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Luxembourg Legal Update

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Banking, Finance & Capital Markets

Legislation

Bill N° 6398
Modification of the Insurance Sector Law

A new bill modifying the Insurance Sector Law has been lodged with the Luxembourg Parliament.
The bill brings together certain existing and new professions active in the insurance sector in a newly created part of the Insurance Sector Law. This new part of the law makes certain professionals subject to licensing, and introduces increased financial, reporting and supervision requirements in order to avoid the emergence of fragile structures in the insurance sector.

The new part of the Insurance Sector Law covers the newly regulated category of insurance sector professionals (*professionel du secteur assurance*, PSA). PSAs comprise of (i) management companies of captive insurance companies, insurance companies in run-off, reinsurance companies, pension funds or insurance portfolios, as well as (ii) certain types of insurance sector service providers. Only legal persons are eligible to obtain a PSA licence. The minimum capitalisation for a PSA is fixed at EUR 125,000. Several PSA types are subject to statutory professional confidentiality obligations. This will facilitate the outsourcing by a Luxembourg insurance company which is itself subject to statutory professional confidentiality obligations to such PSA types because there will exist an exemption from the statutory professional confidentiality obligation of such insurance if it outsources to certain of such new PSA types.

The new part of the Insurance Sector Law also covers managers (*dirigeants*) of insurance or reinsurance companies, PSAs or insurance brokerage companies. Such managers have to be natural persons (except managers of reinsurance companies or pension funds) and are not subject to minimum capital requirements.The new part of the Insurance Sector Law further covers insurance and reinsurance brokers and agents. The existing regime widely based on the EC Insurance Intermediation Directive is kept while modifying certain technical details. These types of intermediaries will not be included in the PSA category and may either be legal or natural persons. The bill eventually extends the scope of AML/TF legislation to PSAs.

Bill N° 6397
Implementation of Directive 2010/78/EU "Omnibus I"

A bill implementing the so-called "Omnibus I" Directive 2010/78/EU has been lodged with the Luxembourg Parliament.

The bill introduces the necessary legislative framework permitting the Luxembourg financial and insurance sector regulators, namely the CSSF and the Commassu, to exercise their respective functions and tasks as members of the new European system of financial supervision. These changes enable the CSSF and the Commassu to exchange information with the new European supervisory authorities (EBA, ESMA and EIOPA) and the European Systemic Risk Board (ESRB) and to refer disputes between national regulatory authorities to the competent European supervisory authority for settlement. Given the task of European supervisory authorities to protect financial services users (e.g. depositors, investors, insured persons), the bill also makes provision for an enhancement of the competences of the CSSF and the Commassu to promote financial services user protection, including consumer protection.

In addition, the bill clarifies a limited number of technical points in Luxembourg financial sector legislation. This includes clarifications on the scope and meaning of the minimum capital base that professionals of the financial sector need to hold. The bill also introduces into law an explicit power of the CSSF to fix rules with regard to *the scope of the mandate of audit of the annual accounting documents of professionals of the financial sector and the contents of the report to be issued by the external auditor on the control of such documents.*

The bill also makes some other changes to financial sector legislation, including legislation concerning UCI, their managers and advisors, in which respect we kindly refer you to the **Funds and Investment Management** section.

Regulatory Developments

CSSF Circular 11/529
Clarification of AML/CTF Risk Analysis Requirements for Financial Sector Professionals

The CSSF has issued a new circular dated 22 December 2011 which details the risk analysis obligations arising under the AML Law. This circular is applicable to all regulated professionals subject to CSSF supervision, with the exception of credit institutions whose risk analysis obligations were already specified by the CSSF in another circular issued earlier in 2011.

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As such, the CSSF distinguishes between two stages in the risk analysis that such professionals have to comply with. First of all, the managers of such professionals have to identify the risks of money laundering or terrorism financing, before consequently creating a methodology helping to characterize these risks. In the second step, the managers will have to define and implement measures to mitigate the risks that have been identified.

CSSF Circular 12/530
Annual Survey Concerning the Deposits and Claims Guaranteed by the Luxembourg Deposit Protection Scheme

The CSSF has issued a new circular dated 11 January 2012 requesting member institutions of the Luxembourg deposit protection scheme *Association pour la Garantie des Dépôts, Luxembourg* (AGDL) to communicate the amounts of deposits and financial instruments protected by the AGDL (as on 31 December 2011) to the CSSF. This enables the CSSF to calculate the overall amount protected by the AGDL and the contribution share of each member. Members have until the end of March 2012 to report to the CSSF. The Circular clarifies the technical details of reporting and contains relevant forms.

The Circular also draws the attention of AGDL members to the scope of AGDL protection in cases where the depositor or investor is not the beneficiary of the funds deposited or the sums or securities held, particularly where the depositor or investor is a financial institution holding money or investments for the account of clients on an omnibus account with a deposit bank. The CSSF clarifies the reporting obligations of such financial institutions to the deposit bank to preserve AGDL protection rights of the beneficiaries in the case of the insolvency of the deposit bank.

CSSF Circular 12/533 and 12/534
Simplified Regulatory Regime for Certain Payment Institutions and Electronic Money Institutions

The CSSF has issued two circulars dated 6 March 2012 specifying the conditions and modalities of the simplified regulatory regime for payment institutions and electronic money institutions with payment operations or electronic money in circulation below certain thresholds, in line with Article 26 of the Payment Services Directive 2007/64/EC and Article 9 of the Electronic Money Amendment Directive 2009/110/EC (as implemented in Luxembourg). The circulars also contain forms to be used by professionals to apply for this regime.

CSSF Circular 12/535
Modifications of Advanced Measurements Approach for Operational Risk

The CSSF has issued a new circular dated 6 March 2012 concerning modifications to the Advanced Measurements Approach (AMA) for operational risk.

Following the publication on 6 January 2012 of the "EBA Guidelines on Advanced Measurement Approach (AMA) - Extensions and Changes" (GL 45), the CSSF hereby implements the GL45 in Luxembourg regulation with immediate effect.

Accordingly Luxembourg credit institutions which, upon approval by the CSSF, are currently using the AMA approaches for determining the minimum own funds (*fonds propres*) requirements for operational risk have to comply with Section III of the GL45. This section categorizes modifications to AMA approaches pursuant to their impact. While extensions and significant modifications to the AMA approaches have to be first approved by the CSSF, major and minor modifications have to be notified to the CSSF only, which in the latter case the CSSF may refuse.

CSSF Circular 12/536
ESMA Guidelines for Systems and Controls in an Automated Trading Environment

The CSSF has issued a new circular dated 27 March 2012 implementing the Guidelines for systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities issued by the ESMA with effect on 1 May 2012.

The circular applies to regulated markets, multilateral trading facilities, as well as Luxembourg credit institutions, investment firms, Luxembourg branches of non-EU/EEA credit institutions and investment firms trading in their own account or executing client orders in an automated trading environment.

The ESMA guidelines are intended to clarify the obligations of trading platforms and investment firms under the existing EU legislative framework. In particular, the guidelines cover (i) the operation of an electronic trading system by a regulated market or a multilateral trading facility, (ii) the use of an electronic trading system, including a trading algorithm, by an investment firm for own account dealing or for the execution of orders on behalf of clients, and (iii) the provision of direct market access or sponsored access by an investment firm as part of the service of execution of orders on behalf of clients.

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The CSSF kindly asks the entities subject to its supervision to notify the CSSF if they are directly or indirectly affected by the circular.

CSSF Activity Report for 2011

The CSSF has published its Activity Report for 2011 at the beginning of May 2012. In addition to statistical information concerning the Luxembourg financial sector, the Report contains information on the exercise by the CSSF of its regulatory powers. The following points, without being exhaustive, are of relevance for banks and other actors of the financial sector. The Report also contains a section on investment funds and SICARs which will be discussed in the **Funds and Investment Management** section of this newsletter.

CSSF Guidelines on Appreciation of Professional Integrity ("Fit-and-Proper Tests")

Professional integrity of the members of administration, management and supervision organs or shareholders with a qualifying participation is a licence condition for financial sector professionals licensed under the Financial Sector Law and certain other financial sector laws. Professional integrity is assessed on the basis of prior judicial decisions and other factors which demonstrate that a person is of good repute, inferring that a financial sector professional's conduct will be irreproachable (the"fit-and-proper test"). However, while a rigorous application has to be made, the CSSF specifies that having a criminal does not necessarily mean that a person does not fulfil the necessary conditions. Conversely, it is possible that a person having criminal record at all is not fit for such a profession from the point of view of professional integrity standards.

The CSSF publishes three guidelines regarding its appreciation on professional integrity.

- Firstly, the facts forming the basis of convictions which are older than ten years can no longer be the sole reason for a negative decision on professional integrity. This however also means that the incumbent has to inform the CSSF in the relevant request for approval of all convictions, even if they are not mentioned on the police record and even if they are older than 10 years.

- Secondly, facts affecting professional integrity need to have a direct link with the activity type for which approval is requested. The CSSF refers to Luxembourg court decisions confirming that the authorities deciding on such matters specifically have to take into consideration the moral behaviour of the person at stake with other persons with whom it will be in professional relations and the trust at stake in these relations.

- Thirdly, the elements of fact on which the CSSF bases its refusal decision must be exactly established and be verifiable with the help of the file documents. It is thus necessary that the person in question transmits all required information and documents to the CSSF and gives exhaustive answers to the questions asked by the CSSF.

Client Complaints - Procedural Aspects

According to administrative practice under the Financial Sector Law, the CSSF is not competent to deal with client complaints if clients have gone to court or involved another body in the same matter:

- In a matter regarding a mortgage loan, a bank's client has gone to court and while awaiting court hearing sought to involve the CSSF. The client based his complaint filing with the CSSF on the argument that article L. 224-26 of the Consumer Code provides that the CSSF is competent in consumer credit matters to mediate disputes between banks and consumers in consumer credit matters and that such mediation proceedings are without prejudice to the right of recourse before civil courts. The CSSF rejected its competence because the client had misinterpreted the spirit of the law and the mortgage loan did not fall under consumer credit legislation.

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- In a second matter, a client had asked the CSSF to examine a garnishment operated by his bank on sums transferred to his bank account following the sale of his flat. The CSSF noted that the bank had received a judicial authorisation to make a garnishment on all sums that it would receive up to the amount of its claim and that the client had been informed of this authorisation and its reasons. As one of the parties had gone to court, the CSSF rejected its competence to deal with the complaint.

Investment Firms

In the past, in the framework of prudential supervision, the CSSF had taken the decision to exempt investment advisors and brokers in financial instruments from the obligation to deposit a long form report from the external auditor (*compte rendu analytique de révision*). The CSSF has decided that it will not grant this exemption anymore in the future. The investment firms concerned will also have to deposit a long form report from the external auditor with the CSSF for the corporate year closing on 31 December 2011.

The CSSF also reports on results of onsite inspections concerning MiFID conduct of business rules. The CSSF has detected in several cases that suitability tests had not been carried out appropriately. The professionals had allocated investor profiles to their clients which were only abstract descriptions of investment profiles without a real value for the clients' investment decision-taking process. The CSSF had therefore asked these professionals to provide to their clients information on the allocation of assets associated with each investment profile and, in case of portfolio management, the details of the financial instruments composing the model portfolio.

Domiciliation Agents – Outsourcing of IT Functions

The CSSF considers that domiciliation agents wishing to outsource the IT systems establishing the accounting situation and financial figures of the domiciled companies have to use an financial sector primary IT systems operator licensed in accordance with Article 29-3 of the Financial Sector Law. The outsourcing of other IT functions (excluding those establishing the accounting situation and financial figures) e.g. concerning the company life of the domiciled companies, can be entrusted to an operator of secondary IT systems of the financial sector licensed in accordance with Article 29-4 of the Financial Sector Law.

Support PFS

The Report again contains clarifications on the regulatory practice of the CSSF with respect to Support PFS.

The CSSF specifies, amongst others that service provisions which are sensitive as a result of professional secrecy obligations of a Luxembourg credit institution or PFS do not necessarily entitle the credit institution or PFS to a support PFS as service provider. The disclosure of confidential information by the credit institution or PFS has to be necessary for the service provision by the support PFS to be covered by the exemption from professional secrecy obligations anticipated in the Financial Sector Law.

Accordingly, the CSSF considers that recourse to a support PFS for cleaning services is not necessary, even if the persons in charge of cleaning services need to pack away confidential documents. In contrast, the credit institution or PFS is negligent if it does not establish and enforce a clean desk policy in accordance with its professional confidentiality obligations.

Support PFS who have obtained a licence with the only aim to be able to respond to requests by a credit institution or PFS however need to remain prudent because:

- they risk the loss of their licence with one year of receipt if the CSSF asks to be provided with a contract justifying the licence and if such contract is considered by the CSSF to be inadequate for the licence, and
- they assume a responsibility which initially lies with their client and which goes further than the responsibilities linked to the service they provide.

Payment and E-Money Institutions

The CSSF had specified in circulars published in 2011 that the central administration and infrastructure requirements applying to Luxembourg credit institutions and investment firms apply *mutatis mutandis* to payment and electronic money institutions (*cf.* CSSF Circular 11/510 and 11/520, **see the September 2011** and **the January 2012 edition of our Luxembourg Legal Update**).

In 2011, the CSSF has noticed in licensing applications for payment and e-money institutions that they have a clear tendency to outsource IT processing which supports their licensable services. The CSSF emphasizes that such institutions have to meet the requirements for the outsourcing of IT functions set forth in its Circular 05/178.

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This ensures, among other things, that outsourcing to a foreign entity is made either to a group entity or an entity specialised in IT matters controlled by the group, while the entity responsible for the service is subject to prudential supervision. The CSSF sets out that if its IT outsourcing requirement cannot be complied with, the CSSF only grants exemptions after assessment of the global situation of the institutions and the measures proposed by it to guarantee the uninterrupted and high quality of the outsourced service provision.

Prospectus Law

The CSSF expresses the view that a modification of the rating of an issuer or its securities generally qualifies as a significant and material change having a direct impact on the valuation of the securities. This triggers the application of the Prospectus Law provision requiring the preparation of a supplement to the approved documents (prospectus etc.). The CSSF further considers that this general approach may not be appropriate in specifically justified and motivated cases only.

The CSSF has changed its position in 2011 with respect to the incorporation by reference of a registration document in a prospectus. In the past the CSSF had refused the incorporation by reference of registration documents approved by the CSSF into complete prospectuses. This was however possible with regard to documents issued by a foreign authority. In order to treat all issuers equally the CSSF now permits such incorporation by reference.

Transparency Law

The CSSF specifies the consequences of the increase of the unitary nominal value threshold from EUR 50,000 to EUR 100,000 in the Transparency Law once the law implementing Directive 2010/73/EU will have entered into force on 1 July 2012 (**see the January 2012 edition of our Luxembourg Legal Update** on the proposed Bill N°6319). Issuers subject to the Transparency Law and issuing exclusively debt instruments with a unitary nominal value equal to or above this threshold are exempted from the obligation to publish annual and semi-annual financial reports as well as interim management statements.

Accordingly, issuers which have issued on 31 December 2010 or thereafter debt instruments whose nominal value is less than EUR 100,000 (or the equivalent thereof in another currency) will be subject as of 1 July 2012 to the transparency obligations applicable since the entry into force of the Transparency Law to issuers having issued securities with a nominal unitary value less than EUR 50,000 (or the equivalent thereof in another currency).

The CSSF also specifies that the Transparency Law rules applicable to reports and management statements will have to be applied fully with respect to periods beginning on 1 July 2012 or thereafter. However, reports or statements relating to periods having begun before 1 July 2012 but closed after such date or reports published on or after 1 July 2012 but concerning periods closed before such date may comply with the content requirements for such reports or statements in force before 1 July 2012, i.e. before entry into force of the amendments to the Transparency Law, while having to comply with the new requirements concerning modalities and deadlines for publication.

Use of Cloud Computing by Financial Institutions

The CSSF emphasizes the importance of at least three prudential principles applicable in the context of the use of cloud computing by financial institutions, in particular in the case of outsourcing in a cloud mode and where the processing or storage concern essential activities of the finance professional:

- the financial institutions have to keep control at all times over their activities from a technical and operational point of view,
- the risks have to be correctly assessed, reduced, transferred or accepted,
- the residual risk has to be known and accepted.

Without prejudice to the limits on outsourcing due to professional confidentiality obligations, the Luxembourg finance professional considering outsourcing to an IT services provider in a cloud computing mode will have to ensure that he receives all the necessary information and practical details from all service providers involved in the cloud computing (geographic localisation, inter-sectoral mutualisation, segregation mechanisms for the environments in the cloud, management of environments with or without virtualisation etc.).

In order to comply with its obligation to ensure continuity of its activities, the professional will also have to be prepared to take back the outsourced activities or transfer them to another cloud in case one service provider in the chain ceases its activities. In addition, the CSSF draws the attention of finance professionals to the difficulties of a proper risk assessment due to the relative youth of cloud computing.

The CSSF nevertheless underlines that many difficulties are resolved where the provider of the cloud is a Luxembourg support PFS subject to the same prudential

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principles and legal framework as the Luxembourg finance professional. The CSSF also specifies that the entire chain of providers involved in Luxembourg must dispose of a support PFS licence even if they manage only part of the information system. Only the last provider offering "white" rooms (*salles "blanches"*) does not need a support PFS licence, provided it does not intervene with the IT equipment.

A Luxembourg finance professional planning to use cloud computing provided by a support PFS will have to ensure different aspects by contract, notably in light of its own professional confidentiality obligations. The CSSF finally invites support PFS putting in place cloud offers outside the financial sector to present even these to the CSSF.

Update of CSSF Questions and Answers relating to PFS

The CSSF has published on its website an updated version of its "Questions and Answers" Paper relating to PFS. The update takes into account the legal and regulatory developments since the 2011 version of the paper (**see the January 2012 edition of our Luxembourg Legal Update**). It namely replaces references to the law of 28 December 1988 with the law of 2 September 2011 regulating the access to the artisan, merchant and industrial professions, as well as certain liberal professions (**see the January 2012 edition of our Luxembourg Legal Update**).

The update further withdraws some general positions the CSSF had published in the past in such paper in relation to the scope of the licence requirement in the Financial Sector Law for granting loans for own account and by way of business "*to the public*". The former general position of the CSSF was broadly that granting of loans exclusively to certain types of MiFID professional clients or to a restricted group of persons to the extent they are clearly identifiable in advance because they meet pre-determined criteria does not constitute granting of loans "*to the public*", provided that the lender does not solicit the public, notably by making advertisement. The withdrawal of its general position has to be seen in light of the wider discussion on shadow banking. Nevertheless, it has to be noted that the terms of the law have not changed and that only grants of loans "*to the public*" constitutes a licensable activity. As no reliance on a general position will be possible, the question whether loans are granted "*to the public*" or not will henceforth need to be considered on a case-by-case basis and certainty can, as the case may be, only be obtained by receiving written clearance by the CSSF on this point. Generally, it should however be noted that in many loan structures lenders rely on intra-group exemptions and the exemption from licence requirements for intra-group activities continues to apply as well.

Finally, the CSSF has clarified in its new version of the "Questions and Answers" Paper that factoring operations falling under the factoring licence requirement in the Financial Sector Law need to include a lending element (*élément de crédit*). Accordingly, where the professional acquiring claims does not make a payment to the transferor of the claims before he has recovered the payments due under such claims, no factoring licence requirement would be triggered for the acquirer of the claims.

New Circular Letters Concerning the Insurance Sector

The Luxembourg insurance sector regulator Commassu has, amongst others, issued the following circulars:

- Circular Letter 12/1 modifying and supplementing Circular Letter 98/1 on technical interest rates,
- Circular Letter 12/2 modifying Circular Letter 03/2 on annual reporting of Luxembourg direct insurance undertakings,
- Circular Letter 12/3 on the annual actuarial report of Luxembourg life insurance undertakings,
- Circular Letter 12/4 on the annual actuarial report of Luxembourg non-life insurance undertakings,
- Circular Letter 12/6 on the report of insurance brokers (natural persons and legal entities), and
- Circular Letter 12/7 modifying Circular Letter 99/6 on the annual report of reinsurance undertakings.

Case Law

Court of Appeal, 9 June 2010
Liability of Bank intervening as an Agent of its Client

A bank's clients have made a bank transfer to a certain account in view of buying certain shares sold by a bank. They then ask for the retransfer of the outstanding amount and mainly argue that the receiving bank is liable as it has credited a client's account without requiring further information, whereas the transfer documents referred specifically to the acquisition of shares and the recipient was an employee of the bank.

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The Court of Appeal[1] held that the bank was an agent of the clients. It however had to determine the duties the bank had to execute. The main question was whether the bank intervened as an agent in the transfer or whether it was an agent for the purpose of the acquisition of the shares. The Court notes that it clearly appeared that the account to which the money had been transferred was not an internal account of the bank but a client account and that it had not been proven that there had been a perfected sale of shares. For this reason, it appeared that the bank, acting as an agent, had only to transfer the given amounts to the account of the beneficiary. As transfer agent a bank is held to make sure that it executes the order correctly and therefore takes all the necessary steps if an order appears incomplete or inconsistent and if there is a risk of error. Furthermore a transfer order is only possible if the beneficiary's account exists. In the given circumstances, the transfer order did not contain any anomalies, and there was no reason why the bank had to doubt its accuracy. The bank had thus correctly performed its obligations. An appeal in law against this judgment has been dismissed by the Supreme Court[2].

Supreme Court, 6 January 2011
Moral Damage in Case of Disclosure of Confidential Data by a Luxembourg Bank to the Tax Authorities

Luxembourg law requires banks to keep confidential any information confided to them in the course of their professional activity.

In the last years, different chambers of the Court of Appeal were confronted with the question of whether a bank's client had suffered a 'moral damage' caused by the invasion of privacy and the breach of the client's legitimate expectation vis-à-vis the bank to keep the client's information confidential. The 4th chamber[3] held that such a damage existed, the 7th[4] and 9th[5] chambers denied the existence of such a damage and held that the alleged moral damage of a loss of confidence in the application of banking confidentiality by the bank actually consists only of the disappointment at having to pay taxes owed and is thus not sufficiently specific and autonomous from the tax debt to constitute moral damage.

[1] Court of Appeal, 9 June 2010, n°34634.
[2] Supreme Court, 19 May 2011, n°33/11.
[3] Court of Appeal, 4th chamber, 2 April 2003, n°26050.
[4] Court of Appeal, 7th chamber, 20 March 2011, n°35545
[5] Court of Appeal, 9th chamber, 5 November 2009, n°32824.

The 9th chamber's judgement has been the subject of an appeal in law filed with the Supreme Court[6]. The parties mainly criticised the motivation of the Court of Appeal's judgment pretending that the Court of appeal had not answered their conclusions having held that the damage suffered by the bank's client was not sufficiently specific.

The Supreme Court held that the Court of Appeal's judgement was sufficiently motivated and answered all the parties' arguments. Even though the Court doesn't answer the question whether the bank's client suffers a moral damage in case of non respect of banking confidentiality, it is clear that it will be difficult to criticise a judgement deciding that such a damage does not exist.

Court of Appeal, 16 March 2011
Garnishment of Pledged Account

The Financial Collateral Law aims to protect financial collateral arrangements against potential challenges. In line with this reasoning, a debtor argued that, as long as a bank account is pledged, a third party could not garnish the account (*saisie-arrêt sur compte*), and that such garnishment would be void. The Court of Appeal[7] however considers that a garnishment by a third party is not void, even if a pledge falling within the scope of the Financial Collateral Law takes effect against third parties at the time of its conclusion. Simply the pledgee benefits from a legal privilege once the pledged property is realised. As it has been noted, this means that either the property is realised

[6] Supreme Court, 6 January 2011, n°1/11.

[7] Court of Appeal, 16 March 2011, n° 36477.

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when the pledge is still in force, and then the pledge is necessarily served first, or the property is realised after the pledgee has been satisfied and the pledge has been discharged. In these circumstances the creditor having ordered a garnishment will be paid first.

Court of Appeal, 25 May 2011
Opening of Insolvency Proceedings – Cessation of Business – Causes of Insolvency

In a recent decision, the Court of Appeal[8] had to answer two questions related to the opening of insolvency proceedings. As a matter of principle, it is not possible to open insolvency proceedings for a person that has ceased all commercial activities for more than 6 months. The Court had to answer the question whether this also rule applied to commercial companies. It held that when it comes to commercial companies, insolvency proceedings can be opened as long as it exists as a legal entity, even though it has ceased to trade for more than 6 months.

With regard to the concept of cessation of payments, the Court held that its cause does not matter. The courts do not need to research which cause(s) or circumstances have led to the cessation of payments. The only thing that matters is the actual fact that the legal entity has ceased its payments.

District Court, 26 May 2011
Guarantee - Competent Jurisdiction

The facts of this case were that the obligations of a debtor, situated in Luxembourg, had been guaranteed by a guarantor who was domiciled in France. When the debtor did not perform his obligations, the creditor asked the guarantor to pay. As he didn't, the creditor introduced an action against the guarantor. The main question was then whether Luxembourg or French courts had jurisdiction. Both alternatives could be contemplated. One could argue that a contract of guarantee, being accessory by nature, would necessarily imply that the courts of the main debtor had jurisdiction. It's also possible to consider that for the purpose of jurisdiction, a contract of guarantee has a certain autonomy and that one has to apply the general rules applicable to contractual matters resulting, for matters falling into its scope, from the Rome Convention on the law applicable to contractual obligations or Council Regulation 44/2001/EC on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

[8] Court of Appeal, 25 May 2011, n° 36933.

Confronted with these alternatives, the District Court[9], held that the guarantor had to perform its own obligation to pay a debt, and that this obligation was of an autonomous nature. For this reason, it is necessary to consider the rules regarding jurisdiction taking into account the contract of guarantee only. To determine the competent jurisdiction, one has to identify the place of performance of the primary obligation, the latter being determined by the law applicable to the contract. Here, this law is the law of the country of residence of the party performing the primary obligation, the guarantor. According to French law, in the absence of contractual clauses to the contrary, a payment obligation is performed at the domicile of the debtor. The guarantor's domicile in France being the place of performance of the principal obligation, the Luxembourg courts did not have jurisdiction.

Court of Appeal, 15 June 2011
Scope of a Guarantee – Accessories of the Secured Obligation

According to article 2016 of the Civil Code, a guarantee (*caution*) not only secures the principal obligation but also its accessories.

In a recent decision[10], the Court of Appeal decided that late payment interests fall into the scope of article 2016 of the Civil Code. In the same decision, the Court decided that the indemnity for legal costs, which had to be paid by the debtor and which comprised the costs for legal counsel, is not an accessory within the meaning of article 2016 of the Civil code.

District Court, 16 June 2011
Discharge of Debt through Payment to a Third Party

In the course of an action against a debtor, the latter argued that it had paid its debt by bank transfer to the account of a third party, a GIE (*goupement d'intérêt économique*). In general, to be discharged of its debts, a debtor has to pay directly to the creditor. If he doesn't do so, he can be obliged to pay a second time, unless the debtor can prove that in the given circumstances it was authorised to do so. Actually article 1239 of the Civil Code provides that a debtor is discharged if it pays to a third party being an agent for the creditor, or if it didn't have the power to receive monies for the creditor, if the latter had ratified the payment or had benefitted from the payment.

In the case at hand, it was clear that payment had not been made to the creditor but to a third party. For this

[9] District Court, 26 May 2011, n° 136264.
[10] Court of Appeal, 15 June 2011, n°36212.

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reason, the debtor was expected to prove that the conditions of article 1239 of the Civil Code were met. It appears however, that the debtor knew at the time of the bank transfer that the creditor had no longer been member of the GIE. Furthermore, the debtor could not prove that the creditor had benefitted in any way of its payment. For these reasons the District court[11] held that the debtor, having transferred the monies to the bank account of the GIE, had not validly discharged its obligation.

Court of Appeal, 16 November 2011
Property of Parts in an Investment Fund Detained by a Service and Transfer Agent

A bank had asked a service and transfer agent to buy parts in an investment fund on its behalf. Even though the bank had not paid for these parts, the service and transfer agent registered the acquisition of the parts on an account of the bank. In the accounts of the management company of the investment fund, the service and transfer agent had been inscribed as holder of the parts. Three months later the bank, which had never paid for the parts, became insolvent.

The fund has been liquidated and the relative amounts have been transferred to a bank account. During the insolvency proceedings, the bankruptcy receiver of the bank claimed that the bank was the legal owner of the parts and that it was the owner of the amounts set on the bank account. The service and transfer agent argued that the bank had not become owner of the parts as the service and transfer agent was holder of these parts.

In a recent decision[12], the Court of Appeal decided that, in the relationship between the bank and the service and transfer agent, once the parts have been inscribed on its account, the bank has become owner of the parts, and that it has possession of them. This is the case even though the service and transfer agent appears as holder of the parts in the accounts of the management company of the investment fund.

The service and transfer agent also argued that it had been acting as a broker for the bank and that for this reason it benefitted of the privilege provided for in article 92 of the Commercial code for all advances made for and on behalf of the bank. However, to benefit from the privilege it is necessary that the broker still has possession of the principal's property. And in the given circumstances the only way to get possession of the parts was to void their inscription on the account of the bank and such act would be illegitimate.

In the end, the service and transfer agent raised an argument with respect to the loyal execution of contracts. Basically, parties to a contract can only demand execution of the mutual obligations once they have fulfilled their own obligations. Actually, and contrary to the bank, the service and transfer agent had executed all its contractual obligations. The Court of Appeal however answers that, even if the service and transfer agent had executed its obligations it could not rely on the principle requiring a loyal execution of contracts because, as the bank became insolvent before it could execute its contractual obligations, the rules relating to insolvency are applicable. For all of the above reasons, the service and transfer agent has to pay the monies received for the parts to the bankruptcy receiver of the bank.

Supreme Court, 1 December 2011
Banks' Obligation of Professional Confidentiality and Garnishment of Bank Account

According to Articles 709, 710 and 713 of the Code of Civil Proceedings, in the course of garnishment proceedings (*saisie-arrêt*), a third party holding assets of the debtor has to prove that he has given those assets back to the debtor. Otherwise the third party might be considered to become debtor for the said amounts. In the course of a garnishment of a bank account, the creditor had been informed by the bank that the balance of the account was insufficient. The creditor wanted to know whether and when the balance of the accounts had been paid to the debtor. The bank opposed its obligation of professional confidentiality to this query.
The Supreme Court[13] held that the banks' obligation of professional confidentiality can only be lifted if it is strictly necessary for the creditor. According to the court, as the attachment creditor only needs to know the balance of the account at the moment of the garnishment, the bank does not have to provide the creditor with the account history.

Supreme Court, 29 March 2012
Bank's Liability for Wrongful Information

A client invested into bonds issued by certain countries and asked his bank for information whether to hold or sell these securities. As the bank did not tell him that these bonds were unsafe, the client did not sell them at the right moment. In fact, in 1997 the client was told that these bonds were particularly interesting, which was a common opinion in the market at the time. In 2001, the bank

[11] District Court, 16 June 2011, n° 134023.
[12] Court of Appeal, 16 November 2011, n°31289.
[13] Supreme Court, 1 December 2011, n°66/11.

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confirmed that the country's situation was unchanged, but that repayment of the bonds could not be guaranteed. It appeared from newspaper articles that this was the general opinion at the time. For these reasons the Court of Appeal[14] held that the bank was not liable for providing wrong information to its client.

This decision was upheld by the Supreme Court[15] which decided that a bank, providing information to its clients which is based on specialist opinions, is only liable if it knowingly provides its clients with wrong information or if the communication of false information results from the fact that a bank did insufficient research. In this second case, the bank would be liable for negligence.

Corporate, M&A

Legislation

No legal changes have occurred to the general provisions of the Luxembourg corporate law during the period covered by the present newsletter.

Grand Ducal Regulation

Grand Ducal Regulation of 14 December 2011
New Mandatory Procedure for the Filing of Financial Information with the Luxembourg Register of Commerce

The Grand Ducal Regulation of 14 December 2011 contains new rules with respect to the establishment and filing of the accounting documents for SA, SARL, SCA, SE, SCS, SNC and SPF, to the extent that such companies prepare their annual accounts under Luxembourg GAAP and are not regulated.

As from 1 January 2012, and irrespective of the financial year to which the accounts relate, these companies shall file electronically, using the Internet website of the Luxembourg Register of Commerce, their so-called "accounting package", consisting mainly of a balance sheet, profit and loss account, trial balance but also of the management and audit report if any.

Moreover, with a view to improving the standardisation and centralisation of the accounting information, these companies shall follow the new standard chart of account (*plan comptable normalisé*) for any financial year started after 31 December 2010, and shall, prior to proceeding to the electronic filing with the Luxembourg Register of Commerce, submit their balance sheet, profit and loss account and trial balance under xml or pdf format to a new electronic platform set by the Luxembourg state, the eCDF platform.

The companies which are not subject to compliance with the new standard chart of account (*plan comptable normalisé*) (mainly credit institutions, insurance companies, reinsurance companies, PFS, SICAF, SICAR, SICAV) shall file, as from 1 January 2012, and irrespective of the financial year to which the accounts relate, their accounting package electronically through the Internet website of the Luxembourg Register of Commerce directly, and for the avoidance of doubt, without prior submission to the eCDF platform. Consolidated accounts may also be filed directly through the website of the Luxembourg Register of Commerce.

Case Law

Court of Appeal, 18 May 2011
Removal of Manager of SARL by Shareholders

According to article 191 of the Companies Law, unless otherwise provided for in the articles of a SARL, a manager of a SARL may be removed by its shareholders for legitimate reasons only. Luxembourg courts generally consider that a management fault, wilful misconduct , or a breach of the provisions of the articles or of Luxembourg law may each constitute a legitimate reason justifying the removal of a manager.

In the case submitted to the Court of Appeal[16], a manager of a Luxembourg SARL was removed with immediate effect by the shareholders, without any indication of legitimate reasons justifying such removal. In these circumstances, it was questioned whether such removal was valid and, if not, whether a Luxembourg judge may reappoint the removed manager.

The Court of Appeal considered that the present removal was invalid, as no legitimate reasons were mentioned by the shareholders to justify the removal of the manager. However, the Court decided that although such removal was not valid, a Luxembourg judge does not have the power to reverse the shareholders' decision to remove a manager of a SARL and reappoint the removed manager in his functions. In this situation, the Company can only be sued for damages by the removed manager.

[14] Court of Appeal, 27 October 2010, n°34564.
[15] Supreme Court, 29 March 2012, n°19/12.
[16] Court of Appeal, 18 May 2011, n°36809.

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Supreme Court, 15 December 2011
Transfer of Bearer Shares

According to article 42 of the Law on Commercial Companies, the transfer of bearer shares operates by the delivery (*tradition*) of the certificate. In circumstances where the delivery had not taken place, it was thus questioned whether such transfer could be valid.According to the Supreme Court[17], as long as a bearer share has been duly individualised, its transfer takes effect between the parties once the contract has been validly concluded.

Court of Appeal, 21 December 2011
Opening of Bankruptcy Proceedings at the Company's Registered Office

In a case where a company had its registered office (*siège statutaire*) in Luxembourg and a branch in Switzerland, the question was whether the Luxembourg courts had jurisdiction to open bankruptcy proceedings. Actually, only the courts of the place of the headquarters have jurisdiction to open such proceedings.

According to the District Court, the actual headquarters of the company were situated in Switzerland because its employees had been hired by the Swiss branch and worked in Switzerland and because the company had no commercial activity at its Luxembourg registered office. For this reason, the Court decided that the company's actual operational headquarters (*siège reel d'exploitation*) were in Switzerland and that it had no jurisdiction to open bankruptcy proceedings.

It has been submitted to the Court of Appeal that the general assemblies of the company had been held in Luxembourg, that it had two bank accounts here, that all the accounting for the company was done in Luxembourg, that the company made income declarations to the Luxembourg tax administration and that for these reasons Luxembourg courts had jurisdiction.

The judgment has been reverted by the Court of Appeal[18]. According to article 2 of the Commercial Code, a company's headquarters are at the place of its central administration and the central administration is deemed to be at the place of the registered office unless proof to the contrary is provided. If, for a company, the place of the central administration is different from its principal place of business, the place of the central administration has to be considered as the relevant criterion to determine the courts having jurisdiction to open bankruptcy proceedings.

[17] Supreme Court, 12 December 2011, n°70/11.
[18] Court of Appeal, 21 December 2012, n°37940.

Funds & Investment Management

Legislation

Law of 26 March 2012
Amendment of the SIF Law

The law of 26 March 2012 amending the SIF Law[19] has been published in the *Memorial* and entered into force on 1 April 2012.

The amendments:

- anticipate some of the requirements to be introduced by the AIFM Directive[20], in particular as regards risk management, conflicts of interests and the delegation of functions to third parties, but do not yet comprehensively implement these or other requirements of the AIFM Directive;
- strengthen the supervisory framework for SIFs, e.g. by requiring SIFs to obtain approval prior to carrying out their activities; and
- make available to SIFs some of the innovations introduced by the UCI Law[21], such as the relief for some corporate SIFs from some of the requirements of the Companies Law or the possibility of cross sub-fund investments for umbrella SIFs.

SIFs created after 1 April 2012 must comply with the above amendments from the outset. SIFs created before 1 April 2012 benefit from grandfathering provisions until 30 June 2012 as regards the implementation of: (i) procedures to verify investors' eligibility, (ii) appropriate risk management systems, and (iii) arrangements to minimise conflicts of interests. They must comply with the new conditions applicable to the delegation of functions to third parties by 30 June 2013.

As of today, there are no official detailed guidelines from the CSSF on the content or format for the risk management process and conflicts of interest procedures to be adopted by SIFs. However, this obligation will be

[19] Luxembourg law of 13 February 2007 (as amended) relating to specialized investment funds.
[20] Directive 2011/61/EU of 8 June 2011 of the European Parliament and the Council on alternative investment fund managers.
[21] Luxembourg law of 17 December 2010 (as amended) on undertakings for collective investment.

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further specified by a Regulation of the CSSF. In the meantime, the CSSF has indicated in its Press Release 12/16 of 20 April 2012 that SIFs created after 1 April 2012 must provide, together with the other documents to be sent to it for the approval of the new SIF, a succinct description of the measures put in place to manage risks and conflicts of interest. SIFs created before 1 April 2012 must provide the CSSF with the required information by 30 June 2012.

Clifford Chance has prepared a **client briefing** which provides an overview of the main changes to the SIF Law brought forward by the new law and its impact for SIFs.

Law of 20 December 2002 relating to UCIs to Be Repealed as of 1 July 2012

As a reminder, the Luxembourg law of 20 December 2002 relating to UCIs will be repealed with effect from 1 July 2012. Most of the UCITS IV requirements contained in the UCI Law have been applied as of 1 July 2011, while some other measures have either entered into force on 1 January 2011 or have been subject to grandfathering provisions until December 2011 or July 2012.

The key requirements UCITS, other UCIs and their management companies must comply with by 1 July 2012 are the following:

Delegation Agreements

Management companies governed by Chapter 16 of the UCI Law (Chapter 16 management companies) and self-managed SICAVs governed by Part II of the UCI Law (Part II SICAVs), both created before 1 January 2011, will have to bring their delegation arrangements into compliance with the UCI Law requirements by 1 July 2012.

Most importantly, the new rules require that where the delegation concerns investment management, the mandate may only be given to undertakings which are authorised or registered for the purposes of asset management and subject to prudential supervision; when the mandate is given to a third country undertaking, cooperation between the CSSF and the supervisory authority of that country must be ensured.

Chapter 16 management companies and Part II SICAVs, which have delegated their investment management function to unregulated entities or to entities in third countries for which cooperation between supervisory authorities and the CSSF is not ensured, should therefore take the necessary steps to bring the delegation in line with the new requirements. This may require an unregulated investment manager to seek authorisation with a supervisory authority which has a cooperation agreement with the CSSF. A Chapter 16 management company or Part II SICAV that currently has an unregulated investment manager may also consider assuming itself the investment management function and transforming the role of the entity hitherto acting as investment manager into that of an investment adviser.

KIID

For all Luxembourg UCITS existing on 1 July 2011 and which have been, up to that date, subject to the law of 20 December 2002 relating to UCIs, issuing a KIID[22] was optional during a transitional period expiring on 1 July 2012. As a result, existing UCITS which have continued to provide simplified prospectuses during the transitional period must submit their KIID to the CSSF through the e-file process by 1 July 2012 at the latest.

Website

Given that the requirement to create a website is related to the requirement to issue a KIID, existing UCITS which decided to continue providing simplified prospectuses during the transitional period running from 1 July 2011 to 1 July 2012 and which did not market their units or shares on a cross-border basis were not required by the UCI Law to create a website before the date they would issue a KIID. These UCITS will have to create a website compliant with the UCI Law requirements by 1 July 2012. For the avoidance of doubt, existing UCITS issuing KIIDs during the transitional period were already required to publish their KIIDs on their website or the website of their management company or, under certain conditions, a third party's website.

[22] Key investor information document.

Bill N° 6397
Implementation of Omnibus I Directive

The Luxembourg Parliament is currently examining a new bill aiming to implement into national law the Omnibus I Directive[23] in respect of the powers of the three European Supervisory Authorities, namely EBA[24], EIOPA[25] and ESMA[26].

The objective of the bill is to enable the CSSF[27] and the Commassu[28] to exercise their functions and duties as members of the ESFS[29]. The bill also strengthens the competences of the CSSF and the Commassu for the protection of financial services users. Finally, it clarifies a limited number of technical points in laws regarding financial services. As a result, several Luxembourg financial services sectoral laws will be amended, including, amongst others, the UCI Law, the SIF Law and the SICAR Law[30] as well as the Financial Sector Law[31].

The common change to the UCI Law, the SIF Law and the SICAR Law is the re-insertion of the provision that granted powers to the CSSF to fix rules with regard to the scope of the mandate of the audit and the contents of the audit report on the control of the annual accounting documents, as such provision applied before the modifications introduced by the law of 18 December 2009 concerning the audit profession.

Other proposed changes to the UCI Law mainly concern the information sharing and cooperation obligations between the CSSF and ESMA to ensure effective operation of the ESFS. This includes, *inter alia*:

- the obligation for the CSSF, in respect of the 25% derogation to the 10% single issuer limit, to send to ESMA a list of the categories of bonds issued by a credit institution which has its registered office in a Member State and is subject, by law, to special public supervision designed to protect the bondholders, together with the categories of issuers authorised to such bonds; and

- the obligation for the CSSF to notify to ESMA the authorisation granted by it to a Luxembourg management company governed by Chapter 15 of the UCI Law.

Last but not least, the bill also amends the scope of the Financial Sector Law to render it applicable to investment advisers of investment funds governed respectively by the UCI Law and the SIF Law. This modification aims to harmonise Luxembourg legislation with MiFID requirements. As a result, any Luxembourg-based investment advisers to UCIs and SIFs will need to be a regulated entity subject to prudential supervision of the CSSF. However, existing Luxembourg-based investment advisers will have until 31 December 2012 to comply with the provisions of the Financial Sector Law.

In addition, the bill proposes to define the concept of "managers" of UCIs and SIFs (as referred to in article 1-1 (2), i) of the Financial Sector Law) in order to clarify that only management companies governed by Chapters 15, 16, 17 or 18 of the UCI Law (to the opposite of other investment managers) are excluded from the scope of the Financial Sector Law. This clarification seems logical as these management companies are already covered by another specific law: therefore, they do not need to obtain authorisation as PFS under the Financial Sector Law but shall be authorised by the CSSF according to the UCI Law.

For a general analysis of the bill, see **Banking, Finance and Capital Markets** section.

[23] Directive 2010/78/EU of 24 November 2010 of the European Parliament and the Council.
[24] European Banking Authority.
[25] European Insurance and Occupational Pensions Authority.
[26] European Securities and Markets Authority.
[27] *Commission de surveillance du secteur financier*, the Luxembourg supervisory authority of the financial sector.
[28] *Commissariat aux assurances*, the Luxembourg insurance sector regulator.
[29] European System of Financial Supervisors.
[30] Luxembourg law of 15 June 2004 (as amended) relating to the investment companies in risk capital.
[31] Luxembourg law of 5 April 1993 (as amended) on the financial sector.

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CSSF Activity Report for 2011

The CSSF published its activity report for 2011 at the beginning of May 2012. In addition to statistical information concerning the Luxembourg fund industry, the report contains information on the exercise by the CSSF of its regulatory powers. The following points, without being exhaustive, are of relevance for Luxembourg UCITS.

Transparency in relation to Leverage

Box 24 of ESMA Guidelines[32] provides that UCITS disclose in their prospectus the expected level of leverage and the possibility of higher levels of leverage (for UCITS using the VaR approach). In this respect, the CSSF specified in its Circular Letter 11/512 that the commitment approach could be used for the determination of leverage to be disclosed in the prospectus.

To the extent that not all Member States have adopted the same approach, the harmonisation of rules could lead to the abandonment of this possibility. As a result, UCITS shall then in any case apply the method that uses the sum of the notional derivatives instruments completed, as the case may be, by a leverage determined on the basis of the commitment approach. The CSSF is aware that this matter is of significant importance for UCITS and will ensure to communicate, as the case may be, in an adequate manner, any change of position.

The CSSF has also observed that the use by UCITS of certain particular strategies of certain derivative financial instruments could lead to high leverage levels. In these cases, prospectuses have to contain information and explanations on the reasons and on the impacts, in terms of risks for investors, of the use of these high levels of leverage.

Limitation of Global Exposure

In accordance with article 46 (3) of CSSF Regulation n°10-4 and point 2 of Box 1 of ESMA Guidelines, global exposure shall be calculated by using the commitment approach, the VaR approach or other advanced risk measurement methodologies as may be appropriate, provided that such method is provided for by ESMA Guidelines.

In this context, article 46 (2) of CSSF Regulation n°10-4 and point 1 of Box 1 of ESMA Guidelines provide that global exposure shall be calculated at least once a day, regardless of the NAV publication's frequency. This calculation also implies instrument positions generating leverage (for sub-funds using the commitment approach), respectively giving rise to a market risk (for sub-funds using the VaR approach) to be taken into account in accordance with the provisions of CSSF Regulation n° 10-4 and ESMA Guidelines.

Furthermore, the CSSF recalls that, in accordance with point 1 of Box 1 of ESMA Guidelines, the global exposure's limit must be complied with on an ongoing basis. Consequently, and notwithstanding the NAV publication's frequency, the CSSF considers that a daily calculation of the NAV shall therefore be ensured :

- for UCITS using the commitment approach if any doubts arise on the possibility of exceeding the global exposure's limit referred to in article 42 (3) of the UCI Law ; and
- for all UCITS using the VaR approach in order to calculate global exposure, knowing that the global exposure's daily calculation implies, in any case, a revaluation of risk factors linked to the overall sub-fund's portfolio positions.

Please also see **Banking, Finance and Capital Markets** section.

Litigation

Supreme Court, 2 February 2012
Consumer Protection Association's Interest to Act in case of Contractual Clauses contrary to Consumer Protection Legislation

In a case where a car had been sold "as is", without any warranty, an action had been lodged by a consumer protection association in view of getting an injunction against the seller not to use this type of clause again. A Court decided that such a sale was contrary to the consumer protection legislation and ordered the seller not to sell cars again without respecting the legislation regarding consumer protection.

The Court of Appeal[33] decided that the action by a consumer protection association could not be admitted by the court, as such an association may only act in a collective interest, and when it comes to contractual clauses, only if a clause contrary to the consumer protection legislation has been inserted into a model

[32] ESMA's guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS, July 2010 (ref.: CESR/10-788).

[33] Court of Appeal, 10 February 2010, n°35099.

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contract which has been used in a large number of transactions, or which will be used in number of transactions. In the case at hand it appears that the clause had been inserted into the contract of sale of this particular car and it is not a clause taken from the model contract used by the seller. It is thus not probable that the seller will conclude more contracts containing this clause.

An appeal in law against this judgment has been dismissed by the Supreme Court[34]. It mainly decides that an action by a consumer protection association in view of an injunction against a professional using clauses contrary to the consumer protection legislation cannot be admitted if the clause has only been used in an isolated, specific, contract. Furthermore, a consumer protection association only has an interest to lodge such an action if it is to be feared that the acts contrary to the law will be repeated.

Court of Appeal, 29 February 2012
Revocation for Just Cause of the Representative of the Bondholders

Companies can issue bonds in order to finance their operations. The holders of the bonds form a group (*masse*) organised in accordance with the Companies Law. In this respect, the Companies Law provides that a group representative of the bondholders will be appointed in order to represent the group and that such representative can either be removed by the general meeting of bondholders or by the District Court dealing with interim applications. In the latter case, the group representative of the bondholders can only be removed for just cause[35].

In the case submitted to the Court a former director of a company had been nominated as representative of the bondholders of that company. The former director, in order to end a dispute existing between him and the company, had previously entered into a settlement agreement with the company. Such settlement agreement provided that each party undertook not to make any statement, create any written document or to participate in any communication or speech which would harm the reputation or affect the business or the interests of the other party.

Based on the settlement agreement, the company requested the removal of the representative for just cause, as the latter could not carry out his functions as representative of the bondholders without breaching the above mentioned contractual obligation of the settlement agreement. Indeed the position of representative would certainly lead to a situation in which the representative would bring forward comments or negative statements concerning the company, although the contractual obligations of the settlement agreement would not allow him to express such views.

The Court[36] decided that in case of a removal for just cause, the just cause needs to present a certain level of importance and needs to be based on clear facts. Furthermore the Court was of the view that a removal for just cause does not only relate to the activity or the behaviour of the person to be removed but should also encompass considerations relating to the general interest, in particular the real and certain interest of the company. Therefore a representative should exercise his mandate without any conflict of interest.

In the above case the Court decided that the capacity of the representative would certainly lead to a situation in which he would be obliged to take certain actions or make comments which he would however not be allowed to express under the settlement agreement. The Court decided therefore that the conditions of just cause were fulfilled and hence removed the person from his position of representative of the bondholders.

Court of Appeal, 18 May 2011
Liability of a Broker in case of Non Performance of a Trade

In principle the role of a broker is to provide a point of contact for clients, to inform each party of the terms and conditions of the transaction, to advise, and to reconcile differing interests of the parties. The broker only acts as an intermediary. His main mission is therefore to find a common agreement between the parties without participating in the transaction in itself.

In the above case a broker acted as intermediary between two entities in order to facilitate, from an organizational point of view, the purchase of a printer, its transport and installation. However the realization of the transaction did not proceed as expected for the purchaser. Therefore the purchaser pursued the broker (claiming damages) and argued that the broker acted as a subcontractor as he provided to the purchaser a detailed offer regarding the purchase price and the various operations required for the installation of the printer.

However, in the above case, the Court of Appeal[37] rejected this argument, stating that the activity of the broker cannot be considered as being related to a service

[34] Supreme Court, 2 February 2012, n°2/12.
[35] Article 87(4) of the Law of 10 August 1915 on Companies Law.
[36] Court of Appeal, 29 February 2012, n°37705.
[37] Court of Appeal, 18 May 2011, n°35162.

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agreement (*contrat d'entreprise*). Its activity includes bringing together two or more parties, organizing their negotiations, enabling a transaction between these parties and does not comprise the realization of the transaction in itself. Hence a broker cannot be held liable for the non performance or the improper execution of the transaction enabled by the broker.

Court of Appeal, 5 May 2010
Application in Luxembourg of the Theory of the "Single Contractual Whole" (*ensemble contractuel*)

Further to the theory of the "single contractual whole" (*ensemble contractuel*), in the presence of several agreements constituting a complex and indivisible single contractual whole, the termination of one of the agreements leads to the obsolescence (*caducité*) of the other agreements.

Such a whole may exist when the various agreements relate to the same object (as is the case between an equipment purchase agreement and the maintenance agreement for the equipment). They may also constitute a whole by their cause (as is the case between an equipment purchase agreement and the financing agreement for the purchase). The indivisibility may also result from the nature of the agreements (again, as is the case between an equipment purchase agreement and the maintenance agreement for the equipment) or legal (such as a purchase order linking two agreements between them by establishing from the beginning the financial conditions of both agreements, of an identical duration, concluded at very close dates and proposed by the same principal to the other party).

The Court of Appeal[38] had the opportunity to apply the above principles in a case where individuals had bought a building site from a company, under the condition precedent of obtaining from the authorities a building permit for a house, the plans of which were annexed to the agreement.

The buyers had signed, the day after the purchase, a service agreement with a contractor to build the house. Said agreement foresaw that the clients committed themselves to buy the land and that, otherwise, the agreement would be cancelled which would be considered a wrongful act by the buyers who would then have to pay contractual damages to the contractor.

It then appeared that the land was classified as floodplain, which the seller had not indicated to the buyers. The buyers were therefore refused the building permit. The buyers alleged that the sale agreement as well as the service agreement were therefore cancelled. In the subsequent dispute, the contractor claimed the payment of contractual damages.

The Court, considering the condition precedent had not been fulfilled, first declared the cancellation of the sale agreement of the land. The Court then considered the existing links between the sale agreement of the land and the service agreement, and decided that both agreements constituted an interdependent and legally linked framework.

The Court noted that both agreements had been concluded by the buyers with two different companies. It nevertheless observed that both agreements had been signed by the same natural persons and had been signed one day apart. The sale agreement referred to house plans which were the same as the ones the service agreement referred to, and the sale was concluded under the condition that the authorities issue the permit for a building indicated in the plans. The Court has therefore judged that the cancellation of the sale agreement by non-realization of the condition precedent had led to the cancelation of the service agreement.

Employment

Legislation

Law of 8 December 2011
EU Blue Card for Highly Qualified Workers

The law of 8 December 2011 modifying the amended law of 29 August 2008 on the free movement of persons and on immigration entered into force on 7 February 2012. This law has implemented the Council Directive 2009/50/EC of 25 May 2009 on the conditions of entry and residence of third-country nationals for the purposes of highly qualified employment and has introduced in Luxembourg the so-called EU blue card.

The object of this directive is to improve the EU Member States' ability to attract qualified workers from third countries by facilitating the admission of these persons (by means of harmonization of entry and residence conditions throughout the EU), simplifying admissions procedures and improving the legal status of highly qualified workers already working in the EU. In Luxembourg, the EU blue card replaces the former residence authorization for highly qualified workers.

[38] Court of Appeal, 5 May 2010, n°34372.

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To obtain the EU blue card, the applicant must among other items:

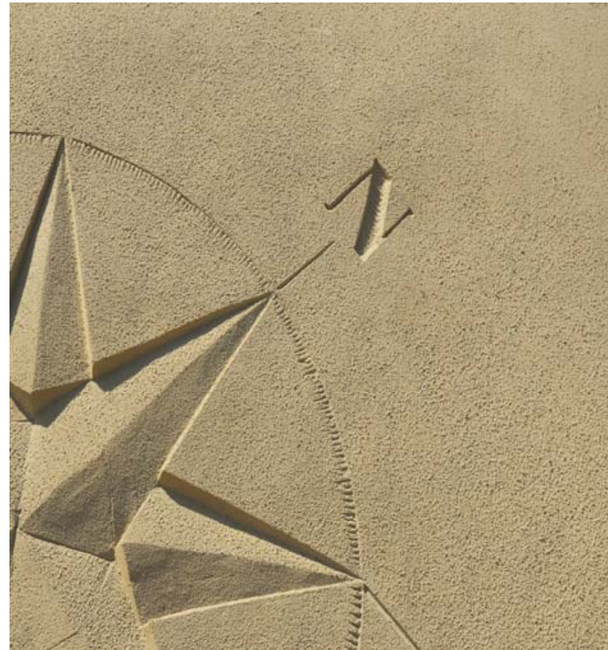
- have concluded an employment contract of at least one year for the purpose of highly qualified employment;
- show high level qualifications (e.g. a higher education diploma or a professional experience of at least 5 years in the job or the sector concerned); and
- earn a remuneration equivalent to at least 1.5 time the Luxembourg average gross annual salary, i.e., for the year 2012, a minimum gross annual salary of EUR 66,564.39

Once issued by the relevant authority, namely the minister being responsible for immigration, the EU blue card is valid for 2 years (or for the duration of the employment contract increased by 3 months) and is renewable upon request. It is valid for any employer but limited to the activity for which the EU blue card has been issued. After the first two years the EU blue card gives access to any highly qualified employment in the private sector. The members of the family of the EU blue card holder are entitled to immediately stay with the latter on the territory of the Grand Duchy of Luxembourg.

In case of unemployment during the validity period of the EU blue card, the EU blue card is not withdrawn and the highly qualified worker is entitled to stay on the territory of the Grand Duchy of Luxembourg, provided that the unemployment period lasts less than 3 months and occurs only once. After 18 months of legal residence in the EU Member State having issued the EU blue card, the EU blue card holder may move with the members of his family to another Member State to take up a highly qualified employment there (subject to the conditions that this second Member State may impose in accordance with the above-mentioned directive).

The second Member State may decide not to allow the third-country national to work on its territory until a positive decision on his application has been taken, which is the case in the Grand Duchy of Luxembourg. The application for a EU blue card may already be filed with the authorities of the second Member State while the EU blue card holder is still residing and working in the first Member State.

If the authorities of the Second Member State decide not to grant a EU blue card to the highly qualified worker already benefiting of a EU blue card issued by Luxembourg authorities, this worker, together with the members of his family, may return to Luxembourg without any formalities, even if his EU blue card has expired or has been withdrawn in the meantime.



Case Law

Court of Appeal, 5 May 2011
Communication to the Dismissed Employee of the Reasons for his Dismissal

The Labour Code[40] provides that where an employee has been dismissed with notice period, he may, within a delay of one month following the notification of the dismissal, request from his employer, by registered mail, the reasons for his dismissal. The employer has one month following the notification of the employee's request to provide the employee, by registered mail, with the reasons that justify the termination of the employment contract. Failure to respond in writing to the employee's request within the above-mentioned timeframe renders the dismissal automatically unfair.

In practice, it is not unusual that the employee's request to be provided with the reasons for his dismissal is sent by e-mail or is delivered by hand to the employer. In a recent decision, the Court of Appeal[41] had to decide whether the fact that an employee had not requested the reasons for

[39] This amount is determined by the Ministerial decree of 15 February 2012 (published in *Memorial A – Nr 33* of 27 February 2012). The Luxembourg Government may lower this salary threshold to 1.2 time the Luxembourg average gross annual salary (i.e. EUR 53,251.20) for certain professions in which there is a particular need for third-country workers.

[40] Article L.124-5 of the Labour Code.
[41] Court of Appeal, 5 May, n°35985.

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his dismissal by registered mail (the employee had requested the reasons for his dismissal by a letter delivered by hand to the employer, the employer having countersigned the letter for reception) authorises the employer not to respond in writing by registered mail to the request (the employer had only responded orally to the employee's request).

After having noted that non compliance with the formal requirement of sending out the request by registered mail is not specifically sanctioned by the Labour Code, the Court of Appeal has made it clear in its decision that this formality (registered mail) was hence only foreseen *ad probationem* and does not constitute a condition of validity of the demand. As the employee had brought evidence that his employer actually had received his request, the employer therefore had to respond in writing to said request within the timeframe and the conditions foreseen by the Labour Code.

Data Protection

Draft EU Regulation

On 25 January 2012, the European Commission has published a proposal for a new regulation to replace the Data Protection Directive 95/46/EC which has been implemented in Luxembourg by the Data Protection Law.

Although the need for a global reform was highly anticipated in business circles, especially because of the current absence of harmonization of the Data Protection rules within the EU Member States and because of the technical changes that have taken place since 1995, the European Commission proposal includes many provisions which have already been criticized both by some of the EU Data Protection regulators and by business leaders.

The decision of the European Commission to propose a Regulation instead of a Directive is in general welcomed by the field players as it will allow a consistent approach to data protection issues throughout the EU. Given the different approaches taken by the EU legislators when implementing the Data Protection Directive 95/46/EC, the entry into force of the Regulation does however give rise to raise practical issues.

The key elements of the European Commission proposal are:

- The extension of the geographical scope of the EU Data protection law. The Regulation would apply to the processing of personal data carried out outside of the EU by data controllers or processors established outside of the EU if this processing is related to (i) the offering of goods or services to EU residents or to (ii) the monitoring of the EU residents' behavior (e.g. CCTV).

- The reinforcement of the data subject's rights (introduction of specific provisions concerning the processing of data related to children, introduction of a right to be forgotten, introduction of the concept of data portability).

- The abolition of the current administrative formalities, such as notifications or requests for authorization to be filed with the Data Protection regulators (i.e. in Luxembourg with the Data Protection Agency). These formalities are however replaced by new requirements such as: (i) the maintenance of detailed documentation on the data processing, (ii) the appointment of a data protection officer, (iii) the requirement to consult the EU Data Protection regulators in relation to processing which is likely to present specific risks, (iv) the implementation of transparent and easily accessible data protection policies and internal procedures, etc. Exceptions to certain of these administrative formalities are foreseen for micro, small and medium size companies (with less than 250 employees).

- The introduction of an obligation for the data controllers and data processors to notify their Data Protection regulator of any data breach, usually within 24 hours of the breach.

For further information, please click **here**.

Tax

Legislation

Law of 18 February 2012
Amendment to the SPF Tax Regime

The *Société de gestion de Patrimoine Familial* or SPF was implemented by the law dated 11 May 2007 in order to answer the needs of individuals wanting to manage their private wealth and assets through a dedicated vehicle. Up to now, the SPF regime provided for a tax exemption on corporate income tax, municipal business tax, net wealth tax and VAT. However, this favorable tax regime was denied when at least 5% of the annual dividend income were derived from non-resident and unlisted companies.

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Every year, the SPF had to provide a certificate confirming the 5% limit was not reached. The law of 18 February 2012 has amended the SPF tax regime and abolished this 5% restriction. This confirms the attractiveness of SPF as a vehicle for wealth management purposes.

New tax treaty between Luxembourg and Germany

Our client briefing on this topic can be downloaded from the Luxembourg Clifford Chance website.

Circulars LIR of 26 March 2012
Clarifications of the Double Tax Treaty between Germany and Luxembourg

On 26 March 2012, the Luxembourg tax authorities issued four circulars[42] clarifying the status of German cross border workers (i.e. German residents employed by a Luxembourg employer). Those circulars detail the practical consequences of the mutual agreements entered into on 26 May 2011 and 7 September 2011 between the Luxembourg and German authorities with respect to the interpretation of the double tax treaty concluded between these two countries. For more detailed information, please refer to the **September 2011 edition of our Luxembourg Legal Update.**

Circular n°56 gives the most significant clarifications. According to this circular, it is now confirmed that:

- In principle the right to tax salary income is attributed to the State where the activity is exercised.
- If the activity is performed in Luxembourg and in Germany (or in a third country), the right to tax salary income is shared between Luxembourg and Germany on a prorata basis, depending on the number of working days spent in Luxembourg or in Germany (or in a third country) according to the employment contract. Working days means any calendar day, except public holidays, week-ends and holidays.
- However, the salaries associated with the work performed in Luxembourg by a German cross-border worker is exempt in Germany only if (i) he/she physically works less than 20 aggregate working days per year in Germany or in a third country and (ii) the income is taxed in Luxembourg. For computing the 20 days ceiling, productive and non productive days are taken into account (e.g. training sessions, conferences).

The three other circulars are the following :

- The circular n°137/243 related to the taxation of individuals resident in Germany and working in Luxembourg (the circular n°137 overrides the previous circular L.I.R. n°137/2 dated 22 June 2005 and applies as from 8 September 2011). This circular gives additional clarification applicable to professional drivers (amongst others).
- The circular n°51 on the taxation of train drivers and accompanying staff (this circular overrides the circular L.G.-Conv. D.I. n°51 dated 18 April 2005).
- The circular n°5744 describes the tax regime of unemployment benefits, benefits paid after the termination of an employment or a social plan. This agreement aims to prevent double taxations or double exemptions.

The circulars can be downloaded from the **Luxembourg tax authorities' website.**

EU Developments

European Commission Press Release, 26 January 2012
Luxembourg requested to change its VAT rules for independent groups of persons

In a press release[45] published on 26 January 2012, the European Commission has officially asked Luxembourg to amend its VAT rules applicable to independent group of persons ("IGP"). Under Luxembourg VAT law, the services rendered by an IGP to its members are free of VAT provided that the members' taxed activities do not exceed 30% of their annual turnover (or 45% under certain conditions). IGP members are also allowed to deduct the VAT charged to the IGP on its purchases of goods and services.

According to the European Commission, these Luxembourg rules are incompatible with the EU VAT law which provides that the IGP's exempt activities must be linked exclusively to the exempt (or not taxable) activities of group members (meaning that IGP members should not

[42] Circular L.I.R n° 137/2; L.G.-Conv. D.I. n° 51; L.G.-Conv. D.I. n° 57; L.G.-Conv. D.I. n° 56

[43] Circular L.I.R. n° 137/2 dated 26 March 2012.

[44] Circular L.G.-Conv. D.I. n° 57 dated 26 March 2012.

[45] IP/12/63.

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be allowed to deduct VAT charged to the group). Moreover, based on the EU VAT law, group members should not be allowed to deduct VAT charged to the group. Luxembourg may therefore amend the IGP regime in the future in order to be in line with the EU law.

European Commission Press Release, 15 May 2012
EU Savings tax rules and Savings Agreements with third countries : frequently asked questions

The FAQ can be downloaded from the **EU Press release website**.

Case Law

Administrative Court of Appeal, 16 February 2012
Sale of Equity Warrants

On 16 February 2012[46], the court issued a decision that widens the scope of the domestic participation exemption to include gains derived from the disposal of equity warrants (*bon de souscription d'actions*). This decision overturned the ones of the Administrative Court issued on 30 June and 14 July 2011.

In the case at hand, the Luxembourg tax authorities stated that the income derived from the sale of equity warrants could not benefit from the Luxembourg participation exemption for capital gains because the definition of equity warrants differs from the definition of a participation including the Grand-Ducal Decree of 21 December 2001 implementing article 166 of the Luxembourg income tax law ("ITL"). The court disagreed concluding that even if equity warrants can be traded independently and only give right to subscribe to future shares, they cannot be considered as disconnected from the shares and have to be viewed as an attribute of the those existing shares.

Therefore, (i) the issue of equity warrants should be considered as an income derived from a participation which benefits from article 166 ITL, and (ii) their disposal is to be treated as the sale of part of the substance of the participation benefiting from the participation exemption.

Administrative Court, 15 February 2012
Net wealth Tax Exemption for Participations in Belgian SICAV

This decision clarifies the scope of the domestic participation exemption under the net wealth tax law and could also impact the reading of the Parent-Subsidiary Directive.

[46] Administrative Court of Appeal, 16 February 2012, n°28977C.

The tax authorities stated that a Luxembourg company having a participation in a Belgian SICAV does not benefit from the net wealth tax exemption arguing that a Belgian SICAV does not fall within the scope of the said Directive (i.e. Belgian SICAV not being liable to corporate income tax in Belgium). On 15 February 2012[47], the court rejected this position claiming that a Belgian SICAV qualifies as a company subject to corporate income tax according to the Belgian tax code (whatever is the effective tax rate applicable). Based on this argument, the court ruled that a participation in a Belgian SICAV may benefit from the participation exemption in Luxembourg for net wealth tax purposes. This decision may also impact the reading of participation exemption under corporate income tax law.

Administrative Court, 20 March 2012
Exchange of Information

The tax treaty between Luxembourg and Sweden was amended on 7 September 2010 in order to include an exchange of information clause in line with the article 26 of the OECD Model Convention. In this respect, when the requested information is foreseeably relevant for the application of the tax treaty or the international tax law of the requesting state, the other contracting state cannot decline to supply information solely because it is held by a bank, other financial institution, nominee or person acting in an agency or fiduciary capacity. The provision entered into force on 11 September 2011.

On 20 March 2012[48], the court rendered a decision relating to a Swedish information request. In the case at hand, a Luxembourg bank was requested to provide certain information in relation to a Malaysian company holding a bank account with a Luxembourg bank (e.g. closing and ending balance, the amount of interest, the name of the person authorized to carry out transactions on the accounts). The Malaysian company introduced a request in voidance before the court arguing that the request of the Swedish tax authorities was a fishing expedition (the requested information was not pertinent). The court decided that requested information was pertinent for the Swedish tax authorities as it was directly linked to a tax audit in Sweden.

[47] Administrative Court, 15 February 2012, n°27587.
[48] Administrative Court, 20 March 2012, n°29592A.

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Supreme Court, 6 January 2011
Moral Damage in Case of Disclosure of Confidential Data by a Luxembourg Bank to the Tax Authorities

Please see Banking, Finance and Capital Markets section.

Administrative Court of Appeal, 20 March 2012
Taxation of Rental Income

On 20 March 2012[49], the court confirmed that rental income received by a German commercial company (with no permanent establishment in Luxembourg) must not be treated as commercial profit according to articles 14 and 15 ITL but as rental income within the meaning of article 98 ITL. The court confirmed the application of the principle of isolated assessment of income (*isolierte Betrachtungsweise*) to non-resident taxpayers. Consequently, a commercial company residing in Germany can only apply an amortisation rate of 2% on the real estate property (amortization rate corresponding to the one for individuals holding real estate property). The decision also detailed the amortization rules and basis for real estate.

Administrative Court of Appeal, 15 March 2012
Commercial Activity

In its 15 March 2012[50] decision, the court dealt with the requalification of an activity carried out by a real estate civil company (*société civile immobilère*) as a commercial activity subject to corporate income tax and municipal business tax. The court ruled that the conditions of a commercial activity were fulfilled in the present case, notably due to the numerous sales of real estates in a short period.

European Court of Justice, 10 May 2012
Tax Discrimination against Foreign Investment Funds

On 16 February 2012, the European Court of Justice ("ECJ") held a hearing on the joined cases C-338/11 to C-347/11 further to the request of a preliminary ruling by the French Administrative Court of Montreuil on 4 July 2011. This preliminary ruling dealt with the compatibility with the EU principle of the free movement of capital with a withholding tax levied in France on dividends paid to foreign investment funds. The ECJ's decision issued on 10 May 2012 should be carefully followed as Luxembourg investment funds may have soon an opportunity to obtain a refund of the withholding tax suffered in France and should consider to filing protective tax reclaims in front of the French tax authorities.

European Court of Justice, 1 March 2012
Deduction Right of Input VAT before VAT Registration

The Polish tax authorities denied the right for a Polish partnership to deduct input VAT related to operations realised before the formal registration of the partnership to VAT. The ECJ[51] brought clarifications regarding the right for a partnership to deduct input VAT for operations realized before its formal VAT registration. The ECJ ruled that the partnership has to be entitled to deduct VAT from investment expenditures incurred by its partners prior to its VAT registration provided that the investment expenditures are linked and necessary to the future economic activity of the partnership. The ECJ also ruled that the right to deduct the input VAT cannot be limited by formal requirements (e.g. invoicing) if the relevant conditions for deduction are fulfilled, i.e. that the transaction were performed for the purposes of taxable activities of the partnership.

[49] Administrative Court of Appeal, 20 March 2012, n°28771C.
[50] Administrative Court of Appeal, 15 March 2012, n°29541C.
[51] European Court of Justice, 1 March 2012, C-280/10.

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