Luxembourg Legal Update

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BREXIT topic guide

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We are pleased to provide you with the latest edition of our Luxembourg Legal Update.

The newsletter provides a compact summary and guidance on the new legal issues which could affect your business, particularly in relation to banking, finance, capital markets, corporate, litigation, employment, funds, investment management and tax law

Banking, Finance and Capital Markets

International and EU Developments

New Delegated, Implementing and other EU Regulations, and EU and International Texts

Over the past few months, a number of other new Commission Delegated, Commission Implementing and other EU Regulations, as well as EU and international texts, have been published. These include, amongst others, the following:

Basel Committee of Banking Supervision (BCBS)

- BCBS final guidance of 27 September 2016 on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion
- BCBS final standard of 12 October 2016 on the regulatory capital treatment of banks' investments in instruments that comprise total loss-absorbing capacity (TLAC) for global systemically important banks.

CRD IV/CRR:

- N°2016/1702 of 18 August 2016 amending Implementing Regulation 680/2014 as regards templates and instructions
- N°2016/1646 of 13 September 2016 laying down ITS with regard to main indices and recognised exchanges in accordance with the CRR
- N°2016/1799 of 7 October 2016 (which entered into force on 1 November 2016) laying down ITS with regard to the mapping of credit assessments of external credit assessment institutions for credit risk in accordance with Articles 136(1) and 136(3) of the CRR
- N°2016/1801 of 11 October 2016 (which entered into force on 1 November 2016) on laying down ITS with regard to the mapping of credit assessments of external credit assessment institutions for securitisation in accordance with the CRR
- Updated EBA Common Equity Tier 1 (CET1) list of 8 September 2016 on capital instruments that Competent Authorities across the EU have classified as CET1
- EBA final report of 10 October 2016 on the monitoring of Additional Tier 1 (AT1) instruments of European Union (EU) institutions
- EBA standardised templates for AT1 instruments of 10 October 2016
- EBA final guidelines of 11 October 2016 on corrections to modified duration for debt instruments under Article 340(3) of the CRR.

BRRD:

- N°2016/1712 of 7 June 2016 supplementing the BRRD with regard to RTS specifying a minimum set of the information on financial contracts that should be contained in the detailed records and the circumstances in which the requirement should be imposed
- N°2016/1066 of 17 June 2016 laying down ITS with regard to procedures, standard forms and templates for the provision of information for the purpose of resolution plans for credit institutions and investment firms pursuant to the BRRD
- N°2016/1075 of 23 March 2016 supplementing the BRRD with regard to RTS specifying the content of recovery, resolution and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements

and of notice of suspension, and the operational functioning of the resolution colleges

- N°2016/1450 of 23 May 2016 supplementing the BRRD with regard to RTS specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities
- Single Resolution Board (SRB) "Introduction to Resolution Planning" publication of 22 September 2016 including:
  - a description of banks under the remit of the SRB and the Single Resolution Mechanism
  - tasks of the SRB
  - resolution planning (strategic business analysis, preferred resolution strategy, financial and operational continuity in resolution, information and communication plan, conclusion of the assessment of resolvability, opinion of the bank).

MiFID2 and MiFIR:

- ESMA Q&A of 11 October 2016 on the application of MiFID to the marketing and sale of financial contracts for difference (CFDs) and other speculative products to retail clients, notably with regard to:
  - the use of trading benefits when offering CFDs or other speculative products
  - the withdrawal of funds from trading accounts when investing in CFDs or other speculative products
  - the use of leverage when offering CFDs or other speculative products to retail clients
  - best execution obligations for firms offering CFDs or other speculative products to retail clients.

EMIR:

- N°2016/1178 of 10 June 2016 supplementing EMIR with regard to RTS on the clearing obligation under EMIR.

MAR:

- ESMA final guidelines of 13 July 2016 clarifying the implementation of the Market Abuse Regulation (MAR) for persons receiving market soundings and on delayed disclosure of inside information.

Solvency II:

- N°2016/1376 of 8 August 2016 laying down technical information for the calculation of technical provisions and basic own funds for reporting with reference dates from 30 June until 29 September 2016 in accordance with Solvency II
- N°2016/1630 of 9 September 2016 laying down implementing technical standards with regard to the procedures for the application of the transitional measure for the equity risk sub-module in accordance with Solvency II
- N°2016/1800 of 11 October 2016 (which entered into force on 1 November 2016) laying down ITS with regard to the allocation of credit assessments of external credit assessment institutions to an objective scale of credit quality steps in accordance with Solvency II.

AML/CTF:

- N°2016/1675 of 14 July 2016 supplementing Anti-Money Laundering Directive (Directive (EU) 2015/849 – AMLD4) by identifying high-risk third countries with strategic deficiencies

Legislation

MIF Regulation Implementation and Modification of Bank Confidentiality Rules

Bill N°7024

Bill N°7024/00 supporting Regulation (EU) 2015/751 of 29 April 2015 on interchange fees for card-based payment transactions (MIF Regulation) and modifying various laws on financial services was lodged with the Luxembourg Parliament on 29 July 2016.

The Bill appoints the CSSF, as the competent authority for the purposes of application of the MIF Regulation, and confers on the CSSF investigation and sanctioning powers in this area. The Bill further caps the interchange fee announced for debit card-based national payment transactions at 0.12% of the transaction value.

The Bill also introduces a number of adjustments and clarifications in financial sector legislation. In particular, the Bill modifies the Luxembourg statutory professional confidentiality obligation applying to banks and other professionals of the financial sector in order to support the outsourcing of functions by such professionals.

The publication of the Bill constitutes the start of the legislative procedure.

MAR and CSDMAD Implementation

Bill N°7022

Bill N°7022/00 on market abuse was lodged with the Luxembourg Parliament on 29 July 2016.

The Bill follows the Market Abuse Regulation (EU) N°596/2014 (MAR) and implements the Criminal Sanctions for Market Abuse Directive 2014/57/EU (CSMAD), as well as Commission Implementing Directive (EU) 2015/2392 on the reporting to competent authorities of actual or potential infringements. The Bill repeals the Luxembourg market abuse law of 9 May 2006 that implemented the Market Abuse Directive 2003/6/EC in Luxembourg.

The publication of the Bill constitutes the start of the legislative procedure.

Mortgage Credit Directive Implementation

Bill N°7025

Bill of law N°7025/00 on credit agreements for consumers relating to residential immovable property was lodged with the Luxembourg Parliament on 29 July 2016.

The Bill implements the Mortgage Credit Directive 2014/17/EU (MCD) by introducing new provisions to the Luxembourg Consumer Code. The new rules will apply to:

- credit agreements secured by either a mortgage or another comparable security on residential immovable property, or by a right related to residential immovable property
- credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or planned building.

The Bill introduces, amongst other things, standard pre-contractual information for consumer borrowers through a European standard information sheet (ESIS), a pre-contractual obligation to assess the creditworthiness of the consumer, and rules for the calculation of the annual percentage rate of charge. The Bill further introduces an early repayment right for consumers, in case of which the creditor is entitled to compensation for costs incurred, limited to a certain level.

The Bill also introduces the immovable property credit intermediary as a new category of financial sector professional, and appoints the CSSF as the competent authority for the purposes of supervision of immovable property credit intermediaries. Authorised immovable property credit intermediaries will benefit from the European passport under the MCD.

The publication of the Bill constitutes the start of the legislative procedure.

CRD IV/CRR: Voluntary Reciprocity for Macroprudential Policy Measures

CSSF Regulation N°16-04

On 30 August 2016, the CSSF published Regulation N°16-04 with regard to voluntary reciprocity for macroprudential policy measures.

The new Regulation follows the Luxembourg Systemic Risk Committee's recommendation of 25 July 2016 (CRS/2016/005) regarding the reciprocity measure taken by the National Bank of Belgium (NBB) under Article 458 (5) of the Capital Requirements Regulation (EU) N°575/2013 (CRR) and is in line with the European Systemic Risk Board's recommendation of 15 December 2015.

The CSSF recognises in the new Regulation the decision of the NBB to apply to Belgian branches of Luxembourg credit institutions using the internal ratings-based (IRB) approach a 5% increase in risk-weighted retail mortgage credit exposure (other than SME) relating to residential real estate in Belgium.

The Regulation has entered into force and became immediately applicable to Belgian branches of Luxembourg credit institutions using the IRB approach.

CRD IV/CRR: Setting of Countercyclical Buffer Rate for Fourth Trimester of 2016

CSSF Regulation N°16-05

CSSF Regulation N°16-05 dated 26 September 2016 sets the countercyclical buffer rate (*taux de coussin contracyclique*) for the fourth trimester of 2016.

The new Regulation follows the Luxembourg Systemic Risk Committee's recommendation of 22 August 2016 (CRS/2016/006) and maintains a 0% countercyclical buffer rate for relevant exposures located in Luxembourg for the fourth trimester of 2016.

The new regulation entered into force on 1 October 2016.

BRRD/SRMR: *Ex Ante* Contributions to be paid to the Luxembourg Resolution Fund

CSSF Regulation N°16-06

CSSF Regulation N°16-06 dated 10 October 2016 on *ex ante* contributions to be paid to the Luxembourg Resolution Fund (*Fonds de Résolution Luxembourg*) was published on 10 October 2016 in the *Mémorial* and the CSSF website.

The CSSF Regulation sets out the annual contributions to be collected from the relevant in-scope entities for 2015 and 2016.

CSSF Annual Activity Report for 2015

On 18 July 2016, the CSSF published its Annual Activity Report for 2015. In addition to statistical information concerning the Luxembourg financial sector and information on legal and regulatory developments in the past twelve months, the report contains information on the CSSF's exercise of its regulatory powers. The following points are of particular interest for banks and other actors in the financial sector.

The report also contains a section on investment funds and SICARs, which will be discussed in the Investment Funds section, as well as a section on client complaints which will be discussed in the Litigation section of this Luxembourg Legal Update.

Financial Innovation and Fintech

In relation to Fintech, the CSSF stresses its proactiveness and openness in financial innovation matters.

The CSSF further reports on recent initiatives taken at the national level to promote financial innovation including, in particular:

- the Grand-Ducal regulation of 5 August 2015 foreseeing a simplified customer due diligence regime for online payment operations not exceeding EUR 250
- a more open approach taken by the CSSF on IT outsourcing by Luxembourg institutions
- a CSSF Frequently Asked Questions paper permitting, subject to certain conditions, Professionals of the Financial Sector the online and video identification of their clients.

The CSSF further clarifies its positions relating to the licensing of new actors wishing to set up a Fintech establishment in Luxembourg. The CSSF stresses that it takes a technologically neutral approach when assessing a new project and in relation to Fintech companies in general. The CSSF emphasises that particular care and attention will be taken by the CSSF in its supervisory assessment of new projects in relation to compliance with the requirements in AML/CTF and IT matters. Finally, the CSSF confirms its cooperation with professionals to find a business model adapted to the EU regulatory requirements and the technological requirements applicable to the relevant products, services or solutions.

Supervision IT Systems

The CSSF Activity Report contains some explanations on the supervisory practice and requirements on several issues in the area of IT systems, including, amongst others, the following:

- outsourcing in a cloud
- data protection
- principles of privacy by design, of need to know, and of security by design
- cyber-criminality and cyber-resilience
- recovery of data from an insolvent outsourcing service provider.

Further Elements Discussed

The CSSF report also contains further specifications on the regulatory practice by the CSSF in respect of the prospectus law, takeover offers and squeeze-outs, as well as decisions or other actions taken in reaction to customer complaints in the past year (including in the area of asset management, fees charged by professionals to their clients and rights and obligations of agents and effective beneficiaries of bank accounts).

Regulatory Developments

CRD IV/CRR: Supervisory Reporting Requirements of Credit Institutions

CSSF Circular 16/640

On 8 August 2016, the CSSF issued circular 16/640 dated 29 July 2015 providing an update of CSSF circular 14/593 (as amended) on reporting requirements applicable to credit institutions.

The update reflects the latest developments and requirements for credit institutions in relation to prudential reporting and provides practical details and requirements of the CSSF in this respect. The new requirements include:

- additional monitoring metrics for liquidity (ALMM) applicable from 30 April 2016
- the new liquidity coverage requirement (LCRDA) which replaces the former liquidity coverage requirement in respect of the reference period as from 30 September 2016
- new leverage ratio reporting (LEVDA) which replaces the former leverage ratio reporting in respect of the reference period as from 30 September 2016.

Financial Conglomerates Directive: Supplementary Capital Adequacy Requirements for Financial Conglomerates

CSSF Circular 16/641

On 5 August 2016, the CSSF issued circular 16/641 providing an update of CSSF Circular 15/629 on supplementary supervision applicable to financial conglomerates and the definition of structure coefficients to be complied with by regulated entities belonging to financial conglomerates.

The circular is addressed to all Luxembourg-established credit institutions, investment firms, portfolio management companies and alternative investment fund managers.

The aim of the circular is to implement the modifications made by Article 2(5) of Directive 2011/89/EU to Article 6(4), paragraph 1 of the Financial Conglomerates Directive 2002/87/EC in respect of capital adequacy for regulated entities in a financial conglomerate.

The circular clarifies the technical methods and principles for calculating the supplementary capital adequacy requirements with respect to a financial conglomerate applying the accounting consolidation method.

CRD IV/CRR: Compliance with EBA Guidelines on the Management of Interest Rate Risk Arising from non-Trading Book Activities

CSSF Circular 16/642

On 5 August 2016, the CSSF issued circular 16/642 modifying CSSF circular 08/338 on the implementation of a stress test in order to assess the interest rate risk arising from non-trading book activities and CSSF circular 12/552 on the central administration, internal governance and risk management.

The circular is addressed to all Luxembourg established credit institutions and investment firms and Luxembourg branches of third country credit institutions and investment firms.

The aim of the circular is to implement the European Banking Authority (EBA) guidelines on the management of interest rate risk arising from non-trading activities, published on 22 May 2015. The EBA guidelines apply to the interest rate risk arising from non-trading book activities (IRRBB), one of the Pillar 2 risks specified in the CRD IV.

In particular, the circular introduces updated rules for the management of IRRBB and requires institutions to:

- measure their exposure to IRRBB, in terms of both potential changes to economic value and changes to expected net interest income or earnings
- document these measures in their Internal Capital Adequacy Assessment Process (ICAAP).

The circular applies from 1 December 2016. As a result, stress tests based on the situation of institutions as at 31 December 2016 will have to be performed in compliance with the new requirements.

CRD IV/CRR: Risk Weights Applicable to Retail Exposures Secured by Mortgages on Residential Immovable Property in Luxembourg

CSSF Circular 16/643

On 30 August 2016, the CSSF issued circular 16/643 on risk weights applicable to retail exposures (other than SME) secured by mortgages on residential immovable property in Luxembourg.

The new circular follows the Luxembourg Systemic Risk Committee's (LSRC's) recommendation of 1 July 2016 (CRS/2016/004) on the use of rating systems for the purpose of the internal ratings-based (IRB) approach. The risk-weighted exposure for credit risk of credit institutions should accordingly not amount to an average risk weight of less than 15% in relation to retail exposures (other than SME) secured by mortgages on residential immovable property in Luxembourg.

The CSSF was required, by 31 October 2016, to submit to the LSRC a report on the practice of Luxembourg credit institutions in relation to this. Therefore, credit institutions which:

- operate in the residential real estate sector in Luxembourg and
- use the IRB approach to calculate risk-weighted exposure for credit risk,

were required to inform the CSSF by 30 September 2016 whether they are compliant with the LSRC's recommendation, and where not, to indicate which measures will be taken to ensure their compliance.

In addition, the relevant credit institutions are required to document the above within their internal capital adequacy assessment process (ICAAP) on an annual basis.

Deposit Guarantee and Investor Compensation Schemes: Clarifications on Scope of Protection

Circular CSSF-CPDI 16/02

The CSSF, in its function as council of protection for depositors and investors (*conseil de protection des déposants et des investisseurs*) (CPDI), issued on 18 October 2016 circular CSSF-CPDI 16/02 on the scope of the deposit guarantee and investor compensation.

This circular aims at clarifying certain eligibility criteria with respect to the deposit guarantee and investor compensation, in accordance with Titles II and III of the BRRD Law. The circular further reiterates the exclusions from the deposit protection scheme defined in Circular CSSF 15/630 and extends them to the SIIL.

Investor Compensation Scheme: Survey on Covered Claims

Circular CSSF-CPDI 16/03

The CSSF, in its function as CPDI, issued on 18 October 2016 circular CSSF-CPDI 16/03 to conduct a survey on covered claims in connection with investment business.

Pursuant to the amended Luxembourg law of 18 December 2015 on the failure of credit institutions and certain investment firms (BRRD Law), the CPDI requests a particular set of data from members of the *Système d'indemnisation des investisseurs Luxembourg* (SIIL) for the purpose of calculating the share of the contribution that each member would have to make in accordance with the BRRD Law, should a compensation by the SIIL occur. The data survey is aimed at collecting the volume of covered claims (instruments and money) in relation to investment business of which members are debtors, in accordance with Article 198(1) of the BRRD Law.

The amounts of covered claims need to be reported based on the figures as at 31 December 2015. To this end, members are requested to complete one of the sheets (simplified or detailed) of the document available on the CSSF's website and transmit the completed document no later than 15 November 2016.

CRD IV/CRR: Stress Tests for Non-Trading Book Interest Rate Risk Assessment

CSSF Information Notice dated 7 October 2016

The CSSF issued on 7 October 2016 an information notice regarding the transmission of the results of the stress test referred to by Circular CSSF 08/338 (as amended by Circular CSSF 16/642) (Circular) for the assessment of the interest rate risk arising from non-trading book activities of credit institutions and CRR investment firms to the CSSF.

The CSSF draws the attention of the credit institutions and CRR investment firms concerned to the fact that in order to transmit the results of the stress test to the CSSF, the new electronic reporting tables to be used as from 1 December 2016 are now included in the annex to the Circular.

Links to the CSSF website where these new electronic reporting tables are available, are also provided in the CSSF information notice.

Solvency II: Technical Reserves of Direct Insurance Undertakings

CAA Circular N°16/9

On 16 August 2016, the CAA issued circular 16/9 on the deposit of securities and liquid assets used as assets representing technical reserves of direct insurance undertakings.

The new circular repeals, subject to a transitional regime, circular 15/4 with respect to direct insurance undertakings. However, circular 15/4 remains applicable for pension funds. The purpose of the new circular is mainly to update references to relevant legal provisions set out in circular 15/4 as well as in the template deposit agreement, following the implementation in Luxembourg of the Solvency II by means of, amongst others, the law of 7 December 2015 on the insurance sector and CAA Regulation 15/03. The substantive provisions of CAA circular 15/4 remain unchanged.

An updated template deposit agreement is annexed to the new circular.

The new circular applies to deposit agreements entered into by direct insurance undertakings as of 1 October 2016. The validity of deposit agreements concluded before 1 October 2016 in compliance with circular 15/4 is not affected.

Solvency II: Technical Interest Rates Applicable to Reinsurance Companies

CAA Circular N°16/10

On 24 October 2016 the CAA issued a circular 16/10 modifying CAA Circular 15/12 on technical interest rates applicable to reinsurance undertakings.

Technical interest rates have to be used by reinsurance undertakings for drawing up the financial balance as provisioned for fluctuations in claims rates.

Following its annual review of registered currency interest rates, the CAA decided to fix lower new maximum technical interest rates for all currencies reviewed.

The new technical interest rates are applicable as of 1 December 2016.

Insurance Distribution Directive: Product Oversight and Governance Arrangements by Insurance Undertakings and Distributors

CAA Information Notice dated 20 July 2016

On 20 July 2016, the CAA issued an information notice concerning the preparatory guidelines on the product oversight and governance arrangements of insurance undertakings and insurance distributors published by the European Insurance and Occupational Pensions Authority (EIOPA) on 18 March 2016. The preparatory guidelines are intended to support and provide guidance to national authorities in their preparatory steps leading to a consistent implementation of the organisational requirements on product oversight and governance arrangements of the Insurance Distribution Directive (IDD).

The CAA has informed EIOPA that it will fully apply the preparatory guidelines.

In the information notice the CAA invites insurers and insurance distributors to take all necessary measures to comply with the preparatory guidelines by 23 February 2018, the date by which the IDD must be implemented. Insurers and insurance distributors are, in particular, required to set out an action plan detailing the steps to be taken to comply with the new requirements. The CAA reserves the right to carry out *ad hoc* reporting during 2017 to monitor progress towards full compliance with the preparatory guidelines.

AML/CFT: New Mandatory Electronic Reporting to CRF

CRF Announcement dated 11 October 2016

The Luxembourg Financial Intelligence Unit of the State Prosecutor's Office to the Luxembourg District Court, *Cellule de Renseignement Financier* (CRF), announced in a press release of 11 October 2016 that it will adopt mandatory electronic reporting to receive all suspicious transactions reports in relation to anti-money laundering and countering the financing of terrorism (AML/CFT). The CRF will use goAML to receive the reports, which is the standard software system of the United Nations Office on Drugs and Crime (UNODC).

The CRF will begin using the system from 1 January 2017, and the Luxembourg Ministry of Justice invites those subject to the Luxembourg law of 12 November 2004 on the fight against money laundering and terrorism financing (as amended) to obtain a LuxTrust certificate, which is necessary for the use of the system and to register for training sessions.

Case Law

Financial Collateral Arrangements – Pledge – Enforcement – Summary Proceedings

Court of Appeal (summary proceedings), 27 January 2016

District Court (summary proceedings), 26 August 2016

Accountant's and Bank's Professional Confidentiality Obligation – Heir of the Beneficial Owner of a Bank Account

Court of Appeal (summary proceedings), 22 June 2016

Please refer to the Litigation section of this Luxembourg Legal Update for further details on the above.

Corporate

National Legislation

Entry into Force of Law of 10 August 2016 on the Modernisation of Company Law

For further details on the above, please refer to the client briefing prepared by Clifford Chance.

Law of 23 July 2016 on Audit Profession transposing the EU Directive 2014/56 dated 16 April 2014 and implementing the EU Regulation N°537/2014 of 16 April 2014

The Law of 23 July 2016 transposing the Directive 2014/56/EU on statutory audits (audits of annual accounts or consolidated accounts) and the EU Regulation 537/2014 on the specific requirements applicable to the statutory audit of public interest entities (the "Audit Profession Law") was published in the *Mémorial* on 28 July 2016 and entered into force on 1 August 2016.

Key changes of interest to companies and audited entities introduced by the Audit Profession Law, (repealing the law of 18 December 2009 on the audit profession), may be summarised as follows:

- Auditors (*réviseurs d'entreprises)* now have the same duties as the approved auditors (*réviseurs d'entreprises agréés*), except for statutory audit (*contrôle légal des comptes*), which is reserved to the latter.
- As a consequence, the reports foreseen by the Companies Law (in particular, pursuant to Article 26-1) may be prepared by the auditors going forward.
- Additional rules are introduced in order to ensure and enhance independence of the approved auditors, approved audit firms (*cabinets de révision agréés*) and audit firms (*cabinets d'audit*) in relation to the statutory audit.
- General shareholders' meeting or the members of the controlled entity shall appoint the approved auditors, approved audit firms and audit firms and any clause restricting the choice of the general shareholders' meeting or the members of the controlled entity to certain categories or lists of auditors or audit firms in particular in relation to the statutory audit is prohibited and shall be considered null and void.
- Approved auditors, approved audit firms and audit firms may be revoked for legitimate reasons only; the Audit Profession Law sets out additional rules in relation to the revocation in the public interest entities (*entité d'intérêt public*).
- Statutory audit is carried out in accordance with the international audit rules as adopted by the EU Commission.
- The Audit Profession Law sets out specific requirements in relation to the statutory audit of a public interest entity:
  - duration rules are set out in relation to the statutory audit: as a general rule, the audit engagement may not exceed 10 years in accordance with Article 17, par 1 of the EU Regulation 537/2014; however, if a public tendering process has been launched, the maximum duration of the audit engagement may be of 20 years in accordance with Article 16, par 2 to 5 of the EU Regulation 537/2014;
  - as a general rule, each public interest entity shall have an audit committee in place; the audit committee members as a whole shall have competence relevant to the sector in which the audited entity is operating and a majority of the members of the audit committee shall be independent of the audited entity;
  - amongst the new tasks conferred to the audit committee by the Audit Profession Law are:
    1. the responsibility of informing the administrative or supervisory body of the audited entity of the outcome of the statutory audit and explain how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process
    2. the responsibility for the procedure of the selection of approved auditor(s) or audit firm(s) and the recommendation of the approved auditor(s) or the audit firm(s).
- The CSSF is the public authority empowered in particular to receive claims from third parties regarding the statutory audit and has the power to impose sanctions and various administrative measures for breaches of the provisions of the Audit Profession Law.

Law of 23 July 2016 on the New Form of Simplified S.à r.l. which is Reserved to Physical Persons and Intended to Facilitate the Commencement and Development of New Business Activities

The Law of 23 July 2016 introducing a simplified form of the *société à responsabilité limitée* ("S.à r.l.-S") (the "S.à r.l.-S Law") was published in the *Mémorial A* on 4 August 2016. The purpose of this simplified form of *société à responsabilité limitée* is to boost the economic growth by increasing the number of companies set up by natural persons.

The key features of the S.a r.l.-S are the following:

- The provisions of the Companies Law relating to the *société à responsabilité limitée* apply save for the specific provisions relating to the S.à r.l.-S introduced by the S.à r.l.-S Law.
- Only natural persons (*personnes physiques*) may be shareholders of a S.à r.l.-S and those natural persons cannot be shareholders of more than one S.à r.l. unless he/she has acquired shares by reason of death.
- The object of the S.à r.l.-S must fall within the scope of the law of 2 September 2011 governing access to the craft, trade and industrial professions as well as certain other professions (*loi réglementant l'accès aux professions d'artisan, de commerçant, d'industriel ainsi qu'à certaines professions liberales*).
- The share capital shall be comprised between EUR 1.- and EUR 12,000 and be contributed by the shareholders by way of contribution in cash or kind.
- From the net profit of the S.à r.l.-S, five per cent. would have to be deducted and allocated to a reserve. That deduction will cease to be mandatory when the amount of the reserve, together with the amount of the share capital, reaches EUR 12,000
- Only natural persons may be managers of a S.à r.l.-S.

Law of 23 July 2016 implementing Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards Disclosure of Non-Financial and Diversity Information by Certain Large Undertakings and Groups

The Law of 23 July 2016 on the disclosure of non-financial and diversity information applicable to some large companies and some groups was published on 4 August 2016. It implements Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU (the "Accounting Directive") as regards disclosure of non-financial and diversity information by certain large undertakings and groups. The purpose of this law is to increase EU companies' transparency and performance in respect of environmental and social matters.

The main changes introduced by this law can be summarised as follows:

Targeted entities:

- The new law applies to commercial companies establishing their annual accounts in accordance with the Law on the Register of Commerce and Annual Accounts. It also applies to Luxembourg credit institutions.
- The new law only applies to commercial companies fulfilling all of the following criteria:
  - they are either an SA, European Company (*société européenne*), SCA, SARL or SCS all of whose unlimited shareholders are SA, SCA or SARL
  - they are public interest entities within the meaning of the Accounting Directive (i.e. companies whose securities are listed on a regulated market of a Member State)
  - they exceed at least two of the following three criteria (the "Criteria of Article 47") on their balance sheet date and for two consecutive financial years:
    1. total balance sheet: EUR 20 million
    2. net turnover: EUR 40 million
    3. average number of full-time staff employed during the financial year: 250
  - they must as at their balance sheet date exceed the criterion of an average number of 500 employees during the relevant financial year.

Targeted entities must disclose certain information in their management report, or in a separate report published with the management report or made available to the public on its website, and to which reference is made in the management report:

- A non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and the impact of its activity relating to, at least, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:

  - a brief description of the undertaking's business model
  - a description of the policies carried out by the undertaking in relation to those matters, including due diligence processes implemented
  - the outcome of those policies
  - the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how to manage those risks
  - non-financial key performance indicators relevant to the particular business.
- A description of the diversity policies applied in relation to the undertaking's administrative, management and supervisory bodies with regard to aspects such as, for example, age, gender, educational or professional background, the objectives of that diversity policy, how it has been implemented, and the results in the reporting period. If no such policy is applied, the statement shall contain an explanation as to why this is the case. It should be noted that the description of the diversity policies obligation shall only apply to companies whose securities are admitted to trading on a regulated market, and which exceed at least two of the three Criteria of Article 47 on their balance sheet date and for two consecutive financial years.

Subsidiaries may be exempted from such reporting obligations if they are included in the consolidated non-financial statement of another group parent company.

The independent auditor of the targeted entities must verify whether the non-financial statement and the description of the diversity policies have been provided.

A similar non-financial statement must be included by Luxembourg parent companies establishing consolidated accounts, in their consolidated management report related to the group or in a separate report published with the consolidated management report or made available to the public on the company's website and to which reference is made in the consolidated management report. This obligation shall only apply to:

- Luxembourg public interest entities which exceed, together with their subsidiaries on a consolidated basis, at least two of the following three criteria on their balance sheet date and for two consecutive financial years:
  - total balance sheet: EUR 20 million
  - net turnover: EUR 40 million
  - average number of full-time staff employed during the financial year: 250
- the criterion of having on their balance sheet date an average number of 500 employees during the relevant financial year.

This obligation shall also apply to Luxembourg credit institutions.

The independent auditor of the parent company must verify whether such non-financial statement has been provided.

A fine between EUR 500 to EUR 25,000 may be imposed on directors or managers who have breached the publication requirement regarding non-financial and diversity information (either in connection with the annual accounts or the consolidated accounts of the relevant company).

Data Protection

EU Developments

EU-US Privacy Shield

On 12 July 2016, the European Commission adopted the final version of the EU-U.S. Privacy Shield, which enables the transfer of personal data between the EU and the U.S. The Privacy Shield replaces the Safe Harbor arrangement, which was invalidated by the European Court of Justice in October 2015.

For further details on the above, please refer to the client briefing prepared by Clifford Chance.

National Legislation

Protection of Individuals with regard to the processing of Personal Data

Bill N°7049

On 31 August 2016, the Luxembourg Government introduced legislation to amend the law of 2 August 2002 on the protection of individuals with regard to the processing of personal data, as amended ("DPL").

Amongst the proposed modifications, the main innovation is to ease the system of prior authorisation by the National Data Protection Commission ("CNPD") by removing some prior authorisations for the sake of administrative simplification.

The deletion of prior authorisations by the CNPD anticipates the entry into application of the EU Regulation 679/2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data ("GDPR"). Once the Regulation becomes applicable i.e. on 25 May 2018, the system of prior notification and prior authorisation (applicable for certain kind of data processing) will be abolished.

Once the Bill is adopted – and is adopted as it currently stands – prior authorisation by the CNPD will no longer be needed in the following cases:

- *Interconnection of data*: Interconnection of data remains, however, subject to the specific rules foreseen in the DPL
- *Supervision in general and supervision at the work place in particular*: Supervision in general and supervision at the work place will, however, still need to comply with the conditions and limits foreseen in the DPL and the Luxembourg Labour Code.
- *Processing relating to the credit status and the solvency of the data subjects*: Currently the processing of this kind of data is subject to a prior authorisation by the CNPD unless the processing is carried out by professionals of the financial sector or insurance companies in respect of their clients.
- *Transfer of data outside the EU/EEA*: Controllers relying on the so-called EU standard model clauses or on Binding Corporate Rules (BCR) duly approved by the data protection authorities will not be required any longer to request from the CNPD the authorisation for the international data transfers.

It shall however be noted that even though a prior authorisation would not any longer be needed in relation to the processing described above, these processing will still need to be notified to the CNPD (until 25 May 2018).

Employment

National Legislation

Reform of Parental Leave

Law of 11 October 2016

The statutory provisions on parental leave have been amended by a law dated 11 October 2016 which will enter into force on 1 December 2016.

The aim of the reform is to make parental leave more flexible, to enable a better balance between private and professional life.

The employees will continue to be entitled to take full-time parental leave, but this full-time parental leave can be either six months in duration or reduced to four months.

Full-time parental leave will not only be available for employees working a minimum of 20 hours per week, but also for employees working between 10 and 20 hours per week, as well as for apprentices.

The first parental leave must be taken immediately after the maternity leave (or adoption leave), except for single parents.

The second parental leave may be taken at any time until the child attains the age of six years (currently five years), or, in the case of adoption, until the child attains the age of 12 years.

Full-time parental leave which is taken immediately after the maternity leave cannot be refused by the employer (assuming that all conditions for the parental leave are met, such as the obligation to be affiliated to the Luxembourg social security system at the time of birth, and for an uninterrupted period of 12 continuous months prior to commencement of the parental leave).

The second full-time parental leave can only be taken by the parent who did not benefit from the first parental leave.

In exceptional circumstances, the employer may, but only for a limited period of time, postpone the second full-time parental leave.

Additional flexibility is available in that it will also be possible to take part-time parental leave for eight or 12 months. This option will, however, only be available to employees whose working time amounts to a minimum of 50% of the working hours corresponding to a full-time job in the company (i.e. in general, a minimum of 20 hours per week). The working time will, in that case, be reduced to half of the working hours applicable prior to the parental leave. However, this form of parental leave is subject to the employer's approval.

Finally, the law also introduced the possibility of splitting the parental leave by reducing the working time by one day per week during 20 months or by opting for four periods of one month of parental leave to be spread over 20 months. This option is only available for employees working on a full-time basis, and requires the employer's approval. In case the employer refuses the split parental leave, he must provide a valid reason for doing so, and propose an alternative.

Another innovation is that the law provides the possibility of parents taking their parental leave at the same time.

During the parental leave, the employment contract is suspended (either in full, partially, or proportionally), depending on the type of parental leave which has been chosen by the employee.

The employees are entitled to an allowance (currently EUR 1,778.31 per month for full-time parental leave, and EUR 889.15 per month for part-time parental leave), which will be increased, and will depend on the level of the employee's income. The allowance will be calculated on the basis of the employee's average monthly income earned during the 12 months prior to commencement of the parental leave, with a minimum set at EUR 1,922.96 (minimum social salary for unskilled workers) and a maximum of EUR 3,204.93 (minimum social salary increased by 2/3). These amounts are those which are applicable to full-time contracts, and will be reduced proportionally in accordance with the number of hours effectively worked. The allowance will be subject to tax and social security charges, which is not the case under the current statutory provisions.

As from the last day of the notice period for the notification of a request for parental leave, and during the entire period of parental leave, the employer is not entitled to terminate the employment contract (or to invite the employee to a preliminary meeting to discuss dismissal), and any termination notified in breach of this prohibition will be null and void. This protection also applies in case of split parental leave (i.e. the protection may apply during 20 months).The parental leave shall, however, not prevent either the expiration of a fixed-term employment contract or a dismissal for gross misconduct without a notice period.

Entitlements of an Employee having resigned due to Misconduct by his Employer[1]

The Luxembourg Labour Code provides that an employee may resign with or without a notice period in case his or her employer does not comply with his statutory or contractual obligations, such as paying the compensation due to the employee in a timely manner.

Articles L.124-6 and L.124-7 of the Luxembourg Labour Code provide that in case of unlawful termination by the employer of the employment contract without a notice period, the employee is entitled to an indemnity for the notice period that has not been granted (*indemnité compensatoire de préavis*), and, if he has more than five years of service, to a statutory severance indemnity (*indemnité de départ légale*). By contrast, Article L.124-10 of the Luxembourg Labour Code (which grants the employee the possibility to resign by reason of a breach by the employer of his obligations) only foresees an entitlement to damages (*dommages et intérêts*) in cases where the court rules that the resignation by the employee was based on valid grounds.

In its two decisions of 8 July 2016, the Constitutional Court considered whether this discrepancy between the situation where an employee is dismissed without valid reasons by his employer, and the situation where an employee resigns due to non-compliance by the employer with his contractual and/or statutory obligations, is contrary to the general principle of equal treatment stipulated in Article 10 bis of the Luxembourg Constitution.

The Constitutional Court (unsurprisingly) ruled in its two decisions of 8 July 2016 that this difference of treatment cannot be justified, as ultimately the employee who is dismissed without valid reason and the employee who decides to resign by reason of a breach by the employer of his obligations, are placed in the same situation where the termination of the employment contract is attributable to the employer.

It can be expected that the Luxembourg legislator, as a consequence of these two decisions rendered by the Constitutional Court, will amend the relevant provisions of the Luxembourg Labour Code in order to grant the employee who resigns by reason of a breach by his employer of his statutory and/or contractual obligations, an indemnity corresponding to the amount of salary that would have been due had a notice period been granted and, where the employee has more than five years of service, a statutory severance indemnity.

[1] Constitutional Court, 8 July 2016, decisions N°123/16 and 124/16

Investment Funds

EU Developments

UCITS

ESMA Publication of UCITS Remuneration Guidelines

Following the publication of its final report on guidelines on sound remuneration under the UCITS Directive and AIFMD on 31 March 2016[2], ESMA officially published on 14 October 2016 the translation in all official EU languages of its definitive guidelines on sound remuneration under the UCITS Directive (UCITS Remuneration Guidelines)[3].

As a reminder, the UCITS Remuneration Guidelines, which will apply from 1 January 2017, provide clarity on the UCITS V requirements to be complied with by UCITS management companies and self-managed investment companies when establishing and applying their remuneration policy.

The publication of the translations in all EU official languages triggered a period of two months within which national competent authorities (NCAs) must notify ESMA whether they comply or intend to comply with the guidelines (with reasons for non-compliance), and ESMA will publish a compliance table based on the responses from the NCAs. For the avoidance of doubt, UCITS management companies and self-managed investment companies are not required to notify ESMA whether they comply with the UCITS Remuneration Guidelines.

For more information on UCITS Remuneration Guidelines, please refer to the July 2016 edition of our Luxembourg Legal Update.

ESMA Updated Q&As on UCITS Directive

On 12 October 2016, ESMA published an updated version of its Q&As on the application of the UCITS Directive[4].

The updated version of the Q&A includes the following clarifications:

- *Regulated market concept*: The term "regulated market in a Member State" as used under the UCITS Directive includes a multilateral trading facility (MTF) within the meaning of MiFID that complies with the requirements of Article 50(1)(b) of the UCITS Directive, i.e. the relevant MTF must operate regularly and be recognised and open to the public. Moreover, ESMA recalls that instruments in which a UCITS invests and that are traded on such an MTF on behalf of a UCITS must also comply with the eligible assets requirements of the UCITS Directive, including in particular those relating to the liquidity and negotiability of the relevant instrument.
- *Translation of remuneration policy disclosure*: The information on the remuneration policy, which has to be made available on a website and a paper copy made available on request (as per UCITS V requirements), falls under Article 94(1)(c) of the UCITS Directive in term of translation requirements. Therefore, this information should be translated, at the choice of the UCITS, into the official language, or one of the official languages, of the UCITS host Member State, a language approved by the NCAs of that Member State, or a language customary in the sphere of international finance.
- *Cash collateral reinvestment:* If a UCITS, whose acquisition is contemplated by another UCITS, has a clause in its fund rules limiting investment in units of other UCITS and UCIs to 10% (in line with Article 50(1)(e)(iv) of the UCITS Directive), envisages to reinvest cash collateral in short-term money market funds, such reinvestment has to be treated in the same way as any other investment made by such UCITS in units of other UCITS or UCIs. As a result, such cash collateral reinvestment must be compliant with all the requirements of the UCITS Directive, including that it will be taken into account for the calculation of the 10% limit laid down in Article 50(1)(e)(iv) of the UCITS Directive.
- *Commencement of reporting under SFTR:* Article 13 of SFTR requires UCITS management companies and self-managed investment companies to provide information to investors on the use made of securities financing transactions (SFTs) and total return swaps in the annual and half-yearly reports of each UCITS. As Article 13 of SFTR applies as from 13 January 2017, ESMA considers that the information should be included in the next annual or half-yearly report to be published after 13 January 2017, which may relate to a reporting period beginning before that date.

[2] ESMA/2016/411
[3] ESMA/2016/575
[4] ESMA/2016/1455

AIFMD

ESMA Revised AIFMD Remuneration Guidelines

Following the publication of its final report on guidelines on sound remuneration under the UCITS Directive and AIFMD on 31 March 2016[5], ESMA published on 14 October 2016 its second set of guidelines on sound remuneration under the AIFMD[6] (AIFMD Revised Remuneration Guidelines), which amend the current guidelines on sound remuneration policies under the AIFMD as published in 2013[7].

The sole amendment introduced by the AIFMD Revised Remuneration Guidelines relates to the application of the remuneration rules in a group context, which amendment is intended to align the AIFMD Remuneration Guidelines with the UCITS Remuneration Guidelines and to acknowledge the potential outreach of the CRD IV rules in a banking group. Thus, like the UCITS Remuneration Guidelines, the AIFMD Remuneration Guidelines are rephrased to provide that there shall be no exception to the application of the AIFMD remuneration requirements to AIFMs that are subsidiaries of a credit institution, which implies that AIFMs part of a banking group must always comply with the AIFMD remuneration rules. However, ESMA also indicates that non-AIFMD sectoral prudential applying to group entities may lead certain staff of an AIFM which is part of that group to be so-called "identified staff" for the purpose of those sectoral remuneration rules.

The AIFMD Revised Remuneration Guidelines will apply from 1 January 2017.

ESMA Updated Q&As on AIFMD

On 6 October 2016, ESMA published an updated version of its Q&As on the application of the AIFMD[8], including a new question and answer on the commencement of periodical reporting under Article 13 of the SFTR for AIFMs.

As is the case for UCITS management companies and self-managed investment companies (see above), the information on the use of SFTs and total return swaps by AIFs must be included in the next annual report of each AIF to be published after 13 January 2017 (meaning that the reporting period may also start before that date).

[5] ESMA/2016/411
[6] ESMA/2016/579
[7] ESMA/2013/232
[8] ESMA/2016/1439

SFTR

ESMA Consultation on Draft RTS and ITS

On 30 September 2016, ESMA launched a consultation on draft regulatory technical standards (RTS) and implementing technical standards (ITS) under SFTR[9].

The draft RTS and ITS include rules on:

- the procedure and criteria for registration as a trade repository under the SFTR
- the use of internationally agreed reporting standards, the reporting logic and the main aspects of the structure and content of securities financing transaction (SFT) reports
- the requirements on transparency of data, data collection, aggregation and comparison
- the levels of access for different competent authorities.

ESMA consultation also sets out proposals for certain amendments to the existing RTS under EMIR in order to take into account legal developments and ensure consistency, where relevant, between the EMIR and SFTR frameworks.

Comments to the consultation will close on 30 November 2016. ESMA will then use the feedback to finalise its draft RTS and ITS which are due to be submitted to the EU Commission by the end of the first quarter or beginning of the second quarter of 2017. The finalised SFTR implementing measures would then be expected to apply from 2018.

For more information on the SFTR, please refer to the April 2016 edition of our Luxembourg Legal Update.

Benchmark Regulation

EU Commission Implementing Regulation on EURIBOR Benchmark

On 11 August 2016, the EU Commission adopted implementing regulation (EU) 2016/1368 (Implementing Regulation) establishing a list of critical benchmarks used in financial markets pursuant to Benchmark Regulation.

EURIBOR is the first benchmark included in the list of critical benchmarks established by the EU Commission to the extent that it complies with one of three conditions as

[9] ESMA/2016/1409

set out in Article 20(1) of the Benchmark Regulation, which is to be used as a reference for financial instruments or financial contracts or for the determination of the performance of investment funds having a total value of at least EUR 500 billion on the basis of the whole range of maturities or tenors of the benchmark. Indeed, it is estimated that EURIBOR underpins more than EUR 180,000 billion worth of contracts. While these contracts are mostly interest rate swaps, the benchmark also covers more than EUR 1,000 billion of retail mortgages. Therefore, the value of financial instruments and financial contracts using that benchmark in the EU far exceeds the threshold of EUR 500 billion.

Although the Benchmark Regulation will generally apply from 1 January 2018, certain provisions relating to the identified critical benchmarks (i.e. critical benchmarks, mandatory contribution to or administration of a critical benchmark) are applicable as from 30 June 2016. Those provisions apply to the EURIBOR from 13 August 2016 (which is the date of entry into force of the Implementing Regulation).

The EU Commission will review and update the list of critical benchmarks regularly and will include, in due course, other benchmarks that fulfil the criteria.

ESMA Final Technical Advice under Benchmark Regulation

On 10 November 2016, ESMA published a final report on its technical advice to the EU Commission under the Benchmarks Regulation[10].

This follows a consultation on draft technical advice published in May 2016. In the final report, ESMA provides advice on:

- how benchmarks' reference values can be calculated by using data reporting structures under existing EU rules such as MiFID2 and EMIR
- some of the criteria for deciding when third country benchmarks can be endorsed for use in the EU; and
- what constitutes making a benchmark figure available to the public.

As regards the transitional provisions in the Benchmark Regulation, ESMA indicates in its final technical advice that, after the comments received by stakeholder and a second analysis of the Benchmark Regulation, its understanding is the following:

- the transitional provisions for EU benchmarks in Article 51(3) and (4) apply to EU benchmarks existing on 1 January 2018 and given the definition of a "benchmark" this would seem to mean indices "used" in the EU in the manner specified in the definition of a benchmark as at 1 January 2018
- the transitional provisions for non-EU benchmarks in Article 51(5) apply to non-EU benchmarks already "used" in the EU on 1 January 2018 (for these purposes "use" would seem to mean use within the defined meaning in the Benchmark Regulation,).

Delegated acts should be adopted by the EU Commission on the basis of ESMA's final technical advice so that they enter into application by 1 January 2018, which is the date on which most rules of under the Benchmarks Regulation will apply.

ESMA Consultation on Draft RTS and ITS

On 29 September 2016, ESMA published a consultation paper on draft RTS and ITS under the Benchmark Regulation[11].

The key provisions of the draft RTS and ITS cover both benchmark contributors and administrators, and relate to:

- procedures, characteristics and positioning of the oversight function
- appropriateness and verifiability of input data
- transparency of the methodologies applied
- governance and control requirements for supervised contributors
- provisions for significant and non-significant benchmarks
- provisions for recognition by third country administrators.

Each chapter includes a summary of the relevant provisions and their objectives, an explanation of related policy issues and the draft text of each technical standard. Comments are due by 2 December 2016 and ESMA intends to submit

[10] ESMA/2016/1560

[11] ESMA/2016/1406

the final draft RTS and ITS to the EU Commission by 1 April 2017.

For more information and resources on the Benchmark Regulation, please see our last briefing paper The new EU benchmarks regulation: what you need to know and our Benchmark Topic Guide on the Clifford Chance Financial Markets Toolkit. This topic guide is a compliance tool developed by Clifford Chance to assist clients with their implementation projects on the Benchmark Regulation.

PRIIPs

Publication of Delegated Regulation on Product Intervention

Commission Delegated Regulation (EU) 2016/1904 with regard to product intervention under the PRIIPs KID Regulation has been published in the Official Journal on 29 October 2016.

This delegated regulation, which specifies the rules relating to supervisory measures on product intervention by NCAs and the European Insurance and Occupational Pensions Authority (EIOPA), entered into force on 18 November 2016 and will apply from 31 December 2016.

EU Parliament Rejecting RTS on KID Content

On 14 September 2016, the EU Parliament voted in its plenary session to reject the RTS adopted on 30 June 2016 by the EU Commission on the presentation, content, review and revision of the key information documents (KIDs) for packaged retail and insurance-based investment products (PRIIPs).

As a result, the EU Parliament returned the RTS to the EU Commission for revision, and the Commission has now to propose new RTS for implementing the PRIIPs KID Regulation.

Besides rejecting certain aspects of the RTS content, the EU Parliament also asked, along with several Member States, to the EU Commission to consider a delay in the application of the PRIIPs KID Regulation itself - which is in principle due to apply as from 31 December 2016 - arguing that the PRIIPs KID Regulation should be implemented at the same time as the RTS to avoid uncertainty in the industry's implementation.

EU Commission Extending Application Date of PRIIPs KID Regulation and Reviewing RTS

Further to the rejection of the RTS by the EU Parliament in September 2016, the EU Commission proposed on 9 November 2016 extending the date of application of the PRIIPs KID Regulation by one year to 1 January 2018.

The EU Commission believes that the objectives of the PRIIPs KID Regulation would be better served by having the RTS already in place and has now called on the three European Supervisory Authorities (ESAs) to resubmit the RTS and make targeted changes to certain areas such as multi-option products, performance scenarios, comprehension alert and presentation of insurance-related costs. The EU Commission has also invited the ESAs to develop guidance on the practical application of credit risk mitigation factors under the RTS for insurers.

The ESAs have six weeks to resubmit the revised RTS to the EU Commission. Once the revised RTS have been adopted by the EU Commission, they will subject to scrutiny by the EU Parliament and the Council. The revised PRIIPs framework is expected to be in place during the first half of 2017 and apply as of 1 January 2018.

For more information on the PRIIPs KID Regulation and its implementing measures, please refer to the July 2016 edition of our Luxembourg Legal Update and to our last briefing papers Implementing PRIIPs – the uncertainty persists and The PRIIPs KID Regime.

EuVECA & EuSEF

EU Council Presidency publishes Compromise Text

On 24 October 2016, the EU Council Presidency published a new compromise text on the EU Commission's proposal dated 14 July 2016 for a Regulation amending Regulations 345/2013 and 346/2013 on European venture capital funds (EuVECA) and European social entrepreneurship funds (EuSEF).

As a reminder, the initial EuSEF and EuVECA Regulations were adopted in 2013 to diversify fund-raising and investment opportunities for innovative small and medium-sized enterprises (SME) and social undertakings across the EU. However, the EuSEF and EuVECA initiative did not bring the success expected, as only 70 EuVECA and four EuSEF were registered by ESMA by the beginning of April 2016. Therefore, the EU Commission decided to anticipate the review of the EuSEF and EuVECA Regulations, expected to start in 2017, in three main ways:

- extending the range of managers eligible to market and manage EuVECA and EuSEF
- increasing the range of companies that can be invested in by EuVECA

- making the registration and cross-border marketing of these funds easier and cheaper.

Please refer to the June 2013 edition of our Luxembourg Legal Update for further information on the EuVECA and EuSEF Regulations.

EMIR

Please refer to the Banking, Finance and Capital Market section of this Luxembourg Legal Update for further details on the above.

MiFID 2 and MiFIR

Please refer to the Banking, Finance and Capital Market section of this Luxembourg Legal Update for further details on the above.

AML/CTF

Please refer to the Banking, Finance and Capital Market section of this Luxembourg Legal Update for further details on the above.

Luxembourg Legal and Regulatory Developments

Modernisation of Company Law

Law of 10 August 2016

The law of 10 August 2016 on the modernisation of the Company Law, which had been voted upon by the Luxembourg parliament on 14 July 2016, was published in the *Mémorial* on 19 August 2016 and entered into force on 23 August 2016.

Some of the modifications to the Company Law as introduced by the law of 10 August 2016, namely in relation to the capital structure, management and/or meetings of shareholders of Luxembourg SA, Sàrl and SCA, may impact investment funds and their management companies or AIFMs as long as they are incorporated under one of these legal forms. Another important modification for investment funds of a corporate type is the possibility explicitly recognised by the law of 10 August 2016, for all types of companies (civil and commercial) to create tracking shares.

Please refer to the briefing prepared by Clifford Chance for further details on the above.

Electronic Filing of Tax Returns

Law of 23 July 2016

Please refer to the Tax section of this Luxembourg Legal Update for further details on the above.

Withholding Tax on Interest

Law of 23 July 2016

Please also refer to the Tax section of this Luxembourg Legal Update for further details on the above.

MAR and CSDMAD Implementation

Please refer to the Banking, Finance and Capital Market section of this Luxembourg Legal Update for further details on the above.

Depositary Regime of Luxembourg Part II UCIs

Bill N°7024

Bill N°7024 was deposited with the Luxembourg Parliament on 29 July 2016 supporting Regulation (EU) 2015/751 of 29 April 2015 on interchange fees for card-based payment transactions (MIF Regulation). Bill 7024 also proposes to amend the depositary regime of Luxembourg Part II UCIs as last amended by the Luxembourg law of 10 May 2016 (2016 Law) implementing the UCITS V Directive.

As a reminder, the 2016 Law, which entered into force on 1 June 2016, has imposed the UCITS V depositary regime not only on Luxembourg UCITS (as required by the UCITS V Directive), but also on all Part II UCIs independent of the amount of the assets under management of their AIFM (i.e. regardless whether the AIFM of these Part II UCIs is below or above the EUR 100/500 million thresholds laid down in the AIFM Law).

As regards Part II UCIs, Bill 7024 now envisages limiting the scope of application of the UCITS V depositary regime only to those Part II UCIs that are marketed to retail investors in Luxembourg. As an exception, other Part II UCIs (the offering documents of which do not allow marketing to retail investors in Luxembourg) will remain subject either to the AIFM Law depositary regime or to the depositary regime of SIF Law, depending on whether or not the AIFM of these Part II UCIs is a sub-threshold or small AIFM.

Please also refer to the Banking, Finance and Capital Market section of this Luxembourg Legal Update for further details on the other amendments introduced by Bill 7024.

RAIF List Features and RCS Registration and Publication Formalities

Grand-Ducal Regulation of 1 August 2016 and Circular RCSL 16/02

The procedure for registration on the RAIF list as well as the registration and publication formalities with the RCS and RESA, as imposed by the law of 23 July 2016 on reserved alternative investment funds (RAIF Law), are clarified as follows by the Grand-Ducal Regulation of 1 August 2016 – which modifies the amended Grand-Ducal regulation of 23 January 2003 (GDR) implementing the law of 19 December 2002 on the register of commerce and companies and the accounting and annual accounts of undertakings (2002 Law) – and by Circular RCSL 16/02 of 3 August 2016.

Registration and publication formalities

The RAIF Law requires that a RAIF having been established is then recorded by notarial deed within a deadline of five days from the establishment of the RAIF. It further requires that a notice thereof is filed, together with an indication of the name of the external AIFM of the RAIF, with the RCS within fifteen days from the notarial deed attesting the establishment of the RAIF, and published on RESA.

In practice, registration with the RCS will be made electronically on the RCS website under the legal form used for the establishment of the RAIF (and under the relevant section) by communicating to the RCS the information prescribed by the 2002 Law and the GDR.

As regards the publication, a document evidencing by notarial deed the establishment of the RAIF and the name of its AIFM will be deposited in the RAIF file kept by the RCS so that it can be published on RESA. Such deposit will be made through the specific deposit tab titled "*Dépôt de la mention de la constitution d'un FIAR*" on the RCS website.

The costs of filing the registration of a RAIF with the RCS amount to EUR 105.91, but publication on RESA is free of charge.

Inscription on the RAIF list

The RAIF Law provides that a RAIF will be registered on a list of RAIFs kept by the RCS within twenty days from the date on which the notary has attested the constitution of the RAIF. In practice, the registration will be made in paper form by sending a registered letter to the RCS manager. This letter shall contain the name and registered office of the RAIF, the name of its management company (if applicable) and the date of the notarial deed attesting the establishment of the RAIF.

For further information on the RAIF Law, please see the separate brochure prepared by Clifford Chance.

CSSF Regulation 16-07 – Out-of-court Resolution of Complaints

On 26 October 2016, CSSF adopted Regulation 16-07 relating to the out-of-court resolution of complaints with the CSSF, which regulation entered into force on 11 November 2016 and replaced CSSF Regulation 13-02 on the same topic.

To a large extent, the main changes introduced by CSSF Regulation 16-07 aims at clarifying the conditions to be complied with so that an out-of-court complaint can be filed with, accepted and processed by the CSSF. However, some new rules are also included in CSSF Regulation 16-07, including among others the following:

- *Timeframe for acknowledgement of receipt and treatment of complaints by the CSSF*: the complainant will now have a period of one year maximum (starting from the filing of his prior complaint with the relevant professional) to file an out-of-court resolution of complaint with the CSSF in the case the complainant did not receive an answer or a satisfactory answer from the relevant professional concerned within one month from the date at which the prior complaint was sent by to that professional by the complainant.
- *Publication of complaint handling policy*: all institutions under the supervision of the CSSF which have a website must publish details on their website of (i) their complaint handling policy and (ii) the information on the role of the CSSF as competent entity policy for the out-of-court resolution of complaints. In case an institution has no website, it is required to provide the same information to its customers by other means, e.g. in its contractual documentation, brochures or flyers.
- *New professionals' information obligations towards complainants*: where the initial complaint handling at the level of the relevant professional did not result in a satisfactory answer for the complainant, the relevant professional must inform him/her in writing about the possibility to introduce an out-of-court complaint with the CSSF within a period of one year starting from the filing of his/her prior complaint with that professional.

CSSF Regulation 16-07 further sets out that the CSSF may terminate the procedure at any time if it finds that a party uses the procedure for other purposes than the search for

an amicable settlement of the complaint. Furthermore, CSSF Regulation 16-07 clarifies that this CSSF resolution procedure is not a mediation procedure and that the CSSF's intervention is subject to the principles of impartiality, independence, transparency, expertise, effectiveness and fairness.

For the avoidance of doubt, like CSSF Regulation 13-02 CSSF regulation 16-07 is applicable to all professionals being defined as any physical or legal person falling under the supervision of the CSSF (including therefore Luxembourg regulated investment funds and their Luxembourg management companies and alternative investment fund managers).

CSSF Circular 16/641 – Supplementary Supervision Applicable to Financial Conglomerates

The CSSF issued circular 16/641 dated 5 August 2016 providing an update of CSSF Circular 15/629 on supplementary supervision applicable to financial conglomerates and the definition of structure coefficients to be complied with by regulated entities belonging to financial conglomerates.

The circular is addressed to all Luxembourg established credit institutions, investment firms, UCITS management companies and AIFMs.

Please also refer to the Banking, Finance and Capital Market section of this Luxembourg Legal Update for further details on the above.

CSSF Circular 16/644 – Depositary Regime of UCITS

On 11 October 2016, the CSSF issued Circular 16/644 on the provisions applicable to credit institutions acting as a depositary of UCITS subject to Part I of the UCI Law and to all UCITS, where appropriate, represented by their management company.

The new Circular is intended to clarify the standard organisational rules concerning the rights and duties attached to the depositary function of Luxembourg UCITS under the UCI Law (as amended by the law of 10 May 2016 implementing the UCITS V Directive) and under Commission Delegated Regulation (EU) 2016/438 supplementing the UCITS V Directive with regard to the obligations of depositaries.

Amongst other things, the clarifications concern the custody duties and segregation of assets, the due diligence requirement for the appointment and ongoing monitoring of any delegate involved in the custody chain of the UCITS' assets, the prevention and management of conflicts of interests (including information on other functions), and the activities that can be performed by the depositary under certain conditions.

Circular 16/644 also clarifies certain other Luxembourg-specific points not covered by the UCITS V Directive and the Delegated Regulation, such as the asset segregation obligation to be complied with for the time being as regards Luxembourg UCITS throughout the entire delegation chain (i.e. for the assets held by the depositary, by the first sub-custodian and by any delegate further down the custody chain). The Circular also provides detailed rules regarding the application file and information to be submitted by a Luxembourg credit institution in order to be approved by the CSSF, in addition to its banking licence, as a UCITS' depositary. However, credit institutions already approved as a UCITS' depositary do not need to submit a new application file to the CSSF but must comply with the provisions of Circular 16/644.

The Circular entered into force on 13 October 2016, which was also the date of application of the Delegated Regulation, and replaces Circular 14/587 (as amended) on the same topic

CSSF Updated FAQ on UCITS

On 24 August 2016, the CSSF published a new version of its FAQ document on UCITS (UCITS FAQ), including additional clarifications on eligible assets and diversification rules applicable to UCITS.

The updated version of the UCITS FAQ also includes new questions and answers relating to the concept of "public interest entities" (PIE) within the meaning of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts as amended by Directive 2014/56/EC (Audit Directive) and of Regulation (EU) N°37/2004 on specific requirements regarding statutory audit of public interest entities (PIE Regulation). In particular, the CSSF considers that Luxembourg UCITS are PIEs under the condition that their units are admitted to trading on a regulated market within the meaning of point 14 of Article 4(1) of MiFID. According to the CSSF, the Audit Directive and PIE Regulation have the following implications for UCITS:

- Mandatory audit firm rotation is requested after twenty years subject to a public tendering process for the statutory audit after a period of ten years (Article 17 of the PIE Regulation).

- Provision of non-audit services are only allowed for the (Articles 4 and 5 of the PIE Regulation):
  - preparation of tax forms
  - identification of public subsidies and tax incentives
  - support regarding tax inspections by tax authorities
  - calculation of direct and indirect tax, and deferred tax
  - provision of tax advice
  - valuation services, including valuations performed in connection with actuarial services or litigation support services, provided that the following requirements are complied with:
    1. they have no direct (or have only an immaterial) effect, separately or in the aggregate, on the audited financial statements
    2. the estimation of the effect on the audited financial statements is comprehensively documented and explained in the additional report to the audit committee
    3. the principles of independence laid down in the Audit Directive are complied with by the statutory auditor or the audit firm.
- The audit report will be enlarged mainly with a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud (Article 10 of the PIE Regulation).

However, by way of derogation, UCITS qualifying as PIE are not required to have an audit committee (point 6(b) of Article 41 of the Audit Directive).

ALFI Risk Management Guidelines

ALFI has published new risk management guidelines on considerations for the management of operational risks associated with the distribution of funds. The aim of these guidelines is to present to board members and conducting officers of UCITS management companies and self-managed investment companies and AIFMs the areas that they may wish to consider when looking at the management of operational risks associated with the distribution or marketing of funds and in developing their risk management function by:

- highlighting the key sources of legal and regulatory guidance in relation to the risk management function in order to obtain a common understanding thereof
- outlining a potential approach to:
  - the identification of relevant operational risks associated with distribution or marketing to which the funds and/or their management companies are or may be exposed
  - the measurement and management of these identified operational risks
  - the reporting of these risks and related information to board members and conducting officers by the risk management function.

AED Circular N°781 – VAT Status of Directors

On 30 September 2016, the Luxembourg Luxembourg Indirect Tax Administration (AED) published Circular N°781 (AED Circular 781) concerning the VAT treatment of directors' fees. On the same date, the AED also issued a FAQ document providing some guidance on this subject.

AED Circular 781 does not specifically deal with the situation of directors of Luxembourg investment funds. However, some practitioners consider that it should be possible to apply the VAT exemption relating to the management of regulated investment funds as set out in Article 44 (1) d) of the VAT Law to the extent that these services could qualify as “specific and essential” for the activity of the fund. Further to this approach, fees paid to directors of management companies should be exempt only for the portion that relates to the management of the investment funds managed by the management company (FCP and SICAV that have designated a management company) while the portion that relates to the management of the management company as such would be subject to VAT.

Please refer to the Tax section of this Luxembourg Legal Update for further details on the above.

Litigation

Banking, Finance and Capital Markets

Financial Collateral Arrangements – Pledge – Enforcement – Summary Proceedings

Court of Appeal (summary proceedings), 27 January 2016, N°42.760 & 42.971

District Court (summary proceedings), 26 August 2016, N°177.250

If, following the occurrence of an event of default under a facilities agreement, a pledge over shares is enforced, a borrower may try to obtain the cancellation of the enforcement or the cancellation of the consequences of the enforcement in summary proceedings.

The Court of Appeal sitting in summary proceedings, and confirming previous case law, decided that a judge sitting in summary proceedings may not take measures that would make ineffective provisions of the law on financial collateral arrangements which provide that the enforcement of such contracts continues notwithstanding coercive measures provided for by Article 19 (b) of the law on financial collateral arrangements. The Court adds that if the enforcement of a pledge under the law on financial collateral arrangements may not be stopped in summary proceedings, it may certainly not be challenged after it has taken place.

In the second case, the District Court, referring directly to the Court of Appeal decision, decided that if the enforcement of a pledge under the law on financial collateral arrangements may not be stopped in summary proceedings, it may certainly not be challenged after it has taken place. For this reason, an action in summary proceedings having as its aim the suspension of the effects of the enforcement of a pledge – the revocation of the directors by the new shareholders following the appropriation of shares – is inadmissible.

Accountant's and Bank's Professional Confidentiality Obligation – Heir of the Beneficial Owner of a Bank Account

Court of Appeal (summary proceedings), 22 June 2016, N°43.294

According to the Court of Appeal, a bank's and an accountant's[12] professional confidentiality obligations are matters of public policy. However, the right of heirs entitled to a statutory share attempting to preserve their statutory share is also a matter of public policy, whether they act as a successor of the deceased or by their own right as heir having suffered damage.

According to the Court, a judge has to balance the interests of the parties and may set aside the professional confidentiality obligation if the plaintiff justifies his or her case that there is an interest of equal importance. For this reason, the professional confidentiality obligation does not exist with regard to financial information requested by heirs, who continue in the person of the deceased, and banks or accountants may not oppose such an obligation to the heirs entitled to a statutory share.

In the case at hand, the heir asked for information regarding an account of a company of which the deceased was the beneficial owner. According to the bank and the accountant, the deceased was a third party with regard to his relationship with the company. However, according to the Court, it is difficult to envision that the beneficial owner or his heir could not obtain information regarding a relationship between the bank and the company. A bank has to inform the beneficial owner or his heirs with regard to the accounts, the nature of the financial relations, and the property structure and control structure between the client (the company) and its beneficial owner. The aim is to protect the heirs against misappropriation by a person with information on the structure.

However, according to the Court, it is generally admitted that the professional confidentiality obligation has effect against the beneficial owner with regard to contracts between the parties and any transactions undertaken with regard to the client's accounts, i.e. the relationship of the bank with its client. The beneficial owner may only obtain

[12] According to the court, when an accountant is acting as domiciliation agent, this covers, amongst other matters, information on the client, his assets and his financial situation.

such information when contacting the accountholder via the control structure. There may, however, be an exception to this general rule in certain circumstances; in particular, the Court may overcome the professional confidentiality obligation by a special justification which balances the legitimate interests of both parties.

In the case at hand the Court considered that the heir has strong reasons to believe that his hereditary rights have been violated and that there are serious reasons that justify that the professional secrecy obligation of banks and accountants is overridden.

Real Estate

The Right for the Creditor to Terminate Unilaterally the Agreement in case of Serious Infringements from the Debtor

Court of Appeal, 25 November 2015, N°41785

Two individuals had concluded a service agreement for the construction of their house with a contractor.

Several serious infringements occurred during the works as concluded in an expert's report that led to the refusal of the ten-year guarantee coverage by the insurer. The individuals had thus terminated the service agreement by sending a letter. The contractor challenged the validity of that termination.

In its decision, the Court of Appeal initially reminded that the Civil Code foresees that the termination of an agreement for wrongful non-execution shall be requested before the courts. However, current case law admits the possibility for a party to an agreement to terminate unilaterally the agreement, without requesting the court to do so, if the seriousness of the behaviour of the other party justifies that he immediately terminate the agreement. The Court adds that this unilateral termination is at the risk of the person who ends the agreement, the extent of his behaviour being eventually submitted to the determination of the judge. The person who terminated the agreement will be liable if that termination is not justified or if the infringement invoked is not deemed sufficiently serious.

In the case at hand, the Court judged that, given the infringements, the individuals had justified grounds to proceed with the unilateral termination of the service agreement.

The Ten-Year Guarantee and the Obligation to act within a Short Time

Court of Appeal 19 June 2013, N°37858

Two individuals had entered into a construction contract with a contractor for the construction of their house.

After the construction, they found construction defects in the building and therefore brought a court action for damages against the contractor, on the basis of the ten-year guarantee.

The defendant argued that the applicants' claim was not admissible since it should have been filed within a short time, in accordance with Article 1648 of the Civil Code which, as far as a sale is concerned, provides that the buyer is deprived of the right to claim on a basis of a defect of the thing sold if he has not, within a short time, brought the vendor's attention to this defect and has then not brought a court action against the vendor.

The Court rejected the contractor's argument and ruled that:

- Article 1648 of the Civil Code is not applicable to construction contracts
- an action based on the ten-year guarantee remains admissible during the whole period covered by that guarantee.

Tax

Application of the Tax Unity Regime

Administrative Court of Luxembourg, 27 July 2016, N°36841C

In February 2014, the Luxembourg Tax Administration issued tax bulletins denying a Luxembourg company the application of the tax unity regime. The Luxembourg Tax Administration claimed that the company never requested the application of such regime; the tax unity regime is subject to a written request made to the Luxembourg Tax Administration before the end of the first tax year for which the tax unity is requested. Moreover, according to the Luxembourg Tax Administration, companies should not file tax returns applying the tax unity regime without first receiving an acceptance letter from the Luxembourg Tax Administration. The company attempted to provide evidence supporting its contention that the tax unity request had been sent, but the Luxembourg Tax Administration director refused its explanation.

On 13 July 2015, the District Court of Luxembourg ruled in favour of the Luxembourg Tax Administration. The

company appealed to the Administrative Court of Luxembourg claiming that neither Article 164bis LIR nor the Grand Ducal Decree of 1 July 1981 which enumerate the conditions required to benefit from the tax unity require the Luxembourg Tax Administration to provide a formal answer to a request for the application of the tax unity regime.

The Administrative Court confirmed the District Court decision and ruled that the Luxembourg Tax Administration should take a decision regarding the application of the tax unity when it receives a request. The decision is independent from the tax bulletin, and should necessarily be made in writing expressly confirming that the request for the application of the tax unity regime had been received.

The Application of an agreed Ruling

Administrative Court of Luxembourg, 12 July 2016, N°37448C

On 28 January 2013, the Luxembourg Tax Administration agreed on a ruling filed by a Belgian resident in 2012. The ruling states that the know-how provided by the Belgian resident to the company should be considered as hidden capital corresponding to 80% of the profit. In this respect, 80% of the dividends paid should be considered as reimbursement of capital and be exempt from withholding tax.

However, the Luxembourg Tax Administration issued a tax bulletin for tax year 2012 denying the qualification of the know-how as hidden capital. On 16 December 2015, the District Court of Luxembourg ruled in favour of the Belgian resident. The Luxembourg Tax Administration appealed this decision, and on 12 July 2016, the Administrative Court of Luxembourg confirmed the District Court decision.

The Administrative Court of Luxembourg stated that the Luxembourg Tax Administration cannot refuse the application of the ruling for which it gave its approval considering that the factual background had not changed and that there had been no change in the law in the period between the approval of the ruling and the issue of the tax bulletin.

Hidden Dividend Distribution Qualification

Administrative Court of Luxembourg, 27 July 2016, N°36855C

A Luxembourg company concluded an advisory services agreement with a company located in the British Virgin Islands. In this respect, the Luxembourg Tax Administration argued that the reality of the services rendered cannot be evaluated and therefore qualified the fees payable under the advisory services agreement as a hidden dividend distribution.

On 15 July 2015, the District Court of Luxembourg ruled in favour of the Luxembourg company. The Luxembourg Tax Administration appealed this decision and, on 27 July 2016, the Administrative Court of Luxembourg confirmed the District Court decision.

As there is no exchange of information process between Luxembourg and the British Virgin Islands, the Luxembourg tax Administration was not able to provide any proof that the Luxembourg company and the British Virgin Islands company were linked or that the companies have the same ultimate beneficial owner.

The Administrative Court of Luxembourg stated that, even if domiciliation in the British Virgin Islands could raise some questions, the Luxembourg Tax Administration needed evidence supporting its qualification of the fees payable under the service agreement as hidden dividends.

VAT Deduction Right for Cost borne by a Branch

Order of Court of Justice of the European Union – C-393/15

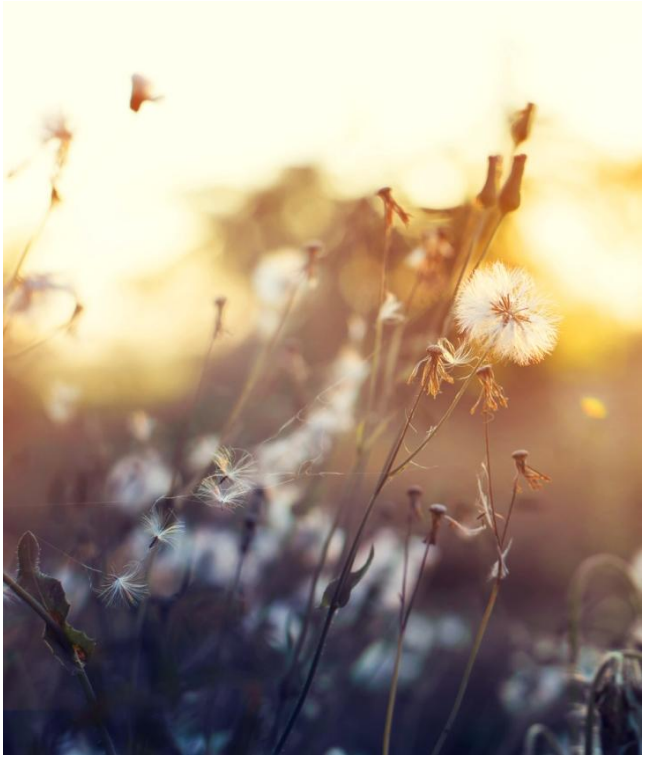
On 21 June 2016, the ECJ published an order regarding the deduction right of input VAT by a branch.

A Slovakian entity receives software services from its Polish branch. In turn, the software is incorporated in products sold by the Slovakian entity. The Polish branch mainly carries out internal transactions for the Slovakian company which are not subject to VAT, but occasionally carries out transactions subject to VAT in Poland. The Polish entity requested the right to deduct all input VAT on the purchase of goods and the services received in Poland for the purposes of its activity.

The Polish tax authorities denied the deduction, arguing that the Polish branch has no input VAT deduction right due to the fact that its main activity is not subject to VAT in Poland. The Polish Administrative Court overturned the decision, and the Polish tax authorities decided to go to the final Court of appeal.

The ECJ ruled that a branch can recover input VAT incurred on goods and services used for a VAT-able activity carried out through its head office in a Member State where the branch is not registered. In other words, a branch registered for VAT in one Member State (e.g. Poland) which provides internal services not subject to VAT to its head office registered in another Member State

(e.g.Slovakia) is entitled to deduct input VAT on related costs in the Member State where it is registered (i.e Poland).



Tax

National Legislation

Electronic Filing of Tax Returns for Investment Funds

Law of 23 July 2016

The law implementing the electronic filing of tax returns for undertakings for collective investment funds was passed and published on 23 July 2016. As from 1 January 2018, those undertakings for collective investment and investment funds subject to subscription taxes should file electronic tax returns with the Luxembourg Tax Administration.

Repeal of the Law implementing the EU Savings Directive

Law of 23 July 2016

The new law repealing the law of 21 June 2005 implementing the EU Savings Directive in Luxembourg and amending the law of 23 December 2005 on the application of a flat rate tax on certain interest payments on savings was published on 23 July 2016.

The amendments to the law of 23 December 2005 relate to the deletion of references to definitions under the EU Savings Directive. There are no other substantial changes to the law (please see the Luxembourg tax reform for 2017 below for more information).

Please also refer to the July 2016 edition of our Luxembourg Legal Update for further information.

Exchange of Information in Tax Matters

Law 23 July 2016

On 14 July 2016, the Luxembourg Parliament formally adopted the bill of law N°6972 regarding the automatic exchange of cross-border tax rulings and advance pricing agreements ("APA") with the tax administration of other EU Member States and the EU Commission. This new law amends the Law of 29 March 2013 by implementing Directive 2015/2376/EU. In this respect:

- All cross-border tax rulings and APAs issued, amended and renewed after 31 December 2016, should be automatically communicated to the relevant European tax administration and to the EU Commission. The communication should occur no later than three months after the end of the semester during which the cross-border rulings and APAs have been issued, amended or renewed.
- Cross-border tax rulings and APAs issued, amended and renewed within a period beginning five years before 1 January 2017 should also be communicated before 1 January 2018, and take account of the following specifications:
  - Cross-border tax rulings and APAs issued, amended or renewed between 1 January 2012 and 31 December 2013 should be communicated if those rulings and APAs were still valid on 1 January 2014
  - Cross-border tax rulings and APAs issued, amended and renewed between 1 January 2014 and 31 December 2016 should be communicated whether or not they are still valid

Cross-border tax rulings and APAs issued, amended or renewed before 1 April 2016 to a particular person or a group of persons, with a group-wide annual net turnover of less than EUR 40,000,000 (or the equivalent amount in any other currency) in the preceding fiscal year should not be communicated.

APAs should always be communicated, unless such pricing agreements are bilateral pricing agreements with a third-party state, and if the double taxation treaty between Luxembourg and that third-party state prohibits the communication of the APAs.

Moreover, cross-border tax rulings and APAs relating to the tax treatment of one or more individuals are also exempt from the automatic exchange.

The information to be communicated include the following:

- the identification of the person, other than a natural person, and where appropriate the group of persons to which it belongs
- a summary of the content of the cross-border tax ruling or APAthe dates of issuance, amendment or renewal of the cross-border tax rulings or APA
- the start date of the period of validity of the cross-border tax ruling or APA
- the end date of the period of validity of the cross-border tax ruling or APA
- the type of cross-border tax ruling or APA
- the amount of the transaction or series of transactions of the cross-border tax ruling or APA
- the description of the set of criteria used for the determination of the transfer pricing, or the transfer price itself in the case of an APA
- the identification of the method used for the determination of the transfer pricing, or the transfer price itself in the case of an APA
- the identification of the other Member States, if any, likely to be concerned by the cross-border tax ruling or APA
- the identification of any person, other than a natural person, in the other Member States, if any, likely to be affected by the cross-border tax ruling or APA.

In order to organise compliance with the new Law, the Luxembourg tax authorities have published form 777 on their website. This form should be completed by tax-payers and include all of the above-mentioned information.

Luxembourg Tax Reform for 2017

Bill N°7020

On 26 July 2016, the bill N°7020 relating to the 2017 tax reforms was submitted to the Luxembourg Parliament.

The main proposals for individual taxation are as follows:

- Married taxpayers can choose to be taxed separately. They can choose between two different regimes:
  - Strict allocation of the remuneration to each spouse where the potential deductions are divided equally
  - Reallocation of the common adjusted taxable income, which will be by default allocated equally between the spouses.
- The tax regime for non-resident married taxpayers would be aligned with the tax regime of the resident married taxpayer in several aspects (e.g. non-resident married taxpayers would be able to opt for separate taxation)
- The maximum deduction for an old age pension plan would be set at an annual maximum of EUR 3,200 and would no longer be dependent on the age of the taxpayer. The taxpayer would have the possibility to obtain a refund of the accumulated savings either as capital, as monthly annuity for life, or as a mix of these.
- The tax deduction for interest payments and insurance premiums would be merged under a single deduction of a maximum of EUR 672 per member of the household. Presently, the maximum deduction is EUR 336 for interest payments and EUR 672 for insurance premiums.
- The tax deduction for a home saving scheme should increase to EUR 1,344 for each taxpayer aged under 40. The possible tax deduction remains EUR 672 for taxpayers 40 or older.
- New income tax rates would be introduced for taxable income exceeding EUR 150,000 and EUR 200,004 (respectively, 41% and 42%).
- The 0.5% temporary budget tax should be abolished as from tax year 2017.
- As from 2017, a new tax deduction (of up to EUR 5,000) for the purchase of zero-emission vehicles, as well as for natural gas/hybrid vehicles, would be introduced.
- Tax credit for employees, pensioners and self-employed individuals would be increased by up to EUR 600 depending on the annual income of the taxpayer. No tax credit would be granted for those with annual incomes exceeding EUR 80,000.
- Tax credits for single parents (*crédit monoparental*) would be denied to parents sharing a common residence. The tax credit would be increased where the joint annual income does not exceed EUR 105,000, under certain conditions.

- The withholding tax rate on interest income received by a Luxembourg resident would be increased from 10% to 20%.
- The tax discount for extraordinary charges for children who are not residing with the tax-payer should be increased from EUR 3,480 to EUR 4,020.
- The tax discount for domestic help should be increased from EUR 3,600 to EUR 5,400 per year.
- The face value of luncheon vouchers should be increased to EUR 10.80 (currently EUR 8.40).

The main proposals for corporate taxation are as follows:

- The maximum corporate income tax rate should be reduced from 21% to 19% for the tax year 2017 and to 18% for the tax year 2018 for companies with taxable income exceeding EUR 30,000. In addition, the minimum corporate income tax rate should be reduced from 20% to 15% as from fiscal year 2017 for companies with taxable income below EUR 25,000 (currently EUR 15,000). For companies having taxable income between EUR 25,000 and EUR 30,000 the corporate income tax rate would be:
  - EUR 3,750 plus 39% for income exceeding EUR 25,000 for tax year 2017
  - EUR 3,750 plus 33% for income exceeding EUR 25,000 for tax year 2018.
- The minimum net wealth tax would increase from EUR 3,210 to EUR 4,815 for any company whose financial assets (i.e. assets to be accounted for in accounts 23, 41, 50 and 51 of the *Plan Comptable Normalisé*) represent more than 90% of its balance sheet and a minimum amount of EUR 350,000.
- Deferred amortization/deprecation would be introduced. The taxpayer could opt to defer the deduction allowed by amortization/depreciation of an asset for a given year until the end of the useful life of such asset.
- To facilitate the transfer of businesses, immovable properties owned by the divested business but not sold could be assessed at book value by the transferor. In this respect, the capital gains realised on the immovable property would benefit from a tax deferral until such asset is effectively transferred.
- The scope of Article 54bis of the Luxembourg income tax law (i.e. the deferral of taxation of foreign exchange gains from assets denominated in a foreign currency) would be extended to all companies as from tax year 2016.
- As from tax year 2017, the losses would be carried forward for a maximum period of 17 years. Losses realised between 1 January 1991 and 31 December 2016 would be carried forward without limitation.
- The rate of the investment tax credit will be increased from 12% to 13% for complementary investment and from 7% to 8% for global investment (for a tranche not exceeding EUR 150,000). The investment tax credit rate for fixed assets qualifying for special depreciation would also increase, from 8% to 9%.
- As from tax year 2017, corporate income tax, municipal business tax and net wealth tax returns would have to be filed electronically.
- Penalties for late filing would be increased up to a maximum of EUR 25,000 (currently EUR 1,239).
- The 0.24% registration duty on the transfer, use or capitalisation of claims would be abolished.
- Managers (but also liquidators and trustees) would be liable for the fulfilment by the company of its VAT obligations and especially for the payments of such VAT. The liability would be personal and joint. The range of the fixed penalties would be increased from EUR 50/5,000 to EUR 250/10,000.
- The penalties for not providing the VAT Administration with the requested information would be increased from the range of EUR 50/1,000 per day to EUR 25,000 per day.
- The penalties where the payment of VAT has been evaded or the reimbursement of VAT has been obtained illegally would be increased from 10% to a range of 10% up to 50% of the evaded VAT.

The bill of law also introduced a new "aggravated tax fraud". In this respect, three types of fraud would have to be differentiated: simple tax fraud, aggravated tax fraud and tax swindles (*escroquerie fiscale*). Simple tax fraud would be sanctioned by the relevant tax Administration, while aggravated tax fraud and tax swindles would be sanctioned by criminal law.

Country by Country Reporting

Bill N°7031

On 2 August 2016, the Luxembourg Government introduced legislation for country-by-country reporting. The bill of law implements Directive 2016/881 regarding the automatic exchange of information in the field of taxation.

Luxembourg ultimate parent entities of multinational companies (i.e. multinational companies with a group turnover above EUR 750,000,000 and at least two

companies whose tax residency is in a foreign country) should file an annual country-by-country report with the Luxembourg Tax Administration. Such country-by-country reports should include the following information:

- aggregate information relating to the amount of revenue, profit /(loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets other than cash or cash equivalents with regard to each jurisdiction in which the multinational company operates
- a list of all the companies that are part of the multinational company including their tax residences, the jurisdictions under the laws of which those companies are organised, and the nature of their main business activity
- any additional necessary information to understand the information provided.

The country-by-country report should be filed at the latest 12 months after the last day of the tax year. In cases of late filing or default of filing, a maximum penalty of EUR 250,000 could be applied.

The Luxembourg tax Administration would have to communicate this country-by-country report to the relevant tax authorities (i.e. tax authorities of other Member States or of any jurisdiction which has an agreement with Luxembourg regarding such communication). The country-by-country report should be communicated at the latest 15 months after the last day of the tax year.

The first country-by-country report should be filed by parent entities for tax year 2016.

Transfer Pricing Provisions introduced in Luxembourg Domestic Law

Bill N°7050

On 12 October 2016, the bill N°7050 (i.e. budget law for 2017) was submitted to the Luxembourg Parliament.

This law introduces a new Article 56 bis in LITL. Until now, only Article 56 LITL addressed the transfer pricing principles in Luxembourg domestic law by defining the concept of arm's-length transactions.

The new Article 56 bis contains the basic rules and the methodology to perform transfer pricing analysis in line with the arm's-length principle. The new article focuses on the comparability analysis essential to determine the arm's-length price. This article introduces to Luxembourg domestic law the conclusions of the BEPS Actions 8-10 final report.

Small Enterprise VAT Regime

Bill N°7050

The bill N°7050 submitted on 12 October 2016 introduces an amendment of Article 57 of Luxembourg VAT law. The amendment provides that the annual turnover threshold to benefit from the VAT regime for small enterprises would be increased from EUR 25,000 to EUR 30,000.

Regulatory Developments

Luxembourg VAT Administration published a New Circular on VAT and Directors Fees.

Circular N°781 of 30 September 2016

On 30 September 2016, the Luxembourg VAT Administration published circular N°781 on the VAT treatment of the directors' fees.

The circular confirmed that independent director services are an economic activity subject to VAT. These services are subject to Luxembourg VAT at a standard rate of 17% when rendered in Luxembourg. The circular mentions various exemptions:

- Employees representing their employers on the board are not acting independently and are not taxable persons for VAT purposes. However, their employers would be liable to VAT
- Independent directors should be able to benefit from the small enterprise regime if their annual turnover does not exceed the threshold of EUR 25,000
- Directors rendering "honorary" services and who are remunerated with *jetons de présence* should be able to benefit from VAT exemption. According to the circular, the activity is considered as honorary if the indemnity is considered as a defrayal.

All directors who are liable to charge VAT on the services rendered are required to respect all of their VAT obligations as from 1 January 2017.

Circular of the Tax Authorities on the Impact of the Introduction of the Minimum Net Wealth Tax following the Abolition of the Minimum Corporate Income Tax.

Circular I.Fort N°51 of 25 July 2016

On 25 July 2016, the Luxembourg Tax Administration issued Circular I.Fort N°51 replacing Circular I.Fort N°51 dated 2 June 2016.

This circular provides the practical explanation for the implementation of the Law of 18 December 2015 introducing a minimum net wealth tax ("NWT") and amending the net wealth tax rate.

As from tax year 2016 (i.e. 1 January 2016 for NWT purposes), companies are either subject to the normal NWT rate or to the minimum NWT if the normal NWT is lower than the minimum NWT. The normal NWT is computed in accordance with the following scale:

- 0.5% of the rounded unitary value below EUR 500 million
- 0.05% of the portion of rounded unitary value exceeding EUR 500 million.

The minimum NWT amounts to EUR 3,210, assuming the Luxembourg company's assets, transferable securities and cash deposits represent more than:

- 90 per cent of its total balance sheet
- EUR 350,000.

Alternatively, should one of the conditions not be met, a progressive annual minimum NWT ranging from EUR 535 to EUR 32,100, dependent on the Luxembourg company's total gross assets, would be due.

The minimum NWT amount can be reduced by the corporate income tax due for the preceding year (increased by the solidarity charge and due after potential tax credits). If after the reduction the minimum NWT is lower or equal to the normal NWT, companies are subject to the normal NWT.

Please refer to the April 2016 edition of our Luxembourg Legal Update for further details on the above.

Circular of the Tax Authorities on the Conditions to reduce Net Wealth Tax as provided for by §8a VStG.

Circular I.Fort N°47 of 16 June 2016

On 16 June 2016 the Luxembourg Tax Administration issued Circular I.Fort N°47 ter regarding the condition to reduce NWT as provided by §8a VStG as from 1 January 2016. Concurrently, Circular I.Fort N°47 bis of 18 November 2015 remains applicable before 2016.

Under §8a VStG, it is possible to reduce the NWT liability by allocating part of the profit (equal to five times the reduced amount of NWT) of the company to a balance sheet reserve to be maintained during a five-year period. If the reserve is not maintained until the end of the five-year period, the NWT due for the following year will be increased by one fifth of the amount released.

The new circular reflects the changes arising from the Law of 18 December 2015 which amended the VStG. As from 1 January 2016, all corporate companies are subject to either the normal NWT or to the minimum NWT if the minimum NWT is higher than the normal NWT. Only normal NWT can benefit from the reduction as provided by §8a VStG.

The reduction under §8a VStG cannot be higher than:

- the amount of corporate income tax (including the solidarity charge) due for the preceding tax year before deduction any tax credit
- the minimum NWT which would be due.

Case Law

Application of the Tax Unity Regime

Administrative Court of Luxembourg, 27 July 2016, N°36841C

The Application of an Agreed Ruling

Administrative Court of Luxembourg, 12 July 2016, N°37448C

Hidden Dividend Distribution Qualification

Administrative Court of Luxembourg, 27 July 2016, N°36855C

VAT Deduction Right for Cost Borne by a Branch

Order of Court of Justice of the European Union – C-393/15

Please refer to the Litigation section of this Luxembourg Legal Update for further details on the above.

Glossary

ABBL: The Luxembourg Bankers' Association

ACA: *Association des Compagnies d'Assurance*, Luxembourg Association of Insurance Undertakings

AIFM: Alternative Investment Fund Manager

AIF: Alternative Investment Fund

AIFM Directive: Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers

ALFI: Association of the Luxembourg Fund Industry

AML Law: Luxembourg law of 12 November 2004 (as amended) on the fight against money laundering and terrorism financing

AML/CTF: Anti-Money Laundering and Counter-Terrorism Financing

AMLD 4: Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing

Bank Resolution Law: Luxembourg law of 18 December 2015 law on the failure of credit institutions and of certain investment firms implementing the BRRD and DGSD 2

BCBS: Basel Committee on Banking Supervision

BCL: Banque Centrale du Luxembourg

Benchmark Regulation: Regulation (EU) 2016/1011 of the European Parliament and the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts

BRRD: Directive 2014/59 of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms

CESR: Committee of European Securities Regulators (replaced by ESMA)

CAA: *Commissariat aux assurances*, the Luxembourg insurance sector regulator

Companies Law: Luxembourg law of 10 August 1915 (as amended) on commercial companies

Collective Bank Bargain Agreement: *La convention collective du travail applicable aux banques*

CRA: Credit Rating Agencies

CRD: Capital Requirements Directives 2006/48/EC and 2006/49/EC

CRD III: Directive 2010/76/EU amending the CRD regarding capital requirements for the trading book and for resecuritisations, and the supervisory review of remuneration policies

CRR/CRD IV Package: Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC and Regulation (EU) N° 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, and amending Regulation (EU) N°648/2012 Text with EEA relevance

CSSF: *Commission de Surveillance du Secteur Financier,* the Luxembourg supervisory authority of the financial sector

Data Protection Law: Luxembourg law of 2 August 2002 (as amended) on the protection of persons with respect to the processing of personal data

DGSD 2: Directive 2014/49 of 16 April 2014 on deposit guarantee schemes

EBA: European Banking Authority

ECB: European Central Bank

ECJ: European Court of Justice

EIOPA: the European Insurance and Occupational Pensions Authority

ESMA: European Securities and Markets Authority

ESRB: European Systemic Risk Board

ETFs: Exchange Traded Funds

ETDs: Exchange Traded Derivatives

FATF: Financial Action Task Force / *Groupe d'Action Financière* (FATF / GAFI)

FCP: *Fonds Commun de Placement* or mutual fund

Financial Collateral Directive: Directive 2002/47/CE of 6 June 2002 on financial collateral arrangements

Financial Sector Law: Luxembourg law of 5 April 1993 (as amended) on the financial sector

Insolvency Regulation: Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings

Insurance Sector Law: Luxembourg law of 6 December 1991 (as amended) on the insurance sector

IORP Directive: Directive 2003/41 of the European Parliament and the Council dated 3 June 2003 on the activities and supervision of institutions for occupational retirement provision

KIID: Key Investor Information Document (within the meaning of the UCITS Directive) that aims to help the investors to understand the key features of their proposed UCITS investment

Law on the Register of Commerce and Annual Accounts: Luxembourg law of 19 December 2002 (as amended) relating to the register of commerce and companies as well as accounting

RCSL or **Register of Commerce**: Luxembourg register of commerce and companies (*Registre de commerce et des sociétés de Luxembourg*)

MiFID: Directive 2004/39/EC of the European Parliament and of the Council dated 21 April 2004 on markets in financial instruments, amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council, and repealing Council Directive 93/22/EEC

PFS: Professional of the Financial Sector other than a credit institution and subject to CSSF's supervision in accordance with the Financial Sector Law

Public Contracts Law: Luxembourg law of 25 June 2009 (as amended) on government contracts

Public Contracts Regulation: The Grand-Ducal Regulation of 3 August 2009 implementing Law of 25 June 2009 on public contracts

Public Interest Entities:

a) entities governed by the law of a EU member state, whose securities are admitted to trading on a regulated market of a member state within the meaning of article 4, paragraph 1, point 21 of the directive 2014/65/EU

b) credit institutions as defined under article 1, point 12 of the law of 5 April 1993 on the financial sector as amended, other than the institutions covered by article 2 of the directive 2013/36/EU

c) insurance and reinsurance undertakings as defined under article 32, paragraph 1, points 5 and 9 of the law of 7 December 2015 on the insurance sector, to the exclusion of the entities covered by articles 38, 40 and 42, of the pension funds covered by article 32, paragraph 1, point 14, of the insurance captive companies covered by article 43, point 8 and reinsurance captive companies covered by article 43, point 9 of the law dated 7 December 2015 on the insurance sector.

PRIIPs KID Regulation: Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products

REMIT: Regulation (EU) N°1227/2011 of 25 October 2011 on wholesale energy market integrity and transparency

SICAR Law: Luxembourg law of 15 June 2004 (as amended) on investment companies in risk capital

SFTR: Regulation (EU) No 2015/2365 of the European Parliament and the Council of 25 November 2015 on transparency of securities financing transactions and of their reuse and amending Regulation (EU) No 648/2012.

SIF Law: Luxembourg law of 13 February 2007 (as amended) relating to specialised investment funds

SRB: the Single Resolution Board

SRF: the Single Resolution Fund

SRM: the Single Resolution Mechanism

SSM: the Single Supervisory Mechanism

Transparency Law: Luxembourg law of 11 January 2008 (as amended) on the transparency obligations concerning information on the issuers of securities admitted to trading on a regulated market

UCI Law: Luxembourg law of 17 December 2010 (as amended) on undertakings for collective investment

UCITS Directive: Directive 2009/65/EC of 13 July 2009 of the EU Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to UCITS

UCITS V Directive: Directive 2014/91/EU of the European parliament and Council of 23 July 2014 amending Directive 2009/65/EC as regards depositary functions, remuneration policies and sanctions

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