


**REVIEW**  
**of private equity**  
**collective investment undertakings' (CIU)**  
**legal regulation**

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On 1 March 2008, the recast Law on Collective Investment Undertakings of the Republic of Lithuania came in force. From this date on, new special collective investment undertakings may be established in the Republic of Lithuania, including real estate investment trusts, private equity funds, funds of funds as well as hedge funds, etc.

**Definition of CIUs and private equity CIUs**

According to the Law on Collective Investment Undertakings of the Republic of Lithuania, a 'collective investment undertaking' is an investment fund or an investment company the sole purpose of the incorporation whereof is to accumulate personal funds by offering the units or shares and to invest such funds collectively into the assets.

A fundamental quality of 'private equity CIUs' (differentiating from CIUs active at present) is that property of an investment fund or company could be invested in the securities issued by companies which do not admit these securities to trading on a regulated market, securities or money market instruments. However, private equity collective investment undertakings are allowed to invest in other investment objects as well (see below).



### **Form and types of activities**

Private equity CIUs may be established in the form of activities of an investment company or an investment fund.

Investment company may be either 1) an investment company with variable capital (whose shareholders have the right to request at any time that their shares be redeemed and the amount of whose capital varies depending on the issue and redemption of shares) or 2) a closed-ended investment company (a public limited liability company that issues a fixed number of the shares redeemed upon the expiry of the period of activity of the company provided for in the articles of association of the public limited liability company or another time specified in advance therein).

Investment fund shall mean a type of activity whereby the assets managed by legal or natural persons by the right of common partial ownership under the trust right.

Private equity CIUs may be either open-ended or closed-ended; a more comprehensive analysis of their differences is provided below.

### **Objects of investment**

Private equity CIUs may invest to:

1. securities of newly incorporated and/or operating companies whose transferable securities have not been admitted to trading on the market.
2. the money market instruments issued by the whose transferable securities have been acquired by a private equity collective investment undertakings, provided they have not been admitted to trading on the markets.
3. other investment instruments, such as: transferable securities (shares, units of a company, bonds and non-equity securities of other forms) and money market instruments, admitted to trading on a market that is considered regulated and operating; fixed-term deposits with maturity not exceeding 12 months; units and shares of the collective investment undertakings; derivative financial instruments (futures, forwards, options); money market instruments, short selling.

In conclusion, private equity CIUs enable an investment not only in shares, bonds and non-equity securities of other forms of listed companies but in the securities that have not been admitted to trading on a market, as well. The Law also enables private equity CIUs to use investment instruments such as short selling as well as derivative financial instruments (futures, forwards, options).



### **Restrictions**

1. An investment company or a management company managing the assets of a collective investment undertaking may borrow, on the account of the collective investment undertaking, up to 80 percent of the value of net assets as of the date of the loan contract conclusion for the term laid down in advance in the instruments of incorporation of the collective investment undertaking.
2. Only a private equity CIU intended for professional investors may be comprised of the units or shares of different classes. In this case, the different classes of the units or shares as well as the scope of rights and duties of the investors holding them must be disclosed in the rules of a collective investment undertaking, or, where applicable, in the prospectuses thereof.
3. It shall be prohibited to lend the assets of a private equity CIU or to use such assets to guarantee or secure the discharge of liabilities of other persons. The prohibition to lend shall not apply only to a collective investment undertaking intended for professional investors; however, the value of the assets lent may not exceed 50% of the value of net assets of the private equity CIU.

### **Diversification of the investment portfolio of private equity CIUs**

Investment in transferable securities or money market instruments of a single company may not exceed 30 percent of the net assets comprising the assets of a private equity CIU. The investment portfolio of a newly incorporated private equity CIU shall be allowed, for 4 years from the approval of its instruments of incorporation and prospectuses by the Securities Commission, not to comply with the established diversification requirements. The diversification requirements shall be waived only in respect of the collective investment undertakings intended for professional investors.



### **Establishment of the value of net assets**

The value of net assets of private equity CIUs shall be established on the basis of the market price of the assets of a collective investment undertaking and in compliance with the Securities Commission's rules. Since the Law which has been recast comes in force on 1 March, the rules have not yet been passed. However, the Law has provided for that the value of net assets shall be established at least once in 3 months, while the term of 6 months is applied in respect of the of collective investment undertakings intended for professional investors.



### **Participant in a private equity CIU**


According to the Law, participant in a private equity CIU shall be a co-owner of an investment fund or a shareholder of an investment company, i.e. a participant is not subject to any limitations of its status. Participants in private equity CIUs may be both legal and natural persons. Furthermore, no quantitative restrictions or qualification requirements apply in respect of participants in private equity CIUs.

It is noteworthy that a specific kind of participants in private equity CIUs is established in the Law, i.e. a professional investor. Professional investor shall mean a person with sufficient knowledge, skills and experience for taking reasonable investment decisions by one's own account and is able to evaluate the related risks and a participant of a collective investment undertaking whose instruments of incorporation provide for a minimum investment amount of EUR 50.000 or more. Such investor of a specific kind is referred as a person allowed assuming bigger risk by the Law; regulation of their activity is less mandatory than of that of other investors.

### **Management company**

Only a management company shall have the right to engage in the management of funds and/or investment companies. Only a private limited liability company or a public limited liability company holding a licence for the activities of a management company issued by the Securities Commission shall have the right to engage in the management of investment funds and/or investment companies in the Republic of Lithuania. In order to apply for the license the following documents have to be provided to the Securities Commission: a) an application, b) a business plan containing a description of areas of the activities to be performed, the organisational structure of the company, as well as information about the legal person, participants, heads thereof, activities, compliance with capital requirements, and other information specified by the Securities Commission. Currently there are still no rules approved by the Securities Commission that would list necessary documents precisely, however, the rules should be approved until the Law on Collective Investment Undertakings comes in force.

Management companies have to satisfy general requirements for companies of specific legal forms, i.e. if a management company is a public limited liability company, it has to satisfy all requirements generally applicable to public limited liability companies. However, there are certain peculiarities pertaining to heads of management companies.



Heads of management companies are 1) head of the administration; 2) deputy head of administration; 3) members of the board of the company. Heads of the company shall be of sufficiently good repute and have sufficient experience. Heads can assume their duties only after they have been approved by the Securities Commission. Thus one of the essential differences between a management company and a conventional company is its heads' possession of respective qualification and approval of candidates by the Securities Commission.

It is furthermore noteworthy that a disposal of shares of a management company is also subject to control. According to the Law, where in consequence of a proposed acquisition of shares by a natural or legal person the proportion of voting rights at the General meeting of shareholders or of the capital that the person holds would reach or exceed in the increasing order 20%, 33% or 50% or the company would become a subsidiary of that legal person, must obtain a prior consent of the Securities Commission.

### **Notification of investors**

A management company is obliged to publish the following:

1. a full prospectus;
2. a simplified prospectus;
3. a report for each financial year;
4. a report covering the first six months of each financial year.

A private equity CIU whose participants may include solely professional investors, a management company or a private equity closed-ended investment company whose shareholders may include solely professional investors shall not be under an obligation to publish the listed documents.

### **Depository**

Assets of a collective investment undertaking must be entrusted to a depository for safe-keeping. Only a bank which has the right to provide investment services in a Member State and having the registered office or a division in the Republic of Lithuania may be the depository. Depository is an additional section in the supervision system, which shall supervise all activities of investment of assets of all kinds of special collective investment undertakings and any other activities related to the management of assets.



## **Taxation**

Asset management services provided by both closed-ended and open-ended private equity CIUs (investment companies and funds) are not subject to VAT.

Investment income of investment companies with variable capital and closed-ended investment companies, except dividends and other distributable profits, are not subject to corporate income tax.



We hope you found the provided information useful.

The review is of an informational nature and shall in no event be treated as a legal opinion or consultation.

If you choose to establish special collective investment undertakings *Šarka, Sabaliauskas, Jankauskas* are ready to help you with all related legal issues. If you have any questions, please feel free to contact us.

Best regards,

*Šarka, Sabaliauskas, Jankauskas*  
2008 05 28

**Appendices.**

**Comparison of a private equity investment company and an investment fund**

|   | <i>Private equity investment company</i>  | <i>Private equity investment fund</i>  |
|---|---|--|
| <b>1. Types of private equity CIUs.</b> | A private equity investment company may be either closed-ended or open-ended.   | A private equity investment fund may be either closed-ended or open-ended.   |
| <b>2. Subject.</b>                      | Only a limited liability company which has received a license issued by the Securities Commission can be a private equity investment company.   | A private equity investment fund is a type of activity whereby the assets managed by legal or natural persons by the right of common partial ownership under the trust right.  |
| <b>3. Establishment/formation.</b>      | Is considered established from registration in the State Enterprise “Centre of Registers”   | Is considered established from approval of formation of an investment fund by the Securities Commission.   |
| <b>4. Commencement of activities.</b>   | A public limited liability company wishing to engage in the activities of a private equity investment company shall provide to the Securities Commission: a) an application b) a business plan containing a description of areas of the activities to be performed, the organisational structure of the company, as well as information about the legal person, participants, heads thereof, activities, compliance | A private equity investment fund is formed by a decision of the board of a management company, by which the rules of an investment fund shall be approved. The management company may start collecting the investors’ funds intended to constitute the investment fund only after the Securities Commission approves the rules of the fund, a simplified prospectus if required and a full prospectus. |



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|   | <p>with capital requirements, and other information by the Securities Commission. Upon evaluation of the required documents, the Securities Commission shall issue or refuse the license. By March 1, new rules will be drawn up; they will be compatible with the recast Law on Collective Investment Undertakings. An investment company shall be subject to the same requirements of bodies' experience and qualification. However, an investment company the management of whose assets has been delegated to a management company shall not form any management bodies and all decisions shall be taken by the management company.</p> | <p>A decision of the board regarding the formation of an investment fund must indicate:</p> <ol style="list-style-type: none"> <li>1. the name of the investment fund;</li> <li>2. the name and registered office of a depository;</li> <li>3. the initial amount allocated for the formation of the investment fund.</li> </ol>   |
| <p><b>5. Relation between a management company and a collective investment undertaking.</b></p> | <p>An agreement on the management of assets of a private equity CIU shall be concluded with the management company. It must provide for:</p> <ol style="list-style-type: none"> <li>1. objectives and forms of investment activities;</li> <li>2. methodology of calculation of remuneration for the management company and the procedure for paying it;</li> <li>3. functions of the board which the management company undertakes to</li> </ol>   | <p>The rules of an investment fund shall determine the relations between a management company and participants in the investment fund. The rules must indicate:</p> <ol style="list-style-type: none"> <li>1. the name of the investment fund;</li> <li>2. the names and registered offices of the management company and a depository;</li> <li>3. a strategy for investment of the assets constituting the investment fund, investment restrictions and specialisation in</li> </ol> |



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|  | <p>perform;</p> <ol style="list-style-type: none"><li>4. powers of the management company in its relations with the depository and other institutions;</li><li>5. the information which the management company will furnish to the investment company;</li><li>6. the composition and market value of the investment portfolio whose management is delegated;</li><li>7. liability for a failure to perform obligations;</li><li>8. conditions of and procedure for terminating the agreement.</li><li>9. the risks relating to investment into an investment company, a description of such risks indicating that investment in a private equity investment company is related to long-term risk.</li></ol> | <p>the geographical area or economic branch;</p> <ol style="list-style-type: none"><li>4. rights and duties of participants;</li><li>5. rights and duties of the management company in the management of the investment fund, the transactions which the management company may enter into and carry out on the account and for the benefit of the investment fund;</li><li>6. the methodology of calculation of the remuneration payable to the management company, the depository and the distributor as well as the amount of the fee and the procedure for paying it;</li><li>7. a finite list and methods of calculation of other expenses covered with assets comprising the investment fund;</li><li>8. investment risks and their description providing that investment in a private equity investment fund is related to long-term risk</li><li>9. other information.</li></ol> |
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**Comparison of closed-ended and open-ended private equity CIUs**

|                                 | <i>Open-ended private equity CIU</i>   | <i>Closed-ended private equity CIU</i>  |
|---------------------------------|--|---|
| <b>1. Period of activity.</b>   | Unlimited.   | Closed-ended CIUs may be established for the term laid down in advance only. The period of operation of a closed-ended investment company issuing shares not entitling to dividends may not exceed 10 years. The same period of operation applies to a closed-ended investment fund the rules whereof provide for the issue of units not entitling to a share in investment proceeds. |
| <b>2. Redemption of shares.</b> | The shares shall be redeemed upon a request of a shareholder. A management company or a collective investment company must, upon the request of a participant in a collective investment undertaking, redeem his units or shares at the price valid on the day of filing the request. As a general rule, the shares have to be redeemed not later than | The shares of the company (or units of an investment fund, respectively) shall not be redeemed upon a request of a shareholder/participant. Shares are redeemed upon the expiry of the period of activity of the CIU.   |



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|  | <p>within 30 calendar days from the request to redeem them. However, the term of settlement can be postponed for no more than 6 months where the total value of the units or shares being redeemed exceeds the value established in the instruments of incorporation or prospectuses of the undertaking which may not be less than 10% of the value of net assets of the undertaking, or, in exceptional cases, where there are no sufficient funds to settle for the units or shares being redeemed and the sale of the investment objects held thereby would be loss-making. The settlement time limit can be postponed only provided such right is stipulated in the instruments of incorporation or prospectuses of the undertaking.</p> |  |
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