, it shall be shown that the delegated party meets the necessary requirements in its home country to perform the delegated duties.

To the extent the management company/AIFM delegates third parties to market funds managed by it (marketing agent), written marketing agreements must be concluded guaranteeing that the marketing agent complies with all provisions governing investor protection and acts in accordance with market integrity. When delegating marketing to a third party domiciled in a member state of the EU or the EEA, a marketing licence in accordance with the legal provisions of the marketing country in question (MiFID or UCITS/AIFM Directive) is required. If the distributor is domiciled in a third country, the distributor must be authorised to market funds in that country.³

2. Organisation

The management company/AIFM and the depositary shall take the necessary organisational measures to guarantee sound and proper business conduct as well as sound and proper valuation, posting, and safekeeping of the assets.

Taking into account their operational structure and size, a clear separation of functions between investment decisions (decision-making), trading operations (execution), and valuation of the fund assets (administration) as well as risk management must be observed. This separation of functions must also be observed in the event of delegation. The board of directors and any general management shall cumulatively have sufficient theoretical knowledge and sound practical experience in the area of funds.

The management bodies of the management company/AIFM and of the depositary must be constituted in such a way that they can fulfil the duties assigned to them independently of instructions and that legal separation is guaranteed.

The principles of organisation relating to structure and processes as well as the internal control system and the distribution of competences must be specified in internal documents (instructions, guidelines, rules, etc.).

³ If the marketing country does not provide for marketing licences or authorisations, the management company/AIFM must ensure that the third party to be delegated meets the necessary requirements for the delegated duties.

3. Conflicts of interest

3.1 Organisational and personnel measures

Appropriate organisational and personnel measures shall be taken to reduce the risk of conflicts of interest in investment decisions. In particular, it must be ensured that no incentives are created that influence the investment behaviour of the asset manager in such a way that it conflicts or could conflict with the interests of the investors.

Portfolio and transaction controls of the assets shall be undertaken independently of the asset manager.

Appropriate provisions shall be issued for the management bodies and employees of the management company/AIFM to counter conflicts of interest with respect to transactions for own account.⁴ At the same time, practices (such as insider trading⁵ and front running⁶) shall be prevented that could be exploited to improperly obtain pecuniary advantages.

Compliance with the aforementioned provisions shall be ensured contractually in relation to delegated parties.

Should the precautions not be sufficient in an individual case to guarantee that the risk of interference with client interests through conflicts of interest is prevented, then this must be indicated in an appropriate manner.

Potential conflicts of interest may for instance include the following non-exhaustive list of points:

- incentive systems for employees,
- employee transactions,
- inducements to members of the company,
- transfers within the fund,
- improvement of fund performance on cut-off date (window dressing),
- transactions between the company and the funds or individual portfolios it manages or transactions between funds and/or individual portfolios managed by the company,
- combination of several orders ("aggregated orders"),
- delegation of closely associated companies and persons,
- individual investments of substantial size,
- frequent trading,

⁴ Securities transactions of the management company/AIFM or its employees are considered transactions for their own account or proprietary trading if they undertake them for their own account. In the case of proprietary trading, the management company/AIFM or its employees themselves act as investors.

⁵ See Article 1(1) of Directive 2003/6/EC (Market Abuse Directive) to assist in the definition of insider.

⁶ See Article 1(1) of Directive 2003/6/EC (Market Abuse Directive) to assist in the definition of front running.

- specification of cut-off time,
- IPO allocations.

3.2 Exercise of membership and creditor rights

Membership and creditor rights shall be exercised exclusively in the interest of investors. The most important principles shall be available for review at the management company/AIFM.

4. Information and transparency

4.1 Investment principles and investment rules

Investment principles, investment rules, and the associated risks of the funds shall be explained to the investors in a manner and language appropriate to the client.

The investment objectives of the fund and the risks specific to the investments shall be indicated in the constitutive documents, so that the investor can gain an objective understanding of the possible changes in value of the units. The sample prospectus of the LAFV contains suggested formulations.⁷

4.2 Historical performance

A consistent information policy must be ensured to enable the investor to gain an objective understanding of the performance of the fund units.

4.3 Cost transparency

All costs arising from the issue and redemption of units and from the management of the funds shall be disclosed in the constitutive documents. When publishing net asset values, the management company/AIFM shall indicate any commissions. In the interim and annual reports,⁸ the total expense ratio (TER), the performance fee, and the transaction costs⁹ must be published.¹⁰ For all funds domiciled in Liechtenstein, the TER must be calculated in accordance with the method explained in CESR Guideline 09-949 and defined in CESR Guideline 09-1028 (ongoing charges). The TER is thus calculated in accordance with ongoing charges for AIFs and UCITS.

The costs shall be determined in a way that they correspond to market practices, that they can be calculated in an objective manner, and that they do not favour any investment or transaction behaviour that contradicts the interests of the investors.

Performance fee:

Performance fee models must be designed in a clear and understandable manner (as set out in the technical advice of CESR 09-949). The performance fee must ensure a sufficient degree of continuity.

⁷ Liechtenstein Investment Fund Association (LAFV), www.lafv.li

⁸ If the constitutive documents specify in accordance with Article 154(3) of the AIFM Ordinance that no interim report need be prepared, the costs must be indicated only in the annual report.

⁹ Analogous to the specifications in CESR Guideline 09-949 and CESR Guideline 09-1028

¹⁰ The AIFM must publish the costs incurred only if the AIF under management is marketed to private investors.

The management company/AIFM is responsible for the design and implementation of the performance fee models. The design of the performance fee model must be explained precisely and in understandable language in the constitutive documents or presented with a schematic case example.

In the case of performance fee models including a high water mark, it is not permitted to reduce the high water mark, with the following exception.

The FMA accepts one exception in which the high water mark can be reduced: the use of a rolling high water mark. In that case, the performance fee is paid out only if the unit value at the time the performance fee is assessed exceeds the previous highest level of the unit value that was achieved in the previous five years (in the case of UCITS) or the previous three years (in the case of AIFs). A rolling high water mark can be applied only if the UCITS took up business activities at least five years previously (in the case of AIFs, three years) and has performed those activities since then without interruption.

5. Dealing with valuation errors and investment limit violations

5.1 Valuation errors

The net asset value (NAV) per unit of a fund is calculated by dividing the net assets of the fund, i.e., the assets minus liabilities, by the number of units in circulation.

Taking account of external factors such as tradability, availability of data, etc., the valuation of the net asset value per unit represents the best possible approximation of the actual market value of the fund. If the rules for valuation of the net asset value per unit set out in the constitutive documents of a fund are continuously and in good faith applied on the basis of the most current and reliable information available at the time of valuation, it should be assumed that the valuation of the net asset value per unit is correct.

An error in the valuation of the net asset value per unit occurs if one or more factors or circumstances arise that entail an incorrect result.

5.1.1 Significance thresholds

A valuation error shall be considered significant if its difference to the correct valuation reaches or exceeds the following thresholds:

In the case of UCITS:

Investments Funds by asset category:	Majority of investments in developed markets	Majority of investments in emerging markets
Money market	0.250%	0.375%
Fixed income	0.500%	0.750%
Convertible bonds	0.750%	1.500%
Equities	1.000%	2.000%
Asset allocation funds <50% in equities	0.750%	1.375%

Asset allocation funds => 50% in equities	1.000%	2.000%
Liquid alternative investments	2.000%	2.000%

In the case of AIFs:

Investments Funds by asset category:	Majority of investments in developed markets	Majority of investments in emerging markets
Money market	0.250%	0.375%
Fixed income	0.500%	0.750%
Convertible bonds	0.750%	1.500%
Equities	1.000%	2.000%
Asset allocation fund <50% in equities	0.750%	1.375%
Asset allocation fund => 50% in equities	1.000%	2.000%
Liquid alternative investments	2.000%	2.000%
Non-liquid alternative investments (e.g. private equity)	8.000%	8.000%

These significance thresholds constitute maximum values. In its internal documents, the management company/AIFM may define lower values as significance thresholds. If valuation errors are classified as insignificant, the originally published net asset value per unit can be maintained. The settled issues and redemptions of fund units do not have to be corrected.

5.1.2 Consequences of significant valuation errors

Significant valuation errors must be corrected immediately, and the lawful state of affairs must be restored. If the significant valuation error is discovered by the depositary, the depositary must inform the management company/AIFM without delay; the management company/AIFM must institute the measures described below to restore the lawful state of affairs.

If a significant valuation error is discovered:

- the net asset value per unit determined during the error period must be recalculated,
- the loss to the fund and/or the fund's investor must be estimated on the basis of the corrected net asset value per share, and
- the FMA and the auditor must be informed immediately.

To ensure a uniform approach, the management company/AIFM is required in the event of a loss due to a significant valuation error to prepare a compensation plan as further specified in the points set out below in Section 5.1.3 as part of a compensation procedure (subject to the simplified procedure set out in Section 5.4). This compensation plan does not affect any civil claims for damages by the investor, however. It is expressly pointed out that the fund must be indemnified if a loss occurs.

5.1.3 Compensation procedure in the event of significant valuation errors

The compensation procedure encompasses the preparation of a compensation plan and compensation payment for the benefit of the fund or for the benefit of investors who already returned their units, but were still invested in the fund at the time the loss occurred.

a) Compensation plan

The compensation plan must be prepared to correct the significant valuation error and must contain the following points:

- recalculation of the net asset value per share for the error period;
- determination of the compensation that must be paid to the investors or for the benefit of the fund assets;

As part of the auditor's audit in accordance with FMA Guideline 2014/3, the auditor must include a statement on any compensation plans. Furthermore, the compensation plan must be presented to the FMA upon request. The scope of the compensation plan and the verification thereof may be adjusted according to the amount of the loss incurred.

b) Determination of the amount and the time of the compensation payment in the event of significant valuation errors

A significant valuation error has an impact on the assets of investors and the fund only if units were traded between the time the loss was incurred and the error was corrected by the management company/AIFM. Moreover, a loss is considered remedied if the respective trade in units was cancelled and corrected. If this is not possible, however, a distinction must be made between an overvaluation and an undervaluation of the unit value.

Compensation payments must be made close in time to the correction of the valuation error and the preparation of a compensation plan.

5.2 Investment limit violations

In the event of an investment limit violation, a distinction is made in principle between active and passive investment limit violations.

Active investment limit violations are caused by the person entrusted to manage the portfolio when misinvestments are undertaken that are not due to market conditions, where they are either unlawful or do not comply with the requirements set out in the constitutive documents.

Passive investment limit violations may be due to the following, non-exhaustive circumstances, without any direct purchases or sales having been made: market fluctuations, unit trades, rating changes,

prospectus changes, etc. As a consequence of these circumstances, investments exceed or fall below the limits set out either in the constitutive documents or by law.

A passive investment limit violation may become an active investment limit violation if it is not corrected within a reasonable period of time. If the correction is not made within a reasonable period of time, the management company/AIFM must document the decisions made and any measures taken in a comprehensible manner. The FMA may demand inspection of this documentation.

What is understood to be a reasonable period of time is determined on a case-by-case basis and must be documented by the management company/AIFM in each individual case and audited by the auditor.

5.2.1 Consequences of active investment limit violations

The active investment limit violation must be corrected immediately, and the lawful state of affairs must be restored. If the active investment limit violation is discovered by the depositary, the depositary must inform the management company/AIFM without delay; the management company/AIFM must institute the measures described below to restore the lawful state of affairs.

If the fund incurs a loss due to the correction of an active investment limit violation, the fund must be indemnified by the management company/AIFM. The management company/AIFM must determine the missing amount (loss) and credit it to the fund or any injured investors who have already exited the fund. Even if no unit transactions occurred during the error period, the missing amount must be credited to the fund. If the correction of the active investment limit violation results in a gain, the gain shall remain in the fund assets. Irrespective of whether the correction of the active investment limit violation resulted in a loss or a gain, the FMA must be informed of the active investment limit violation immediately once the lawful state of affairs has been restored.

To ensure a uniform approach, the management company/AIFM is required in the event of a loss to prepare a compensation plan as further specified in the points set out below in Section 5.2.2 as part of a compensation procedure (subject to the simplified procedure set out in Section 5.4). This compensation plan does not affect any civil claims for damages by the investor, however.

5.2.2 Compensation procedure in the event of active investment limit violations

The compensation procedure encompasses the preparation of a compensation plan and compensation payment for the benefit of the fund or for the benefit of investors who already returned their units, but were still invested in the fund at the time the loss occurred.

a) Compensation plan

The compensation plan must be prepared to correct the active investment limit violation and must determine the compensation to be paid to the investors or for the benefit of the fund assets.

As part of the auditor's audit in accordance with FMA Guideline 2014/3, the auditor must include a statement on any compensation plans. Furthermore, the compensation plan must be presented to the FMA upon request. The scope of the compensation plan and the verification thereof may be adjusted according to the amount of the loss incurred.

b) Determination of the amount and the time of the compensation payment in the event of active investment limit violations

In the event of an active investment limit violation, the compensation payment encompasses the loss arising from the non-compliant transaction as well as the resulting costs (e.g., transaction costs for purchase and sale) in connection with the correction of the active investment limit violation (absolute approach) or the negative difference between the loss/gain arising from the non-compliant transaction as well as the resulting costs (e.g., transaction costs for purchase and sale) in connection with the correction of the active investment limit violation and the loss/gain of the overall portfolio during the time between occurrence and correction of the active investment limit violation (relative approach).

For each fund, the management company/AIFM must decide on one of the two methods in advance and apply it in any event of an active investment limit violation. The selection of the calculation method must be set out in an internal instruction. Any change to the method must be in the interest of the investor and may only be made with the approval of the auditor.

Compensation payments must be made close in time to the correction of the active investment limit violation and the preparation of a compensation plan.

5.3 Responsibilities of the auditor

When reviewing the compensation plan as part of the supervisory audit of the fund, the auditor must assess whether the cases enumerated in the compensation plan have been dealt with correctly. The auditor must also assess whether the procedures for determining the financial compensation payments to be made for the benefit of the fund or the investors meet the requirements of the UCITS Act/AIFM Act and the Code of Conduct. In the audit report on the annual financial statement, the auditor must expressly mention the cases of significant valuation errors and/or active investment limit violations occurring in the current business year.

5.4 Simplified procedure

If the total amount of the compensation payment is lower than 0.01% of the net asset value or CHF 20,000 (or the equivalent in a different currency), whichever is larger, the preparation and submission of the compensation plan and the participation of the auditor described above are not necessary. However, it is expressly pointed out that the fund/the investors must be indemnified in any event of a loss.

Entry into force

This Guideline was approved by the Board of Directors of the FMA on 17 December 2015 and enters into force on 1 January 2016.

Transitional provision

Chapter 4.3 (TER) shall be applied for the first time to business years that begin after 31 December 2016.



FMA

Phone: +423 236 73 73
Fax: +423 236 73 74
E-mail: info@fma-li.li

Updated: 17 December 2015