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Luxembourg Legal Update

July 2014

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Luxembourg Legal Update

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

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

Banking, Finance & Capital Markets

EU Developments

Single Supervisory Mechanism (SSM): Publication of Framework Regulation

The Single Supervisory Mechanism (SSM) Framework Regulation that was published in the Official Journal on 14 May 2014 has entered into force on 15 May 2014.

The SSM Framework Regulation will provide the basis for the SSM's work when it takes over as supervisor of Euro area banks in November 2014. The identification of significant banks, which will be subject to direct supervision by the ECB, will take place pursuant to certain criteria provided for in the SSM Council Regulation and further specified in the SSM Framework Regulation. The result of this process is expected to be announced in September 2014.

On 14 May 2014, an amending ECB Regulation on the powers of the ECB to impose sanctions and an ECB Recommendation for a Council Regulation amending Regulation (EC) N°2532/98 concerning the powers of the ECB to impose sanctions were also published in the Official Journal.

On 19 June 2014, a further ECB Regulation concerning the establishment of a mediation panel and its rules of procedure has been published in the Official Journal as well.

The SSM Framework Regulation entered into force on 20 June 2014.

CRR/CRD IV: New Delegated and Implementing Regulations

Over the last months, the following Commission Delegated Regulations and Commission Implementing Regulations have been published in the Official Journal:

- N°523/2014 of 12 March 2014 supplementing the Capital Requirements Regulation (CRR) with regard to regulatory technical standards for determining what constitutes the close correspondence between the value of an institution's covered bonds and the value of the institution's assets
- N°524/2014 of 12 March 2014 supplementing the Capital Requirements Directive (CRD IV) with regard to regulatory technical standards specifying the information that competent authorities of home and host Member States supply to one another
- N°525/2014 of 12 March 2014 supplementing the CRR with regard to regulatory technical standards for the definition of market
- N°526/2014 of 12 March 2014 supplementing the CRR with regard to regulatory technical standards for determining proxy spread and limited smaller portfolios for credit valuation adjustment risk
- N°527/2014 of 12 March 2014 supplementing the CRD IV with regard to regulatory technical standards specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration
- N°528/2014 of 12 March 2014 supplementing the CRR with regard to regulatory technical standards for non-delta risk of options in the standardised market risk approach
- N°529/2014 of 12 March 2014 the CRR with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach
- N°530/2014 of 12 March 2014 supplementing the CRD IV with regard to regulatory technical standards further defining material exposures and thresholds for internal approaches to specific risk in the trading book
- N°591/2014 of 3 June 2014 on the extension of the transitional periods related to own funds requirements for exposures to central counterparties in the CRR and EMIR

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- N°602/2014 of 4 June 2014 laying down implementing technical standards for facilitating the convergence of supervisory practices with regard to the implementation of additional risk weights according to the CRR
- N°604/2014 of 4 March 2014 supplementing the CRD IV with regard to regulatory technical standards with respect to qualitative and appropriate quantitative criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile
- N°620/2014 of 4 June 2014 laying down implementing technical standards with regard to information exchange between competent authorities of home and host Member States, according to the CRD IV
- N°625/2014 of 13 March 2014 specifying the requirements for investors, sponsors, original lenders and originator institutions relating to exposures to transferred credit risk
- N°650/2014 laying down implementing technical standards with regard to the format, structure, contents list and annual publication date of the information to be disclosed by competent authorities under the CRD IV
- N°680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to the CRR
- N°710/2014 of 23 June 2014 laying down implementing technical standards with regard to conditions of application of the joint decision process for institution-specific prudential requirements according to the CRD IV.

The above Delegated and Implementing Regulations entered into force in the meantime or will enter into force very shortly.

The EU Commission has also published a set of frequently asked questions (FAQs) on the Delegated Regulation N°604/2014 on identified staff under the CRD IV. The FAQs discuss why the Delegated Regulation has been adopted and the key elements of the criteria for identifying staff that the remuneration requirements will apply to.

Bank Recovery and Resolution Directive: Publication in the Official Journal

On 12 June 2014, the Bank Recovery and Resolution Directive (BRRD) has been published in the Official Journal. The BRRD provides national authorities with tools to pre-empt bank crises by introducing instruments at preparatory and preventative, early intervention and resolution stages of bank failure. The BRRD includes provision for:

- bail-in, to enter into force in January 2016, which will enable resolution authorities to write down or convert into equity the claims of the shareholders or creditors of banks that are failing or likely to fail
- setting up resolution funds or national financing arrangements that can make temporary support available to banks under resolution equal to at least 1% of covered deposits within all credit institutions authorised in a country
- exceptional measures enabling the temporary injection of funds to address capital shortfalls emergent from stress tests, asset quality reviews or equivalent exercises conducted by the European Central Bank (ECB), the European Banking Authority (EBA) or national authorities
- a stabilisation tool that provides for public capital injections where extensive bail-in would endanger financial stability
- minimum requirements for own funds and eligible liabilities (MREL) of each institution, based on size, risk and business model, to ensure institutions have adequate loss-absorbing capacity.

Member States have until 31 December 2014 to transpose the Directive into national law.

Single Rulebook: EBA updates Q&A

On 6 June 2014, the European Banking Authority (EBA) has updated its set of questions and answers (Q&As) on the Single Rulebook. Amongst other things, the EBA has published new answers relating to country-by-country reporting, the treatment as own funds under the CRR, the definition of liquidity facility, the derogation from the application of liquidity requirements on an individual basis, stand-by credit facilities as liquid assets and the calculation of outstanding Tier 2 capital.

MiFID 2/MiFIR: Publication in the Official Journal

On 12 June 2014, the new Markets in Financial Instruments Directive (MiFID 2) and Regulation (MiFIR) have been published in the Official Journal.

Amongst other things, under the new rules:

- firms will be required to trade on organised venues, including regulated markets (RMs) such as stock exchanges, multilateral trading facilities (MTFs) controlled by approved market operators or larger investment firms and organised

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trading facilities (OTFs) for non-equities, such as interests in bonds, emission allowances or derivatives

- firms will be required to design investment products for specified groups of clients according to their needs, withdraw products deemed to be "toxic" from trading and ensure that any marketing information is clearly identifiable as such and not misleading – clients should also be informed whether the advice offered is independent or not and about the risks associated with proposed investment products and strategies
- positions in commodity derivatives (traded on trading venues and over the counter), will be limited, to support orderly pricing and prevent market-distorting positions and market abuse – the European Securities and Markets Authority (ESMA) will determine the methodology for calculating these limits, to be applied by the competent authorities
- any investment firm engaging in algorithmic trading in financial instruments will have to have effective systems and controls in place, such as "circuit breakers" that stop the trading process if price volatility gets too high
- third countries whose rules are equivalent to the new EU rules will be able to benefit from the EU passport when providing services to professionals.

Member States have two years to transpose the new rules, which will be applicable starting January 2017.

For more information on the new MiFID2 and MiFIR as well as the expected implementation timeline we kindly refer you to two client briefings Clifford Chance has produced in June 2014.

Revised Deposit Guarantee Schemes Directive: Publication in the Official Journal

On 12 June 2014, the revised Directive on Deposit Guarantee Schemes has been published in the Official Journal.

The Directive will establish bank-financed guarantee schemes in each Member State reimbursing guaranteed deposits up to EUR 100,000 when a bank is unable to do so itself. The target level for funding of the deposit guarantee scheme is 0.8% of covered deposits to be collected from banks over ten years. In addition, deadlines for repayment of guaranteed deposits will be reduced fromtwenty working days to seven days by 2024.

Mortgage Credit Directive

On 28 February 2014, the Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) N°1093/2010 has been published in the Official Journal.

The new directive is intended to create an efficient and competitive single market for mortgage credit in the EU. It sets out principles for marketing and advertising, and obligations for pre-contractual information, as well as requirements for information concerning credit intermediaries and for information on the borrowing rate. The directive includes provisions requiring the creditor to assess the creditworthiness of the consumer, as well as imposing disclosure obligations on the part of the consumer. It also includes regulatory and supervisory principles with regard to credit intermediaries, as well as provisions to enable adequate regulation and supervision of non-credit institutions.

The directive entered into force on 20 March 2014 and Member States have to transpose it in national law by 21 March 2016. The directive does not apply to credit agreements existing before 21 March 2016.

European Account Preservation Order: Adoption by EU Council

On 13 May 2014, the EU Council formally approved the regulation establishing a European Account Preservation Order procedure, which is intended to facilitate cross-border debt recovery in civil and commercial matters, and establish a new and self-standing European procedure for the preservation of bank accounts to enable a creditor to prevent the transfer or withdrawal of its debtor's assets in any bank account located in the European Union. The European procedure would be available to citizens and companies as an alternative to procedures existing under national law.

The regulation will enter into force on the twentieth day following that of its publication in the Official Journal. It will apply from thirty months after its entry into force with the exception of Article 48, which will apply six months before its date of application.

EMIR: New Delegated and Implementing Regulations

Over the last months, the following Commission Delegated Regulations and Commission Implementing Regulations have been published in the Official Journal:

- N°285/2014, supplementing EMIR with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the EU and preventing the evasion of rules and obligations (this Delegated Regulation entered

into force on 10 April 2014, but Article 2 on contracts with a direct, substantial and foreseeable effect within the EU will only be applicable as of 10 October 2014)

- N°484/2014 of 12 May 2014 laying down implementing technical standards with regard to the hypothetical capital of a central counterparty according to EMIR (this Implementing Regulation applies from 2 June 2014, except for the provisions foreseeing an option for competent authorities to require daily or weekly reporting, which shall apply from 1 January 2015)
- N°591/2014 on the extension of the transitional periods related to own funds requirements for exposures to central counterparties (CCPs) in the CRR and EMIR (this Implementing Regulation entered into force on 5 June 2014)
- N°667/2014 supplementing EMIR with regard to rules of procedure for penalties imposed on trade repositories by ESMA including rules on the right of defence and temporal provisions (this Delegated Regulation entered into force on 22 June 2014).

EMIR: Update of Q&A Document

On 22 May and 23 June 2014, ESMA has published updates of its Q&A document on EMIR. The new Q&As, amongst others, clarify issues related to funds counterparties, the calculation of the clearing threshold, intra-group transactions, the classification of non EU-related banks and organisational requirements.

The new Q&As also provide answers to questions in relation to the population of specific fields relating to reporting of data on exposures (i.e. collateral and valuations). The reporting start date for such data is 11 August 2014, which means that the first counterparties' reports are due no later than the end of 12 August 2014.

The updated Q&As also cover how to report contracts with no maturity date, notional amount field, OTC derivatives novations, and the issue of backloading.

Prospectus Directive: New Delegated Regulation – Publication of Supplements to Prospectus

On 15 April 2014, the EU Commission Delegated Regulation (EU) N°382/2014 of 7 March 2014 supplementing the Prospectus Directive 2003/71/EC (as amended) with regard to regulatory technical standards for publication of supplements to the prospectus was published in the Official Journal.

The Delegated Regulation specifies situations requiring a supplement to the prospectus to be published. The Delegated Regulation entered into force on 5 May 2014.

Market Abuse: Publication of New Rules in the Official Journal

On 12 June 2014, the new Market Abuse Regulation (MAR) and Directive (MAD 2) have been published in the Official Journal.

The MAR extends the scope of Directive 2003/6/EC, which prohibits insider dealing and the manipulation of financial instruments that are admitted to trading on regulated markets, to include financial instruments traded on multilateral trading facilities and organised trading facilities, as well as OTC-traded financial instruments.

The new MAD 2 obliges Member States to provide in their national legislation for criminal sanctions in respect of insider dealing, market manipulation and unlawful disclosure of inside information. It will require them to ensure that inciting as well as aiding and abetting criminal offences is also punishable. To ensure that sanctions are effective and dissuasive, the directive establishes minimum levels for the maximum term of imprisonment. Offences related to insider dealing and to recommending or inducing another person to engage in insider dealing and market manipulation will be punishable by a maximum term of at least four years. Offences related to unlawful disclosure of inside information will be punishable by a maximum term of at least two years.

MAR will enter into application in July 2016 and Member States have two years to transpose MAD 2 into their national law.

Credit Rating Agency Regulation

ESMA Q&A Update

ESMA published on 2 June 2014 a Q&A document update intended to provide clarity on the requirements and practice in the application of the Credit Rating Agencies (CRA) Regulation and, in particular, the CRA 3 Regulation (Regulation (EU) N°462/2013 of 21 May 2013). The updated Q&A provides clarifications regarding the publication of sovereign ratings and conflict of interests concerning investments in CRAs.

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Statistics concerning Balance of Payments, International Trade in Services and Foreign Direct Investment: New EU Commission Implementing Regulation

On 10 March 2014, the EU Commission adopted a new implementing regulation N°228/2014 amending Regulation (EC) N°601/2006 and implementing Regulation (EC) N°184/2005 of the European Parliament and of the Council on statistics concerning balance of payments, international trade in services and foreign direct investment, as regards the format and the procedure for the transmission of data.

Omnibus II Directive

On 22 May 2014, Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014 amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) N°1060/2009, (EU) N°1094/2010 and (EU) N°1095/2010 in respect of the powers of EIOPA and ESMA (Omnibus II Directive) has been published in the Official Journal.

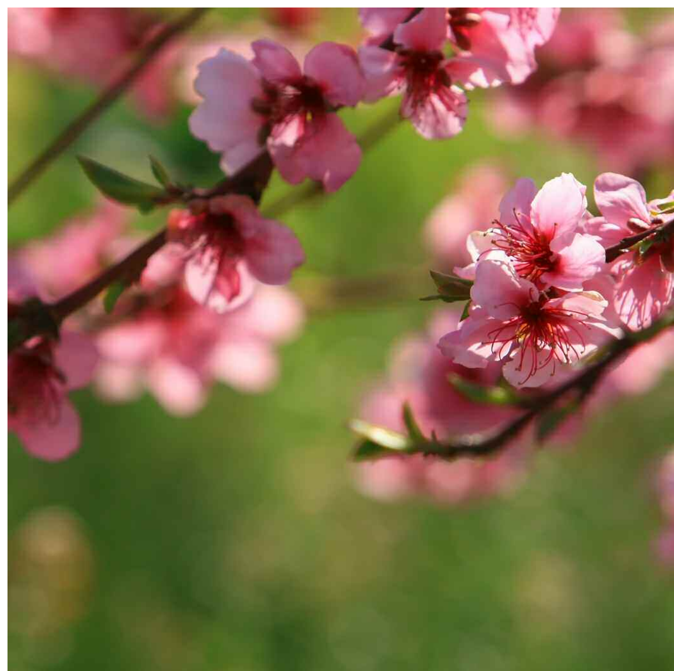
The amendments introduced by the Omnibus II Directive include the provision of specific tasks for EIOPA and ESMA. They clarify the role of EIOPA in ensuring harmonised technical approaches on the calculation of technical provisions and capital requirements. The new rules also amend Solvency II and the Prospectus Directive following the creation of EIOPA and ESMA in 2010 as part of the new European system of financial supervision. The amendments broadly fall into the following categories:

- definition of the appropriate scope of technical standards
- enabling EIOPA and ESMA to settle disagreements
- enabling the existing rules to operate in the context of the new supervisory system
- transitional requirements and other amendments to Solvency II.

Member States have until 1 January 2016 to transpose the Omnibus II Directive into national law.

EU Insolvency Regulation: Implementing Regulation replacing Annexes A, B and C to the EU Insolvency Regulation published in the Official Journal

On 19 June 2014, the Council Implementing Regulation (EU) N°663/2014 of 5 June 2014 replacing Annexes A, B and C to the EU Insolvency Regulation has been published in the Official Journal. The Implementing Regulation entered into force in the meantime.



Legislation

Implementation of CRD IV

Bill N°6660 of 7 March 2014

The Luxembourg government deposited a new bill for the implementation of CRD IV with the Luxembourg Parliament on 7 March 2014.

The bill amends, in particular, the provisions of the Financial Sector Law, which in the past implemented directives 2006/48/EC and 2006/49/EC to reflect the modifications to these directives by CRD IV. The bill further abrogates those legal provisions which are now covered by the CRR being directly applicable in Luxembourg.

The most innovative parts of the CRD IV are, first of all, those which require credit institutions and investment firms concerned to hold capital buffers (*coussins de fonds propres*) on top of own funds requirements. These are new tools of prudential supervision to be introduced in Chapter 5 of the new Part III of the Financial Sector Law. The CRD IV in addition foresees:

- modifications in the area of pecuniary administrative sanctions, which become more dissuasive, and other administrative measures
- reinforced requirements in the area of governance in the financial sector

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- newly introduced provisions regarding remuneration policies
- adaptations to the scope of application of the CRD IV regime, in particular as regards investment firms.

Establishment of a Systemic Risk Committee

Bill N°6653 of 28 February 2014

A new bill N°6653 establishing a systemic risk committee in Luxembourg and implementing the recommendation of the European Systemic Risk Board (ESRB) of 22 December 2011 on the macro-prudential mandate of national authorities (ESRB/2011/3) and the recommendation of the ESRB of 4 April 2013 on intermediate objectives and instruments of macro-prudential policy (ESRB/2013/1) was submitted to the Luxembourg Parliament on 28 February 2014.

The systemic risk committee encompasses four members, namely a member of the Luxembourg government responsible for the financial sector, the chief executive of the BCL, the chief executive of the CSSF, and the chief executive of the Commassu.

The new committee is entrusted with coordinating the implementation of the macro-prudential policy by the authorities represented in the systemic risk committee. Its ultimate objective is to contribute to the safeguard of the Luxembourg financial system, in particular by strengthening the resilience of the financial system and decreasing the build-up of systemic risks, ensuring thereby a sustainable contribution of the financial sector to economic growth. The systemic risk committee is established as a board contributing to an adequate cooperation between those authorities that are competent for the micro- and macro-prudential supervision.

The systemic risk committee identifies, monitors and assesses risks in relation to financial stability and issues opinions, warnings and recommendations in order to prevent and mitigate those risks.

Contributions to the Staff and Operating Costs of the Commassu

Grand-Ducal Regulation of 28 April 2014

The Luxembourg Government Council has passed a new Grand-Ducal Regulation dated 28 April 2014 on contributions to the staff and operating costs of the CAA.

The Regulation sets out the new taxes the CAA is authorised to collect from undertakings and persons subject to its supervision, such taxes being designed to contribute to the staff and operating costs of the CAA.

The new regulation is retroactively applicable from 22 January 2014 and repeals the modified Grand-Ducal Regulation of 11 May 2007 on contributions to the staff and operating costs of the CAA.

Capability Examination for Insurance Agents and Sub-Broker Candidates

CAA Regulation N°14-1 dated 1 April 2014

The CAA has issued Regulation N°14/01 on the capability examination for insurance agents and sub-broker candidates. The regulation contains detailed provisions on the organisation, contents to be covered and process of such examinations.

The new regulation was published in the Official Journal on 8 April 2014 and entered into force the same date. The content requirements for the examination foreseen by the new regulation were first applied on 17 June 2014.

Regulatory Developments

CRD IV – Implementation of Certain Discretions contained in CRR

CSSF Regulation N°14-1

A new CSSF Regulation N°14-1 on the implementation of certain national discretions contained in the CRR has been published in the Official Journal on 20 February 2014 and entered into force retroactively as of 1 January 2014.

Regulation CSSF N°14-1 thus supplements the CRR and includes notably implementation provisions relating to own funds requirements and capital buffers applicable since 1 January 2014 (the new CSSF Regulation introduces a capital conservation buffer of 2.5% ahead of the future implementation of the respective CRD IV requirement by Bill N°6660), as well as to the exposures exempted from the regulations on large exposure, including intra-group exposure exemptions, subject to certain conditions being fulfilled.

CRR – Entry into Force

CSSF Circular 14/583

The CSSF published on 13 February 2014 a new circular 14/583 on the entry into force of the Capital Requirements Regulation (CRR) on 1 January 2014.

Through Circular CSSF 14/583, the CSSF wishes to draw the attention of Luxembourg credit institutions, Luxembourg investment firms within the meaning of the CRR, as well as the

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branches of such non-EU institutions to which the CRR applies (commonly referred to as CRR institutions) on the following points:

- the CRR is directly applicable to them as of 1 January 2014, without any transposition into Luxembourg law of this regulation being necessary. The fact that the transposition of the CRD IV, which supplements the provisions of the CRR, is still under way in Luxembourg, does not affect the applicability of the CRR in any way
- the CRR takes precedence over all other provisions of the Luxembourg rules and regulations which would conflict with the provisions of the latter. Thus, as an example, as regards the definition of capital ratios, the bulk of Circular CSSF 06/273 and the bulk of Circular CSSF 07/290 no longer applies to CRR institutions. The Financial Sector Law as well as these two circulars are being amended in that respect
- as the CRR is further supplemented by detailed technical standards developed by the EBA and issued by means of regulations of the European Commission directly applicable in Luxembourg, CRR institutions are further invited by the CSSF to regularly consult the Official Journal of the European Union as well as the CSSF's website to be kept informed of such developments.

CRD IV/MiFID – Implementation of the ESMA Guidelines on MiFID Remuneration Policies and Practices

CSSF Circular 14/585

The CSSF has issued a new circular 14/585 dated 25 February 2014. This new circular implements the "Guidelines on remuneration policies and practices (MiFID)" published by ESMA on 11 June 2013 by adding them as an additional annex V to CSSF Circular 07/307.

The ESMA guidelines provide for the consistent and improved implementation of the existing MiFID conflicts of interest and conduct of business requirements in the area of remuneration (Chapters 7 and 8 of CSSF Circular 07/307). The guidelines specifically target persons likely to have a significant influence on the service provided by or the conduct of the firm whose remuneration may create inappropriate incentives to act against the interests of clients.

This new circular completes the CRD IV legislation as well as guidelines deriving from the CRD III and AIFMD. The circular entered into force with immediate effect and is applicable to banks providing investment services and investment firms as well as UCITS management companies and external managers of alternative investment funds providing MiFID portfolio management or auxiliary services.

Out-of-court Resolution of Complaints

CSSF Circular 14/589

On 27 June 2014, the CSSF published Circular 14/589 the purpose of which is to clarify some of the obligations imposed on professionals subject to the prudential supervision of the CSSF by CSSF Regulation 13-02 of 15 October 2013 relating to the out-of-court resolution of complaints. For further details on this new circular, we kindly refer you to the Funds and Investment Management section of this Luxembourg Legal Update.

New FAQ on the Information Requirements of Issuers Benefitting from Exemptions under the Transparency Law

CSSF Press Release 14/13

The CSSF has issued a press release dated 25 February 2014 drawing the attention to the publication on its website of a new Frequently Asked Question (FAQ) N°48 in relation to the information requirements of issuers who benefit from certain exemptions under the Luxembourg Transparency Law ("exempted issuers").

Signing of a Multilateral Memorandum of Understanding (MMoU) by the CSSF

CSSF Press Release 14/28

The CSSF has signed a MMoU, which provides a legal framework for cooperation arrangements and information exchange among competent authorities and ESMA. The MMoU updates and replaces the existing CESR MMoU. The update was necessary in order to take into account developments in European law and to incorporate other cooperation procedures that have been agreed between competent authorities with the assistance of ESMA. The new MMoU is intended to cover all competent authorities of the EU, the EEA, the EFTA and ESMA.

The MMoU entered into force on 27 May 2014.

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CSSF Activity Report 2013

The CSSF has published its Activity Report for 2013 on 9 May 2014. In addition to statistical information concerning the Luxembourg financial sector, the report contains information on the exercise by the CSSF of its regulatory powers. The following points, without being exhaustive, are of relevance for banks and other actors of the financial sector.

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

Bank Secrecy Waivers – Requirement of Explicit Customer Consent to Data Disclosure in the Context of Outsourcing

CSSF Circular 12/552 on central administration, internal governance and risk management (as amended) applies to credit institutions, investment firms and professionals carrying out lending transactions. Point 193 of this circular provides that "*credit institutions may contractually use services for the management/operation of their systems […] in Luxembourg […] and abroad from an entity of the group to which the institution belongs and which exclusively deals with group transactions provided that these systems do not include any readable confidential data on the customers other than institutional customers, unless explicit consent is given by the customer or the owner of the data or his/her proxy, on the basis of an informed opinion on the interest of this outsourcing, the specificity of the envisaged purpose, of the content of the transmitted information, of the recipient and of the location as well as of the duration in time; in respect of institutional customers, the specific characteristics of this outsourcing shall be made explicit in the contract*".

Following various questions received in 2013 about the "explicit customer consent" requirement mentioned above, the CSSF has provided the following clarifications on such requirement in its new activity report:

- The requirement of consent applies to customers falling within the scope of professional secrecy as defined in Article 41 of the Financial Sector Law. Thus, in the area of investment funds with an international clientele, the point of primary attention remains the Luxembourg bank relationship of the customer which is subject to confidentiality. Holders of units in a fund operating from a Luxembourg bank relationship hence have to be covered by the professional secret provided for in Article 41 of the Financial Sector Law.
- As regards the "explicit" character of the consent to be obtained, the following has to be specified:

  (a) Consent is required for any type of customer, whether it is an institutional customer or a natural/private person.

  (b) Such consent is required for all customers, be they former, existing or future customers. For the former customers whose data are *a priori* archived, if it is not possible to obtain their consent, the contractual relationship being terminated, the system concerned by the outsourcing must not contain their data.

  (c) With respect to private clients, an "explicit consent given by the customer or the data owner or his/her proxy on the basis of an informed opinion regarding the interest of such outsourcing, the specificity of the envisaged purpose, of the content of the transmitted information, of the recipient and of the location as well as of the duration in time" is required.

  - Customer consent must be requested at a visible place and therefore cannot only be part of the general terms and conditions. In the framework of a transfer agent activity, consent may, for example, be integrated into the distribution agreements for fund managers and into subscription/redemption forms for investors.
  - Existing private customers need to receive and sign a specific consent document.

  (d) With respect to institutional customers, CSSF Circular 12/552 simply provides in point 193 that "*in respect of institutional customers, the specific characteristics of this outsourcing shall be made explicit in the contract*".

  - A provision in the contract is hence sufficient, but this is still an explicit consent given by signing the contract and is not simply implied information or a tacit agreement.
  - Existing institutional customers also need to receive and sign a specific consent document which may, for example, be an annex to the contract.

Supervision of IT Systems

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

Proper Use of Encryption Algorithms

The CSSF notes that cryptography technologies are not always used with a sufficient level of accuracy, in particular with respect to

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the correct choice of encryption algorithms, key size, implementation of protocols and taking into account their respective obsolescence. The CSSF reminds that a point-by-point and up-to-date cryptography technology, subject to proper use, is currently the only way to efficiently protect the confidentiality of information and information flows for which the entity is responsible under its professional confidentiality obligation. The CSSF therefore invites all entities to systematically verify the used cryptography, cryptographic applications, the security protocols and their encryption algorithms, sizes of encryption keys, best security practices relating to implementing encryption, etc. and their potential obsolescence.

By way of illustration, the CSSF draws the attention of professionals to the following points:

- protocols, algorithms and encryption keys
- server negotiation in an HTTPSconnection
- protocols for remote connection
- MPLS (Multiprotocol Label Switching) protocols

and sets out non-exhaustive examples of obsolete cryptographic practices in these areas.

Online Financial Services

The CSSF insists that any type of entity providing online financial services performs a penetration test of the chosen protective measures during their implementation and also in case of major configuration changes. The results of the penetration test have to be submitted systematically to the CSSF.

Messaging Systems and VoIP Systems: Confidentiality and Subcontracting

In relation to the confidentiality of a company's messaging system, a key distinction is to be made between an external and an internal messaging system.

Regarding external messaging systems, i.e., systems where messages are received from or sent externally, the CSSF considers that the client of a professional of the financial sector is aware of the risks of information divulgation to the Internet when it chooses to communicate with the professional by e-mail or other electronic communication means through the Internet (e.g., messaging service). The CSSF takes the view that the professional of the financial sector has a duty to inform its client of the risks associated with this type of communication, in case the agreement between the client and the professional provides for this communication mode. A professional of the financial sector should also set its own limits concerning the use of Internet messaging, even if its clients do not see the need for such limitation.

While the client of a professional of the financial sector is expected to know and accept the risk of divulgation of information on the Internet relating to external messaging systems, the confidentiality of its data within the financial sector professional, i.e., by using internal messaging systems, is supposed to be guaranteed. Consequently, if a professional of the financial sector wishes to entrust the management of an internal messaging server to a third party, it must comply with the requirements applicable to IT outsourcing set out in CSSF Circulars 12/552 or 05/178, as applicable.

By analogy with messaging systems, the CSSF makes the following distinction regarding VoIP systems:

- internal VoIP flows within an entity (i.e., between employees of the same legal entity) that may contain confidential information covered by the statutory professional confidentiality obligation of the Luxembourg professional
- external VoIP flows (i.e., between a person of an entity and a person outside that entity) that can get outside the entity, i.e., on a telecom network the operator of which is subject to the secrecy of telecommunications.

In case of projects of outsourcing of a VoIP system, a professional of the financial sector has to ensure that the same rules applicable to messaging systems are complied with.

Group Relationship

The CSSF reminds us that professionals of the financial sector must retain full control of the resources which they are responsible for and of the access to these resources for compliance and governance reasons, and to protect confidential data subject to the statutory professional confidentiality obligation. Controlling an IT system requires supervising its access rights. When an IT system is shared or is part of a group of entities to which the entity belongs, its control becomes unclear. Some of the proposed solutions claim to maintain control within the entity by additional technical and organisational security measures. These solutions may indeed add effective intermediary access controls, but do not remove the ultimate access possibility of persons outside the Luxembourg entity and for interventions out of its control (e.g., access of Enterprise Administrators). That is why a group entity

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located in Luxembourg must always analyse a solution proposed to it where there is an ultimate means to obtain the access rights (privileged or not) to the IT resources of the Luxembourg entity. This means must at all times be under the control of the Luxembourg entity.

With respect to business applications which can be accessed remotely and which are often outsourced to a group entity located abroad, the CSSF reminds us that the major problem with such applications is to maintain confidentiality of data and compliance with the statutory professional confidentiality obligation. In this context, a simple anonymisation of the data cannot be considered as a possible solution because the data are used within a complex process. Even if the data are routed to the application in encrypted form, the application has to dispose of them in readable form in order to process them. This is however very problematic as regards the professional confidentiality obligation, since the application then needs to decrypt the information locally to make it available and readable to other employees of the group, in particular IT administrators. The CSSF stresses that the technical implementation of applications, which include encryption and decryption formalities and pretend to guarantee technically the confidentiality of the data, is very special and their compliance for the Luxembourg financial sector remains delicate to establish. It is not possible to technically prove that confidentiality is ensured in an absolute manner by these technical solutions presented by IT solution providers to the CSSF in the past. The professionals of the financial sector remain responsible for showing and providing proof that the business applications they want to implement, including on a technical level, comply with the applicable legal requirements.

Continuity

With respect to Business Continuity Plans (BCP) providing for the use of emergency workstations located abroad in case of unavailability of the premises of a financial sector professional, the CSSF reminds us that entities must, at all times, and hence also in the event of activation of the BCP, have their central administration in Luxembourg and ensure the control and the confidentiality of information. The CSSF specifies that the emergency premises in the context of activation of a BCP mandatorily have to be located in Luxembourg, meet the standards of professional offices and guarantee the same level of safety as conventional offices, while taking into account the proportionality with the usual activity. Emergency premises located in private homes or public places (e.g., restaurants or hotels) are not acceptable.

With respect to business continuity risks associated with the dependence from a supplier of core business software, the CSSF notes that, when a professional of the financial sector uses an application provided by a third party, the professional should check and detect dependencies and organise the continuity of its business activity, e.g., by anticipating the conditions of a migration to an alternative solution. Specific clauses should be inserted in the agreements:

- to take account of these events which should not lead to a prohibition to use a certain application or software or provoke a contractual imbalance (e.g., an important price increase in case of re-negotiation)
- to give the professional sufficient time to migrate to another system in good conditions.

In case of high or even total dependency from a specific supplier or business software, contract management is particularly important. The CSSF finally notes that the dependence from professional software exists even in a case of proprietary software that does not completely eliminate the risks mentioned above.

Remote Access to IT Services (Mobility and Teleworking)

The CSSF reminds us the rules defined in its 2007 Activity Report in relation to remote access to IT services and clarifies that these rules apply to all professionals of the financial sector, including support PFS, and are still in force. In particular the number of people benefiting from these remote access systems as well as the systems which can be accessed must both be limited.

These remote accesses are mainly used by IT staff in the context of urgent interventions or executives travelling abroad within the group. The CSSF has experienced that some institutions are now considering use of remote access by business teams on a regular basis. The CSSF considers that this type of use, similar to teleworking, increases the risk of disclosure of confidential data. In addition, the central administration of the entity, which must remain on the territory of Luxembourg, is no longer guaranteed in such case. In any event, a professional of the financial sector wishing to implement a mobility/remote access project must take into account the elements presented above and submit its project to the CSSF in advance.

CRD IV – Excessive Leverage Risk

The CSSF considers that, until the entering into force of a mandatory provision on EU level from 2018, the leverage calculated for Luxembourg CRR institutions under CRD IV is excessive if the ratio between the regulatory own funds,

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determined according to Art. 72 of the CRR, and the total of assets in the balance sheet and the commitments and guarantees granted off-balance sheet, is inferior to 3%.

Prospectus Law

The CSSF specifies that where an issuer decides to include in a supplement to a base prospectus, changes modifying the conditions attached to securities, such issuer has to specify in the supplement that these changes can only affect the securities to be issued after the approval of such supplement by way of the final terms.

The CSSF also sets out that it is not possible to prepare a supplement to a base prospectus in order to include a new product type. In order to determine whether the changes made by way of a supplement have to be considered as an introduction of a new product type, the CSSF carries out a case-by-case assessment based on certain criteria set out in its report, including, amongst others, whether it is necessary to use a new annex to the EU Prospectus Regulation to verify the changes made in the supplement.

Public Acquisition Offers

The CSSF reminds that break fees agreements concluded in the context of public acquisition offers within the scope of the Luxembourg Public Acquisition Offer Law between a target company and the bidder are capable of constituting a violation of the principles of that law. The CSSF indicates however that such agreements require to be analysed on a case-by-case basis. The CSSF considered for instance in a specific case submitted to it in 2013 that the break fees agreement did not violate these principles because certain conditions were fulfilled, including amongst others that:

- the management body of the target company considered that the conclusion of such agreement was in the interest of the company and its shareholders and in line with the principle of equal treatment
- the indemnity had to be paid only in case a competing offer had success over the offer of the bidder
- such indemnity was inferior to the costs engaged by the bidder and 1% of the company capital of the target
- such indemnity did not have a dissuasive character for potential initiators of a counter-offer.

Squeeze-Out

The CSSF specifies that the consideration paid to minority shareholders in squeeze-out proceedings mandatorily needs to be in cash. The CSSF however admits that it is possible for the majority shareholder to carry out simultaneously, but outside the scope of the Law on Squeeze-Out and Mandatory Redemption, a public exchange offer on the securities of the relevant company, provided such offer does not call into question the rights of the securities holders concerned in the squeeze-out proceedings.

ECB Guideline on Temporary Measures Concerning Refinancing Operations of Eurosystem and Eligibility of Collateral

BCL Regulation 2014/N°16 dated 12 May 2014

The BCL has issued a new regulation 2014/N°16 dated 12 May 2014 which implements the ECB Guideline of 12 March 2014 amending Guideline EC/2014/4 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline EC/2007/9 (ECB/2014/12).

The new regulation also amends BCL Regulation 2013/N°15. The BCL regulation thereby reflects the changes to the Eurosystem's collateral framework, relating to:

- the extension of loan-level reporting requirements to asset-backed securities backed by credit card receivables in Annex I to Guideline ECB/2011/14
- the revision of the mapping of certain credit ratings in the context of the Eurosystem harmonised rating scale
- clarification of the rating rules relating to asset-backed securities.

The new regulation is applicable as of 12 May 2014.

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Modification of Statistical Data Collection of Securitisation Vehicles

BCL Circular Letter 2014/236 dated 25 April 2014

The BCL has issued a new circular letter 2014/236 dated 25 April 2014 on the modification of the statistical data collection of securitisation vehicles. The new circular has been issued to adapt the data collection set-up in this area to the developments at EU level by way of Regulation (EU) N°549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (European System of National Accounts 2010) (ESA 2010), and implementing regulations and guidelines issued by the governing council of the ECB.

The main innovations of the new data collection system include:

- harmonisation of codification of items and original maturities with those used for the data collection for other Luxembourg financial entities
- modification of the list of economic sectors and the list of security types, in accordance with the changes in the ESA 2010
- introduction of a monthly security by security reporting together with a lightening of the quarterly reports on transactions and write-offs/write-downs on securitised loans
- in the quarterly balance sheet, breakdowns by country, currency, economic sector and original maturity of items other than those in relation with securities are now required in order to estimate the financial transactions on these captions
- introduction of a new nature of securitisation linked to the insurance and re-insurance area.

The new circular applies to all undertakings located in Luxembourg and governed by the Luxembourg Securitisation Law as well as commercial companies located in Luxembourg that fall within the definition of a securitisation vehicle in the sense of article 1 of regulation ECB/2013/40. Small-sized securitisation vehicles may be exempted from reporting requirements.

The reported data may also be exchanged with the Luxembourg financial and insurance sector authorities CSSF and CAA, and the Central Service for Statistics And Economic Studies (Statec) if required for their respective missions.

The new reporting starts for the period of reference ending December 2014 and no later than 30 January 2015.

New Circular Letters and Other Publications concerning the Insurance Sector

The CAA issued the following circular letters:

- Circular Letter 14/4 dated 4 March 2014 modifying Circular Letter 03/2 on annual reporting for Luxembourg direct insurance undertakings
- Circular Letter 14/5 dated 12 March modifying Circular Letter 99/6 on annual reporting for Luxembourg reinsurance undertakings
- Circular Letter 14/6 dated 16 April 2014 on the annual report of management companies of reinsurance undertakings
- Circular Letter 14/7 dated 16 April 2014 on the annual report of management companies of pension funds
- Circular Letter 14/8 dated 26 May 2014 modifying Circular Letter 09/7 on the deposit of securities and funds used as assets covering technical provisions of direct insurance companies and pension funds subject to the supervision by the CAA
- Circular Letter 14/9 dated 1 July 2014 on the FATF statements concerning 1) jurisdictions whose anti-money laundering and combating the financing of terrorism regime has substantial and strategic deficiencies; 2) jurisdictions not making sufficient progress; 3) jurisdictions whose anti-money laundering and combating the financing of terrorism regime is not satisfactory
- The CAA has published on its website on 15 May 2014 the EIOPA guidelines applied by it on the examination of internal model in the pre-candidature phase, on the future assessment of its own risks, on the governance system, on communication of information to competent national authorities and on the treatment of complaints by insurance undertakings
- The CAA has published on its website on 20 May 2014 a letter sent to it by the Belgian Financial Services and Markets Authority (FSMA), asking the CAA to inform Luxembourg insurance undertakings and insurance intermediaries providing insurance intermediation services in Belgium, either through a branch or by way of free provision of services, of the changes to Belgian insurance legislation and the new conduct of business rules resulting therefrom for foreign undertakings carrying out insurance intermediation in Belgium. The FSMA considers that these rules constitute rules of general good to be applied also to foreign EU undertakings acting under their EU passport in Belgium.

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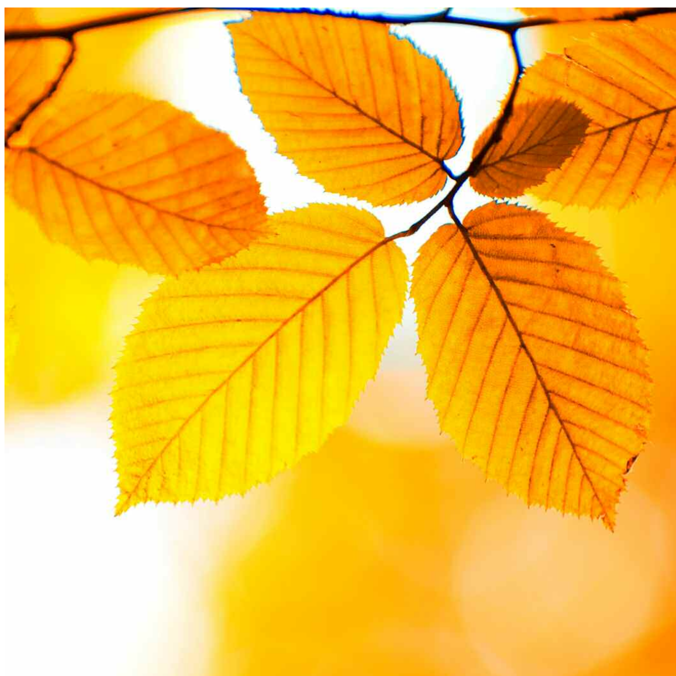

Case Law

Theft of Confidential Document by Employee of Bank

Supreme Court, 3 April 2014

Voidability of a Loan and the attached Pledges – Mistake, Fraud and Lack of a Valid "cause"

District Court, 19 February 2014

CSSF Annual Report – Clients' Complaints

Investor Profiles: Management of Investor's Funds by the Client or by the Bank

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

Corporate and M&A

Legislation

Some changes have come into force in the general provisions of Luxembourg corporate law during the period covered by the present newsletter and these changes are likely to affect the activities of Luxembourg companies.

Law of 10 March 2014

Law of 10 March 2014 amending the Companies Law in order to execute Council Regulation (EC) N°1435/2003 of 22 July 2003 on the Statute of a European Cooperative Society

The Luxembourg Parliament implemented on 21 January 2014 into domestic legislation the Council Regulation (EC) N°1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) (the "Law"). This Law has been published in the Memorial on 19 April 2014 and amends the Luxembourg Company Law by inserting a new sub-section 3 under Section VI – Cooperative Societies and new articles 137-11 to 137-62. These provisions form a complement to:

- the Council Regulation (EC) N°1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society
- the Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society concerning the involvement of employees

and are to be applied concomitantly.

The Law establishes a legal statute for an SCE to ensure equal terms of competition between cooperative societies and other companies. The aim of the Law is to facilitate cross-border and transnational activities of cooperative societies.

Main provisions governing the SCE (notably rules for its incorporation, organs of the SCE, management of the SCE, dissolution and liquidation of the SCE) are actually contained in the Council Regulation (EC) N°1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society. The Law however clarifies some of the provisions of the Council Regulation (EC) N°1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society and specifies certain rules which shall be applicable to SCE incorporated in Luxembourg. Such particularities may be summarised as follows:

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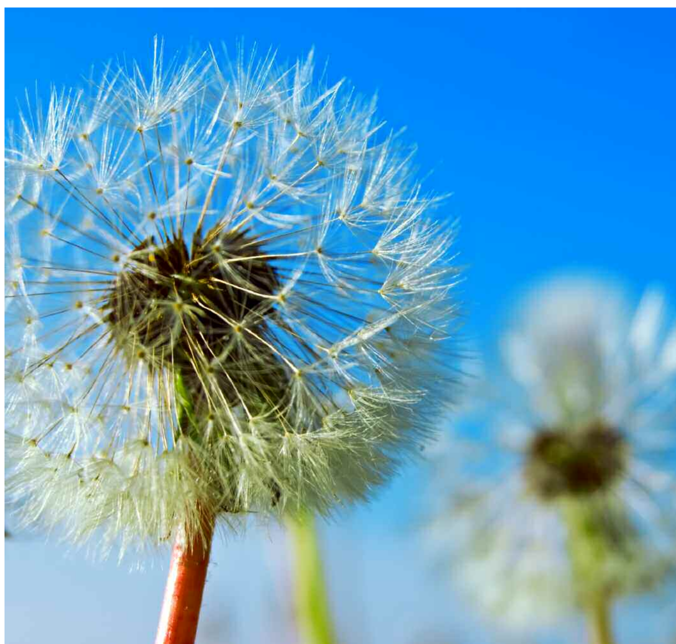

Particularities related to incorporation of the SCE

The SCE must be formed by a notarial deed.

The rules governing the contributions in kind in a Luxembourg SA (e.g., valuation report on the contribution from a Luxembourg *réviseur d'entreprises agréé*) shall also apply to contribution in kind in SCE.

The articles of the SCE may foresee that persons who are not entitled to use or produce the goods and services of the SCE may become members of the SCE as non-user (investor) members.

In case the SCE is constituted by merger of existing cooperative societies, it will be to the Luxembourg notary enacting the merger to proceed with the control of legality of the merger process.

Particularities related to management of the SCE

The SCE can be managed by a board of directors (one-tier system) or a management board and a supervisory board (two-tier system). It is possible that legal entities become members of the board of directors or management board or supervisory board of an SCE, in which case they must designate a permanent representative which will be a physical person.

The SCE shall be bound by any acts of persons with capacity to represent the company, even if such acts exceed the corporate object, unless it proves that the third party knew that the act exceeded the corporate object, could not in view of the circumstances or have been unaware of it, without the mere publication of the articles constituting such proof.

If the SCE is managed by a board of directors (one-tier system), the board must be composed of at least three members.

The board of directors may delegate the daily management of the company to one or more persons. Where in an SCE, a delegation of powers has been validly granted and where the holder of such delegation passes a deed which is within the limits of such delegation but belongs to a category of transactions which, under the articles of the SCE, require an express decision of the board of directors, such holder shall bind the company without prejudice to damages, where applicable.

In the two-tier system, the SCE is managed by a management board composed of one or more members, which is under the supervision of a supervisory board composed of at least three members.

The management board shall have the power to take any action necessary or useful to realise the corporate object, with the exception of those powers reserved by law or the articles to the supervisory board and to the general meeting. The articles of SCE shall list the categories of transactions which require authorisation of the management board by the supervisory board.

The management board may delegate the daily management of the company to one or more persons. Where in an SCE, a delegation of powers has been validly granted and where the holder of such delegation passes a deed which is within the limits of such delegation but belongs to a category of transactions which, under the articles of the SCE, require authorisation of the management board by the supervisory board, such holder shall bind the company without prejudice to damages, where applicable.

Members of the management board shall be appointed by the supervisory board. The articles may nevertheless provide that the members of the management board shall be appointed by the general meeting. In such a case, the general meeting will therefore have sole authority. The members of the management board may be removed by the supervisory board and, where provided for in the articles, by the general meeting.

If there is more than one member of the management board, the members of management board will form a collegiate body which shall deliberate in accordance with the articles.

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The supervisory board shall carry out the permanent supervision of the management of the company by the management board, without being authorised to interfere with such management. The supervisory board may require the management board to provide information of any kind which it needs to exercise supervision. The supervisory board forms a collegiate body which shall deliberate in accordance with the articles.

The supervisory board shall be convened upon notice of its chairman. The chairman must convene it on the request of at least two of its members or by the management board. The board shall meet at intervals laid down by the articles. The supervisory board may invite the members of the management board to be present at the meetings of the board, in which case they shall have an advisory role only.

The members of the management board and of the supervisory board may receive fees in that capacity. The type of remuneration and the amount of the fees payable to the members of the management board are determined by the supervisory board. The type of remuneration and the amount of the fees payable to the members of the supervisory board are determined by the articles, failing which by the general meeting.

The members of the board of directors, the management board or the supervisory board shall be liable to the SCE in accordance with general law for the execution of the mandate given to them and for any misconduct in the exercise of their functions. They shall be jointly and severally liable both towards the company and any third parties for damages resulting from the violation of the Council Regulation (EC) N°1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society, the Companies Law or the articles of the SCE. They shall be discharged from such liability in case of a violation to which they were not a party, provided no misconduct is attributable to them, and they have reported such violation to the first general meeting after they had acquired knowledge thereof.

Particularities Related to General Meeting of the SCE

The board of directors, the management board, the supervisory board or the *réviseur d'entreprises agréé* performing the legal review of the annual accounts of the SCE may convene the general meeting of the members of the SCE.

The general meeting of the members of the SCE shall be held once a year, within six months of the closing of the financial year of the SCE, and the first general meeting may be held within eighteen months after its incorporation.

The articles of the SCE may provide for a member to have a number of votes determined by his/her participation in the cooperative activity other than by way of capital contribution. This attribution shall not exceed five votes per member or 30% of total voting rights, whichever is the lower.

SCEs involved in financial or insurance activities may provide in their articles for the number of votes to be determined by the members' participation in the cooperative activity, including participation in the capital of the SCE. This attribution shall not exceed five votes per member or 20% of total voting rights, whichever is lower.

In SCEs, the majority of members of which are cooperatives, the articles may provide for the number of votes to be determined in accordance with the members' participation in the cooperative activity, including participation in the capital of the SCE and/or by the number of members of each comprising entity.

Non-user (investor) members may not together have voting rights amounting to more than 25% of total voting rights.

The articles of the SCE may provide for the participation of employees' representatives in the general meetings or in the section or sectorial meetings, provided that the employees' representatives do not together control more than 15% of total voting rights. Such rights shall cease to apply as soon as the registered office of the SCE is transferred to a Member State in which the law does not provide for such participation of employees.

Where the SCE undertakes different activities or activities in more than one territorial unit, or has several establishments or

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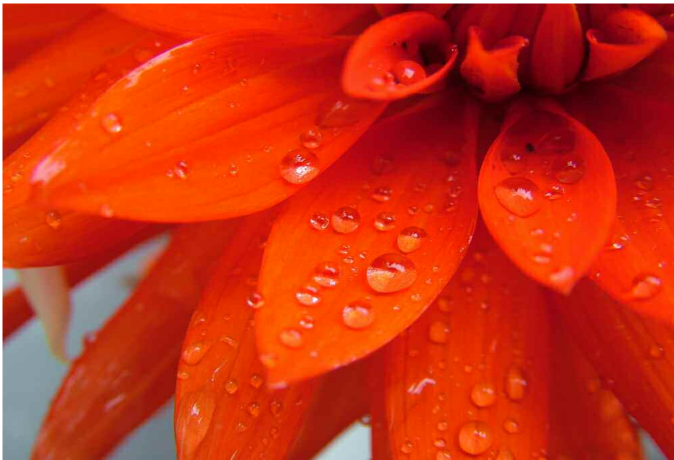

more than 500 members, its statutes may provide for sectorial or section meetings. The articles shall establish the division in sectors or sections and the number of delegates thereof.

Particularities Related to Liquidation of the SCE

In the event of a winding-up of the SCE, net assets and reserves should be distributed according to the principle of disinterested distribution, i.e., to another cooperative body pursuing similar aims or general interest purposes. It is however possible to derogate to such principle of distribution in the articles of the SCE.

Case Law

Obligation for a Legal Person being the General Partner of a Luxembourg SCA to Designate a Permanent Representative who will be a Physical Person

District Court Luxembourg, 11 December 2013

Notary Subject to a Personal Duty to Apply Diligence Measures Following the Anti-Money Laundering Provisions when Holding a General Meeting Changing the Corporate Name and Nominating Additional Directors

District Court Luxembourg, 31 October 2013

A Share Capital Increase through Conversion of a Loan Regarded as a Share Capital Increase by Contribution in Kind and not as a Capital Increase by Contribution of Convertible Bonds – Nullity of General Meeting of Shareholders Due to the Absence of a Report Evaluating the Contributions in kind by an Approved Auditor Prior to the Share Capital Increase

District Court Luxembourg, 16 May 2013

Please refer to the Litigation Section of this Luxembourg Legal Update for details of the above.

Employment

Remuneration policies in the financial sector: Bill N°6660 of 7 March 2014 – CSSF Circular 14/585

The Luxembourg government deposited a new bill (N°6660) for the implementation of the CRD IV with the Luxembourg Parliament on 7 March 2014.

As currently drafted, the bill merely implements the CRD IV principles in relation to the remuneration requirements. This means in particular that it allows the financial institutions to increase the ratio between the fixed and the variable remuneration from 1:1 to 1:2 subject to the approval of the shareholders or owners or members of the institution under the procedure foreseen in the CRD IV.

CSSF Circular 14/585 has implemented the ESMA guidelines dated 11 June 2013 on remuneration policies and practices (MiFID) into Luxembourg regulation in the form of an annex to CSSF Circular 07/307.

Bill N°6660 and the CSSF Circular 14/585 and related developments are dealt with in the Banking, Finance & Capital Markets section of this newsletter.

Case Law

New Trial Period in an Existing Employment Contract

Court of Appeal, 27 March 2014

Please refer to the Litigation Section of this Luxembourg Legal Update for details of the above.

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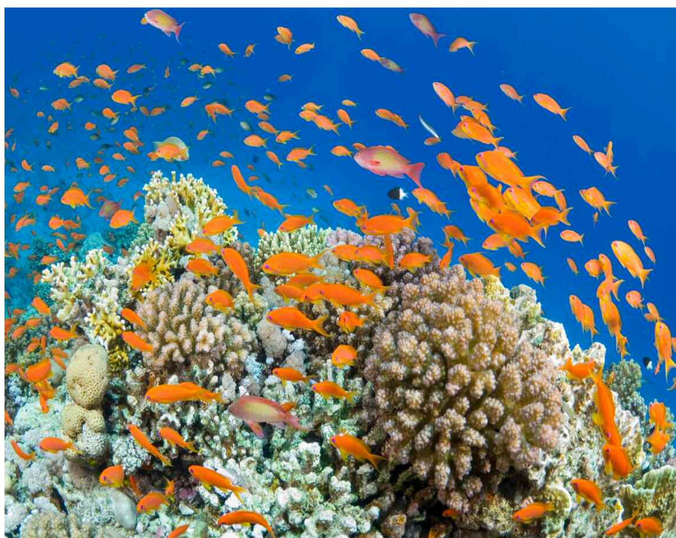

Funds and Investment Management

EU Developments

UCITS V

On 15 April 2014, the EU Parliament's plenary session has approved the proposed directive amending the UCITS Directive[1]as regards depositary regime, remuneration policies and sanctions (UCITS V Directive).

The UCITS V Directive still needs to be formally adopted by the EU Council before being published in the Official Journal, and will enter into force on the 20th day following it. Thereafter, Member States will have 18 months to transpose the new directive into national law, and depositories will be given an additional transitional period after the transposition deadline to comply with the new UCITS V "eligibility criteria". In the meantime, the EU Commission should adopt a Level 2-delegated regulation to clarify the depositary regime and ESMA should also issue Level 3 guidelines, in particular to clarify the remuneration requirements. These Level 2 and Level 3 implementing measures are expected to be aligned, as far as possible, with those applying to AIFMs under the AIFM Directive[2].

Please read all the information related to UCITS V in Clifford Chance client briefings titled "Remuneration policy of management companies" and "Legal regime of the depositaries under UCITS V".

ETFs and other UCITS Issues

ESMA Final Report and New Guidelines

On 24 March 2014, ESMA published its final report[3] on the revision of its guidelines on ETFs and other UCITS issues concerning the diversification of collateral received by UCITS in the context of EPM techniques and OTC transactions.

This final report follows a consultation organised in December 2013 further to a request formulated by stakeholders who had asked ESMA to reconsider its position given the adverse impact of its guidelines on UCITS collateral management policies. The new guidelines attached as Annex I of the final report will be translated into the official EU languages and published on the ESMA website. Once translated, there will be a two-month period during which national competent authorities must notify ESMA on whether they comply, or intend to comply, with the new guidelines, which will apply from that date.

In brief, the new guidelines modify the rules on collateral diversification in paragraph 43.e) of the existing ESMA guidelines and introduce some further consequential changes, as summarised below:

- In principle, all collateral received by a UCITS in the context of EPM techniques and OTC derivatives must have an exposure of no more than 20% of the UCITS' net asset value to a single issuer. For the purpose of the calculation of this 20% limit, the different baskets of collateral received from different counterparties must be aggregated together.
- By way of derogation from the above, the new guidelines provide that any UCITS may be "fully collateralised" in the form of government securities, i.e. different transferable securities and money market instruments issued or guaranteed by a Member State, one or more of its local authorities, a third country, or a public international body to which one or more Member States belong. The new guidelines also require that the collateral must be diversified across at least six different issues, but securities from any single issue should not account for more than 30% of the collateral received.

1 Directive 2009/65/EC of 13 July 2009 of the EU Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to UCITS.
2 Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on alternative investment fund managers.
3 ESMA/2014/294

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For the avoidance of doubt, ESMA has decided to apply the specific approach for full collateralisation in the form of government securities to all UCITS rather than limiting it to Money Market Funds and Short-Term Money Market Funds (as defined in ESMA guidelines on a common definition of European money market funds).[4]

Such UCITS that receive collateral from any one issuer for more than 20% of their net asset value are required to make additional disclosures in their prospectus and annual report, subject however to the following transitional provisions for UCITS that exist before the application date of the new guidelines:

- compliance by an existing UCITS with the provisions relating to the prospectus transparency on collateral diversification is required until the earlier of:
  - the first occasion after the application date of these guidelines on which the prospectus, having been revised or replaced for another purpose, is published
  - 12 months after the application date of these new guidelines.

the requirements to publish information in the annual report and account of an existing UCITS do not apply in respect of any accounting period that has ended before the application date of the new guidelines.

For the avoidance of doubt, the above derogation does not affect the other criteria for collateral management as set out in paragraphs 41 to 47 of the ESMA guidelines on ETFs and other UCITS issues.

ESMA Updated Q&A

On 24 March 2014, ESMA published an updated version of its Q&A on the practical application of its guidelines on ETFs and other UCITS issues, initially published on 15 March 2013 and which had already been updated in July and November 2013.

The following new questions and answers have been added to the financial indices section of the Q&A:

- As regards paragraph 55 of the ESMA guidelines, it is clarified that the information to be disclosed and provided by the index provider in relation to the full calculation methodology to enable investors to replicate the financial index must be publicly available to investors and prospective investors, and published in such a way that direct access to this information is possible. Such information may be so accessed, for example, as a direct publication or via a source which directly links to a public website or other public forum which is not password protected, encrypted or in any way hinders or impedes immediate and direct access.
- As regards paragraph 50 of the ESMA guidelines, it is specified that a UCITS can invest in a commodity index for which a particular commodity component does not have five years of price history available for the purposes of the correlation observation, provided that a similar asset serves as an adequate proxy.

European Market Infrastructure Regulation (EMIR)

Please see the presentation made in this respect in the Banking, Finance and Capital Markets section of this Luxembourg Legal Update.

Markets in Financial Instruments (MiFID2/MiFIR)

Almost four years since the EU Commission began its review of the original Markets in Financial Instruments Directive (MiFID), the final texts of MiFID2 and MiFIR have been published in the Official Journal on 12 June 2014. The new rules have entered into force on 2 July 2014 and will start to apply 30 months later, i.e. early in 2017.

Even if regulated investment funds (including coordinated UCITS and non-UCITS funds) remain themselves out of scope of MiFID2 and MiFIR, their functioning will nevertheless be impacted by certain new MiFID2 and MiFIR rules designed to strengthen investor protection as summarised below.

- Suitability test – Under MiFID2, the scope of activities that can be carried out on an "execution only" basis and hence without a suitability assessment has been narrowed considerably in relation to certain products such as margin trading, embedded derivatives, and other complex structures which now include structured UCITS. As a result, additional requirements will apply when selling structured UCITS which will become subject to appropriateness assessment and will no longer be covered under the "execution only" regime.
- Information to investors – MiFID2 increases the type of information that investment firms, including investment advisers and distributors, must supply to investors before they invest in a financial instrument or receive investment advice. In

4 CESR/10-049.

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particular, a key development in relation to the best execution requirements is the obligation for investment firms to disclose publicly, on an annual basis, information on which are the top five execution venues by volume in respect of a particular type of instrument used by that firm. The new rules also require trading venues and systematic internalisers to publicly disclose information on the quality of execution they provide, including details about price, cost, speed and likelihood of execution.

- Investment advice – Under the existing MiFID legislation, investment firms providing investment advice are not required to explain to their clients the exact nature of their advisory services. In the future, the concept of independent advice introduced by MiFID2 will imply that investment firms will have to be very clear to their clients as to:

  - whether or not investment advice is provided on an independent basis

  - whether the advice they provide is based on a broad or on a more restricted analysis of what financial products are available on the market.

  When a firm says it is providing investment advice on an independent basis, then it will mean that it has assessed a sufficiently diverse range of financial products available on the market and that it does not accept or retain payments or non-monetary benefits paid from a third party (or a person or firm acting on behalf of a third party) in relation to the provision of the investment advice that is being provided (see below the new MiFID2 rules on inducements). This important change will imply that, when a client decides to receive advice on an independent basis from a firm providing investment advisory services, he will pay the advisory firm for it directly, and he can be confident that this advisory firm has considered and assessed a wide range of products from across a range of product suppliers (not just the ones with links to the firm providing advice).

- Inducements – MiFID2 bans third party inducements for discretionary portfolio managers and for independent investment advisers who can only receive remuneration from their clients. This means that, in the future, any discretionary portfolio manager or investment adviser which says that it provides a client with discretionary management services or independent financial advices will no longer be able to accept or retain payments (fees, commissions or any other monetary benefit) or non-monetary benefits that it receives

  from a third party for the service carried out on behalf of its client (such as payments that an investment fund or portfolio manager or distributor of that investment fund makes to investment firms that sell the relevant investment fund to their clients). For the avoidance of doubt, under certain conditions, minor non-monetary benefits that enhance the quality of the service provided will however be allowed as long as they are clearly disclosed. Moreover, it has to be noted that the new inducement rules only apply to discretionary portfolio management and independent advice and not to investment firms that are only executing client orders under the "execution only" regime, provided however that certain conditions are complied with.

- Amendments of AIFM Directive – Article 92 of MiFID2 resolves the uncertainty as to whether AIFMs authorised under the AIFM Directive may provide certain MiFID investment services as set out in Article 6(4) of the AIFM Directive on a cross-border basis. These amendments are in principle to be applied by Member States from 3 July 2015, although ESMA has already recommended that competent authorities could accept the passport notification for the MiFID services by an AIFM authorised under Article 6(4) of the AIFM Directive even before 3 July 2015.

Please see the presentation made in this respect in the Banking, Finance and Capital Markets section of this Luxembourg Legal Update.

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Packaged Retail Investment and Insurance Based Investment Products (PRIIPs)

On 15 April 2014, the EU Parliament's plenary session has approved the proposed regulation on the Key Information Document (KID) for packaged retail investment and insurance-based investment products (respectively PRIIPs and PRIIP KID Regulation[5]).

The main objectives and expected benefits of the PRIIP KID Regulation are twofold. On the one hand, it aims to harmonise the operating conditions in relation to the information on investment products for all relevant players in the retail investment market (i.e., product manufacturers, persons selling those products and retail investors), and to increase efficiency in cross-border business. On the other hand, the purpose of the PRIIP KID Regulation is to ensure that retail investors are able to understand, compare and use the information that is made available to them about different products. Indeed, while offering considerable benefits for retail investors, investment products are often complex and opaque and it can be difficult to compare their respective features or fully grasp the risks involved. The new regulation will therefore require the provision of basic information to retail investors about investment products, the risk and return that can be expected as well as the overall aggregate costs that will arise in making the investment.

The PRIIP KID Regulation still needs to be formally adopted by the EU Council before being published in the Official Journal. It would then take effect within two years, from mid-2016 or thereabouts. Whilst the PRIIP KID Regulation will set out the overall principles, it is expected to be supported by detailed Level 2 and Level 3 measures in due course.

The main characteristics of the PRIIP KID Regulation are summarised below. Clifford Chance has also prepared a briefing paper reminding that the principal aims of the proposed regulation and discussing some of the key issues for asset managers and distributors of PRIIPs. To view a copy of this briefing paper, please click here.

Investment Products Concerned

The PRIIP KID Regulation defines "PRIIPs" as any product that falls within the following definitions:

- "packaged retail investment product" or "PRIP", meaning an investment, including instruments issued by SPVs (as such term is defined in the PRIIP KID Regulation), where, regardless of the legal form of the investment, the amount repayable to the investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the investor
- "insurance-based investment product", meaning an insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations.

In practice, PRIIPs can take a variety of legal forms, but can be distinguished by the broadly comparable functions they perform for retail investors: they typically combine exposures to multiple underlying assets, they are designed to deliver capital accumulation over a medium to long-term investment period, they entail a degree of investment risk, although some provide capital guarantees, and they are normally marketed directly to retail investors. Broadly speaking, PRIIPs can be categorised into four groups:

- investment funds
- insurance-based investment products
- retail structured securities
- structured term deposits.

For the avoidance of doubt, non-packaged investment products are excluded, such as:

- direct investments (corporate shares or sovereign bonds and other securities which do not embed a derivative)
- non-structured deposits
- simple saving products that do not offer investment opportunities
- products exposed to interest rates.

Private pension products, sometimes called "third pillar pensions" are also out of scope of the PRIIP KID Regulation.

Targeted Investors

Contrary to the UCITS' key investor information document (KIID) which is designed for all investors, including both retail and

5 The term "PRIIPs" will replace "PRIPs" within the agreed regulation and therefore it has been used throughout this Legal Update.

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professional investors, the investors targeted by the PRIIP KID Regulation are retail investors only, e.g.:

- retail clients within the meaning of the MiFID (i.e., a client who is not a professional client)
- customers with the meaning of Directive 2002/92/EC on insurance mediation, where these customers would not qualify as professional clients within the meaning of the MiFID.

Responsible Entity for Drawing KID

Every PRIIP manufacturer or remanufacturer will be responsible for drawing up a KID in accordance with the requirements laid down in the PRIIP KID Regulation for that product and for publishing this KID on its website.

The PRIIP manufacturer or remanufacturer is defined by the PRIIP KID Regulation as any entity that creates or issues a PRIIP, as well as any entity that makes changes to an existing PRIIP including, but not limited to, altering its risk and reward profile or the costs associated with an investment in the PRIIP. Typically, PRIIP manufacturers would include investment fund managers, insurers and banks.

Furthermore, the PRIIP manufacturer should regularly review the KID and revise the document when changes need to be made.

Responsible Entity for Delivering KID

The entity responsible for delivering the KID shall be the person advising on or selling the PRIIP to a retail investor. This includes the PRIIP manufacturer itself for direct sale and the distributor and intermediary for indirect sales.

Main Characteristics of KID

In brief, the PRIIP KID shall follow a common standard (similar to but without completely replicating the UCITS KIID) as regards the structure, content, and presentation in order to allow retail investors to use the document to compare different investment products and ultimately choose the product that best suits their needs.

- Form – Stand alone document, format easy to understand, colours allowed but comprehensible when printed in black and white, brand/logo of the PRIIP manufacturer or the group to which it belongs allowed as long as not distracting for investors (similar to UCITS KIID)
- Language – Plain-speaking and clearly expressed language (no jargon), translated in one of the official or accepted languages of the Member States where the PRIIP is distributed, or in another language accepted by the competent authorities of that Member State, or if it has been written in a different language, it shall be translated into one of these languages (similar to UCITS KIID)
- Length – Short document written in a concise manner of a maximum of three sides of A4-sized paper when printed (contrary to UCITS KIID limited to two A4 sized paper and three pages for structured UCITS)
- Content – Information on the PRIIP's main features focused on the key information that retail investors need (type, objective, means to achieve it, specific outcome, minimum holding period, term, conditions for disinvestment, past performance if applicable, etc.), as well as the risks and costs associated with the investment in that PRIIP, name of the PRIIP product manufacturer, etc. The KID shall also include specific wordings required by the PRIIP KID Regulation explaining, *inter alia*, what the KID does and does not do
- Price – Free of charge (similar to UCITS KIID)
- Time of delivery – In good time before the conclusion of a transaction (i.e., before the retail investor is bound by any contract or offer relating to the PRIIP), but with some possibilities, subject to specific conditions, to deliver it immediately after the conclusion of a transaction in case of use of a means of distance communication (contrary to UCITS KIID that must be delivered in good time before the subscription)
- Means of delivery – Paper or other durable medium or website. However, where the KID is provided by using a durable medium other than paper or by means of a website, a paper copy shall be provided to retail investors upon request and free of charge (similar to UCITS KIID)
- Complaint handling – Harmonisation of rules for alternative dispute resolution, but does not infringe the right to bring legal proceedings before courts (not covered under UCITS KIID).

Impact on Regulated UCITS and non-UCITS

While UCITS are investment products within the meaning of the PRIIP KID Regulation, it is worth mentioning that a similar document to the PRIIP KID already exists for UCITS, i.e., the KIID. Therefore, the PRIIP KID Regulation considers that it would be proportionate to provide to such UCITS a transitional period of five years after the entry into force of the new regulation during which time they would be able to continue to use the

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UCITS KIID without being impacted by the PRIIP KID Regulation. At the end of this five-year period, the EU Commission will have to assess how the UCITS KIID should be treated so as to achieve the greatest possible degree of comparability of information between UCITS and other investment products subject to the PRIIP KID Regulation. Concretely, three solutions could be considered:

- the transitional period might be extended for the UCITS KIID
- the UCITS KIID might be amended or replaced by the PRIIP KID
- an official confirmation might be given that the UCITS KIID is equivalent to the PRIIP KID.

So for the moment, UCITS will continue to have to provide their own KIID and not the KID.

According to the PRIIP KID Regulation, the above five-year transitional period and review should also apply to management companies, investment companies and persons selling or advising on units of non-UCITS funds when a Member State applies rules on the format and content of the KIID document, as set out in Articles 78 to 81 of the UCITS Directive (which is not the case in Luxembourg for the time being).

Other non-UCITS retail funds must issue a KID two years after the enforcement of the PRIIP KID Regulation.

ESMA Good Practices for Structured Retail Product Governance

On 27 March 2014, ESMA issued an opinion on structured retail products, which document sets out good practices for firms when manufacturing and distributing these products.

These structured retail products (SRPs) in question are defined as "compound financial instruments that have the characteristic of combining a base instrument (such as a note, fund or deposit) with an embedded derivative(s) that provides economic exposure to reference assets, indices or portfolios" and therefore captures MiFID investment firms, UCITS management companies and AIFMs both from a manufacturing and distribution angle.

For these structured products falling into scope, ESMA proposes quite extensive product governance arrangements which aim to improve investor protection and to clarify the complexity of the structured retail products and the type of investors targeted. The good practices can be highlighted as follows:

- general organisation of product governance arrangements
- product design
- product testing
- target market
- distributing strategy
- value at the date of issuance and transparency of costs
- secondary market and redemption
- review process.

ESMA expects national competent authorities to embed these good practices in their supervisory approaches to structured retail product providers.

ESMA further advises that although the good practices focus on structured products designed for retail customers, they may also be a relevant reference for other types of financial instruments such as asset-backed securities, or contingent convertible bonds, as well as when financial instruments are being sold to professional clients.

AIFMD

Publication of EU Commission Technical Standards on the Types of AIFMs

Commission Delegated Regulation (EU) N°694/2014 of 17 December 2013 supplementing the AIFM Directive with regard to regulatory technical standards determining types of AIFMs has been published in the Official Journal on 24 June 2014 and will enter into force on 14 July 2014.

As a reminder, the purpose of this regulation is to determine whether an AIFM manages AIF(s) of the open-ended and/or closed-ended type. According to this regulation:

- An AIFM of an open-ended AIF shall be considered to be an AIFM which manages an AIF the shares or units of which are, at the request of any of its shareholders or unitholders, repurchased or redeemed prior to the commencement of its liquidation phase or wind-down, directly or indirectly, out of the assets of the AIF and in accordance with the procedures and frequency set out in its rules or instruments of incorporation, prospectus or offering documents. A decrease in the capital of the AIF in connection with distributions according to the rules or instruments of incorporation of the AIF, its prospectus or offering documents, including one that has been authorised by a resolution of the shareholders or

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unitholders passed in accordance with those rules or instruments of incorporation, prospectus or offering documents, shall not be taken into account for the purpose of determining whether or not the AIF is of the open-ended type. Moreover, whether an AIF's shares or units can be negotiated on the secondary market and are not repurchased or redeemed by the AIF shall not be taken into account for the purpose of determining whether or not the AIF is of the open-ended type.

- An AIFM of a closed-ended AIF shall be an AIFM which manages an AIF other than of the type described above.

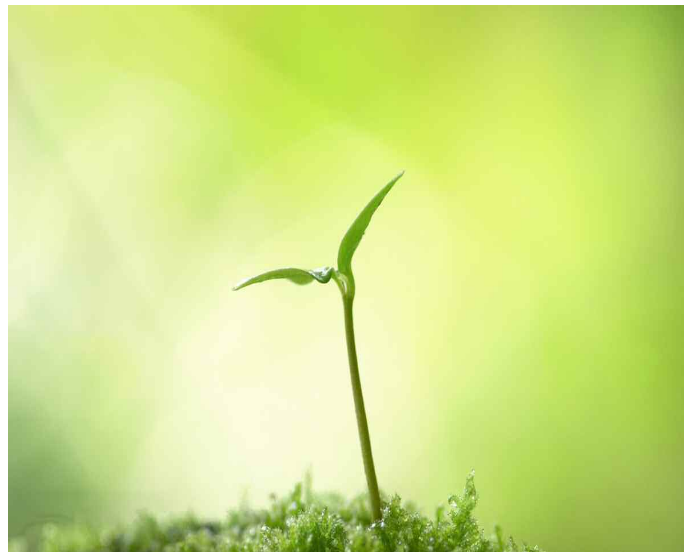
The difference between an AIFM of open-ended or closed-ended AIFs is relevant for the application of some provisions of the AIFM Directive, in particular those relating to liquidity management and the valuation of assets. This difference is also important in relation to certain transitional provisions of the AIFM Directive that only apply to AIFMs of closed-ended AIFs.

ESMA Updated Q&A on Application of the AIFMD

On 25 March and 27 June 2014, ESMA published new versions of its Q&A on the application of the AIFM Directive. The 25 March version of the Q&A updates the section on reporting to national competent authorities under articles 3, 24 and 42 of the AIFM Directive (as initially published on 17 February 2014).

In this respect, the main new Q&A concern:

- the reporting to national competent authorities regarding repurchase transactions
- the reporting period when reporting on "instruments traded and individual exposures"
- the calculation of the geographical exposure as a percentage of the aggregated value of the AIF
- the calculation of the breakdown of investment strategies as a percentage of the net asset value of the AIF
- the reporting period after the liquidation of an AIF
- the calculation of the value for securities and the percentage of trade volumes for derivatives traded on regulated markets and OTC markets
- the valuation of non-liquid assets



- the reporting of the information on investor liquidity
- the definition of inception date of an AIFM
- the language of the reporting.

The 27 June version of the Q&A further clarifies the sections on remuneration, regulatory reporting, and notification of AIFMs and introduces a new section on passporting of MiFID services under Article 6(4) of the AIFM Directive:

- As regards remuneration, ESMA considers that AIFMs cannot choose to exclude portfolio managers from the scope of identified staff for the purpose of ESMA remuneration guidelines[6] purely because they are bound by investment limits set out by law and/or internal risk limits set out in the investment restrictions of the AIF.
- As regards reporting, ESMA indicates that:
    - EEA AIFs and EEA AIFMs should be understood as AIFs and AIFMs established in one of the 28 EU Member States or Iceland, Norway and Liechtenstein.
    - The reference to "the Union" should be understood as including the 28 EU Member States and, once the AIFM Directive has been incorporated into the EEA agreement, Iceland, Norway and Liechtenstein.

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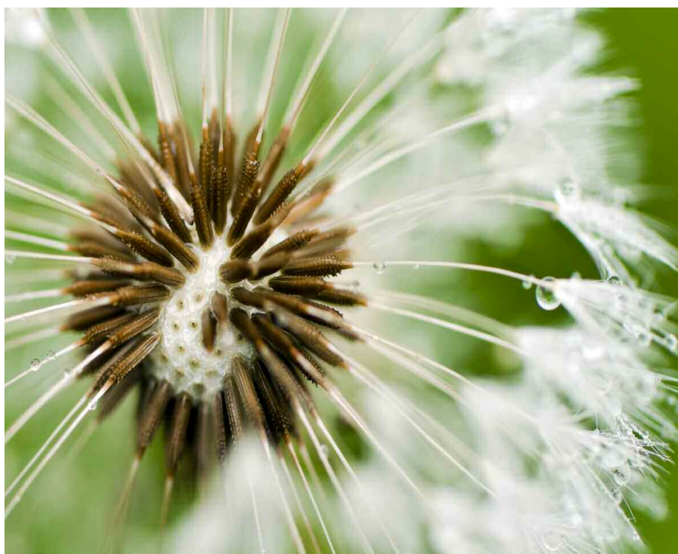

- The information marked as mandatory (M) in the reporting template should be reported by all AIFMs, whilst the information marked as optional (O) has to be reported if the AIFM has information to report (for example if an information point has changed compared to the previous reporting). In addition, the information marked as conditional (C) is linked to other information (flags) in the reporting template. If those flags are answered with "Yes", the corresponding conditional information has to be reported, while nothing needs to be reported if those flags are answered with "No".

- As regards the notification of AIFMs, ESMA clarifies the following points:
  - An AIFM may manage an AIF in a host Member State under Article 33 of the AIFM Directive without having identified any existing AIF in that host Member State beforehand. In practice, however, it may be necessary for an AIFM to first notify its wish to make use of the management passport under Article 33 of the AIFM Directive in order to subsequently be in a position to create and manage AIFs in that host Member State.
  - If an AIFM has no prior presence in the host Member State, it is sufficient for the AIFM to specify the types of strategies of the AIFs it intends to manage in the host Member State, without prejudice however to the obligation for the AIFM to communicate a program of operations stating the services it intends to perform in the host Member State.

- As regards MiFID services under Article 6(4) of the AIFM Directive (which an AIFM will be allowed to passport further to the amendments of the AIFM Directive by MiFID2), ESMA Q&A refers to so-called "principle of sincere cooperation" as set out in Article 4(3) of the Treaty on the Functioning of the European Union. This should imply that Member States could accept the passport of MiFID services by an AIFM under Article 6(4) of the AIFM Directive even before 3 July 2015, which is in principle the deadline for implementation by Members States of the MiFID2 amendments to the AIFM Directive.

ESMA Updated Documents for AIFMD Reporting

ESMA published updated documents regarding the reporting and IT technical guidance on 25 March 2014. Both documents are available on ESMA's website.

ESMA MoU Guidelines Compliance Table

On 20 June 2014, ESMA published a table showing which national regulatory authorities comply or intend to comply with ESMA's guidelines on the model memorandum of understanding (MoU) concerning consultation, cooperation and the exchange of information related to the supervision of AIFM Directive entities[7].

The table shows that all Member States have complied or intend to comply, with the exception of Slovenia. As a consequence of late transposition of the AIFM Directive, the guidelines are not applicable to Slovenia as no competent authority has been designated under Article 44 of the AIFM Directive. The table also shows that Gibraltar, a European territory for whose external relations the UK is responsible, has not responded to ESMA.

EU Social Entrepreneurship Funds (EuSEF) and EU Venture Capital Funds (EuVECA)

ESMA Q&A on the Application of the EuSEF and EuVECA Regulations

On 26 March 2014, ESMA published a Q&A on the application of the European Social Entrepreneurship Funds Regulation (EuSEF) (Regulation 346/2013) and the European Venture Capital Funds Regulation (EuVECA) (Regulation 345/2013), which have

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both entered into force in all EU Member States alongside the AIFM Directive.

As a reminder, Regulation 346/2013 and Regulation 345/2013 provide for optional new EuVECA and EuSEF designations or "labels", together with an EU passport in order to allow small EU AIFMs of unleveraged closed-ended EU AIFs, which have total assets under management below the EUR 500 million threshold laid down in the AIFM Directive, to market these AIFs across the EU and grow while using a single set of rules, provided that they comply with certain "qualifying requirements" in respect of the manager, the fund, and the fund's investment policy and eligible investors.

The aim of the Q&A is to promote common supervisory approaches and practices in the application of the EuSEF and EuVECA Regulations. The questions covered relate to:

- the management of EuSEF and EuVECA by AIFMs
- the registration of EuSEF and EuVECA managers
- the management and marketing of AIFs by EuSEF and EuVECA managers.

Publication of EU Commission Technical Standards for EuSEF and EuVECA

The following EU Commission implementing regulations, which are binding in their entirety and directly applicable in all Member States, have been published in the Official Journal on 4 June 2014 and have entered into force on 7 June 2014:

- EU Commission Implementing Regulation (EU) No 594/2014 of 3 June 2014 laying down implementing technical standards with regard to the format of the notification according to Article 17(1) of Regulation 346/2013 on EuSEF (Regulation 594/2014)
- EU Commission Implementing Regulation (EU) No 593/2014 of 3 June 2014 laying down implementing technical standards with regard to the format of the notification according to Article 16(1) of Regulation 345/2013 on EuVECA (Regulation 593/2014).

As a reminder, Article 17(1) of Regulation 346/2013 and Article 16(1) of Regulation 345/201 require the competent authorities of the home Member State of an EuSEF or EuVECA to notify the competent authorities of the host Member States as well as ESMA with some supervisory information relating to the events related to the passport of the managers of the relevant EuSEF or EuVECA. Article 22(3) of Regulation 346/2013 and Article 21(3)

of Regulation 345/2013 also require the competent authorities of the home Member State to inform the competent authorities of the host Member States of the removal of a manager of an EuSEF/ EuVECA from the register.

Taking into account that a dedicated IT tool for that notification has not yet been developed by ESMA, Regulation 594/2014 and Regulation 593/2014 provide that the notification shall be done by e-mail among competent authorities and to ESMA, by filling in the form set out in the annex to the Regulation 594/2014 and Regulation 593/2014. According to both regulations, a list of relevant e-mail addresses shall also be established by ESMA and made known to all competent authorities.

EU Occupational Pension Funds (IORP)

On 27 March 2014, the EU Commission adopted a legislative proposal for new rules on occupational pension funds (IORP 2). This legislative proposal forms part of a package of measures to stimulate new and different ways of unlocking long-term financing and support Europe's return to sustainable economic growth.

Background

Occupational pension funds or institutions for occupational retirement provision (IORPs) are financial institutions which manage collective retirement schemes for employers, in order to provide retirement benefits to their employees (the scheme members and beneficiaries). There are some 125,000 such funds operating across the EU, holding assets worth EUR 2.5 trillion on behalf of around 75 million Europeans, which represents 20% of the EU's working-age population.

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The Occupational Pension Funds Directive 2003/41/EC (also known as the IORP Directive) lays down basic requirements for IORPs and their supervision, including rules which oblige occupational pension funds to invest their assets prudently, in the best interest of members and beneficiaries. It aims to provide the conditions under which a single market for occupational pension services could start developing.

However, there have been significant developments since 2003. First, the financial crisis has recalled the need for sound governance of financial institutions and clear information to members and beneficiaries. Second, aging populations have increased the pensioner-to-worker ratio, and also the need for more retirement savings and for strong occupational pensions systems which are being developed in several Member States. Third, there is an increasing recognition of the need for long-term investment in Europe's economy, and occupational pension funds are among the largest institutional investors in Europe.

Key Aims and Contents of IORP 2 Proposal

The new IORP 2 proposal aims at improving governance and transparency of occupational pension funds, promoting cross-border activity, and helping long-term investment. In particular, the proposal has four key objectives and introduces improvements in all these areas as summarised below.

Ensure soundness of occupational pensions and better protect pension scheme members and beneficiaries

In this respect, the proposal would introduce:

- new governance requirements on key functions (risk management, internal audit and where relevant actuarial function)
- new provisions on remuneration policy, so that institutions have a sound remuneration and regularly disclose relevant information on such policy
- a self-assessment of the risk-management system (through a "Risk Evaluation for Pensions")
- the requirement to use a depositary, particularly to reduce operational risk
- enhanced powers for supervisors, including for chain-outsourcing (outsourcing and all subsequent re-outsourcing) and stress testing.

Better inform pension scheme members and beneficiaries

The proposal introduces a "Pension Benefit Statement" standardised at EU level that provides pension scheme members with simple and clear information about their individual pension entitlements.

Remove obstacles for cross-border provision of services so that occupational pension funds and employers can fully reap the benefits of the single market

The proposal makes it easier for occupational pension funds to operate a pension scheme that is subject to the social and labour law of another Member State and for fund assets to be transferred across Member States, notably by introducing a pension fund transfer procedure.

Encourage occupational pension funds to invest long-term in growth, environment and employment, enhancing economic activities

The proposal modernises investment rules to allow occupational pension funds to invest in financial assets with a long-term economic profile thereby supporting the financing of growth in the real economy. The proposal would change the existing provisions on investment restrictions to make sure occupational pension funds remained free to invest in infrastructure, unrated loans, etc., thus ensuring that investments, in particular with a long-term profile, should not be restricted if the restriction is not justified on prudential grounds.

Expected Benefits from IORP 2 Proposal

The IORP 2 proposal is expected to improve financial stability, as certain occupational pension funds are large financial institutions with several millions of members and beneficiaries:

- Employers, including SMEs, are expected to benefit through the reduced cost of joining an existing occupational pension fund. Moreover, employers joining a pension scheme in an established market can expect to see a reduction in their administration and investment costs.
- Multinational companies would also benefit from more easily consolidating their existing pension schemes (possibly in different Member States) into one occupational pension fund. Member States would benefit because well-governed occupational pension funds, and wider geographic coverage, are expected to reduce some of the fiscal pressure on state pension systems.

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- Citizens in general and those who are mobile across borders in the course of their careers in particular would also benefit from having the Pension Benefit Statement in a standardised format, for all the Member States in which they have worked. More generally, all citizens would benefit from better protection through strengthened rules for governance of occupational pension funds. They would also benefit from improved personalised information so that they could make better-informed decisions about their retirement provision.

Regulatory Developments

FATCA

Luxembourg and USA sign Model 1 IGA

The so-called Intergovernmental Agreement (IGA) between the Government of the United States of America and the Government of the Grand Duchy of Luxembourg to Improve International Tax Compliance and to Implement FATCA (Foreign Account Tax Compliance Act) has been signed on 28 March 2014 in Luxembourg.

Luxembourg IGA relies on the approach taken by Model 1 IGA and is close to the Model 1 Agreement in terms of content. Thus, the IGA signed by Luxembourg essentially provides for an automatic exchange of information on an annual basis between the Luxembourg tax authorities and the U.S. authorities. It should be noted that Luxembourg has signed a reciprocal agreement, meaning that the exchange of information between the U.S. authorities and the Luxembourg tax authorities encompasses information about account holders in each country's financial institutions that are residents of the other country.

On 15 April, ALFI published a FATCA Q&A. This document represents the view of a group of market participants and is not binding for the Luxembourg Tax Authorities or the national regulator. ALFI reserves the right to amend this document to incorporate new material and to amend previously published material where it considers it appropriate.

Please see the presentation made in this respect in the Tax section of this Luxembourg Legal Update.

CRDIV/MiFID

CSSF Circular 14/585 Implementing ESMA Guidelines on MiFID Remuneration Policies and Practices

On 25 February 2014, the CSSF issued Circular 14/585, which enters into force with immediate effect and transposes into Luxembourg law ESMA guidelines of 11 June 2013 on remuneration policies and practices (MiFID)[8] in the form of a new annex V to its circular letter 07/307.

Circular 14/584 is applicable to credit institutions which provide investment services as well as to UCITS management companies and external AIFMs, when these UCITS management companies and external AIFMs have been authorised to provide the individual portfolio management or non-core investment services according to the UCITS Directive and/or the AIFM Directive.

Please see the presentation made in this respect in the Banking, Finance and Capital Markets section of this Luxembourg Legal Update.

Out-of-court Resolution of Complaints

CSSF Circular 14/589

On 27 June 2014, the CSSF published Circular 14/589 the purpose of which is to clarify some of the obligations imposed on professionals subject to the prudential supervision of the CSSF by Section 2 of CSSF Regulation 13-02 of 15 October 2013 relating to the out-of-court resolution of complaints.

As a reminder, Section 2 of CSSF Regulation 13-02, which is applicable to all professionals (being defined as any physical or legal person falling under the supervision of the CSSF), has entered into force on 1 July 2014 and requires, among other things, that professionals:

- establish a written policy for complaints handling that has to be formalised in an internal procedure for complaints
- ensure that each complaint and the measures taken for its resolution are recorded in an appropriate manner
- designate amongst their management (*direction*) one person responsible for the implementation of the complaints handling policy and procedure
- communicate to the CSSF, on a yearly basis, a grid comprising the number of complaints recorded by the relevant professional as well as a synthetic report of the complaints and the measures taken for their resolution.

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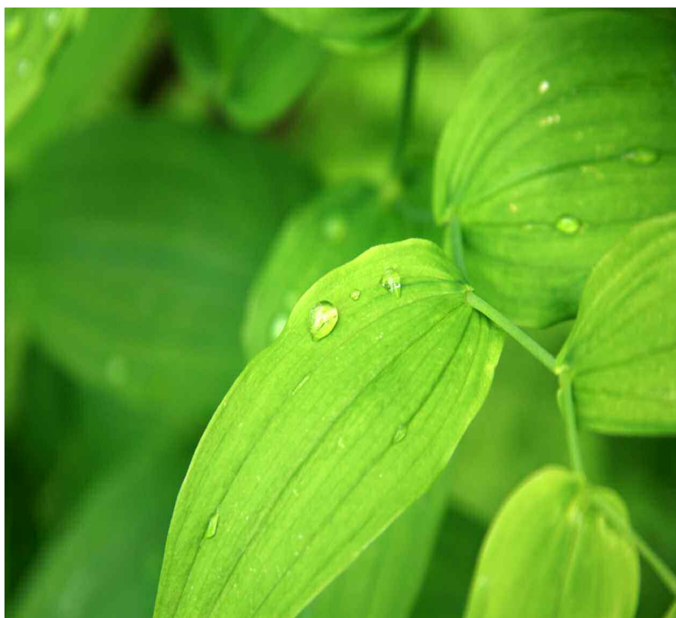

Among other things, Circular 14/589 provides a sample form which can be used by professionals in order to comply with their obligation to communicate to the CSSF a complete grid including the number of complaints they have recorded. It further clarifies that the first grids and reports will have to cover the period running from 1 July 2014 to 31 December 2014 and will have to be communicated to the CSSF by 1 March 2015 at the latest. Thereafter, these documents will have to be communicated for the first of March of each year and will cover the preceding calendar year. Concerning UCITS management companies, however, such communication can be done one month after the general meeting approving the annual account of the relevant management company.

AIFMD

CSSF Updated FAQs on AIFM Law

An updated version of the CSSF FAQ concerning the AIFM Law has been published on the CSSF website on 17 March 2014.

The updated version of the FAQ includes a new question 14.d) relating to the start date for the first reporting obligations applicable to so-called "Authorised AIFMs" and "Registered AIFMs" which have been authorised or registered by the CSSF before 23 July 2014.

To sum up:

- AIFMs authorised by the CSSF between 22 July 2013 and 30 June 2014 will begin reporting to the CSSF on 1 July 2014 (although AIFMs can, should they wish, submit reports for earlier periods in accordance with ESMA reporting guidelines). The end date for the reporting period and transmission deadlines will, of course, depend on the reporting frequency and type of AIFs.
- AIFMs authorised by the CSSF between 1 and 22 July 2014 will be required to cover the period from 1 October 2014 to 31 December 2014 in their first reports, regardless of the AIF's reporting frequency. The deadline for transmission will be 31 January 2015 at the latest (15 February 2015 at the latest when the AIF is a fund of funds) whatever the reporting frequency.
- The start date for small AIFMs, which are only registered and not authorised/licensed by the CSSF, will depend on the year they received their registration confirmation. Registered AIFMs confirmed in 2013 will have to cover the period from 1 January to 31 December 2014 (or earlier for voluntary adopters of ESMA reporting guidelines). For Registered AIFMs confirmed in 2014, a detailed reporting table has been prepared by the CSSF for guidance.

For the sake of completeness, previous question 14.d) (*Reporting requirements applicable to AIFMs benefiting from the transitional provisions under article 58(1) of the Law of 2013*) is renumbered as question 14.e) and rectified to the extent that "Registered AIFMs" do not benefit from the transitional provisions under article 58(1) of the AIFM Law.

CSSF Updated Application Form for Authorisation as AIFM

On 20 March 2014, the CSSF published on its website an updated version of the application form for the set-up of a fully licensed Luxembourg AIFM.

The key modifications concern the remuneration policy:

- Consistent with the CSSF's previous regulatory practice, a new appendix is now explicitly required under the form of a table to allow comparison between the AIF/AIFM's remuneration policy and the requirements outlined in Annex II of the AIFM Law and ESMA guidelines on sound remuneration. For each requirement, the table should include

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an extract of the corresponding part of the remuneration policy, the status of compliance as well as justifications for partial or non-compliance.

- As regards delegation of portfolio or risk management activities, the CSSF follows ESMA guidelines on sound remuneration and ESMA Q&A on the application of the AIFM Directive by requiring the applicant AIFM to demonstrate that the third-party service providers so appointed also respect the remuneration requirements as laid out in Annex II of the AIFM Law. This should include information about any other regulatory standards that they comply with, such as MiFID or CRD.

CSSF Annual Report 2013

The CSSF published its annual report for 2013 in May 2014. In addition to statistical information concerning the Luxembourg financial sector, the report contains some information on the exercise by the CSSF of its regulatory powers. The following points, without being exhaustive, are of relevance for Luxembourg UCIs, SIFs, SICARs and management companies.

The report also contains a section on banks and professionals of the financial sector, which are discussed in the Banking, Finance and Capital Markets section.

AIFM Authorisation

The CSSF recalls that authorisation of a Luxembourg entity as AIFM (including either as external or internal AIFM) is subject to a detailed review by the CSSF of several substance and organisational conditions to be complied with by the AIFM, including:

- the transparency of the direct and indirect shareholding structure of the AIFM
- the quality of the shareholders or members that have qualifying holdings in the AIFM
- the members composing the different organs of the AIFM
- the internal organisation of the AIFM with the number of persons, including the conducting officers, employed by the AIFM in Luxembourg, the establishment of an administrative centre and a decision-making centre at the level of the AIFM
- the scope of the delegation of portfolio management and risk management functions
- the risk management policy.

In its annual report, the CSSF reiterates, in line with its current regulatory practice, that each applicant AIFM should refer to CSSF circular letter 12/546 in order to assess the qualitative criteria enumerated above. According to the CSSF, the clarifications on substance and organisational requirements applying to Luxembourg UCITS management companies and self-managed UCITS-SICAVs as laid down in circular letter 12/546 apply by analogy to the requests for authorisation as well as to the organisation of AIFMs. Thus, as for UCITS management companies, the CSSF insists that AIFMs to be established in Luxembourg, or which are required to comply with the provisions of the AIFM Law, should put into place the necessary framework so as to offer quality services and fulfil their responsibilities to the AIFs they manage.

Review of Annual and Semi-Annual Financial Reports

It follows from the review of annual and semi-annual financial reports conducted by the CSSF that these reports are generally established in accordance with applicable legal provisions.

With regard to the annual reports established by SIFs, the CSSF has observed a certain tendency to present the SIF's exposure with respect to its final investments too succinctly. Indeed, even if the SIF Law does not require the inclusion of every single entry of the investment portfolio in the annual report, the CSSF feels the need to recall that, pursuant to article 52(4) as well as the annex to the SIF Law, the annual report does need to include all significant information, which includes *inter alia* qualitative and/or quantitative information on the investments portfolio, so as to allow investors to make an informed judgement on the evolution of the SIF's activity and on its results.

In this context, pursuant to the SIF Law, the CSSF expects the annual reports to adopt a look-through approach with regard to subsidiaries held by the SIF so as to facilitate SIF's investments in underlying investments of subsidiaries.

Analogously to the requirements for SIFs, the CSSF requires the same degree of transparency to be applied in the annual reports of SICARs.

Finally, the CSSF requires the model for statutory auditor's reports specifically laid down for UCIs (UCITS, Part II UCIs, SIFs) in the NT2011-05 technical note of the IRE's council to be equally employed for statutory auditor's reports of SICARs.

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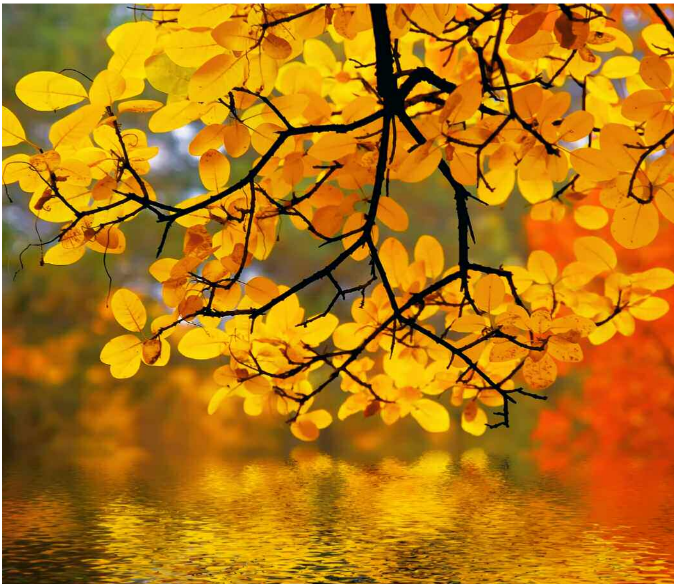


Applicability of the CSSF Circular Letter 02/77 to SIFs

The annual report recalls that CSSF Circular Letter 02/77 on the protection of investors in case of erroneous NAV calculations and on the reparation of the consequences stemming from non-compliance with investment rules is not automatically applicable to SIFs. Nonetheless, the CSSF makes clear in its annual report that SIFs may either opt for applicability of the CSSF Circular Letter 02/77, or lay down other internal rules, which, in the latter case, must remain within reasonable limits with regard to the SIF's investment policy.

In this context, the CSSF considers that SIFs which have not laid down divergent internal rules must apply CSSF Circular Letter 02/77 by default. Furthermore, regarding the notification process, all errors in NAV calculations as well as non-compliance with any of the SIF's investment rules must be notified to the CSSF regardless of whether the SIF has decided to apply CSSF Circular Letter 02/77 or has adopted divergent internal rules.

Eligibility of US ETFs with regard to Article 41(1) of the UCI Law

In its publication entitled "Article 50(2) of the Directive 2009/65/EC" of 20 November 2012, ESMA has specified that article 50(2) (a) of the UCITS Directive (so-called "trash ratio") is relevant only to securities and money market instruments other than those referred to in article 50(1) a) to d) and in article 50(1) h) of the UCITS Directive, and is not applicable to shares of undertakings for collective investment.

Following this publication and that of CSSF press release 12/46, the CSSF received several requests for reclassification from UCIs which had up until that time been considered to fall under the scope of article 41(2) a) of the UCI Law (transposing article 50(2) (a) of the UCITS Directive). The requests regarded, *inter alia*, the question as to whether US ETFs are UCIs eligible to fall under the scope of article 41(1) e) of the UCI Law.

In order for article 41(1) e) of the UCI Law to be applicable to US ETFs, they need to be UCIs as defined under article 2(2) of the UCI Law over and above meeting the conditions set out under article 41(1) e) of the aforementioned law.

In its annual report, the CSSF draws attention to the fact that the company documentation of US ETFs, amongst which the prospectus and the status of additional information (SAI), generally grant facilities which are not equivalent to the requirements applicable to UCITS and which therefore do not permit one to conclude the compliance of US ETFs with articles 2(2) and 41(1) e) of the UCI Law.

Indeed, regarding the equivalence of the level of protection guaranteed to holders of US ETF units or shares with the level of protection guaranteed to holders of UCITs units or shares, US ETFs usually provide for the possibility to have recourse to lending to up to 33.33% of its net assets in their prospectus or SAI.

Furthermore, the prospectus or SAI of certain US ETFs does not exclude the granting of loans, nor the short selling of transferable securities or money market instruments. Equally, in certain cases, US ETFs are allowed to invest in commodities.

Moreover, the prospectus or SAI of US ETFs limits investments in funds to 10% of total net assets, except in the case of money market funds for which no limits have been laid down.

Nonetheless, it must be noted that even if the prospectus or SAI foresees a possible recourse to these facilities, in practice, US ETFs do not always make use of them.

In addition, the CSSF considers that US ETFs must respect the risk diversification principle, which does not imply that US ETFs are subject to the same diversification rules as UCITS, but that they should be subject to equivalent diversification rules.

Given the above, the CSSF considers that even if the company documentation of US ETFs allows recourse to be added to such facilities, these US ETFs usually qualify themselves as "other

UCIs" on the condition that, in practice, they meet the conditions set forth under articles 2(2) and 41(1) e) of the UCI Law.

In light of the specificities of each individual US ETF, a case-by-case analysis is necessary and it is the UCITS' responsibility to ensure that the US ETF it considers acquiring qualifies itself as an "other UCI" within the meaning of article 2(2) of the UCI Law and, in fact, complies with all the requirements set forth under article 41(1) e) thereof.

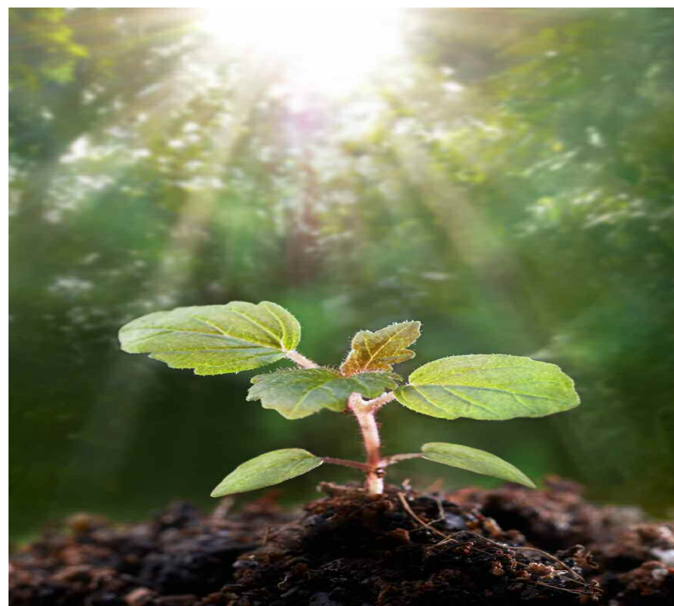
When the prospectus or SIA of a US ETF allows for more flexibility with regard to the requirements pertaining to UCITS, the CSSF recommends that the UCITS continuously ensures that the investment rules being applied are actually equivalent to the investment rules applicable to UCITS, for instance by means of a control system, or written confirmation from the US ETF or its manager.

Investing in China A shares for subject to Part I of the UCI Law

In 2013, the CSSF has been approached by Luxembourg UCITS subject to the provisions of Part I of the UCI Law which wanted to participate in the Chinese Renminbi Qualified Foreign Institutional Investor (RQFII) programme in order to invest up to a 100% in China A shares.

The CSSF is of the opinion that the measures governing the RQFII programme – including *inter alia* the absence of a lock-up period for the repatriation of funds – does not reduce the global liquidity of the UCITS' portfolio and that the UCITS' capacity to deal with investors' redemption requests is not thereby compromised.

In this context, the CSSF has considered that UCITS falling under the scope of Part I of the UCI Law, the manager of which is licensed for RQFII by the China Securities Regulatory



Commission, may invest up to a 100% of their net assets in China A shares.

Indeed, the CSSF is of the view that investments of a Luxembourg UCITS in China A shares by a RQFII-licensed manager are qualified as being transferable securities within the meaning of article 41(1) c) of the UCIS Law and article 2(1) of the Grand-Ducal Regulation dated 8 February 2008, as completed by point 17 of ESMA's guidelines concerning eligible assets for investment by UCITS as updated in September 2008[9].

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Tax

News of Particular Importance

International Legislation

FATCA – Luxembourg and United States

Luxembourg and the United States signed a FATCA Intergovernmental Agreement

On 28 March 2014, Luxembourg and United States signed an Intergovernmental Agreement (the IGA) to improve tax compliance between both countries and to implement the US Foreign Account Tax Compliance Act (FATCA).

The IGA is based on the reciprocal Model 1A agreement. Accordingly, foreign financial institutions (FFIs) in Luxembourg will be required to report tax information about US account holders to the Luxembourg government, which will in turn relay that information to the US Internal Revenue Service (IRS). The United States will also provide similar tax information to Luxembourg regarding residents of Luxembourg with accounts in the United States.

Article 10(1) of the IGA provides that the IGA will enter into force on the later of:

- the date of Luxembourg's written notification confirming completion of the necessary internal procedures for the enactment of the IGA; or
- the date of the United States' written notification confirming that its applicable procedures for ratification of the Protocol amending the DTT between Luxembourg and United States have been satisfied.

In addition to signature of the IGA, the Luxembourg Tax Authorities have set up two working groups that will discuss the implementation of FATCA within Luxembourg law. A Circular and/or guidelines are expected to be published in a near future.

Update

The IRS issued Notice 2013-43 providing that a jurisdiction that has signed an IGA but has not yet brought the IGA into force will be treated as having an IGA in effect, if the jurisdiction is listed on the IRS's webpage. Luxembourg is now listed on the webpage.

Financial Transaction Tax – Update

ECOFIN meeting – Negotiations progress on the Financial Tax Transaction

On 6 May 2014, an ECOFIN meeting was held and a joint statement by the ministers of 10 out of the 11 Member States participating in the "enhanced cooperation procedure" was released. It was expected that detailed proposals on the Financial Tax Transaction (FTT) would be circulated but only the following points were discussed:

- the FTT would, in principle, be introduced no later than 1 January 2016
- the FTT would first focus on the taxation of shares and some derivatives (no further details available yet)
- the FTT's scope would be extended to cover other products at a later point.

In April 2013, the United Kingdom took a legal action in the European Court of Justice (ECJ) seeking annulment of the Council decision authorising enhanced cooperation for FTT. On 30 April 2014, the ECJ ruled against the UK by dismissing its challenge.

For further details, please refer to the Litigation Section of this edition of our Luxembourg Legal Update.

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Council Directive 2014/48/EU of 24 March 2014 amending Directive 2003/48/EC on taxation of savings income in the form of interest payments

European Union Council – Amendment to Savings Income Directive Automatic Exchange of Information

On 24 March 2014, the Council of the European Union adopted a directive strengthening EU rules on the exchange of information on savings income, aimed at enabling the Member States to better fight against tax fraud and tax evasion.

Directive 2003/48/EC, since 1 July 2005, requires the Member States to exchange information automatically whenever an interest payment is made from one Member State to the benefit of an individual or a residual entity being/established in another Member State. However, during a transitional period, Luxembourg and Austria may operate a withholding tax at a rate of 35% unless the beneficial owner has elected otherwise.

The Directive 2014/48/EU broadens the scope of application, reflecting changes to savings products and developments in investor behaviour. The scope now includes payments made to, or secured for, certain other entities and legal arrangements. It also enlarges the definition of "interest payment" to cover income that is equivalent to interest. Finally, a "look-through" approach will be applicable and the tax authorities using such approach will be required to take steps to identify who is benefiting from the interest payments.

Member States have until 1 January 2016 to adopt the national legislation necessary to comply with Directive 2014/48/EU.

Opinion from European Commission – Capital gains

Luxembourg required abolishing its tax regime on capital gains reinvested abroad

On 20 February 2014, the European Commission has formally asked Luxembourg to abolish the discriminatory tax regime applied to taxpayers who reinvest property income abroad, meaning outside the Luxembourg but within the EU/EEA.

In a nutshell, capital gains resulting from the sale of property which are reinvested abroad are taxable immediately, whereas the same capital gains, if reinvested in property in Luxembourg, benefit from a temporary tax deferral. This arrangement applies to natural persons who own property in Luxembourg regardless of whether they are resident in Luxembourg or in another EU/EEA country.

This above regime constitutes an unjustified restriction on the free movement of services and free movement of capital, established respectively by articles 56 and 63 of the Treaty on the Functioning of the European Union and the corresponding Articles 36 and 40 of the EEA Agreement. The EU Court of Justice (ECJ) has already issued a ruling to this effect in its judgment of 26 October 2006 in Case C-345/05, *Commission v Portugal*.

EU Commission orders Luxembourg to deliver information on tax practices

State aid – EU Commission challenges Luxembourg

The EU Commission has recently launched a "state aid procedural regulation" by gathering information on both tax ruling practices (i.e., decisions for individual companies on specific tax matters) as well as intellectual property (IP) tax regimes in Member States. All this information would allow assessing Member States' compliance with EU state aid rules, i.e., that certain tax practices are not favouring certain companies. For this purpose, it sent information requests to several Member States, including Luxembourg, Ireland, Belgium, the Netherlands and Gibraltar.

On 21 May 2014, the EU Commission ordered Luxembourg to submit information on its tax practices in favour of certain companies, which may be in breach of EU state aid rules. It appears that Luxembourg failed to answer previous requests addressed by the EU Commission. As such, it has now adopted two information injunctions ordering Luxembourg to deliver the requested information within one month. On 25 May 2014, the Luxembourg published a press release on the EU Commission's injunction. It took the position that the order to deliver information on its tax practices is not in line with the EU law and would therefore refer the issue to the ECJ.

Luxembourg VAT exemption for independent groups of persons

EU Commission refers Luxembourg to ECJ over its VAT regime for independent groups of persons

On 20 February 2014, the European Commission referred Luxembourg to the ECJ because of the current VAT system applied by Luxembourg to independent groups of persons.

Under European law, in order to be exempt from VAT, the services provided by an independent group to its members must be directly required for their non-taxable or exempt activities. Under Luxembourg law, the services provided by an independent group to its members are exempt from VAT provided that the members' taxed activities do not exceed 30%

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(or 45% under certain conditions) of their annual turnover. Group members are also allowed to deduct the VAT charged to the group on its purchases of goods and services from third parties. Lastly, operations by a member in his or her own name but on behalf of the group are regarded as outside the scope of VAT.

In view of the above regime, the European Commission is of the view that the 30% threshold does not fulfil the conditions set out in the EU VAT Directive (2006/112). Finally, group members should not be allowed to deduct VAT charged to the independent group.

National Legislation

Exit Taxation Rules

Bill N°6556

On 13 May 2014, the Luxembourg Parliament approved the law (Bill N°6556) amending Luxembourg exit taxation rules. As discussed in the June 2013 edition of our Luxembourg Legal Update, the Bill N°6556 is the result of several EU infringement procedures (see N°2012/4014, 4015 and 4016 of 27 September 2012) further to decisions from the European Court of Justice (ECJ) in the field of exit taxation regarding individuals and companies (see ECJ C-9/02 Lasteyrie du Saillant, C-470/04 N and C-371/10 National Grid Indus and decision E-15/11 Arcade from the European Free Trade Association Court). The following are the key elements:

- upon an outbound migration of a Luxembourg tax resident company, taxation of latent gains will be deferred provided it has been requested by the tax payer and so long as it remains the owner of the assets and liabilities transferred and to the extent the business or permanent establishment or the seat of the migrating company is transferred in an EU/EEA state
- no interest will be charged as a consequence of the tax deferral
- the continuous ownership of the assets and liabilities must be documented annually (there is no indication on the nature of documentation and on the timing and the form of request)
- no distinction between Luxembourg residents and resident individuals within the EU/EEA other than Luxembourg in the event of a transfer of a Luxembourg business or permanent establishment. The above regime will apply *mutatis mutandis* upon an outbound migration provided a request for deferring the payment of tax is addressed to the Luxembourg Tax Authorities.

Bill N°6556 also brought the following changes:

- tax losses linked to assets with unrealised gains at the time of the transfer realised further to the migration of the Luxembourg business would remain deductible in Luxembourg provided that the other ER/EEA do take into account these tax losses
- abrogation of Article 44 LITL which provided for a tax free transfer of assets from Luxembourg business to another Luxembourg business owned by the same taxpayer further to EU challenge on the basis of discrimination
- article 54 LITL and its “roll-over” relief is extended to situations where the sale proceeds of qualifying assets are re-invested to acquire Luxembourg assets linked to a Luxembourg business but also to assets linked to any EEA-located business/permanent establishment.

The law should enter into force three days following its publication in the Luxembourg Official Journal.

Automatic Exchange of Information

Bill N°6668

Further to the official announcement made by the Luxembourg government on 10 April 2013 (see June 2013 edition of our Luxembourg Legal Update), on 18 March 2014, the Luxembourg Ministry of Finance submitted to the Luxembourg Parliament the Bill N°6668. This Bill aims to amend:

- the laws of 21 June 2005, as amended, implementing the EU Council Directive 2003/48/EC on the taxation of savings income in the form of interest payments and ratifying several agreements concluded with certain dependent or associated territories
- the law of 23 December 2005, as amended (“Relibi Law”) introducing a 10% withholding tax on interest payments made by a Luxembourg paying agent to Luxembourg individual residents.

This Bill N°6668 will put an end to the current 35% withholding tax regime applicable for interest payments or similar income made or ascribed to non-Luxembourg resident investors (e.g., individual and certain types of entities) by Luxembourg paying agents as from 1 January 2015. Further to this date, Luxembourg will apply the automatic exchange of information on savings income, i.e., the paying agent will have to provide the following information to the tax authorities where the beneficiary is tax resident:

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- name and address of the beneficial owner
- name and address of the paying agent
- bank account of the beneficial owner or the receivable triggering the interest
- total amount of interest or similar income received by the beneficial owner further to disposal, sale or redemption.

On 3 June 2014, the Luxembourg Conseil d'Etat rendered his opinion on the Bill N°6668 suggesting to amend several points. The major recommendations are:

- to clarify the scope of information to be exchanged (to avoid any large interpretation)
- to provide a procedure to challenge an administrative decision (e.g., administrative fines if not compliant with the automatic exchange).

In view of the above, the adoption of the Bill N°6668 may be delayed. Such amendment should be in force as from 1 January 2015.

Transposition of Article 8 of Directive 2011/16/EU on the administrative cooperation in the field of taxation

Bill N°6632

On 12 March 2014, the Luxembourg Parliament adopted Bill N°6632 regarding the mandatory and automatic exchange of information and implementing Article 8 of Directive 2011/16/EU into Luxembourg law.

Despite the three types of income for which the automatic exchange of information is introducted (income from employment, director's fees and pensions), there are still some categories not being concerned by Directive 2011/16/EU being dividends, capital gains and royalties.

For further details on the Bill N°6632, please refer to the February 2014 edition of our Luxembourg Legal Update.

Double Tax Treaties

On 28 May 2014, Luxembourg has signed a total of 70 Double Tax Treaties (DTT) out of which 39 are in line with the OECD exchange of information standard. In addition, negotiations with other states are under way to either amend the existing DTT or to adopt a new DTT.

Double Tax Treaty between Luxembourg and Laos entered into force

As all the conditions for the entry into force of the DTT signed on 4 November 2012 have been met on 19 February 2014, the DTT, which is based on the OECD Model Convention, has entered into force on 21 March 2014 and its provisions shall have effect on 1 January 2015.

Double Tax Treaty between Luxembourg and Sri Lanka entered into force

On 11 April 2014, the DDT between Luxembourg and Sri Lanka signed on 31 March 2013 entered into force further to the reciprocal implementation by both countries of the DTT within their domestic laws. The DTT shall, in principle, have effect on 1 January 2015. Please refer to the October 2013 edition of our Luxembourg Legal Update for additional information on the Bill N°6501 ratifying 15 DTTs and Protocols.

Double Tax Treaty between Luxembourg and Russia – Clarification on income received from a collective investment fund

On 7 April 2014, the Russian Ministry of Finance issued an official letter clarifying the tax treatment of income from securities paid by a Russian depositary to a Luxembourg collective investment fund.

In a nutshell, the Russian Tax Code provides for a withholding tax of 15% to be levied by the depositary agent upon payment of income paid on securities, which are recorded in a depositary account of a foreign nominee holder. If no information with respect to the tax residence of the beneficial owner is available, then a 30% withholding tax is applicable. If a DTT exists between Russia and the state where the beneficial owner has her tax residence, then the depositary agent should apply the tax rate as provided by the DTT. In this respect, article 10 (Dividends) of the DTT between Luxembourg and Russia provides for a reduced 5% tax rate if threshold requirements are met. Otherwise, the 15% withholding tax rate will be applicable. However, in its letter, the Minister of Finance indicated that the reduced withholding tax rates (5% or 15%) would be applicable only if the recipient of the income is the beneficial owner, which should not be the case for Luxembourg collective investment funds being foreign nominee holders leading to application of the ordinary 30% withholding tax rate.

Protocol to Double Tax Treaty between Luxembourg and Ireland – Signed

On 28 May 2014, Luxembourg and Ireland signed a Protocol amending the existing DTT in order to have the administrative

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assistance clause in line with the applicable international OECD standard for the exchange of information upon request.

Double Tax Treaty between Luxembourg and Andorra – Signed

On 2 June 2014, Luxembourg and Andorra signed a DTT bringing the number of signed DTT by Andorra to two, further to its first DTT signed with France on 2 April 2013. Further to national implementations in both countries, the DTT should enter into force the first day of the second month following the last notification of implementation given by one of the two States. A text of the DTT is not yet available but should be based on the OECD Model Convention.

Protocol to Double Tax Treaty between Luxembourg and United States – Approved by US Senate Foreign Relations Committee

On 1 April 2014, the US Senate Foreign Relations Committee approved the Protocol, signed on 20 May 2009, amending the DTT between Luxembourg and the United States. In Luxembourg, the Protocol has already been approved by the law dated 31 March 2010. This Protocol will incorporate the OECD tax treaty standard on exchange of information for tax purposes and thus will replace the existing article 28 of the current DTT.

Double Tax Treaty between Luxembourg and Saudi Arabia – Approved by Saudi Arabia

On 31 March 2014, the Saudi Arabian cabinet approved the DTT between Luxembourg and Saudi Arabia signed on 7 May 2013. For further information, see October 2013 edition of our Luxembourg Legal Update.

Protocol to Double Tax Treaty between Luxembourg and Slovenia – Approved by Slovenia

On 28 April 2014, the Slovenian parliament ratified the Protocol, signed on 20 June 2013, amending the DTT between Luxembourg and Slovenia.

Protocol to Double Tax Treaty between Luxembourg and France – Negotiations

On 19 May 2014, the government of Luxembourg published a press release with respect to an amending Protocol between Luxembourg and France currently under discussion. The two countries have agreed to continue the current negotiations in order to implement the internationally agreed tax standards on transparency and exchange of information based on the OECD developments. This Protocol would amend the DTT signed on 1 April 1958 and further amended by the 1970 exchange of letters, and by the 1970, 2006 and 2009 Protocols. This new Protocol may also amend the current taxation rules on capital gains from real estate companies; such change has been anticipated for several years.

Double Tax Treaty between Luxembourg and Croatia – Negotiations

On 17 April 2014, the Croatian government authorized the signing of the initialled DTT between Luxembourg and Croatia. Further details will be reported subsequently. As described in the February 2014 edition of our Luxembourg Legal Update, the Protocol deals with the update of exchange of information to comply with the OECD Model.

Double Tax Treaty between Luxembourg and Fiji – Negotiations

On 31 March 2014, following a meeting held in Brussels, the government of Fiji published a press release expressing its will to negotiate and sign a DTT with Luxembourg.

Circulars/Regulatory Developments

Highly Skilled Impatriates

Circular L.I.R. N°95/2 of 27 January 2014

On 27 January 2014, the Luxembourg Tax Authorities issued a new Circular L.I.R. N°95/2 on the special tax regime for highly skilled impatriates replacing the former Circular L.I.R. N°95/2 of 21 May 2013 and is in force with a retroactive effect as from 1 January 2014.

The special tax regime, as initially introduced by the Circular L.I.R. N°95/2 of 31 December 2010 to attract highly skilled foreign workers to Luxembourg, allows the employer to deduct as expenses the benefits provided to the employee (e.g., relocation, housing, cost of living allowances, school fees, etc.) whereas these will not be taxed at the employee's level.

The new Circular broadens its scope and the special tax regime is now applicable to impatriates working in Luxembourg, who were either hired from abroad by a Luxembourg company, or by a foreign company located within the EEA (e.g., a German company hiring a Dutch employee to work in Luxembourg may benefit from the Circular benefits provided several requirements are met).

Other requirements have been amended such as:

- The employer must employ or commit to employ in the medium term at least 20 employees working full time, no matter where they are employed, i.e., in or outside Luxembourg

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- The employee should earn a salary of at least EUR 50,000
- Non-resident employers are not required to withhold wage-withholding tax on salaries and if they did not voluntary opt to levy such tax, then the concerned impatriate worker would have to file an individual income tax return in order to get the benefits of the above-said Circular.

For further information, see our updated client briefing on Beneficial tax regime for Highly Qualified Expatriates.

Supplementary Pension Schemes

Circular L.I.R. N°A03/1 of 25 March 2014

On 25 March 2014, the Luxembourg Tax Authorities issued a new Circular L.I.R. N°A03/1 (2014 Circular) dealing with the tax treatment applicable to employers, employees and pensioners in connection with supplementary pension schemes established by an employer for the benefits of its employees. This Circular replaces the formerly applicable Circular L.I.R. N°A03/1 of 13 August 2003 clarifying the Law on supplementary pension schemes adopted on 8 June 1999.

The 2014 Circular provides for further guidance than the prior Circular. For instance, aspects such as cross-border situations have been added or are now treated in more details. However, the main tax considerations have not been modified.

Net Wealth Tax Reduction

Circular I. Fort N°47 of 20 May 2014

On 28 March 2014, the Luxembourg Tax Authorities issued a new Circular I. Fort. N°47 replacing the former Circular issued on 14 November 2013. Finally, it was further replaced on 20 May 2014. These two additional issuances seek to adjust the form of the Circular and do not alter the substance and all the clarification provided by Circular I. Fort N°47 of 14 November 2013.

For additional information, please refer to the February 2014 edition of our Luxembourg Legal Update.

Automatic Exchange of Information with non-EU countries

Parliamentary Question N°207 of 9 April 2014

On 9 April 2014, the Luxembourg Parliament submitted a question to the Ministry of Finance about the current negotiations with non-EU countries on the automatic exchange of information process. The Parliamentary question seeks whether negotiations on implementation of the automatic exchange of information are being made with the state of Delaware and/or United States. In fact, the issue at hand is that a lot of offshore entities are incorporated in the state of Delaware and thus do not pay taxes.

The Ministry of Finance indicated that EU Member States, including Luxembourg but except Greece, are negotiating bilateral agreements for FATCA implementation. In this respect, under the IGA signed on 28 March 2014 (see above for further information), US financial institutions will provide Luxembourg with the relevant information. In addition, the EU Commission is under negotiations with the United States, Andorra, Liechtenstein, Monaco, San Marino and Switzerland with regards to the amended EU Savings Directive providing that in case of interest payments made to offshore entities, for instance being located in the state of Delaware, the European paying agent will have to identify the beneficial owner of such interest.

Case Law

Financial Tax Transaction – ECJ throws out UK's challenge

European Court of Justice, Case C-209/13, 30 April 2014

Freedom of Establishment – UK Group Relief Scheme

European Court of Justice, Case C-80/12, 1 April 2014

Opinion of Advocate General on Fiscal Unity

ECJ – AG Opinion – joined cases C-39/13, C-40/13, C-41/13 – 27 February 2014

VAT Exemption on Management Services to Special Investment Funds

European Court of Justice, C-464/12, 13 March 2014

Exchange of Information

Administrative Court, Case N°33272a/33273a, 7 March 2014

Please refer to the Litigation Section of this Luxembourg Legal Update for details of the above.

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Litigation

Banking, Finance and Capital Markets

Theft of Confidential Documents by Employee of Bank

Supreme Court, 3 April 2014[10]

Shortly after his resignation, the head risk manager of a bank started a lawsuit against his former employer in the labour court in order to receive damages because of misconduct of his employer during the employment contract. In these proceedings, in order to prove the bank's misconduct, he used a number of internal documents of the bank. For this reason, the bank initiated criminal proceedings against the former employee on the grounds of theft and violation of the professional confidentiality obligations.

The District Court[11] noted that there had been theft, as there had been an appropriation of internal documents by the employee without the knowledge and approval of the employer.

With regard to professional confidentiality rules in the banking sector, the Court noted that the documents used in the proceedings contained information that had been protected by professional confidentiality. Given that this obligation only ceased if this was either authorised or imposed by law, which was not the case when an employee violated the professional secrecy obligation in order to collect documents to be used in proceedings against his employer, the Court decided that the former employee had violated professional confidentiality rules.

However, a criminal act could lose its criminal nature in certain circumstances, if there are certain justifications (*faits justificatifs*).

An employee was allowed to use internal documents of a confidential nature against his employer in his defence in proceedings in labour court. But the use of such documents was only admitted if it was strictly justified by the employee's rights of defence.

Given that the rights of the defence have a superior value to the right of ownership of the employer, in these conditions even though the employee had committed a theft, he was not criminally liable.

With regard to the violation of the obligation of professional confidentiality, the Court admitted that an employee was allowed

to use confidential documents in court proceedings for his defence in order to avoid a conviction. However, such use had to be justified by the exercise of the rights of the defence.

For these reasons, even though there had been theft and violation of professional confidentiality, the employee was acquitted.

This decision was upheld by the Luxembourg Court of Appeal[12] for slightly different reasons. In fact, the Court held that given that the internal documents had been downloaded from the internal computer system of the bank and were immaterial property of the bank. According to the Court the incrimination of theft is only applicable to material property, and for that reason there was no theft. Additionally, with regard to photocopies, the Court held that as long as the former employee had not taken possession of the original documents, he did not have the intention to act as the owner of the documents and only took photocopies in order to produce them in the action against his former employer, there could be no theft of the documents. With regard to the violation of the obligation of professional confidentiality, the Court confirmed the decision of the District Court.

This judgement has been the subject of an appeal in law filed with the Supreme Court, which held that the rules regarding theft were applicable to material as well as immaterial property. The

10 Supreme Court, 3 April 2014, N°17/2014.

11 District Court, 26 June 2012, N°2270/2012 (for more details please refer to the February 2013 edition of our Luxembourg Legal Update).

12 Court of Appeal, 10 July 2013, N°395/13 X.

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Supreme Court also held that making photocopies was equivalent to taking possession of the document, which is the material element of theft. Additionally, the Court of Appeal had to verify whether the documents were strictly necessary with regard to the exercise of the former employee's rights of defence.

With regard to the violation of the obligation of professional confidentiality, the Court admits that an employee is allowed to use confidential documents in court proceedings, if such use is justified by the exercise of the rights of the defence. Such justification (*fait justificatif*) may be raised by a former employee after his resignation or his dismissal.

Voidability of a Loan and the Attached Pledges – Mistake, Fraud and Lack of a Valid "Cause"

District Court, 19 February 2014[13]

A borrower starts an action in court in order for a loan and the attached pledges to be voided on the basis of mistake, fraud and lack of a valid "cause". Such action is dismissed by the District court.

With regard to fraud, the Court notes that the borrower has been warned by the bank and that he has signed documents containing the warning regarding the investments.

With regard to mistake, the Court notes that the client appeared to be and actually pretended to be an informed investor.

Eventually with regard to the absence of a valid "cause", the Court holds that the client knew the nature of his investment, which corresponded to his needs.

CSSF Annual Report – Clients' Complaints

Investor Profiles

The CSSF attaches much importance to the investor profile form to be filled in by clients, as this is very useful for the CSSF when it is asked to take decisions with regard to clients' complaints.

In one case the client had been recommended a certain product by his bank, which later appeared, to him to be too risky. In the procedure, the bank produced a document signed by the client in which the client accepted to invest in products which were more risky than average. When asked by the CSSF, the client admitted that he had signed the document, but that there had been an oral understanding between him and his adviser, which went in a different direction. The CSSF decided that in such circumstances the bank had not committed any fault, and that the words of the client were simple allegations, which could not be proved.

Management of Investor's Funds by the Client or by the Bank

A client asked the CSSF to check whether the bank had respected its contractual duties when investing the client's funds in financial products which had not been provided for in a discretionary management contract.

In the case at hand, the contract provided that the client's portfolio consisted in shares, bonds and money. However, according to a detailed extract it appears that the bank had invested the client's funds in shares and bonds as well as convertible bonds, structured bonds, investment funds of shares and bonds and in other investment funds.

The CSSF decides that the bank exceeded the scope of its powers, and asked the bank to offer an amicable arrangement to the client. Additionally, the CSSF rejects the bank's defence that the client, by not challenging the investments in the contractual 30-day period, had started its action too late.

Corporate

Obligation for a Legal Person being the General Partner of a Luxembourg SCA to Designate a Permanent Representative who will be a Physical Person

District Court Luxembourg, 11 December 2013

In the case at hand, the Luxembourg court had to consider whether the obligations imposed by article 51bis of the Companies Law to Luxembourg SAs, according to which where a legal entity is appointed as director, it shall designate a permanent representative to exercise that duty in the name and for the account of the legal entity, such representative being subject to the same conditions and incurring the same civil responsibility as if he fulfilled such duty in his own name and for his own account, without prejudice to the joint and several liability of the legal entity which he represents, also apply to Luxembourg SCAs, where the general partner managing the SCA is a legal entity.

13 District Court, 19 February 2014, N°134611 and N°137139.

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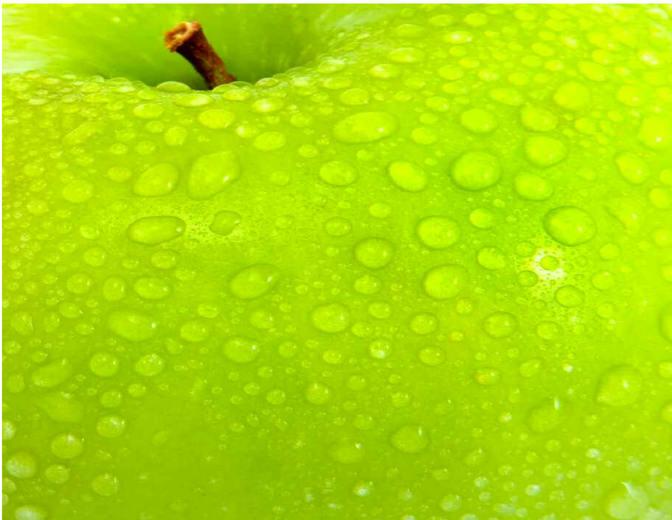

Indeed, article 103 of the Companies Law related to SCAs clearly states that the provisions of the Companies Law regarding SAs shall also apply to SCAs, unless otherwise provided in the Companies Law. There was however some uncertainty on the application of article 51bis to the SCAs considering that the Companies Law already contains specific provisions related to the management of the SCAs, which clearly differs from the ones related to the management of the SAs.

The court[14] considered however that the general reference made in article 103 of the Companies Law includes also article 51bis, thus leading the court to the conclusion that the obligation to nominate a permanent representative for every legal entity holding the position of a manager or director is also applicable to SCA, and then when the general partner of an SCA is a legal entity, it should appoint such a permanent representative.

Notary Subject to a Personal Duty to Apply Diligence Measures Following the Anti-Money Laundering Provisions when Holding a General Meeting Changing the Corporate Name and Nominating Additional Directors

District Court Luxembourg, 31 October 2013

The Luxembourg law of 12 November 2004 (as amended) on the fight against money laundering and terrorism financing (the "AML Law") requires the identification of the clients as well as the verification of their identity, on the basis of documents, data or information obtained from a reliable and independent source. The same law also requires to identify the beneficial owner and to take adequate measures to verify its identity as well as for legal entities, trusts or similar legal arrangements to take adequate measures to understand the proprietary and control structure of the client.

In the case at hand, in 2011, the Financial Intelligence Unit (F.I.U.) received a suspicious transaction report from a company (the "Company"). The Company informed the F.I.U. that another company which is a client of the notary (the "Client") refused to provide to it documents indicating the identity of the beneficial owner(s). The F.I.U. sent a request for information to the notary in order that he indicates the beneficial owner of his Client. The notary having never responded, the F.I.U. asked for an investigation for the offences contained in the articles 3 and 9 of the AML Law against the Notary who has proceeded to an extraordinary general meeting of shareholders for his Client in 2009. During his interrogation, the notary confessed that he did not try to obtain the identification of the beneficial owner(s) and/or clients and declared in part that he had been less vigilant since the general meeting of shareholders only resolved to change the corporate name of the Client and to nominate additional directors but not to generate cash flows, therefore there had not been any risk of money laundering. Secondly, he declared that he relied on the fact that the company that contacted him in order to hold the general meeting of the Client, being a long-term client, would not act for a dishonest client. Thirdly, he declared that he relied on the other legal professionals of his public notary office that they would fulfil all necessary legal requirements prior to a notarial deed.

The court[15] considered that according to the articles 2 and 3 of the AML Law, the provisions of the AML Law do apply to the notaries. The notary was therefore under the duty to apply diligence measures in respect of its clients even if no cash flows are generated by the decision of the general meeting. According to article 3-2 (2) of the AML Law when a client is not physically present for the identification, the notary is even subject to a duty of enhanced diligence measures. For these reasons, the notary should have taken adequate specific measures to identify his clients and/or the beneficial owner. In addition to that, the court also points out that the duty of diligence is a personal duty for the notary prior to the transaction, which means that he cannot

14 District Court Luxembourg, 11 December 2013, N°145725.

15 District Court Luxembourg, 31 October 2013, N°2800/2013.

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delegate this duty to a third party, in particular to the other legal professionals of his public notary office.

A Share Capital Increase through Conversion of a Loan Regarded as a Share Capital Increase by Contribution in kind and not as a Capital Increase by Contribution of Convertible Bonds – Nullity of General Meeting of Shareholders to the Absence of a Report Evaluating the Contributions in kind by an Approved Auditor Prior to the Share Capital Increase

District Court Luxembourg, 16 May 2013

If the issuance of convertible bonds (*obligations convertibles*) corresponds to a time-delayed share capital increase, in other words, to a contribution in cash, a share capital increase by conversion of a loan or loan notes cannot be regarded as a share capital increase by contribution of convertible bonds but has to be analysed as share capital increase by contribution of a claim. Such transaction has to be regarded as a contribution in kind.

In the case at hand, two minority shareholders requested that the general meeting of shareholders resolving on a share capital increase by contribution of loan notes be declared null and void as the statutory provisions concerning a share capital increase by a contribution in cash, especially article 32-3 of the Companies Law on the preferential subscription rights, have not been observed. Alternatively, if the court came to the conclusion that the proposed contribution of loan notes was in fact a contribution in kind, the claimants requested that the general meeting of shareholders be also declared null and void as the articles 26-1 (2) and 32-1 of the Companies Law have not been observed since no report has been produced by any approved auditor prior to the share capital increase by contribution of such loan notes.

The court[16] first points out that since the issuance of convertible bonds corresponds to a time-delayed share capital increase, convertible bonds can only be issued following a decision of the extraordinary general meeting of shareholders or, within the framework of the authorised capital, of the board of directors. The company being unable to prove that such a decision has been taken in the case at hand, it can be concluded that no issuance of convertible bonds had occurred, but instead there has been a share capital increase through contribution of a claim consisting in the loan notes, qualified as a contribution in kind. The court then confirms that according to articles 26-1 (2) and 32-1(1) of the Companies Law a report evaluating the contributions in kind by a accredited statutory auditor has to be produced prior to the share capital increase. The aim of article 26-1 of the Companies Law is to protect the interests of the creditors as well as those of the shareholders. The default of producing such a report prior to the share capital increase by a contribution in kind constitutes an infringement of a substantive requirement foreseen by Luxembourg law, so that the general meeting needs to be declared null and void.

Employment

New Trial Period in an Existing Employment Contract

Court of Appeal, 27 March 2014[17]

The Labour Code strictly regulates the trial periods and provides in particular that a trial period cannot be renewed (Article 121-5 paragraph (3) of the Labour Code).

In a case that had been submitted to the Court of Appeal, an employer had promoted an *aide-soignant* to a new position (*infirmier*) and had included in the amendment agreement evidencing this change of position a new trial period clause.

After a few months, the employer decided to downgrade the employee to the status of *aide-soignant.* This was challenged by the employee for having been made without complying with the formalities prescribed by Article L.121-7 of the Labour Code. The employee also claimed the nullity of the trial period clause included in the amendment to his initial employment contract for being in contradiction with the provisions of Article 121-5 paragraph (3) of the Labour Code.

The employer claimed that it had the right to downgrade the employee as it did so during the trial period and that it had the right to insert a new trial period in the amendment agreement, in order to appreciate the qualification level as well as the professional ability of the employee in his new function.

In the case at hand, the Court of Appeal however decided that the trial period clause included in the amendment agreement to the employment contract was not valid. The Court of Appeal indeed considered that the parties were in the same employment relationship as from the beginning of their contractual relationship (which had notably been evidenced by the fact that

16 District Court Luxembourg, 16 May 2013, N°645/2013.
17 Court of Appeal, 27 March 2014, N°38755.

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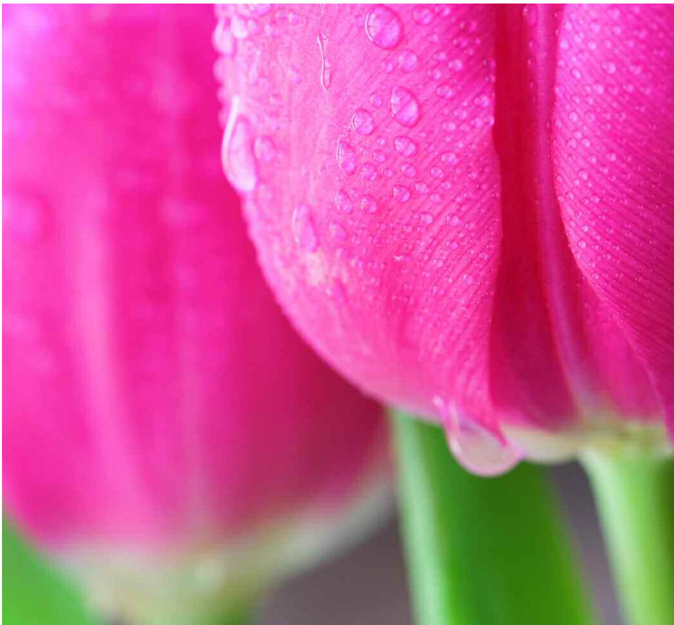

the employer downgraded the employee to his former role) and hence that the employer had not the possibility to subject the promotion of the employee to a trial period.

The Court of Appeal expressly stated in its decision that the trial period:

- starts necessarily on the commencement date of the execution of the employment contract
- needs mandatorily to be stipulated at the moment of the conclusion of the employment contract, which excludes, *a contrario*, that a trial period clause can be validly inserted into an employment contract during the course of its performance.

Extension of the Trial Period (Sickness Leave) –Termination of the Contract During the Extended Trial Period

Labour Court, 25 October 2013[18]

During the trial period and pursuant to Article L.121-6 of the Labour Code, employees on sickness leave benefit from a protection against dismissal. In case of suspension of the employment contract (such as in case of sickness leave), Article L. 121-5 (2) of the Labour Code provides that the trial period is extended by a period equal to the suspension, without however this extension period exceeding one month.

For years, case law has consistently ruled that employers are authorised to terminate the employment contract during the trial period even though their employees would be on sickness leave at the time of termination provided they take into account the maximal extension period of the trial period (i.e., one month) when terminating the employment contract.

In the case at hand, the Labour Court has specified at which precise date the employer recovers the right to dismiss an employee during the trial period.

According to the Labour Court, the employer only recovers the right to terminate the contract on the very last day on which a valid termination of the contract during the trial period may occur.

In the case at hand, an employment contract had been signed between the employee and the employer on 12 December 2011 providing a commencement date on 1 January 2012, a trial period of six months, and a contractual notice during the trial period of 30 days.

The employee had been on sickness leave for 16 days (from 11–22 January 2012, and from 12-15 June 2012).

Given the agreed notice period and in order to validly terminate the employment contract during the trial period (which had been extended until 16 July 2012), the employer had sent a termination letter to the employee on 15 June 2012 (i.e., at a time the employee was still protected against dismissal), with effect as from 16 June 2012.

This termination has been considered as unlawful by the labour court (for having been made in violation of Article L.121-6 of the Labour Code).

As the trial period was due to end on the 16 of July 2012, the very last day for notifying the termination was indeed the 16 of June 2012 (with a starting date of the notice period on the 17 of June 2012).

18 Labour Court, 25 October 2013, N°3910/2013.

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Tax

Financial Tax Transaction – ECJ Throws Out UK's Challenge

European Court of Justice, Case C-209/13, 30 April 2014[19]

On 30 April 2014, the ECJ ruled against the UK by dismissing the action brought against the decision of authorising 11 Member States to establish enhanced cooperation in the area of Financial Transaction Tax.

In the case at hand, the UK challenged the decision by the Council authorising 11 Members to use the enhanced cooperation procedure to set up a FTT on the following grounds being

- the extra-territorial nature of the FTT, i.e., being contrary to EU and international laws
- the imposition of costs on non-participating Member States upon implementation and collection of the FTT.

In this respect, the ECJ ruled in a short judgement that the UK's competencies, rights and obligations were not adversely affected by the decision of the Council, as it simply authorised the use of the enhanced cooperation procedure. Any adverse effect to the UK would result, not from that authorising decision, but from its subsequent implementation of the Council's decision in a Directive agreed by the participating Member States. Accordingly the ECJ rejected the UK's challenge as premature and declined to rule on the substantive question. It remains open to the UK to challenge any subsequent Directive to be further adopted.

Freedom of Establishment – UK Group Relief Scheme

European Court of Justice, Case C-80/12, 1 April 2014[20]

On 1 April 2014, the ECJ ruled against the UK by deciding that the "residence criteria" on group relief scheme introduces a difference in treatment between UK resident companies and companies established in other Member States not being entitled to the benefits of the group relief scheme and is therefore a breach to the freedom of establishment.

Under the UK law on group relief scheme, losses suffered by one company (the surrendering company) may be offset against the profits of another company (the claimant company) when one of these companies is owned by a consortium and the other is in the same group as one of the consortium member, i.e., a link company being a member of both the consortium and of the group.

In the case at hand, the surrendering company as well as the claimant company were both UK resident companies and the link company was a resident of Luxembourg. The companies applied for the application of the UK group relief scheme, but the application UK Tax Authorities refused to grant such because of the link company being neither a resident of the UK nor having a UK permanent establishment.

The ECJ ruled that the UK residence and or permanent establishment requirement for the link company creates a difference in treatment between resident companies connected by a UK company and resident companies connected by a company in another Member State (without a UK permanent establishment). It therefore constitutes a restriction to the freedom of establishment which cannot be justified.

Opinion of Advocate General on Fiscal Unity

ECJ – AG Opinion – joined cases
C-39/13, C-40/13, C-41/13 – 27 February 2014[21]

On 27 February 2014, the Advocate General (AG) rendered her Opinion on the joined cases C-39/13-C-40/13 and C-41/13. The AG concluded that the Dutch regime, under which resident sister companies can be consolidated only in the case the parent company is also established in the Netherlands, constitutes a restriction on the freedom of establishment (Article 49 TFEU). The question of a horizontal tax unity was addressed for the first time at the ECJ level. The Dutch tax unity rules are similar to the Luxembourg tax unity rules and thus this Opinion (if confirmed by the ECJ) should also impact Luxembourg.

In the other cases, a Dutch resident parent company was indirectly owning three Dutch subsidiaries through two German resident companies. The companies applied for the Dutch tax unity regime but the Dutch Tax Authorities refused to allow the benefit of such regime on the basis that the intermediate companies of the group were not Dutch companies or did not have a Dutch permanent establishment. The AG concluded that the current Dutch tax unity regime breaches the freedom of establishment by treating differently group of companies not having Dutch resident subsidiaries. This is in line with the Papillon case C-418/07 of 27 November 2008.

19 ECJ – Case C-80/12 – 1 April 2014.
20 ECJ – Cases-C-39/13, C40/13 and C-41/13.
21 ECJ – Case C-464/12 – 13 March 2014.

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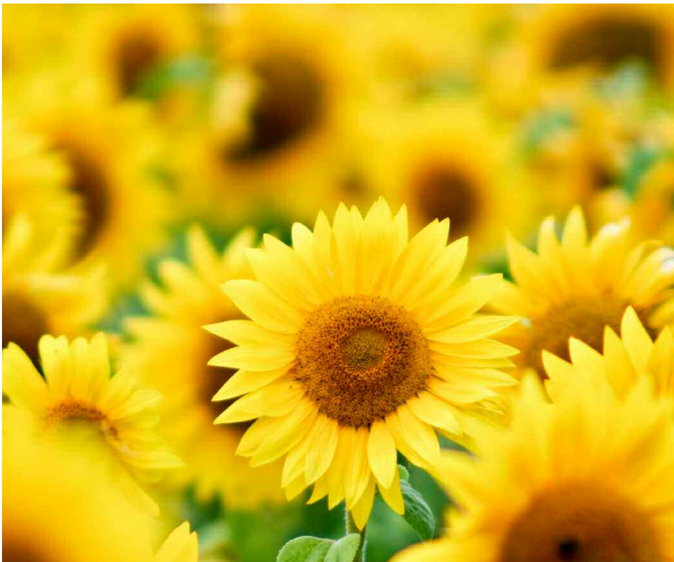

VAT Exemption on Management Services to Special Investment Funds

European Court of Justice, C-464/12, 13 March 2014[22]

On 13 March 2014, the ECJ ruled on whether management and administration services rendered to a Danish pension fund, being a defined-contribution (DC) fund, i.e., a fund whose yield depends on its investment strategy and where the employer does not need to make any extra payments to secure a particular return for the beneficiary employees, could benefit from the VAT exemption.

In the case at hand, ATP Pensions Services (ATP), was providing services to DC such as opening accounts for each pension employee, crediting the accounts with the pensions contributions made by the employer for the benefit of the employees. The Danish VAT authorities were of the view that the VAT exemption would not be applicable to such services. In this respect, the ECJ was asked:

- whether the DC fund could be regarded as a "special investment fund" for VAT purposes (1)
- whether the term "fund management" includes for VAT purposes the services provided by ATP (2)
- whether the transfer and payment services performed by ATP benefit from the VAT exemption (3).

With respect to (1), the ECJ ruled that DC funds and any other collective investment schemes may fall within the scope of "special investment fund" for VAT purposes provided that:

- they are funded by the persons to whom the retirement benefit is to be paid
- the funds are invested using a risk-spreading principle
- the pension customers bear the investment risk.

As for (2), the ECJ stated that term "fund management" covers services such as the opening of accounts in the pension fund system and the crediting of such accounts of the contributions. It also covers accounting services and account information services.

Finally, as for (3), the ECJ decided that ATP services fall within the scope of the VAT exemption, whether these transfers are carried by means of a physical transfer of funds or by means of accounting services.

Exchange of Information

Administrative Court, Case N°33272a/33273a, 7 March 2014[23]

On 7 March 2014, the Luxembourg Administrative Court ruled, in two cases dealing with the exchange of information, that the foreseeable relevance of information requested by foreign tax authorities requires that such request has to be related to a specific tax case. The Luxembourg Administrative Court takes the position that the request cannot be extended in order to provide information on third parties or any other information that is not related to the specific case of the taxpayer concerned.

The before mentioned decisions are in line with the position of the Luxembourg Administrative Court of Appeal rendered on 20 June 2013. Therefore it is expected that the before mentioned decisions will not be overruled by the Luxembourg Administrative Court of Appeal.

22 ECJ – Case C-464/12 – 13 March 2014.

23 Lower Administrative Court, 7 March 2014, N°33272a and N°33273a.

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