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C H A N C E

Luxembourg Legal Update

October 2012

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This publication does not necessarily deal with every important topic nor cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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Banking, Finance & Capital Markets

EU Developments

Four European Commission Delegated Regulations Establishing Regulatory Technical Standards for Credit Rating Agencies

Four European Commission delegated regulations establishing regulatory technical standards for credit rating agencies have been recently published in the *Official Journal*. In particular, these technical standards set out:

- the information to be provided by a credit rating agency in its application for registration to the European Securities and Markets Authority (ESMA);
- the presentation of the information to be disclosed by credit rating agencies in a central repository (CEREP) so investors can compare the performance of different credit rating agencies in different rating segments;
- how ESMA will assess rating methods; and
- the information credit rating agencies have to submit to ESMA and the time intervals in which credit rating agencies have to submit such information to ESMA in order to supervise compliance.

The four standards, which complement the current European regulatory framework for credit rating agencies, were developed by ESMA and endorsed by the European Commission on 21 March 2012.

European Commission Delegated Regulation (EU) N° 486/2012
Amendment of Prospectus Regulation

The European Commission's delegated regulation (EU) N° 486/2012 amending its Regulation (EC) N° 809/2004 with regard to the format and the content of the prospectus, the base prospectus, the summary and the final terms and with respect to the disclosure requirements entered into force on 1 July 2012.

European Commission Delegated Regulation on Rules of Procedure on Fines imposed by ESMA
Credit Rating Agencies

The European Commission adopted on 16 July 2012 a delegated regulation supplementing the Credit Rating Agencies Regulation[1] with respect to rules of procedure on fines imposed to credit rating agencies by the European Securities and Markets Authority (ESMA), including rules on the right of defence and temporal provisions. The delegated regulation will enter into force on the third day following its publication in the *Official Journal*.

Regulation (EU) N° 648/2012 on Over-The-Counter (OTC) Derivatives and Market Infrastructures (EMIR)

The regulation has been published in the *Official Journal* and entered into force on 16 August 2012. The regulation is directly applicable in all Member States.

EMIR introduces a reporting obligation for OTC derivatives, a clearing obligation for eligible OTC derivatives, measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives, common rules for central counterparties (CCPs) and for trade repositories, and rules on the establishment of interoperability between CCPs.

Amongst other things, under EMIR:

- trades in OTC derivatives in the EU will have to be reported to trade repositories;
- the European Securities and Markets Authority (ESMA) will be responsible for the surveillance of trade repositories and for granting/withdrawing their registration;
- trade repositories will have to publish aggregate positions by class of derivatives to give all market participants a clearer view of the OTC derivatives market;
- OTC derivatives that are standardised (i.e. they have met predefined eligibility criteria), such as a high level of liquidity, would have to be cleared through CCPs; and
- if a contract is not eligible and therefore not cleared by a CCP, different risk management techniques must be applied (such as requirements to hold more capital).

EMIR also requires market participants to measure, monitor and mitigate operational risk, e.g. by using electronic means for confirming the terms of OTC derivative contracts.

EMIR applies to all types of OTC derivatives. It applies both to financial firms who use OTC derivatives and to

[1] Regulation (EC) N° 1060/2009 on credit rating agencies.

non-financial firms that have large positions in OTC derivatives. However, non-financial firms that use OTC derivatives to mitigate risk arising from their core business activities or treasury financing activity are exempt from the CCP clearing requirements. EMIR also applies to CCPs and trade repositories.

Legislation

Law of 3 July 2012
Amendments to Prospectus Law and Transparency Law – Implementation of Directive 2010/73/EU

The Luxembourg Parliament has adopted bill N° 6319 amending the Prospectus Law[2] and the Transparency Law[3] by implementing into national law Directive 2010/73/EU[4] (which has amended the Prospectus Directive[5] and the Transparency Directive[6]). The bill is described in more detail in the January 2012 edition of our Luxembourg Legal Update.

Bill N° 6454
Amendments to Insurance Contract and Insurance Accounting Laws

The bill aims to implement the Solvency II Directive[7] provisions that concern the contents of insurance contracts. A further aim is to bring national legislation in line with the ECJ judgment "*Test-Achats*", which declared invalid a provision of the Equal Treatment Directive[8] that permits to make proportionate differences in individuals' premiums and benefits where the use of gender is a determining factor in the assessment of risk based on relevant and accurate actuarial and statistical data. Moreover, the bill aims to increase the readability and coherence of the provisions on the legal protection insurance currently scattered to different legal texts.

Additionally, the bill transfers the provisions concerning the obligation of reinsurance undertakings to constitute equalisation provisions (*provisions pour fluctuation de sinistralité*), which are tax deductible, from the Insurance Sector Law into the law on the annual accounts and consolidated accounts of insurance and reinsurance companies. As the new Solvency II Directive regime and the proposed implementing law provide that the risks currently backed by equalisation provisions need to be covered by own funds, these reserves will, in the future, cease to have a regulatory basis. The legislator decided to keep the concepts of such reserves for accounting and tax purposes.

Finally, the bill introduces new provisions for the insurance sector on the determination of distributable reserves in case of a re-evaluation of assets based on fair value. These new provisions apply the principles introduced in this respect for commercial companies. In essence, a re-evaluation of assets based on fair value may lead to higher values that are not realised. In case of a change in valuation from book value to fair value, the proposed new provisions permit the deduction of non-realised elements from the accounting reserves so that the distributable reserves will be limited to the realised or quasi-realised reserves.

Bill N° 6456
Implementation of Solvency II Directive and Replacement of Insurance Sector Law

The Luxembourg Government has lodged a new bill with the Luxembourg Parliament in order to implement the Solvency II Directive[9]. The implementation of the directive will lead to a paradigm shift in Luxembourg insurance sector legislation. The bill will repeal the existing law and replace it with a new Insurance Sector Law.

The insurance sector undertakings will in the future have to:

- adopt a much more detailed and exhaustive analysis of the risks they are exposed to;
- develop economic and mathematic models enabling them to correctly assess these risks and the financial resources enabling them to confront them;

[2] Law of 10 July 2005 on securities' prospectuses.

[3] Law of 11 January 2008 on transparency obligations concerning information on issuers whose securities are admitted to trading on a regulated market.

[4] Directive 2010/73/EU amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

[5] Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

[6] Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

[7] Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance, as amended by Directive 2011/89/EU.

[8] Council Directive 2004/113/EC of 13 December 2004 implementing the principle of equal treatment between men and women in the access to and supply of goods and services.

[9] Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance, as amended by Directive 2011/89/EU. See also Directive 2012/23/EU, which extends the deadline for the transposition of Directive 2009/138/EC until 30 June 2013.

- regularly adapt their minimum and solvency capital to the risks actually encountered;
- develop precise internal and external control rules;
- subject themselves to more constraining internal governance rules; and
- report to supervisory authorities all of their activities in a more extensive and frequent manner than in the past.

Insurance sector undertakings will therefore need to endow themselves with supplementary financial and human resources, creating costs substantially higher than the current Solvency I regime costs.

The bill also uses the opportunity to replace the Insurance Sector Law currently in force by a new law representing a unique and coherent codification of legal texts governing insurance and reinsurance activities. While the implementation of the Solvency II Directive provisions will lead to a substantial change in the regulatory regime of the insurance sector, many existing provisions remain unaffected.

In the future, numerous implementing measures are expected to supplement the new Solvency II Directive framework, both at European Union level (European Commission regulations and mandatory technical standards issued by the European Insurance and Occupational Pensions Authority (EIOPA)) and at national level (Grand-Ducal regulations and regulations issued by the Luxembourg insurance sector regulator Commassu). The bill also foresees integration into the new European supervisory architecture by providing for a wider coordination and, at least in part, sharing of competences by the Commassu with EIOPA and, indirectly, the European Systemic Risk Board (ESRB).

Insurance and reinsurance undertakings are supposed to be subject to the new requirements by 2014 at the latest. The bill emphasises however the need to adopt the bill before the end of the first quarter of 2013 in order to provide a legal basis for the adoption of Grand-Ducal and Commassu regulations and to permit the validation within good time of the internal models of the different insurance and reinsurance undertakings.

Regulatory Developments

CSSF Circular 12/537 – BCL Circular 2012/229
Financing by Credit Institutions in US Dollars

This common circular issued jointly by the CSSF and the BCL on 29 June 2012 is addressed to all Luxembourg credit institutions and applies both on an individual and on a consolidated level. The circular aims to specify the application of Article 5(1a) of the Financial Sector Law requiring credit institutions to adopt effective processes to detect, manage, control and declare risks to which they are or may be exposed in relation to US dollar (USD) denominated funding. The circular in particular implements in Luxembourg the recommendation of the European Systemic Risk Board (ESRB/2011/2) dated 22 December 2011.

The circular requires credit institutions to apply the recommendation in a proportionate manner, and to adapt their internal governance by putting into place strategies and policies defining their USD liquidity and financing risk tolerance. Such tolerance levels have to remain within the capacity of the credit institutions to support and manage the underlying risk. Credit institutions will also have to develop emergency financing plans that provide measures to counter shocks affecting financing in USD. These plans must be based on feasibility studies for such measures and examine the emergency financing sources available in case of a reduction of several counterparty categories. The circular has entered into force with immediate effect.

CSSF Circular 12/538 – BCL Circular 2012/230
Loans in Foreign Currencies

This common circular issued on 29 June 2012 is addressed to all Luxembourg credit institutions, investment firms and professionals carrying out lending transactions in order to grant loans to non-financial private borrowers in another currency than the currency of the country where the borrower is domiciled. The circular clarifies the application of Articles 5(1a) and 17 of the Financial Sector Law requiring these institutions to adopt effective processes to detect, manage, control and declare risks to which they are or may be exposed in relation to these loans. The circular applies to these institutions both on an individual and on a consolidated level. In particular, the circular implements the recommendation of the European Systemic Risk Board (ESRB/2011/1) dated 21 September 2011.

The circular requires these institutions to apply the recommendation in a proportionate manner. Institutions are also required to apply reciprocity in the sense that, when they grant loans in currencies by way of free provision of services or through branches, they have to treat these loans at least as strictly as they have to be treated in the host Member State where the borrower is domiciled.

Lending institutions are required to draw the attention of borrowers to the risks inherent to the loans in currencies other than those of their place of domicile to permit them to take a prudent and reasoned decision. Additionally, they are encouraged to propose to borrowers loans in the local currency of the country of domicile and to propose financial instruments to hedge the currency risk. Institutions may only grant loans in other currencies to borrowers establishing their solvency and are also encouraged to apply stricter loan conditions for the loans at stake.

Lending institutions will also have to internally detect, manage, control and declare the financing and liquidity risk they take in relation to these loans as well as their global liquidity position. They have to adapt their internal governance by putting into place strategies and policies defining the USD liquidity and financing risk tolerance of the institution. This tolerance level has to remain within the capacity of the credit institution to support and manage the underlying risk. The circular has entered into force with immediate effect.

CSSF Circular 12/539
Technical Specifications on the Filing of Documents with the CSSF under, and General Presentation of, the Prospectus Law

Further to the Prospectus Law[10], as amended by the law of 3 July 2012, the CSSF has published a circular which describes the technical procedures regarding the communication of documents to the CSSF for the approval, notification, filing or communication required when securities are intended to be offered to the public or admitted to trading on a regulated market in Luxembourg.

It also provides an overview of the main changes to the Prospectus Law, further to the implementation of Directive 2010/73/EC amending the Prospectus Directive and the Transparency Directive.

CSSF Circular 12/542
Amendments to CSSF Circular 08/337 on the Entry into Force of the Transparency Law

This circular issued on 17 July 2012 slightly amends CSSF Circular 08/337 to bring it in line with the amendments made by the law of 3 July 2012 to the Transparency Law[11].

CSSF Circular 12/543
Entering into Force of SEPA Regulation

This circular dated 17 July 2012 draws the attention of payment services providers to the entry into force on 31 March 2012 of Regulation (EU) N° 260/2012 establishing technical and business requirements for credit transfers and direct debits in euros and amending Regulation (EU) N° 924/2009.

The new regulation aims to create a single market for electronic payments in euros without any difference between national and cross-border payments and independent of location within the EU. It has to be seen as a means to further implement the Single European Payment Area (SEPA) project of the financial industry by means of a mandatory EU regulation.

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[10] Law of 10 July 2005 on securities prospectuses.

[11] Law of 11 January 2008 on transparency obligations concerning information on issuers whose securities are admitted to trading on a regulated market.

CSSF Circular 12/544
Optimisation of the Supervision Exercised on "support PFS" by a Risk-Based Approach

This circular dated 18 July 2012 is addressed to Luxembourg "support PFS", i.e. professionals of the financial sector, which do not themselves carry out a financial sector activity but which provide certain operational and technical support services to clients that are at least in part professionals carrying out financial sector activities. The circular applies to support PFS classified by the CSSF as type "I" (currently all).

It introduces the new concept of a risk-based approach supervision of such support PFS. This concept is based on the application of the principle of proportionality from the perspective of the importance of activities outsourced by financial sector clients to support PFS and from the perspective of the importance of the financial sector client portfolio of support PFS compared with the non-financial sector client portfolio of support PFS. The circular therefore requires support PFS to establish, on an annual basis, a report with an analysis of the risks to which the support PFS expose the financial sector. Support PFS will also have to annually establish a descriptive report of the services provided to the financial sector and of the organisation and infrastructure of the support PFS. This descriptive report has the purpose of facilitating the understanding and the analysis of the risks reported in the annual risk report. The circular specifies in detail the content requirements for these reports. They will have to be submitted to the CSSF as of 2013.

The CSSF also announces the issuance of a future circular that will define the practical rules regarding the mission of external auditors of such support PFS. This circular will also define the content required for the long-form report to be produced by the external auditors.

CSSF Questions and Answers relating to PFS
Update of Parts relating to Lending Licence Requirement

The CSSF has published on its website an updated version of the questions and answers n°s 51 to 54 in its document "Questions/Answers on the statuses of PFS [Part II]".

The main change concerns the answer given to question n° 51 on the performance of the activity of professionals carrying on lending transactions for own account, including in particular the interpretation given by the CSSF to the notion of the granting of loans to the "public" used in Article 28-4(1) of the Financial Sector Law. The CSSF had withdrawn its former positions on a licence requirement in February 2012 in the context of the discussions around shadow banking (see the **May 2012 edition of our Luxembourg Legal Update**). The new positions provide certainty to market actors to a certain degree, but also raise some new questions.

The CSSF specifies, amongst other things, that one-off lending transactions are out of the scope of the Financial Sector Law. The same applies to an undertaking for collective investment, a specialised investment fund, a pension fund or SICAR or to a person exercising an activity, the access to and exercise of which are regulated by specific regulation and therefore out of the scope of the Financial Sector Law, if such specifically regulated entity or person grants a loan by using a special purpose vehicle entirely owned by it.

The CSSF further takes the position that the notion of "public" designates generally a multitude of persons that are not identifiable. In contrast, where the loans are granted exclusively intra-group or to a restricted group of persons known in advance, they will not be considered as being granted "to the public" and such activity will then not trigger a Financial Sector Law licence requirement.

Finally, the CSSF has set out that, in the recent past, the CSSF has been confronted with transactions of acquisitions of undrawn credit lines and assignments of loans contracted simultaneously with or immediately after the granting of loans by a credit institution. Without questioning their legal validity, the CSSF considers that these transactions can constitute loan transactions, and are hence capable of falling within the scope of the Financial Sector Law. The CSSF therefore invites those wanting to exercise the activities of granting or acquiring loans to provide the CSSF with a detailed description of the envisaged activities, enabling the CSSF to determine whether or not the proposed activities are subject to a licensing requirement and/or to a reporting obligation.

CSSF Website Publication
Form for PFS Licence Applications

This form, published by the CSSF at the end of June 2012, is expected to be duly filled in and signed by the initiators of the project for obtaining a licence as a professional of the financial sector. The form further standardises the application process, but does not introduce major innovations in regard to the information and documents that are required to be provided to the CSSF in a licence application.

CSSF Website Publication
Questions and Answers Paper on Securitisation dated 19 July 2012

This questions and answers paper (Q&A document) regarding securitisation replaces the positions of the CSSF with respect to numerous aspects of application of the Securitisation Law in the CSSF's 2007 annual report.

The CSSF had announced already in 2010 that these positions were subject to review by the CSSF and the new Q&A document therefore creates again certainty as to what the CSSF's positions are.

As a general remark it should be noted that, while only securitisation undertakings issuing securities on a continuous basis to the public are regulated by the CSSF, certain positions taken by the CSSF are relevant for both regulated and unregulated securitisation undertakings, in particular of course those relating to the scope of the Securitisation Law in regard to the activities of a securitisation undertaking.

Shortly Clifford Chance will publish a Client Briefing providing more detailed information on the CSSF's new Q&A document on securitisation.

CSSF Press Release 12/21
Rating Agencies

The CSSF revisits the fact that all entities supervised by the CSSF referred to in Article 4(1) of the Credit Rating Agencies Regulation[12] have to ensure that only credit ratings issued or backed by credit rating agencies registered or certified in the EU are used for regulatory purposes (e.g. calculation of solvency ratio). An updated list of credit rating agencies registered or certified in the EU is available on the website of the European Securities and Markets Authority (ESMA) at: www.esma.europa.eu/page/List-registered-and-certified-CRAs.

Since 30 April 2012, the end of the transitional period, the list of jurisdictions, whose regulatory framework applicable to credit rating activities is at least as stringent as the EU regulatory framework (Article 4(3)(b) of the Credit Rating Agencies Regulation) has been of the utmost importance. This list of jurisdictions already includes Argentina, Australia, Brazil, Canada, Hong Kong, Japan, Mexico, Singapore and the United States. Supervised entities are requested by the CSSF to regularly check on ESMA's website (www.esma.europa.eu) in order to keep up to date with developments in this matter.

[12] Regulation (EC) N° 1060/2009 on credit rating agencies.

Finally, the CSSF notes that Article 4(1) of the Credit Rating Agencies Regulation also provides that, if prospectuses are published under the Prospectus Directive regime and contain a reference to a credit rating or credit ratings, the issuer, offeror, or person asking for admission to trading on a regulated market has to ensure that the prospectus also includes clear and prominent information stating whether or not such credit ratings are issued by a credit rating agency established in the EU and registered under this Regulation. The CSSF refers to the document Frequently Asked Questions on prospectuses (question 76) available on ESMA's website at: www.esma.europa.eu/system/files/11_85.pdf.

CSSF Press Release 12/34
Questions and Answers on the Implementation of the Regulation on Short Selling and Certain Aspects of Credit Default Swaps (CDS)

The CSSF has issued a press release to draw the attention of market participants to the publication by the European Securities and Markets Authority (ESMA) of a set of questions and answers (Q&A document) on the implementation of the Regulation on short selling and certain aspects of credit default swaps[13] (CDS).

The purpose of the Q&A document is to promote common supervisory approaches and practices amongst the EU's national securities markets regulators on the requirements of the short selling regulation once it comes into force on 1 November 2012. The Q&A document is also intended to provide clarity on the requirements of the new regime to market participants and investors.

The Q&A document provides responses to questions asked by market participants, national securities markets regulators, and the general public in relation to the practical application of the forthcoming short selling regime. In particular, it addresses the following:

- territorial scope;
- transparency requirements;
- calculation of net short positions;
- uncovered short sales; and
- the enforcement regime.

[13] Regulation (EU) N° 236/2012 of the European Parliament and the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.

The Q&A document (ESMA/2012/572) will be updated periodically and can be consulted on ESMA's website **www.esma.europa.eu**.

Case Law

Court of Appeal, 15 December 2010
Endorsement of Cheque by a Person without Power – Liability of Bank

A bank had cashed two cheques presented to it by an employee of a company. While the beneficiary of one cheque was the company, the other cheque's beneficiary was the managing director of the company. The second cheque was endorsed by the employee to the account of the company but it had not been signed by the initial beneficiary. Further to the insolvency of the company, the managing director claimed damages from the bank.

The bank argued that the employee endorsing the cheque had received a tacit proxy by the managing director to cash the cheque on behalf of the company. The Court of Appeal[14] decided however that the bank had committed gross negligence by not checking whether the chain of endorsements was not interrupted. As guarantor of the regularity of a cheque, before cashing it, a bank must check the identity of the holder of a cheque and make sure that the holder is also the beneficiary of the cheque, or check whether there is a valid endorsement. The judges held that a bank may not rely on an apparent agency contract and assume a tacit proxy given by the beneficiary only because the latter is also managing director of the company having signature power over the company's accounts.

However, in this particular case, the fact that the beneficiary of the cheque was the managing director of the company was decisive. Given that he had signature power over the company's accounts, he would have been able to correct the bank's mistake. By not doing so, the managing director also committed gross negligence, at the origin of his loss. As a consequence, there was no causal relation between the beneficiary's prejudice and the bank's fault. The managing director therefore had to support the loss of the funds.

District Court, 30 June 2011
Bank's Obligation to Provide Information and Advice

According to the District Court[15], a bank is held by an obligation to provide information and advice whatever the type of contractual relationship it has with its client. This obligation is an obligation of means. For this reason, the person acting for damages has not only to provide evidence of the actual prejudice, but also of the fault of the bank.

In this particular case, the bank's client, a German national, also raised the fact that the bank did not provide him with information in a language that he understood given that he only received information documents in French. The court however noted that, during his relationship with the bank, the client had signed documents in German as well as French. It was, for this reason, not possible to conclude that the client did not understand French, that he had informed the bank of this fact or that the bank had been aware of it. In particular, the court decides that if the client had not understood the content of the contract, he should not have signed it. Given that he had signed it without mentioning that he did not understand it, and without questioning the fact that he received a French version to sign, the bank could validly provide him with information documents in French.

[14] Court of Appeal, 15 December 2010, n°34990.

[15] District Court, 30 June 2011, n°126438.

Court of Appeal, 19 October 2011
Banks' Obligation of Professional Confidentiality and Economic Beneficiaries

In a case where economic beneficiaries tried to receive confirmation from a bank that they had been designated as such in relation to certain accounts of the bank's client, the District Court decided that, even though they were third parties in relation to the bank-client relationship, they had the right to obtain certain pieces of information and that a bank could therefore not oppose its obligation of professional confidentiality categorically to the client.

This decision was criticised by a bank, who argued that by confirming to a person that he or she has been designated as economic beneficiary of a client, the bank reveals that there is a relationship between the bank and the client. The bank argued that this is contrary to its obligation of professional confidentiality.

This judgment was partly upheld by the Court of Appeal[16]. The economic beneficiary is a third party in relation to the bank-client relationship. For this reason, a bank has to oppose its obligation of professional confidentiality to a economic beneficiary when it comes to requests regarding the balance of the account or operations made over the account. The economic beneficiary may nonetheless obtain certain, limited, piece of information regarding the accounts of a client. In fact normally the economic beneficiary is aware of the existence of the client's account. It is therefore not contrary to a bank's obligation of professional confidentiality to confirm this existence.

However, in this case, the economic beneficiaries were not able to obtain information for procedural reasons. In fact, in the given circumstances, the only purpose of the action in court was to obtain information in order to, in a second step, start an action in court against certain people. The Court of Appeal accepted the principle of such an action to obtain elements of proof. Nevertheless, it decided that for such an action to be successful the existence of these elements of proof and its detention by the person against whom the action is launched have to be at least likely, and the parties requesting communication of these elements have to establish this likelihood. Given that, here, the parties first asked for information regarding the existence of elements of proof and then demanded communication of these elements, the legal conditions are not fulfilled and their request had to be rejected.

[16] Court of Appeal, 19 October 2011, n°35715.

Court of Appeal, 8 February 2012
Enforcement of Pledge under 2005 Law – Prior Notification

The origin of the dispute was a classic tripartite arrangement on financial collateral: a pledge agreement over claims was entered into between the company C and the companies A and B. C held a current account claim against A and gave a pledge over EUR 20,000,000 to B. The arrangement stated that the pledge may be enforced "without it being necessary to respect any delay and give prior formal notice". Once B had enforced the pledge, A claimed that the pledged claims were commercial assets and therefore protected by the Commercial Code. In fact, Articles 116 and 117 of the Commercial Code declare void any arrangement that allows the enforcement of a pledge over commercial goods without prior notification.

In a recent decision, the Court of Appeal[17] decided that the 2005 Law on Financial Collateral Arrangements is applicable to the disputed agreement as its definition of collateral includes claims.

In order to determine whether the prior formal notice could be waived validly, the judges analysed Article 11 (3), which provides: "If the pledged financial instruments are held by an agreed upon third party custodian, such third party custodian shall transfer these financial instruments to the pledgee upon notice of an enforcement event, without having to obtain the consent of the collateral provider or having to inform him in advance. If the pledged monetary claim is owed by a third party, the pledgee may, under the same conditions, demand payment of his claim from the third party up to the amount of his claim, without prejudice to Article 1295 of the Civil Code."

The conclusion relating to the above provision was that even though Article 11 (3) of the Law on Financial Collateral Arrangements is inspired by Article 118 (2) of the Commercial Code, it does not require prior formal notice. In fact, the judges pointed out that it has been a major innovation of the directive implemented by the 2005 Law to forbid the requirement of a formal notice prior to enforcement. As a result, the agreement was valid and the pledge was enforced in accordance with the applicable legal provisions.

[17] Court of Appeal, 8 February 2012, n°36641.

Corporate, M&A

Legislation

Some significant changes have entered into force in the general provisions of Luxembourg corporate law during the period covered by this present newsletter. These changes may affect the activities of Luxembourg companies.

Law of 21 July 2012
Squeeze-out and Sell-out of Securities Issued by Companies whose Securities are Listed or Have Been Listed on a Regulated Market, or Have Been Subject to a Takeover Bid

The Luxembourg Parliament has approved bill N° 5978 relating to squeeze-out and sell-out procedures for companies whose securities are listed or have been listed for trading on a regulated market. The law was adopted on 21 July 2012, and was published in the *Mémorial* on 27 July 2012. It has come into effect on 1 October 2012.

The aim of the law is to implement in Luxembourg (i) a squeeze-out procedure pursuant to which shareholders holding 95% of the share capital and 95% of the voting rights of a Luxembourg company may force minority shareholders to sell their remaining shares in the company, as well as (ii) a sell-out procedure offering the possibility to minority shareholders to require the purchase of their shares by a shareholder holding 95% of the share capital and 95% of the voting rights of the Luxembourg company.

These new procedures are supervised by the CSSF, which has a significant role in the determination of the fair price for the shares to be sold or repurchased.

Scope of the Law

The new squeeze-out and sell-out procedures do not apply to all Luxembourg companies but are reserved for Luxembourg companies whose securities (i.e. shares with voting rights and certificates representing share capital with voting rights attached thereto):

- are listed on a Member State regulated market;
- have been listed on a Member State regulated market, but are not listed anymore, if they have not been delisted for more than five years;
- have been subject to a takeover bid, for which a prospectus has been published in accordance with applicable laws or an exemption of publication has been obtained, provided that such takeover bid was not started more than five years beforehand.

The law however contains a transitory provision which effectively allows recourse to these new procedures to Luxembourg companies that have been delisted after 1 January 1991, provided that these procedures are initiated within a period of three years after the entry into force of the law.

Notification Requirements

The law creates new notification and reporting requirements to the CSSF. Thus, according to its provisions:

- a majority shareholder (i.e. a natural or legal person who holds, alone or with persons acting in concert with him, directly or indirectly, shares representing 95% of the capital carrying voting rights and 95% of the voting rights in the company); or
- a majority shareholder who has gone under the 95% threshold mentioned above; or
- a majority shareholder who proceeds to an additional acquisition of shares in the company;

has the obligation to notify the company and the CSSF, as soon as possible and within four business days after the occurrence of one of the above-mentioned situations, with the following information:

- the exact percentage of its shareholding in the company;
- a description of the transaction which leads to this compulsory notification;
- the date on which this transaction occurred;
- its identity; and
- the form of its shareholding (e.g. direct and indirect participation in the company).

The CSSF may also require the majority shareholder or the company to provide other relevant information.

Within three business days after the receipt of the compulsory notification by the company, the company will publish all the information contained in the notification.

The Squeeze-out Procedure

The squeeze-out procedure allows the shareholders holding 95% of the share capital and 95% of the voting rights of a Luxembourg company to force the minority shareholders to sell to them, against the payment of a cash compensation, their remaining shares in the company. In the event of issuance of different classes of shares, the squeeze-out procedure may only apply to those classes of shares for which a 95% threshold has been reached, in addition to the above-mentioned threshold.

The squeeze-out procedure starts with the majority shareholder informing the CSSF of its intention to benefit from the squeeze-out procedure and an undertaking to complete the purchase of the remaining shares. It will then inform the company and publish its decision so that all shareholders will be aware of the transaction in a manner that does not discriminate between the shareholders. The information transmitted to the company shall contain at least the following elements:

- the identity and contact details of the majority shareholder;
- the name of the independent expert, who will be in charge of determining the cash compensation for the shares to be repurchased;
- the payment modalities of such cash compensation; and
- the other conditions precedent for completing the squeeze-out process.

The squeeze-out must be carried out at a fair price determined by an independent expert through objective valuation methods. The fair price and expert's report shall be transmitted by the majority shareholder to the CSSF within one month after the notification of its intention to start the squeeze-out procedure. The fair price and expert's report are then communicated to the company and published.

The remaining shareholders may object to the price proposed during a period of one month following the publication of the price. In the absence of objection, the price is accepted by the CSSF and the majority shareholder shall publish a notice relating to the terms of payment of the fair price. In case of objection, a new independent expert may be appointed by the CSSF to determine the fair price of the shares to be transferred. The CSSF assesses whether the price is fair, and publishes the price. Incidentally, no sell-out procedure can be launched if a squeeze-out is yet to be completed.

The Sell-out Procedure

The sell-out procedure allows the minority shareholders of a Luxembourg company to force the majority shareholder to purchase their shares at a fair price, provided that such minority shareholders have informed the CSSF of their intention to have their shares repurchased within three months of the publication of a compulsory notification by the majority shareholder, mentioned earlier, and that the last sell-out process concerning the company was launched not less than two years beforehand.

The sell-out procedure is quite similar to the squeeze-out procedure. A minority shareholder has to inform the majority shareholder of its intention to benefit from the sell-out procedure by registered letter, copies of this letter being provided to the CSSF and the company. The information transmitted to the majority shareholder must contain at least the following elements:

- the identity and contact details of the minority shareholder exercising the sell-out procedure, and
- evidence that the minority shareholder holds the shares, as well as the number of shares and share categories held by such minority shareholder.

The sell-out must be carried out at a fair price determined by an independent expert appointed by the majority shareholder using objective valuation methods. Such fair price and the expert's report are transmitted by the majority shareholder to the CSSF within one month after the notification by a minority shareholder of its intention to start the sell-out procedure. Such fair price is then transmitted to the company with the expert's report and published.

The minority shareholders may object to the price proposed during a period of one month following the publication of the price. In the absence of objection, the price is accepted by the CSSF and the majority shareholder shall publish a notice relating to the terms of payment of the fair price.

In case of objection, a new independent expert may be appointed by the CSSF to determine the fair price of the shares to be transferred. The CSSF assesses whether the price is fair, and, if it is, it publishes the price.

Supervision by the CSSF

The CSSF shall be the competent authority in Luxembourg for the supervision of these two procedures. In order to ensure compliance with the provisions of the future law, the CSSF shall be granted several powers and the means to efficiently carry out its mission, e.g.:

- to ask for additional information from shareholders, companies, persons acting in concert, the statutory auditor or *réviseur d'entreprises agréé*;
- to refuse or suspend a squeeze-out or a sell-out procedure launched in violation of law;
- to punish certain violations of the provisions of the law by fines (EUR 125 to EUR 125,000) and/or jail term (eight days to five years).

Transitory Provisions

A majority shareholder affected by this law will have two months from its entry into force to notify the CSSF and the company of its identity and the exact percentage and form of its shareholding in the company. The company will then have to publish this information within three months.

Bill N° 6471
Alternative Investment Fund Managers (AIFM)

The Luxembourg Parliament is currently examining bill N° 6471 relating to Alternative Investment Fund Managers (AIFM), with a view to implement into Luxemburg law the provisions of the EC Directive 2011/61/UE on Alternative Investment Fund Managers (AIFM Directive).

The main measures of this bill relate to the investment fund industry (please see the presentation made in this respect in the **Investment Funds** part). However, the bill also proposes to (i) modernise the existing common limited partnership (*société en commandite simple*) and (ii) create a new type of vehicle: the special limited partnership (*société en commandite spéciale*).

Modernisation of the Common Limited Partnership (*société en commandite simple*)

The bill aims to modify certain provisions of the Companies Law in order to modernise the common limited partnership. The bill places emphasis on greater flexibility, which is inspired by both practice and the existing Anglo-American limited partnership regime.

The main proposed changes to the current regime of the common limited partnership are notably the following:

- It will no longer be compulsory to publish the identity of the limited partner(s) and the amount of their contribution.
- In addition to contributions in cash or in kind, it shall be possible to make contributions in the form of services to the common limited partnership.
- Common limited partnerships will be authorised to issue debt securities.
- Any common limited partnership should maintain a register containing:
  a) a complete and conformed copy of the updated articles of association of the partnership;
  b) a list of the names, professions and addresses of the partners, and the number of partnership interests held by each partner; and
  c) a record of transfers of partnership interests and the date of service or acceptance thereof.
- The management of the common limited partnership may be entrusted to one or several managers, who may or may not be unlimited partners. Managers who are not unlimited partners shall only be liable to the partnership in accordance with general law for the execution of the mandate given to them and for any misconduct in the management of the partnership's affairs.
- The bill includes a non-exhaustive list of business acts and management actions that can be accomplished by limited partners without them losing their limited liability. The limited partners may notably give advice to the partnership or its management, and grant loans or guarantees to the partnership. It will also be possible to foresee in the articles of the partnership that certain business acts/management actions shall require the approval of the limited partners.
- The articles of the partnership may freely determine the repartition of profits and losses between the partners.
- The articles of the partnership may freely determine the repartition of the voting rights between the partners and derogate from the "one share-one vote" principle.

- The articles of the partnership may foresee some specific procedures and restrictions for the transfer of partnership interests. A partners' approval, inspired by the procedure existing for a Luxembourg SARL for the transfer of shares, may apply to the transfers of partnership interests.

Implementation of a Special Limited Partnership (*société en commandite spéciale*)

Along with the reform of the common limited partnership, the introduction of a special limited partnership has also been proposed. Such special limited partnership will not have legal personality.

The special limited partnership will be a partnership entered into by one or more general partners with unlimited and joint and several liability for all the obligations of the partnership, and one or more limited partners contributing only a specific amount, represented by shares or not.

The regime of the special limited partnership is quite similar to the new regime applicable to the common limited partnership. The changes described above shall also apply to the special limited partnership. The number of mandatory rules applicable to the special limited partnership is very limited and the partners are largely free to determine in the articles of the partnership their respective political and economic rights, as well as the rules for the governance of the partnership.

This new vehicle may be used by regulated and non-regulated entities whether or not they qualify as alternative investment funds under the AIFM Directive.

Case Law

Court of Appeal, 9 February 2011
Revocation of Company Directors – Agenda of General Meeting

A director of a company had been revoked by the decision of the shareholders' annual general meeting. The director pretended that this decision was void because the meeting's agenda only mentioned "renewal of directors" but not "revocation". He was of the opinion that the decision to end a director's mandate is an extremely important decision and cannot be compared to a decision of renewal.

The Court of Appeal[18] held that the shareholders' meeting's agenda has to be clear and complete in order to facilitate the shareholders' decision to attend the meeting and the administrators' preparation in view of questions to be asked by shareholders. However, the general meeting may discuss any question implicitly and reasonably contained in the agenda. This was the case as the agenda mentioned the "renewal of directors", which implies the possibility of revocation given, in particular, that the company's directors may be revoked at any time.

Court of Appeal, 16 March 2011
Non-Respect of Legal Rules on Approval and Publication of Annual Accounts – Dissolution of Company

A company had not submitted any annual accounts and, more generally, any documents regarding its accounts, to the RCSL since its constitution in 2000. For this reason, the public prosecutor started an action in court leading to the company's dissolution, which had been approved by the Diekirch District Court[19]. In its appeal, the company argued that the annual accounts had not been submitted due to the fault of the fiduciary in charge of the company's accounting, which admitted its fault. Additionally, when these problems became apparent, the company changed its fiduciary, and the annual accounts for every year since its constitution had been submitted to the RCSL. This had happened after the public prosecutor started to act, but before the judgment of the District Court. For this reason, the company argued that the conditions for a judicial

[18] Court of Appeal, 9 February 2011, n°35608.

[19] Diekirch District Court, 13 January 2010.

dissolution were not met on the day of the actual judgment.

This judgment was however upheld by the Court of Appeal[20]. In fact the rules concerning the approval and publication of a company's annual accounts have been established in order to protect the interests of third parties and the reputation of the financial industry. Non-respect of these rules has to be considered as a grave violation of the Companies Law, which can lead to judicial dissolution of a company. For this reason, in the case of non-respect of these rules, a tribunal may, at the request of the public prosecutor, declare the dissolution of the company and order its liquidation.

After a certain time, regularisation is not possible anymore. Firstly, it is in the interest of the public that the annual accounts are approved punctually and published subsequently in order for the public to be able to inspect them. Secondly, the time limits provided for by the law are an essential feature of the law and the effective information and protection of the public are not possible if these times are not respected.

Court of Appeal, 6 April 2011
Cancellation of a Shares Transfer for Lack of Power of the Signatory – Day to Day Management – Conditions

The managing director of a holding company A had sold in the name of the company its participation in a company B to a company C without the consent of A's board of directors. The holding company A treated this sale as being null and void because the managing director did not have the power to do this.

For several reasons, the Court of Appeal[21] held that the sale was null and void because the managing director did not have the power to sell a participation in a company.

Firstly, the Court of Appeal noted that Article 53 of the Companies Law permits the articles of association to provide that the company is not only engaged by the signature of the board of directors, but also by the signature of one director or several directors especially designated in the articles, who thus become real representative bodies of the company. Creating such a body is subject to three conditions: the body must be foreseen in the articles of incorporation, it must include one or several directors (acting alone or jointly), and it must have the general representation power of the company. With these substantive and formal conditions in place, directors may therefore engage, alone or jointly, the company.

It had been provided for in the articles of A that the company would be engaged by the joint signature of two directors or by the signature of an agent of the board of directors who has been especially designated to sign. Here the contract of sale was only signed by the managing director, who had not been designated as an agent for the purpose of selling the participation. The condition of the signatory powers foreseen in the articles of A had thus not been fulfilled.

The court then examined whether the transfer deed in question fell under the powers of the managing director. The transferee pleaded it by arguing that the shares transfer was part of the day-to-day activity of the holding company in the sense of Article 60 of the Companies Law, to which the managing director may proceed with his sole signature.

The court noted that the legislator had not defined the notion of day-to-day management and had left it up to the case law to specify the content. Two kinds of acts fall into this category: (i) acts of lesser importance that are accomplished regularly and habitually and (ii) acts of minor importance that have to be taken urgently and for that reason do not justify the intervention of the board of directors. Both conditions – minor importance and urgency – are cumulative. At the same time an act of day-to-day management is necessarily an act falling into the general direction chosen by the board of directors. Here the transferee considered that this act was part of the day-to-day management given the particular nature of the company as a holding company with a corporate object consisting in buying and selling participations in other companies.

The court held that the shares transfer deed of the transferor goes beyond the framework of the day-to-day life as on one hand it is not a mere act of exploitation carried out in the framework of decisions taken by the board of directors and, on the other hand, it is not an act of minor importance taken urgently. It also held that the criteria regarding an act of day-to-day management have to be fulfilled as otherwise every act by a managing director falling within the corporate object of a holding company would be an act of day to day management.

As these criteria were not fulfilled here, the sale could not be qualified as an act of day-to-day management because the managing director lacked the necessary powers. The sale was therefore void.

[20] Court of Appeal, 16 March 2011, n°35971.

[21] Court of Appeal, 6 April 2011, n°34274.

Court of Appeal, 4 May 2011
Powers of Shareholders or Members of Company in Liquidation

According to Article 144 of the Companies Law, unless the articles or the instrument of appointment provide otherwise, the liquidators may bring and defend any action on behalf of the company and, according to the Court of Appeal[22], a shareholder or member of the company is not allowed to bring an action in court on behalf of the company in liquidation instead of the liquidator.

However, this rule only applies with regard to the management of the actual liquidation of the company. In particular, it does not apply to the appeal against a judgment which declared the dissolution of the company and ordered its liquidation. In fact, in these circumstances the company itself and any person having been a party in first instance which believes that it has suffered prejudice from this decision may form an appeal.

District Court, 12 May 2011
Judicial Dissolution of a Company – Causes

In a company held by two brothers, who each held 50% of the shares, one brother applied for judicial dissolution of the company because of tensions due to the difficult relationship between the brothers.

According to Article 1871 of the Civil Code, applicable in this case, a court can decide to dissolve a company on the demand of one shareholder if there are legitimate and imperious reasons, which have to be appreciated by the courts. The District Court[23] held that these reasons must be such that the survival of the company is in danger because its organs cannot function properly anymore. It is not sufficient that there are tensions between the shareholders of the company and the dissolution must be refused when the company is not in danger. Given that it is not possible, in the case at hand, to prove that the functioning of the company's organs was blocked and that for this reason the company's future was in danger, the court concluded that it could not decide on the dissolution of the company.

District Court, 12 May 2011
Judicial Dissolution of a Company – Action in Court

The District Court[24] held that an action for judicial dissolution of a company on the grounds of serious disagreements (*mésentente grave*) between shareholders of a company has to be brought against the company itself and against the shareholder who is at the origin of the disagreements.

District Court, 18 May 2011
Misuse of Corporate Assets – Use of Corporate Car by Director of Company in Liquidation

According to Article 171-1 of the Companies Law, the misuse of corporate assets is established when the director of a company has acted in bad faith and contrary to the interests of the company.

In a case where a company director had continued to use the company's car during the company's liquidation thus diminishing its value with each passing day, when he had the obligation to hand over all assets of the company to its liquidator, the District Court[25] decided that this was contrary to the company's interest.

Additionally the court decided that the use of the company's car had been in the personal interest of the director who, by using this car, had benefited to the detriment of the company. It was also apparent that the director acted in bad faith. In fact, as director he was aware that the car was the company's property and that it was an important asset. In this capacity, he also should have contacted the liquidator, which he did not. He did not respond to the liquidator's letters, and, given his attitude, he did not take the court proceedings seriously.

Court of Appeal, 26 October 2011
Power to Launch *Actio Mandati*

The Court of Appeal[26] had to decide whether the directors of a company had the power to launch an action against a former director who had committed certain management faults during his term. The court decided that only the general shareholders' meeting may decide on such an action.

In fact the directors are agents of a company and they do not as such have the power to act against themselves or against former directors in the name of the company. However, according to Article 63 of the Companies Law, the shareholders' general meeting can appoint agents to act against acting or former directors. It is free to appoint certain directors or the board of directors to lead such an action.

[22] Court of Appeal, 4 May 2011, n°35883.

[23] District Court, 12 May 2011, n°s 132317 and 134905.

[24] District Court, 30 June 2011, n°132649.

[25] District Court, 18 May 2011, n°1668/2011.

[26] Court of Appeal, 26 October 2011, n°35784.

Funds & Investment Management

Legislation

Bill N°6471
Implementation of AIFM Directive

Bill N° 6471 implementing the AIFM Directive[27] has been transmitted to the Luxembourg Parliament on 24 August 2012 and is expected to be adopted before the end of 2012. As was the case in 2002 and 2010 with respect to the so-called UCITS III and UCITS IV Directives, Luxembourg could henceforth be one of the first Member States to implement the AIFM Directive.

The scope of the bill exceeds the mere implementation of the AIFM Directive. Indeed, the Luxembourg authorities have taken this as an opportunity to further improve the attractiveness of Luxembourg as an alternative investment fund domicile as a whole by adopting, besides one specific new law on Alternative Investment Fund Managers (AIFMs) (AIFM Law), a legal "efficiency package" providing, amongst other things, for:

- amendments to several product laws (e.g. UCI Law[28], SIF Law[29], SICAR Law[30], Pension Fund Law[31], Financial Sector Law[32], etc.) and some tax laws;
- non-directly AIFM Directive related changes to existing fund laws and company law, including essentially the modernisation of the existing Luxembourg common limited partnership (*société en commandite simple*), the introduction of improvements to the existing Luxembourg partnership limited by shares (*société en commandite par actions*) and the introduction of the Luxembourg special limited partnership (*société en commandite spéciale*) without legal personality.

[27] Directive 2011/61/EU of 8 June 2011 of the European Parliament and the Council on alternative investment fund managers.

[28] Luxembourg law of 17 December 2010 (as amended) on undertakings for collective investment.

[29] Luxembourg law of 13 February 2007 (as amended) relating to specialised investment funds.

[30] Luxembourg law of 15 June 2004 (as amended) on the investment company in risk capital.

[31] Luxembourg law of 13 July 2005 (as amended) on institutions for occupational retirement provision in the form of ASSEPs and SEPCAVs.

[32] Luxembourg law of 5 April 1993 (as amended) on the financial sector.

The main changes brought about by the bill to the current legal framework of Luxembourg regulated investment funds or their management companies (as the case may be) are outlined below. Please note, however, that the bill has still to be discussed by the Luxembourg Parliament and that some amendments may be introduced before it is finally passed into law. Moreover, Level 2 measures providing for additional details and guidance on the implementation of the AIFM Directive also have to be finalised by the European Commission (in principle before the end of 2012) and will have to be taken into account.

AIFM Regime

According to the new AIFM Law that will emerge from the bill, all Luxembourg managers managing alternative investment funds (AIFs) need to apply to the CSSF for authorisation as AIFMs, unless (but only within the limits) they are excluded, exempted or grandfathered.

The AIFM Law, which replicates the AIFM Directive, defines an "AIFM" as any legal person whose regular business is managing (i.e. performing at least portfolio management and/or risk management services to) one or more AIFs, being any collective investment undertaking, including investment compartments thereof:

- which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
- which does not require authorisation pursuant to the UCITS Directive[33].

According to the provisions of the AIFM Law (and the AIFM Directive), an AIFM can either be:

- an external manager, which is the legal person appointed by the AIF or on behalf of the AIF and which through this appointment is responsible for managing the AIF; or
- the AIF itself (which shall then qualify and be authorised as the AIFM), where the legal form of the AIF permits an internal management and where the AIF's governing body chooses not to appoint an external AIFM.

Under the new AIFM regime, Luxembourg management companies will essentially be affected as follows:

[33] Directive 2009/65/EC of 13 July 2009 of the EU Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities.

UCITS Management Companies

Chapter 15 of the UCI Law will continue to apply to UCITS management companies, which are not affected by the AIFM regime unless they decide to manage AIFs in addition to UCITS and other UCIs. In such a case, these management companies will cumulate two licences, i.e. the UCITS licence according to Chapter 15 of the UCI Law and the AIFM licence according to Chapter 2 of the AIFM Law.

Non-UCITS Management Companies

Chapter 16 of the UCI Law will continue to apply to non-UCITS management companies, but will be significantly amended so as to introduce a distinction between: (i) non-UCITS management companies without AIFM status and (ii) non-UCITS management companies with AIFM status.

Non-UCITS management companies without AIFM status will continue to be authorised by the CSSF under the UCI Law and their activities will be exclusively limited to:

- managing regulated and/or non-regulated investment vehicles that do not qualify as AIFs under the AIFM Directive, regardless of whether these vehicles are Luxembourg or foreign vehicles;
- acting as the management company for one or more FCPs, SICAVs or SICAFs qualifying as AIFs but for which the management company has designated, on behalf of the relevant FCP, SICAV or SICAF, an external authorised AIFM (i.e. the management company will not act itself as authorised external AIFM);
- managing one or more AIFs the aggregate assets of which are less than the EUR 100/500 million thresholds introduced by the AIFM Directive (commonly referred to as the *de minimis* or small manager exemption). In this case, the relevant management company is subject to specific registration and reporting requirements provided for by the AIFM Law. In the case where the aggregate assets under management exceed the EUR 100/500 million thresholds or if the management company decides to opt in into the AIFM regime, it will then have to apply for an AIFM licence according to Chapter 2 of the AIFM Law and will become a non-UCITS management company with AIFM status (see below).

The bill further provides that non-UCITS management companies without AIFM status may not provide the services under a) above without also providing the services under b) or c) above, unless the investment vehicles referred to under a) above are regulated by specific sector laws (e.g. UCI Law, SIF Law and SICAR Law). This aims at avoiding the case where non-UCITS management companies without AIFM status solely manage non-regulated investment vehicles, such as a Luxembourg soparfi.

As regards non-UCITS management companies with AIFM status, they will be subject, in addition to the CSSF's authorisation as management company under the UCI Law, to an AIFM licence according to Chapter 2 of the AIFM Law. These management companies will comply with all the provisions of the new AIFM regime to the extent applicable. Their activities will be limited to the activities listed in Annex I to the AIFM Law (i.e. investment management of AIFs and complementary functions such as administration, marketing and activities linked to the AIF's assets) and, to the extent permitted by the AIFM Law, the provision of additional and non-core services.

AIF Regime

Although the main objective of the AIFM Directive is to regulate AIFMs and not directly AIFs, it contains some provisions impacting AIFs, in particular as regards the depositary regime, the delegation of functions and the valuation of assets, as well as the reporting and disclosure obligations to investors and regulators.

Consequently, amendments to the UCI Law, SIF Law and SICAR Law are also envisaged by the bill. In a nutshell, the following adjustments to the regulatory regimes of Part II UCIs, SIFs and SICARs are currently envisaged under the bill depending on whether the investment vehicles concerned fall − entirely or partially − within the scope of the AIFM Law or not.

PART II UCIs

The bill provides that all Part II UCIs will qualify as AIFs, making however a distinction between Part II UCIs qualifying as full scope AIFs and those benefiting from and using the so-called *de minimis* exemption.

- In principle, unless it benefits from the *de minimis* exemption and effectively uses it, every Part II UCI must be managed by an authorised external AIFM or be internally managed (as the case may be). In this case, new "product" rules coming from the AIFM Law will apply to such a Part II UCI (e.g. depositary regime, valuation of assets, delegation, transparency and marketing requirements).

- To the contrary, a Part II UCI qualifying as an AIF but benefiting from the *de minimis* exemption and deciding not to opt in into the AIFM regime, will remain subject to legal requirements substantially similar to those applicable under the current Part II UCI regime. However, a Part II UCI benefiting from the *de minimis* exemption will be subject to new registration and ongoing reporting requirements under the AIFM regime.

SIFs and SICARs

The bill proposes to divide the SIF Law and the SICAR Law respectively, into two parts:

- Part I of the SIF Law and the SICAR Law respectively will include common rules applicable to all SIFs, respectively SICARs; and

- Part II of the SIF Law and the SICAR Law respectively will include provisions coming from the new AIFM Law (so-called "product" rules regarding, *inter alia*, the determination of the AIFM, depositary regime, valuation of assets, delegation, transparency and marketing) that will be applicable only to SIFs/SICARs managed by an authorised AIFM. These SIFs/SICARs will be considered as falling entirely within the scope of the AIFM Law.

Consequently, this second part of the SIF Law, and the SICAR Law respectively will not impact:

- SIFs/SICARs that do not qualify as AIFs (these vehicles remaining subject to a large extent to requirements similar to those applicable under the current SIF/SICAR regime), and

- SIFs/SICARs benefiting from one of the derogatory regimes provided for by the AIFM Law (e.g. group and *de minimis* exemptions). For these latter SIFs/SICARs, the current SIF/SICAR regime will also be maintained, subject to new registration and ongoing reporting to the CSSF by the AIFM that must be complied with for SIFs/SICARs benefiting from and using the *de minimis* exemption.

Depositary Regime

The bill introduces a new depositary regime for Part II UCIs, SIFs and SICARs falling entirely within the scope of the AIFM Law, whilst maintaining the existing depositary regime (subject to some changes in particular as regards the eligibility criteria) for Part II UCIs, SIFs and SICARs that do not fall or fall only partially within the scope of the AIFM regime:

Eligibility Criteria

The depositary of all Part II UCIs, SIFs and SICARs (regardless of whether they fall entirely within the scope of the AIFM Law or not) shall be a credit institution (within the meaning of the Financial Sector Law) or MiFID investment firm (within the meaning of the Financial Sector Law, which is also subject to own funds requirements and other conditions laid down in the AIFM Directive).

A new category of PFS is also introduced in the Financial Sector Law and it can act as depositary of any Part II UCI, SIF and SICAR which:

- are closed-ended for a period of five years from the date of their initial investments, and

- do not generally invest in assets to be held in custody or generally seek to acquire the control over the issuers or non-listed companies (e.g. mainly private equity and real estate AIFs).

Depositary's Duties

The main duties of the depositary of Part II UCIs, SIFs and SICARs falling entirely within the scope of the AIFM Law shall include:

- Safekeeping duties, where a distinction is made between:
  - a) the custody duties relating to financial instruments of the relevant Part II UCI, SIF and SICAR that can be held in custody by the depositary, and
  - b) the verification duties over the ownership rights of the relevant Part II UCI, SIF and SICAR relating to the other types of assets (such as real estate or commodities).
- Monitoring duties over the assets and transaction of the relevant Part II UCI, SIF and SICAR.
- Cash monitoring duties, implying the obligation for the depositary to ensure that the relevant Part II UCI, SIF and SICAR cash inflows and outflows are properly monitored.

Depositary's Liability

New liability standards have been introduced for depositaries of Part II UCIs, SIFs and SICARs falling entirely within the scope of the AIFM Law and their investors.

In general, the depositary of these funds shall only be liable for losses due to its negligence or intentional failure to perform its obligations. However, in case of loss of assets held in custody, the depositary will be subject to stricter liability, being required to provide replacement assets (of identical type or corresponding amount) without undue delay. This being said, the depositary shall not be liable if it can evidence that the loss is due to an external event beyond its reasonable control, the consequences of which would have been unavoidable despite all reasonable efforts to the contrary. Equally, limitation and/or discharge of the depositary's liability are possible in case of delegation of custody tasks provided that the depositary has complied with all prescribed obligations under the AIFM Law and there is an objective reason for the delegation of the custody tasks.

Entry into Force and Transitional Provisions

The bill provides that the new AIFM Law, including the proposed modifications to the UCI Law, SIF Law and SICAR Law, will enter into force on the first day of the month following its publication in the *Mémorial*. For the time being, the entry into force of the new law is expected in or around January 2013, while the deadline for each of the Member States to implement the AIFM Directive into national law is set as 22 July 2013.

Without prejudice of the transitional provisions of the AIFM Law, the bill also contains additional transitional and grandfathering provisions specific to Part II UCIs, SIFs, SICARs and their management companies (if any). In brief, as from 22 July 2013, most of all new Part II UCIs, SIFs and SICARs qualifying as full scope AIFs will need to have a licensed AIFM. However, existing Part II UCIs, SIFs and SICARs qualifying as full scope AIFs may benefit of a transitional period until 22 July 2014 in order to comply with the new applicable provisions coming from the AIFM Law.

Clifford Chance has prepared a separate **client briefing** dedicated to the impact of the AIFM Law on the legal and regulatory framework of Part II UCIs, SIFs, SICARs and their management companies, analysing in more detail the expected timeline and grandfathering regime.

Please also see **Corporate M&A** and **Tax** sections.

Regulatory Developments

CSSF Regulation N° 12-01
Risk Management and Conflicts of Interests Requirements for SIFs

On 13 August 2012, the CSSF issued Regulation N° 12-01, containing implementing measures on Article 42bis of the SIF Law in relation to the risk management and conflict of interest requirements applicable to SIFs.

Further to the introduction of Article 42bis in the SIF Law by the law of 26 March 2012, the CSSF had already clarified in a press release dated 20 April 2012 the key elements to be complied with and information to be communicated by all existing SIFs to the CSSF by 30 June 2012 (**see the May 2012 edition of our Luxembourg Legal Update**). The CSSF further clarifies the new requirements of the SIF Law with respect to risk management and conflicts of interests.

The regulation entered into force on 1 October 2012. All existing SIFs have until 31 December 2012 to comply with its provisions. Its main provisions are summarised below.

As regards risk management, the regulation specifies, amongst other things, the following:

- SIFs shall establish and maintain a risk management function that will:
  - a) be hierarchically and functionally independent from the operating units. The CSSF may grant derogations from this requirement, taking into account the nature, size and complexity of the business as well as the structure of the

relevant SIF. In any case, however, SIFs must be able to demonstrate that appropriate safeguards against conflicts of interests have been adopted so as to allow an independent performance of risk management activities;

b) be responsible:

i. for implementing and maintaining an adequate and documented risk management policy that allows the detection, measurement, management and monitoring of market, liquidity and counterparty risk exposure appropriately, as well as exposure to all other risks, including operational risk, that may be material to the SIF's activities, and

ii. for ensuring compliance with the risk limitation system of the SIF. For this purpose, the nature, size and complexity of the business, as well as the structure of the relevant SIF, will also be taken into account;

c) have the necessary authority and access to information allowing the fulfilment of its duties.

- Subject to certain conditions, part or all of the activities of the risk management function may be delegated to third parties having the requisite expertise and resources. However, the directors of the SIF will remain liable for the adequacy and efficiency of the risk management system, as well as for the monitoring of the risks linked to the activities of the SIF.

- The application file for the approval of a SIF by the CSSF has to contain a description of the risk management system, and any important modification of the risk management system shall be notified to the CSSF.

As regards conflicts of interests, the regulation requires, amongst other things, that:

- SIFs establish in writing, implement and maintain an effective conflict of interest policy that will be proportionate to the nature, size and complexity of the SIF's business and that will:

a) identify the circumstances that constitute or may give rise to a conflict of interests entailing a material risk of damage to the interests of the SIF. In this respect, the regulation provides, as the minimum criteria to be taken into consideration, a list of conflicting circumstances, specifying that a SIF shall, as soon as it identifies the type of conflicts of interests, take into consideration the SIF's interests, the interests of the clients and the obligations of the SIF towards its unitholders;

b) describe the procedures to be followed and measures to be adopted in order to manage the conflicts. These procedures will ensure that relevant persons engaged in different business activities involving a conflict of interests carry on those activities independently. Moreover, such procedures must be appropriate to the size and activities of the SIF and of the group to which it belongs as well as to the materiality of the risk of damage to the SIF's interests;

- SIFs keep and regularly update a record of the type of collective portfolio management activities undertaken in which a conflict of interests entailing a material risk of damage to its interests has arisen or may arise;

- SIFs explicitly confirm in the application file for approval by the CSSF the implementation of the requested conflict of interest policy.

Finally, the regulation requires that SIFs establish, implement and maintain a policy aimed at preventing any relevant person from carrying out personal transactions that may give rise to a conflict of interests. Moreover, SIFs must develop adequate policies aimed at preventing or managing any conflict of interests resulting from the exercise of voting rights attached to the securities in their portfolio.

To view the non-official English translation of the regulation, click **here**.

CSSF Circular 12/540
Dormant Sub-Funds

This circular issued on 9 July 2012 concerns non-launched sub-funds, sub-funds awaiting reactivation and sub-funds in liquidation of UCIs, subject to the UCI Law and the SIF Law.

In particular, the circular clarifies that:

- the possible duration of UCI's non-launched sub-funds and sub-funds awaiting reactivation is 18 months from the date of the letter of authorisation

of the sub-fund for a new sub-fund, or from the date of the full redemption for a sub-fund awaiting reactivation, or from the date of publication of the circular for existing dormant sub-funds);

- the update of the UCI's prospectus/issue document in the case where a sub-fund appearing in the prospectus/issue document is not launched or not reactivated shall be done at the latest within six months following the expiration of the above-mentioned 18-month period. Sub-funds put into liquidation shall also be removed from the UCI's prospectus/issue document at the latest within six months following the date on which the decision to liquidate is taken.

Appropriate information in that respect must be submitted by each UCI to the CSSF by using a unique reporting form available on the CSSF's website. UCITS, Part II UCIs and SIFs, which do not have non-launched sub-funds, sub-funds awaiting reactivation or sub-funds in the process of being liquidated, are also requested to indicate it in the same reporting form. The unique reporting form must be sent to the CSSF by 15 October 2012 at the latest and must reflect the situation at the end of the month of September 2012. Moreover, this unique reporting must be transmitted to the CSSF in addition to the financial information concerning the authorised and activated sub-funds, which must be communicated on a monthly and yearly basis, respectively, pursuant to the amended circulars IML 97/136 and CSSF 07/310.

For the avoidance of doubt, the circular concerns UCI's sub-funds only and not share/unit classes issued within sub-funds.

To view the non-official English translation of the circular, click **here**.

CSSF Press Release 12/29
Transparency on UCITS' Level of Leverage

The CSSF had specified in its Circular 11/512 that the commitment approach could also be used to compute the expected level of leverage to be disclosed in UCITS' prospectuses. This faculty was, however, not envisaged as such by ESMA's guidelines[34], which provide for the disclosure of the expected level of leverage being defined as the sum of the notionals of all financial derivative instruments.

[34] ESMA's guidelines on risk measurement and the calculation of global exposure and counterparty risk for UCITS, July 2010 (ref.: CESR/10-788) as clarified by ESMA's questions and answers: risk measurement and calculation of global exposure and counterparty risk for UCITS, 9 July 2012 (ref.: ESMA/2012/429).

Being aware of this divergence between the provisions of Circular 11/512 and European guidelines, the CSSF had announced in its Activity Report for 2011 that it could change its position on the faculty to use the commitment approach as the sole methodology for calculating the level of leverage (**see the May 2012 edition of our Luxembourg Legal Update**).

In a press release dated 31 July 2012, the CSSF has clearly stated that the approach based on the sum of the notionals is now the standard reference for leverage transparency. However, the CSSF recognises that, besides the calculation of the leverage based on the sum of the notionals, UCITS may always calculate it based on the commitment approach.

As a result, the CSSF requires that:

- newly created UCITS (including UCITS' sub-funds) determine the level of the leverage based on the sum of the notionals as soon as they start. The disclosure of the level of leverage in their prospectuses will also be based on the sum of the notionals as soon as they start, but this information may be completed, as an illustration, with the leverage determined based on the commitment approach (provided that the underlying calculation method is clearly and precisely indicated for every mentioned figure) or with other additional explanations;

- existing UCITS (including UCITS' sub-funds) determine the level of leverage based on the sum of the notionals as fast as possible and at the latest as from 1 January 2013 (in the meantime, they may continue to use the commitment approach). These UCITS shall adapt their prospectuses (if necessary) by basing the leverage transparency on the sum of the notionals when updating the prospectuses, this update having to be made at the latest on 31 December 2012.

For the publication of the leverage in the annual report, the CSSF considers that for every financial year closing after 31 December 2012, the information on the leverage to be included in the annual report shall be based on the sum of the notionals for the period following 1 January 2013. This information shall be entirely based on the sum of the notionals at the latest for the financial year closing at 31 December 2013, which does not prevent the UCITS from supplementing this information with other figures, such as those resulting from a calculation based on the commitment approach or with other additional explanations.

However, the CSSF recognises that, besides the calculation of the leverage based on the sum of the notionals (directly for newly created UCITS and at the latest from 1 January 2013 for the existing UCITS), the UCITS may always calculate it based on the commitment approach.

Finally, the CSSF has clarified in its press release that it will update Circular CSSF 11/512 in order to include the specifications on the leverage transparency in the prospectus and annual report.

Case Law

Court of Appeal, 30 November 2011
No Right of Direct Action by Investor against the Depositary of a SICAV

On 30 November 2011, the Court of Appeal[35] rejected a claim filed by an investor of a Luxembourg SICAV against the depositary bank of such SICAV in order to obtain compensation for the damages indirectly suffered by him as a result of the loss in value of its shares in the SICAV.

According to the court, which confirmed earlier decisions of the District Court in the context of the *Madoff Case* on the same issue, only the person suffering the damage, i.e. the SICAV itself, can act for the losses it may have suffered and as a result of which its shareholders are affected only indirectly. It follows that a shareholder cannot act for his part in the collective damage suffered by all shareholders, unless it suffers a prejudice specific, distinct and independent from the prejudice actually and initially suffered by the company.

As these conditions were not fulfilled in the case at hand (indeed the court considered that the main loss alleged by the shareholder, i.e. the devaluation of its shares, constituted at the same time a loss of the assets of the SICAV, and this loss was merely a consequence of the corporate loss), the direct action of the shareholder against the depositary bank of the SICAV had to be dismissed.

Supreme Court, 5 July 2012
Prescription of Action for Damages against Management Company of UCI

In a case where an action for damages was directed against the management company of a UCI organised as a common fund (FCP), the Court of Appeal[36] had decided that this action was prescribed as the management regulations provided for a duration of prescription shorter than the general prescription provided for by law and this time had passed. Additionally the court decided that it was possible to fix a shorter duration in the management regulations.

An appeal in law has been made against this judgment on the grounds that Article 2220 of the Civil Code provides that it is not possible to waive the right to benefit of the legal rules regarding prescription. This appeal in law has been dismissed by the Supreme Court[37]. The court held that a provision regarding the duration of prescription of actions against the management company in the management regulations is not equivalent to a waiver of the right to invoke the legal rules regarding prescription.

Litigation

CSSF – Activity Report 2011 – Client Complaints

Inadmissibility of a Complaint due to Lack of Capacity

Article 58 of the Financial Sector Law provides that the CSSF shall be competent to entertain complaints by clients of persons subject to its supervision and to approach these persons with a view to achieving an amicable settlement of such complaints.

A complaint was referred to the CSSF by the beneficial owner of a company which had an account with a bank. The beneficial owner wished to obtain documents on the company's accounts from the bank. This request for disclosure of documents had been refused by the bank on the basis that the complainant was not a body of the company.

The CSSF declared the complaint lodged by the beneficial owner to be inadmissible pursuant to Article 58 of the Financial Sector Law, because there was no contractual link between the person designated as beneficial owner by the holder of the account opened and the financial institution. Therefore this beneficial owner was not a client within the meaning of Article 58 of the Financial Sector Law.

[35] Court of Appeal, 30 November 2011, n°36253.

[36] Court of Appeal, 9 December 2010, n°34277.

[37] Supreme Court, 5 July 2012, n°40/12.

Forged Transfer Orders

In order to identify forged transfer orders, the CSSF has based its analysis of cases on four typological indicators, as mentioned in the 2009 annual report of the Financial Intelligence Unit of the State Prosecutor's office of the Luxembourg District Court.

Thus, in one case, the CSSF considered the complaint against a bank where the examination of the facts revealed that the transfer order presented elements that should have prompted the bank to proceed with caution. Indeed, the disputed transfer order gathered three of the aforementioned "four typological indicators" insofar as:

- it was received by email;
- it was unusual in its amount and the destination of assets; and
- it was made to a country other than the country of residence of the customer.

The CSSF concluded that the bank employee, who had received the order, should have been alarmed by this series of clues and should have carried out basic checks, before the execution of any transfer, notably by contacting the customer by telephone or by secured messaging.

In a second case, where the dispute opposing the customer and a bank resulted from a transfer order given by telephone by a person pretending to be the customer, the CSSF considered there was no misconduct by the bank, as it had taken sufficient precautions before completing the transfer.

Indeed, the account executive who was instructed by telephone to complete the transfer had requested the caller to send a complete instruction by fax including his/her signature as well as a copy of an ID document. On the same day, the account executive received the required instruction and a copy of the customer's passport.

The bank employee then applied the following verification measures:

- identification of the customer on the basis of the date and place of birth;
- identification of the customer as the account holder on the basis of the last transactions, as the information in question is usually included in an account statement or an estimate;
- identification on the basis of a copy of the customer's ID document;
- verification of the signature on the transfer order as well as on the ID document on the basis of the specimen signature given by the customer when opening the account; and
- verification of the single signing authority of the customer.

Case Law

Court of Appeal, 10 November 2010
Voidness of an Agreement in case of Wrong (*lésion*)

According to Article 1118 of the Civil Code, wrong (*lésion*) vitiates a party's consent in a case where there is an obvious disproportion between the contractual performances of the parties when the agreement is signed and if such disproportion has been inserted into the agreement due to the position of strength of one of the parties knowingly abusing the thoughtlessness and the inexperience of the other party.

In the case submitted to the Court of Appeal[38], a company sold the shares in its subsidiary, a company operating in construction and earthmoving, for a substantial price. The seller was aware of the financial distress of the company, in particular due to the fact that certain members of the board of managers of the target were also members of the board of managers of the seller and that the same person represented both companies during the sale. The buyer however, who had no experience in the construction and earthmoving sector, was not aware of the financial difficulties of the company.

After the sale, the buyer found out that the company was worth close to zero and requested hence before the Luxembourg courts, on the basis of Article 1118 of the Civil code, to have the agreement declared void and to be reimbursed the entire purchase price.

The court decided that, in a case of voidness for wrong, two conditions need to be met.

- Firstly, an obvious disproportion between the rights and obligations of both parties has to exist.
- Secondly, such disproportion has to result from a conscious improper exploitation of the position of inferiority of the other party.

In the case at hand, the first condition was fulfilled due to the fact that the company was sold for a substantial price, although its value, due to its financial distress, was close

[38] Court of Appeal, 10 November 2010, n° 11890.

to zero. Regarding the second condition, the Court of Appeal was of the view that, although the buyer operated in commercial matters, it had not the required experience and was hence not able to understand the scope of the transaction. Indeed, the corporate object of the buyer only related to the holding and management of real estate and did not encompass construction and earthmoving operations, which was the scope of the sold company. It resulted thereof that the buyer had no experience regarding the transactions of the constitution and earthmoving market, which established in turn that the seller was in a position of strength. The Court of Appeal added that the seller, due to its position, was completely aware of the financial distress of its subsidiary, and that through the sale it knowingly abused the inexperience of the buyer.

Court of Appeal, 19 October 2011
Interpretation of Termination Clause

By inserting a termination clause in the contract, the parties agree that it will be automatically terminated in case of failure of a party to execute its obligations specified therein.

In the presence of a termination clause, the creditor does not need to go to court to be released from its obligations. However, the creditor has to send a notice to the debtor telling him that he has to execute his obligations, and this notice has to be in a summons or any equivalent instrument (except if the contrary was agreed). This notice is intended to inform the debtor that the contract will be terminated if he persists in not performing his contractual obligations.

In principle, in presence of a termination clause, the termination is therefore acquired after a notice to perform the obligation was sent by the creditor to the debtor, and if it had no effect. In certain circumstances, this notice may have a different purpose. It might not be used to inform the debtor that he has a certain time to perform its obligations, but rather to materialise the creditor's decision to invoke the termination clause, and as a consequence the summons provided for under this termination clause merely informs the debtor of the termination of the contract.

In this case, however, the parties must specify in the termination clause that there will only be a declaration notified to the debtor informing him of the termination of the contract by the termination clause. In the case at hand, the termination clause, firstly, did not provide that the creditor did not need to inform the debtor of the obligation to settle the overdue instalments remaining unpaid, and secondly, it did not provide that the notice would be made for the sole purpose of terminating the contract.

As the termination clause at hand did not specify the purpose of the notice, it was necessary for the court to proceed by way of interpretation. Given that this clause constitutes an act of private justice, in order to protect the interests of the debtor, such interpretation has to be restrictive. Due to the fact that the formulation of the clause was ambiguous, it had to be interpreted in favour of the debtor of the obligation, i.e. the borrower. For this reason, the Court of Appeal[39] decided that the notice served by the bank had the purpose of giving the borrowers time to regularise their situation and to pay those monthly instalments that had remained unpaid, in order to avoid the automatic termination of the contract.

Given that, in the case at hand, the notice sent to the clients did not specify the amounts due, it could therefore not lead to termination of the contract.

District Court Luxembourg, 25 November 2011
Withdrawal of Documents Unduly Deposited with the RCSL

A company summoned the RCSL before the Commercial Court. In support of its claim, it argued that, for the purpose of publication of its annual accounts, it had mistakenly deposited its balance sheet, its profit and loss account, the annex to the annual accounts, detailed annual accounts and the amortisation table as to 31 December 2010, whereas the law authorised it to publish its balance sheet under the form of a summarised balance sheet.

The company explained that the documents filed in error were internal documents and that they were confidential documents by nature, on the grounds that they stated the identity of service providers, creditors and tenants, the account numbers of the company, the name of the SICAV in which the company invested, etc. It requested that the RCSL be ordered to return the documents filed in error.

The court[40] granted the claim. Moreover, it ordered the company to redeposit annual accounts for the current year in compliance with the law in force, together with the judgment, in the file of the company held by the RSCL in order to justify the withdrawal of the documents.

[39] Court of Appeal, 19 October 2011, n°36734.

[40] District Court Luxembourg, 25 November 2011, n°141049.

Court of Appeal, 12 December 2011
Criminal Liability of a Legal Entity

In this case, a motorcyclist lost control of his motorbike and slipped on a road that was covered with a layer of mud created by trucks leaving a construction site. The company that operated the construction site was prosecuted before the correctional court, the judgment of which was then appealed.

In its decision, the Court of Appeal[41] first recalls that criminal liability is applicable to any legal entity (except the State). The criminal liability of the entity does not, however, exclude the liability of the natural person, who is the immediate perpetrator of the offence. Any offence, except for the lowest category of offences (*contraventions*) may trigger the criminal liability of a legal entity. In order for a company to be held criminally liable, two cumulative conditions must be met:

- The offence must be committed by a corporate body, by a representative of the company or by a *de facto* manager of the company.
- The offence must be committed in the name and in the interest of the company i.e. the offence must be beneficial to the company.

In the above case, it resulted from the submission file that the company had committed itself to carry out the necessary cleaning of the road, that it would be removing the mud, and that it would bear all related costs.

[41] Court of Appeal, 12 December 2011, n°587/11.

The court held that there had been a passive approach to the whole situation by the company, although the team leader was informed of the difficulties encountered with the cleaning of the road. As the mud accumulated, they called in a scrubbing machine to clean the road. However, they did not immediately take preventive actions by using the means at their disposal in order to clean the road or to warn drivers about the hazardous road conditions.

Furthermore, the court held that the internal organisation of the company regarding the available resources and dedicated staff for cleaning was insufficient. Knowing the risk of an accident and failing to foresee adequate security measures in order to prevent them, the company was able to save money or to avoid losses.

The court therefore held the company criminally liable for assault and battery. As regards the applicable sentence, the court recalled that the fine applicable to legal entities is of a minimum of EUR 500. The maximum amount of the fine applicable to legal entities is equal to twice what is foreseen for natural persons. The fine foreseen in case of involuntary assault and battery being from EUR 500 to EUR 5,000, the penalty for the company would be a fine between EUR 500 and EUR 10,000. In view of the severity of the injuries the biker suffered (the motorcyclist sustained a fractured collarbone) and the lack of caution and foresight of the company, but considering the fact that the company had no prior criminal record, the court sentenced the company to a fine of EUR 3,000.

Administrative Court, 24 May 2012
Business License and Professional Respectability

The law of 2 September 2011 regulating the access to the professions of craftsman, and to merchant and industrial as well as certain liberal professions sets out the various conditions to be met by the applicant to obtain a business licence (*autorisation d'établissement*).[42]

One of these conditions is for the applicant to meet the criterion of professional respectability (*honorabilité professionnelle*).

It is generally considered that the fact that an applicant has been involved in the bankruptcy of a former business[43] impairs his professional respectability. This principle has been reaffirmed by the Administrative Court of Appeal in a decision dated 29 March 2012.[44]

[42] For more detailed information on this law, please refer to the January 2012 edition of our Luxembourg Legal Update.

[43] Whether as the bankrupt (natural) person or as a manager of the bankrupt legal entity.

[44] Administrative Court of Appeal, 29 March 2012, n° 29625.

In a decision dated 24 May 2012, the Administrative Court[45] has however revisited the fact that the involvement in a bankruptcy does not necessarily and automatically entail a lack of professional respectability on the part of the applicant. In the case at hand, the applicant of a business licence had challenged, before the court[46], the decision of refusal issued by the Minister of Middle Classes and Tourism. One of the grounds for refusal discussed before the court was based on debts that were owed by a public limited company (*société anonyme*) – the managing director of which had been the applicant – to public creditors[47] and that had led to the bankruptcy of this company.

Based on the report prepared by the bankruptcy receiver of the company, the court pointed out various elements leading to the conclusion that, in this particular case, it could not be considered that the applicant's professional respectability was definitively impaired by this bankruptcy. These elements included, amongst others, the fact that the bankruptcy receiver (i) had neither questioned the management of the company by the applicant nor had he held the applicant liable for the bankruptcy, and (ii) had only alleged the existence of a misuse of corporate assets without showing any evidence in this respect.

Another ground mentioned in the decision of refusal was based on a report of the State Prosecutor, mentioning that the applicant had been convicted for receiving and concealing stolen goods, which, for the Minister of Middle Classes and Tourism, had also impaired his professional respectability. The court nevertheless held that, in this particular case, this report was not sufficient to evidence this criminal offence given that the applicant had contested the existence of the facts characterising the offence, that the judgment of the Criminal Court had been appealed and that there had been no decision, and that no other concrete elements (such as police reports and testimony statements) had been taken into consideration by the Minister of Middle Classes and Tourism when taking its decision.

For the above reasons, the decision of refusal of the Minister of Middle Classes and Tourism was voided by the court.

[45] Administrative Court, 24 May 2012, n° 28663.

[46] This decision had been taken under the former law on business licences, which has been repealed by the law of 2 September 2011. The decision of the Administrative Court remains nevertheless relevant since the condition of professional respectability already existed under said former law.

[47] Joint Social Security Center (*Centre Commun de la Sécurité Sociale*) and VAT Office (*Administration de l'Enregistrement et des Domaines*).

Supreme Court, 5 July 2012
Recognition and Enforcement of Foreign Judgments

Recognition and enforcement of a judgment by the Court of Appeal of Abidjan had not been granted by the Luxembourg Court of Appeal[48], because the contract contained a jurisdiction clause giving jurisdiction to the courts of another country. The court held that a judgment in violation of a jurisdiction agreement is a judgment by an incompetent court and the Luxembourg courts have to take this into account even though the jurisdiction agreement did not designate Luxembourg courts.

This decision was quashed by the Supreme Court[49]. It held that, in the presence of a jurisdiction agreement giving jurisdiction to a foreign court other than the one that pronounced the judgment submitted for recognition and enforcement, Luxembourg courts, in order to declare that the foreign court (before which this issue had been raised) was incompetent and in order to refuse recognition and enforcement to such a judgment, have to verify that this judgment interferes with the sphere of exclusive jurisdiction of the Luxembourg courts or is contrary to Luxembourg public policy and the principles regarding the rights of defence.

Supreme Court, 12 July 2012
Interest to Act – Burden of Proof – Foreign Decisions as Proof

A decision by the Court of Appeal[50] recognising an arbitration award has been challenged on several grounds.

- Firstly, the Court of Appeal had decided that as the parties demanding recognition had obtained the award in arbitration, it had to be presumed that there was a debt and therefore those parties had an interest to act for recognition, unless proof to the contrary could be given by the opposing party. Against this, it was argued that the parties demanding recognition had no interest anymore given that they had assigned the debt recognised by the award to a third party and that the burden of proof lay with the parties demanding recognition.

- Secondly, the parties demanding recognition of the award had also acted in the American courts, which had refused to recognise their interest to act and thus also refused recognition of the award. It was argued that the Luxembourg courts had to take into

[48] Court of Appeal, 21 October 2010, n°35262.

[49] Supreme Court, 5 July 2012, n°42/12.

[50] Court of Appeal, 17 March 2011, n°33236.

consideration this judgment and explain why they did not come to the same conclusions.

The decision of the Court of Appeal was upheld by the Supreme Court[51].

Firstly it decided that the Court of Appeal had correctly applied Article 1315 of the Civil Code. In fact, according to this text, the claimant has to prove the reality of its claim, which the claimants had done by submitting and demanding recognition of the arbitral award. If this is the case, according to paragraph 2 of Article 1315 of the Civil Code, the opponent, claiming that he does not need to pay, has to prove that he is liberated of the debt. It was thus the opposing party who had to provide such evidence.

Secondly, with regard to the foreign court decisions, the Supreme Court held that these decisions are elements of proof to be taken into consideration by the courts. However, the Luxembourg courts are not bound by the findings, which have been recognised as proven facts by foreign courts. For the Luxembourg courts, these findings only have the value of an indication or a presumption. Furthermore, the courts do not have to explain in detail why they do not retain certain elements submitted to them as proof and for this reason it had not been necessary to explain in detail why they did not come to the same conclusions as the American judgments.

Employment

Legislation

Regulation (EU) N° 465/2012
Social security – New EU rules

This regulation amending the Regulation (EU) N° 883/2004 on the coordination of social security systems within the European Union entered into force on 28 June 2012.

The regulation aims at:

- providing clear rules for aircrew;

  The regulation now clearly foresees the use of the "*home base*" criterion to determine the applicable legislation.

- improving the situation of self-employed cross-border workers in relation to the payment of unemployment benefits;

  The regulation now provides that self-employed cross-border workers who may not benefit from unemployment benefits in their country of residence will benefit from the unemployment benefits granted by the Member State in which they pursued their last activity as self-employed workers.

- clarifying the conditions under which the provisions on secondments apply; and

  The regulation now clearly states that the posted employee cannot be sent to replace another posted person.

- specifying the rules applicable to situations where a person is working in two or more Member States for various undertakings or employers.

  The regulation makes it clear that the condition of pursuing a "*substantial part*" of the activity within the meaning of Article 13(1) of the regulation now also applies to individuals working for various employers. The regulation hence now clearly provides that if a worker, employed by two or more employers, does not pursue a substantial part of his activity in the Member State of residence, he will only be subject to the social security system of his state of residence in case at least two of his employers have their place of business in different Member States other than the Member State of residence.

A transitional provision is foreseen in the regulation, which provides that the rules that were applicable to existing situations before the entry into force of the regulation shall continue to apply for a transitional period lasting for as long as the relevant situation remains unchanged, and in any case for no longer than 10 years from the date of entry into force of the regulation. However, individuals may request that the transitional period no longer applies to them. Individuals choosing to apply the new rules shall submit their requests to the competent authority. Requests submitted no later than 29 September 2012 will be deemed to take effect on 28 June 2012. Requests submitted after that date will take effect on the first day of the month following that of their submission.

[51] Supreme Court, 12 July 2012, n°52/12.

Case Law

Court of Appeal, 24 May 2012
Preliminary Meeting to a Dismissal

Article L.124-2 of the Luxembourg Labour Code provides that an employer who employs 150 employees or more shall, before deciding whether a given employee will be dismissed, invite this employee to a preliminary meeting. During this meeting, the employer has to explain to the employee the reasons for the contemplated dismissal, and to give the employee the opportunity of providing his explanations and comments.

The employee may be accompanied during this meeting by another employee of the company or by a representative of a labour union, which is representative at national level and which is represented in the staff delegation ("*délégation du personnel*") of the employer. This threshold of 150 employees has been reduced to 100 employees by the collective labour agreement applicable to bank employees.

The Court of Appeal[52] held that in order to assess whether the threshold is reached, not only the employees of the entity existing in Luxembourg must be taken into consideration, but, when an economic and social unit exists between various companies of the same group, the employees of the latter company have also to be taken into consideration (including the employees of the group companies abroad).

The court reached this conclusion, after having noted that:

- the Luxembourg entity obviously was part of a large group of companies;
- the internal newsletter of the group of companies indicated that the Luxembourg entity was employing worldwide 14,000 employees; and that
- the activities of the various companies of the group were based on the same approach. Finally, the court stressed also that the Luxembourg entity of the group had indicated that it was employing more than 100 portfolio managers and analysts in Luxembourg.

Based on all these factual elements, the court ruled that a preliminary meeting to the dismissal, as foreseen by Article L.124-2 of the Luxembourg Labour Code, was compulsory.

[52] Court of Appeal, 24 May 2012, n°37266.

Tax

Legislation

Law of 21 July 2012

Mutual Assistance for the Recovery of Tax

The law of 21 July 2012 implements the EU Directive 2010/24/UE dated 16 March 2010, which amends and improves mutual assistance between Member States with respect to the recovery of tax claims, facilitating the exchange of information and allowing a Member State to recover tax claims for the benefit of other Member States. The main points of interest in this directive are the following:

- substantial extension of cases where mutual assistance between Member States can take place, as mutual assistance can take place for any type of taxes levied by a Member State;
- banking information can be exchanged within the framework of the assistance for tax recovery.

For more detailed information on this directive, please refer to **the September 2011 edition of our Luxembourg Legal Update**.

Bill N° 6471
Implementation of the Directive on Alternative Investment Fund Managers

Besides the implementation of the Directive 2011/61/EC on Alternative Investment Fund Managers, the bill includes tax provisions aiming at:

- ensuring full tax transparency of partnerships (under relaxed conditions);
- introducing a reduced tax rate for carried interest income (under conditions);
- confirming the VAT exemption on management services rendered to alternative investment funds; and
- confirming that foreign alternative investment funds managed from Luxembourg are not subject to Luxembourg taxes.

Our **briefing note** on this topic can be downloaded from the Clifford Chance website.

Bill N° 6455

Administrative Cooperation between Tax Authorities

On 25 July 2012, the Ministry of Finance submitted to the Luxembourg Parliament the bill that should partially implement into Luxembourg law the EU Directive 2010/24/UE on administrative cooperation between tax authorities. This directive is dated 16 March 2010 and aims at establishing the exchange of information upon request as a general principle of exchange of information within Europe in direct tax matters. Under certain conditions, the directive foresees that banking information may be communicated but prohibits fishing expeditions, i.e. exchange of information that is not relevant for the requesting state. This directive also foresees the application of the automatic exchange of information in specific and limited circumstances. The provisions of the directive related to the automatic exchange of information are not covered in this bill but will be dealt with at a later stage. If approved, the bill should enter into force as from 1 January 2013.

For more detailed information on this directive, please refer to the **January 2011 edition of our Luxembourg Legal Update**.

Circular LIR of 11 June 2012
Taxation of Volunteer Work

On 11 June 2012, the Luxembourg tax authorities issued a circular about the taxation of volunteer work. It concerns the taxation of income received by individuals for the performance of ancillary non-profit sporting, cultural and social activities as well as compensation received from various non-profit organisations. The circular also mentions that income received for voluntary work includes remuneration and reimbursement for expenses.

Based on the circular, such income will be taxable by assessment only, when the gross income (including the expenses reimbursed) exceeds EUR 5,000 per year. A lump-sum expense of EUR 5,000 could be deducted (if the effective costs exceed this deductible amount, such costs could be taken into account provided they can be evidenced). The income is tax exempt and must therefore not be declared if it is below EUR 5,000.

Position of Luxembourg on Financial Transaction Tax

The ECOFIN Council held a policy debate on the Financial Transaction Tax (FTT) on 22 June 2012. The conclusion was that the support for an FTT as currently proposed by the European Commission is not unanimous. Several Member States however want to adopt an FTT under the enhanced cooperation method and under a form that may not necessarily correspond to the European Commission's proposal. Indeed, in the meantime certain EU countries such as France have adopted domestic FTT on a narrow basis.

On the occasion of a recent conference in Luxembourg, the Minister of Finance, Luc Frieden, highlights that it would be important to clearly define the purpose of the FTT: "*While talking about taxation, we should make sure that, first of all, we agree on the objective of the FTT. Is it to increase the income of state budgets? Then we should introduce this tax on the European scale to every country. Is it to avoid high risk speculative transactions? Then we should target those*", he said.

Moreover, the Finance Minister clarified the country's position by declaring that Luxembourg would certainly take advantage of the benefits of further integration between European countries, but he mentioned two caveats: "*I want to make sure that home and host countries are treated equally. Luxembourg is a host country for most of its financial institutions. The interest of these host countries must be fully respected. We should discuss to what extent a closer integration of supervision is relevant to the monetary union*".

EU Developments

European Commission Press Release, 3 July 2012

Reduces VAT Rate on e-Books

According to a recent press release, the European Commission has launched an infringement procedure against Luxembourg because the 3% reduced VAT rate that applies to digital books is potentially incompatible with EU law.

In its press release, the European Commission stated that: "*Luxembourg VAT treatment creates serious distortions of competition that are damaging to economic operators in other Member States*", and that: "*downloading of digital books is regarded as a service supplied electronically, which is not included in the list of goods and services to which Member States may apply reduced VAT rates (Annex III of EU VAT Directive 2006/112/EC) and therefore cannot be taxed at the reduced rate.*" Moreover, it stated that: "*the EC considers that 'it is not possible to ensure convergence towards the reduced rate currently applicable to traditional books without amending the VAT Directive*'".

Tax Treaties

Luxembourg-Poland Double Tax Treaty – New Protocol

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

Luxembourg-Portugal Double Tax Treaty – New Protocol

The protocol dated 7 September 2010 amending the double tax treaty between Luxembourg and Portugal entered into force on 18 May 2012. The aim of the protocol is to align the double tax treaty with the international standards for the effective exchange of information upon request, as set out by the OECD. The provisions of the protocol will apply from 1 January 2013.

Luxembourg-Italy Double Tax Treaty – New Protocol

A new protocol was signed on 21 June 2012 amending the double tax treaty between Luxembourg and Italy. The aim of the protocol is to align the double tax treaty with the international standards for the effective exchange of information upon request, as set out by the OECD.

International Developments

OECD Model Convention – Interpretation of Key Concepts

Since the release of the OECD draft report on the definition of the term "permanent establishment" in October 2011, there have been many discussions on important concepts included in the OECD Model Convention. Those discussions (sponsored by the OECD) are mainly related to the definition of "permanent establishment" and are also related to the concept of "place of management" and "independent agent". As the double tax treaties entered into by Luxembourg are generally interpreted in the light of the OECD Model Convention, the outcome of these discussions and the evolution of those key concepts may significantly affect business restructuring in the future.

OECD Model Convention – Exchange of Information

On 17 July 2012, the OECD Council approved an update to Article 26 of the OECD model convention. The main evolution is that even though "fishing expeditions" are clearly not authorised, the commentary now allows for group request, i.e. request on several taxpayers, whether identified by name or otherwise provided that the requesting State provides:

- a detailed description of the group;
- the facts and circumstances that have led to the request; and
- why there is reason to believe that the taxpayers in the group have not been compliant with the law supported by a clear factual background.

The other updates regard the following:

- Section 2 of Article 26 was amended to allow the competent authorities to use the information received for purposes other than for carrying out the application of double tax treaties and tax laws, subject however to certain conditions.
- The commentary provides for an optional standard of time limits within which the information must be provided.

Case Law

European Court of Justice, 10 May 2012
Withholding Tax on Dividend Payments to EU Investment Funds

The ECJ[53] declared incompatible with the free movement of capital the French tax provision providing for a 30% dividend withholding tax on dividends paid to EU UCITS (e.g. Luxembourg UCITS) while dividends paid to French UCITS are not subject to this withholding tax.

District Court, 8 July 2011
Non-Payment of Tax – Liability of Company Director

Article 495-1 of the Commercial Code provides that if, during bankruptcy proceedings, the company's assets appear to be insufficient, the court can decide, upon petition by the bankruptcy trustee, that part or all of the company's debts shall be borne by those of the company's directors or managers who are guilty of gross and qualified negligence.

The District Court[54] held that a company director is obliged to ensure that the company complies with its legal obligations regarding tax. For this reason, a director may be declared personally liable when the company has neither made any tax declarations for several years nor paid tax during the same time.

[53] ECJ, 10 May 2012, C-338/11.

[54] District Court, 8 July 2011, n°130827.

Administrative Court of Appeal, 24 May 2012
Exchange of Information

In a nutshell, the factual background is the following. A Malaysian company used its Luxembourg bank account to pay consultants resident in Sweden. As the Swedish tax authorities wanted to obtain detailed information on these payments, they sent a request of information to the Luxembourg bank. This request of information was based on the double tax treaty between Sweden and Luxembourg (which includes an article on the exchange of information upon request in line with the OECD requirements).

On 20 March 2012, the Administrative Court[55] held that the information request was pertinent for the Swedish tax authorities as the information was related to a tax audit in Sweden. For more detailed information, please refer to the **May 2012 edition of the Luxembourg Legal Update**.

On 24 May 2012, the Administrative Court of Appeal[56] overruled the decision of the lower court. The court stated that the Luxembourg bank cannot be compelled to provide the requested information, as the Swedish tax authorities' request of information does not clearly include the name of the person actually under investigation in Sweden and the ground of the request (the request of information is unclear as in the first part of the request the persons under investigation seem to be the consultants whereas in the second part it seems to be the Malaysian company itself). Because of its lack of clarity, the court decided that the request of information was not compliant with requirements stated by the double tax treaty between Luxembourg and Sweden.

This decision confirms that the Luxembourg tax authorities (and also the courts) have to check that all the legal requirements for an exchange of information are complied with (and must not merely rely on the foreign tax authorities' position) before requesting a bank to provide information covered by the rules on banking confidentiality.

European Court of Justice, 19 July 2012
VAT Treatment of Discretionary Portfolio Management

A bank was instructed by private investors to manage securities, at its own discretion, in accordance with the investment strategy chosen by the bank (i.e. without instructions from the private investors). The bank disposed of the assets in the name and on behalf of the investors, who paid an annual fee amounting to 1.8% of the value of the managed assets for the services rendered. That fee included a share for asset management and a share for buying and selling securities.

The ECJ[57] held that such portfolio management services were composed of two elements:

- an asset management service (i.e. monitoring and analysing the assets); and
- a service of purchase and sale of the assets.

These two elements are so closely linked that they form, objectively, a single economic service. Considering that neither the VAT exemption for transactions in securities nor the VAT exemption for the management of investment funds was applicable in the case at hand, the ECJ held that the portfolio management service as a whole was subject to VAT.

It should however be noted that the Advocate General mentioned that isolated transactions services should still benefit from a VAT exemption. In light of this jurisprudence, the underlying agreement would then have to be carefully drafted and analysed in order to benefit, even partly, from a VAT exemption.

[55] Administrative Court, 20 March 2012, n°29592a.

[56] Administrative Court of Appeal, 24 May 2012, n°30251C.

[57] ECJ, 19 July 2012, C-44/11.

European Court of Justice, 6 September 2012
Net Wealth Tax Reserve

Under paragraph 8a of the Net Wealth Tax Law, Luxembourg companies do not have to pay net wealth tax for a particular year if they allocate an amount equivalent to five times the net wealth tax due to a non-distributable reserve. In this respect, if this net wealth tax reserve is maintained for five years, the tax does not become due. Alternatively, if it is distributed during the five-year period, the net wealth tax becomes retroactively payable.

In the case at hand, a Luxembourg company allocated funds to the net wealth tax reserve for 2004, 2005 and 2006 in order to benefit from the above-mentioned regime. In 2006, it migrated to Italy keeping the net wealth tax reserve in its accounts after the migration. Subsequently, it merged with another Italian company. As from the migration, the Luxembourg tax authorities retroactively denied the benefit of the net wealth tax reduction, as the company was no longer a Luxembourg resident subject to net wealth tax.

The European Court of Justice[58] recently ruled that a legislation – such as paragraph 8a – which makes the grant of a tax reduction conditional upon remaining liable to that tax in a Member State (Luxembourg in the case at hand) for five tax years is contrary to the freedom of establishment.

[58] ECJ, 6 September 2012, C-380/11.

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