NEWSLETTER

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ELVINGER, HOSS & PRUSSEN
LUXEMBOURG LAW FIRM

CONTENTS

ASSET MANAGEMENT AND INVESTMENT FUNDS

1. QUALIFICATION OF CERTAIN OPEN-ENDED US ETFs AS ELIGIBLE INVESTMENTS FOR UCITS

This article focuses on the eligibility of open-ended US ETFs as investments for UCITS. It does not relate to closed-ended ETFs, which may qualify as eligible transferable securities for UCITS, if they meet all the necessary requirements.

Until December 2012, a legal analysis allowed the conclusion that open-ended US ETFs were eligible investments, either (i) on the basis that they qualified as "other UCIs" under Article 41(1) e) of the Luxembourg Law of 17 December 2010 on undertakings for collective investment (the "**2010 Law**"), provided that they met all the requirements set forth in paragraph e) of Article 41(1) of the 2010 Law, or (ii) on the basis that they were permissible investments under the so called 10% "trash ratio" set forth in Article 41(2) a) of the 2010 Law.

In light of the possibility to choose either of the two options described above to justify investments in US ETFs, managers generally chose option (ii) above as it avoided the need to perform the analysis required in case of choosing option (i), namely checking whether the different requirements set forth in Article 41(1) e) had been met (despite option (ii) resulting in a 10% restriction for this type of investment compared to a 30% restriction in case of option (i)).

The aforesaid choice between the two options was recently declared void by ESMA in its Opinion of 20 November 2012 (ESMA/2012/721), as confirmed by the CSSF shortly thereafter, which states that units of investment funds are not eligible investments under the 10% trash ratio.

As a result, the interest of managers to get a better understanding to what extent certain US ETFs qualify as "other UCIs" has been resurrected with, as a consequence, multiple requests for guidance being submitted to the CSSF.

On this basis, the CSSF has recently reconfirmed that certain US ETFs (open-ended US ETFs subject to the Investment Company Act of 1940 which qualify as a "Diversified Fund") qualify as "other UCIs" provided they meet all the requirements set forth in Article 41(1) e), including the requirement that the rules on assets segregation, borrowing, lending and uncovered sales are equivalent to the UCITS requirements.

Frequently, the offering documents of such US ETFs permit borrowing up to 30%, allow investments in money market funds in excess of 10%, permit the investment in commodities and do not specifically prohibit short sales or the granting of loans, all being flexibilities which are incompatible with the UCITS requirements. In practice, however, many US ETFs do not actually make use of these flexibilities.

In light of the foregoing, the CSSF has taken the position that, even if the offering documents of the US ETFs provide for such flexibilities, they can be considered as eligible investments for UCITS if the investing UCITS have undertaken an appropriate eligibility analysis enabling it to conclude that the US ETF actually complies in all material respects with the UCITS restrictions.

In this context, the CSSF recommends that if the offering document of the US ETF provides for flexibilities which conflict with the UCITS rules, the UCITS should ensure that the investment rules that are actually applied in practice by the US ETF do not conflict in any material respects with the investment rules applicable to UCITS, for example, by means of a written confirmation of the US ETF or its manager.

2. RISK MANAGEMENT PROCESSES AND LEVERAGED UCITS

On 3 May 2013, the CSSF published its 2012 annual report which contains useful regulatory information in particular for Luxembourg UCITS regarding the risk management processes required by CSSF Circular 11/512 and the CSSF approach concerning leveraged UCITS.

1. Review of the risk management processes required by CSSF Circular 11/512

The CSSF gives a brief overview of the results of its review of the risk management processes ("**RMP**") submitted by UCITS management companies and investment companies which have not designated a management company ("**SIAGs**"). The CSSF points out *inter alia* the recurrent deficiencies of the RMPs submitted for its attention which may be summarised as follows:

- Insufficient clarifications on the organisation of the risk management function.

The format of the RMP is laid out in the Appendix to CSSF Circular 11/512. In light of this, the CSSF expects the RMP to contain a precise description of how the risk management function of the management company or the SIAG is structured.

In addition, the allocation of responsibilities between the parties involved in the risk management function shall be clearly described, notably by means of an organisation chart mentioning the main reporting lines between the parties involved in the risk management, in particular in case of delegation of risk management activities.

The CSSF reiterates that all delegations of risk management activities must be mentioned in the organisation chart (i.e. delegations to third parties and delegations within the group of the relevant UCITS management company or SIAG).

- Lack of detail on the *due diligence* and on-going monitoring of third parties in case of delegation of the risk management function and lack of confirmation concerning the existence of a delegation agreement.

According to Article 26 of CSSF Regulation 10-4, UCITS management companies or SIAGs shall, before entering into arrangements with third parties in relation to the performance of risk management activities, take the necessary steps in order to verify that the third party has the ability and capacity to perform the risk management activities reliably, professionally and effectively.

After entering into such arrangements, the management company or the SIAG shall establish methods for the on-going assessment of the standard performance of the third party.

The CSSF further restates that this on-going monitoring requirement applies to entities belonging to the same group of the management company or SIAG as well as to entities outside the group.

In accordance with the applicable regulations, the CSSF expects that the arrangements in relation to the performance of risk management activities are formalised by an executed agreement between the management company or the SIAG and the third party. Again, this requirement applies to arrangements with third parties belonging to the group of the management company or SIAG as well as with third parties outside the group.

- Problems relating to the summary and filing of regular reports on risk management:

According to the Appendix to CSSF Circular 11/512, the RMP shall describe the regular reports on risk management and a copy of each information report shall be filed with the CSSF in the context of the annual update of the RMP.

2. CSSF's approach concerning leveraged UCITS

CESR Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR/10-788) imposed on UCITS calculating their global exposure using the VaR approach, additional disclosure in their prospectus relating to the expected level of leverage and the possibility for higher levels. This additional requirement is not an additional investment restriction but an additional layer of disclosure. It was clarified in a Q&A published by ESMA in July 2012 (ESMA 2012/429) regarding the Guidelines referred to above that this level of leverage should be calculated using the sum of notionals methodology which could be complemented by the level of leverage calculated using the commitment approach (see also CSSF in its Press Release 12/29 of the 31 July 2012 and our Newsflash of 1 August 2012).

In that context, the CSSF has noted that the use of certain types of strategies and financial derivative instruments by Luxembourg UCITS may lead to high levels of leverage and has determined a global approach of analysis and on-going monitoring of highly leveraged UCITS which focuses on the following main lines:

- systematic analysis of investment strategies followed in order notably to assess the risk exposure and the proportionality of the leverage to the risk exposure;
- compliance by UCITS and leveraged UCITS (regardless of the level of risk incurred by such UCITS) with disclosure requirements foreseen in Article 47 of the Law of 17 December 2010 on undertakings for collective investment ("**2010 Law**"). The UCITS prospectus must contain sufficiently elaborated information on the use of financial derivative instruments, such as the types of derivatives used, their underlying assets, the purpose of their use (investment, hedging, arbitrage, etc.), the underlying investment strategies as well as the impact of their use on the level of leverage and risk profile of the UCITS. The level of disclosure to be applied depends on the use of financial derivative instruments by the UCITS (i.e. higher disclosure level for UCITS making extensive use of financial derivative instruments);
- on the basis of the RMP submitted to the CSSF in accordance with section V of CSSF Circular 11/512, the CSSF ensures the adequacy of the RMP implemented by the UCITS pursuant to Article 42 (1) of the 2010 Law and, *inter alia,* that the investment strategies pursued by the UCITS are adequately covered by the RMP;
- the CSSF also scrutinises the shareholding breakdown (for example target investors) of leveraged UCITS.

Following this analysis, the CSSF may decide, on a case-by-case basis, to implement a more stringent on-going monitoring for a particular UCITS by requiring an *ad hoc* quarterly report relating to performance and risks (e.g. leverage, VaR, stress tests).

The CSSF annual report 2012 is available (only in French) on the CSSF's website.

3. AIFMD – RECENT PUBLICATIONS

Not surprisingly, Q2 2013 was very productive from an AIFMD perspective. The application date of this Directive and of the execution acts adopted on this basis is approaching, i.e. 22 July 2013.

The first section of this article highlights the implementing acts and other legislative documents which have recently been published by the EU authorities.

The second section includes a table with all of the EU AIFMD legislative documents currently available.

Finally, the last section gives an update on the status of the AIFMD implementation in Luxembourg.

1. AIFMD implementing acts and other legislative documents recently published

The following AIFM legislative acts have been published since our last Newsletter:

- Commission Implementing Regulation (EU) 447/2013 of 15 May 2013 establishing the procedure for AIFMs which choose to opt in under Directive 2011/61/EU
- Commission Implementing Regulation (EU) 448/2013 of 15 May 2013 establishing a procedure for determining

the Member State of reference of a non-EU AIFM

- ESMA Final Report of 2 April 2013 on draft regulatory technical standards on types of AIFM (ESMA/2013/413)
- ESMA Final Report of 24 May 2013 on guidelines on key concepts of the AIFMD (ESMA/2013/600)
- ESMA Consultation Paper of 24 May 2013 on Guidelines on reporting obligations under Article 3 and Article 24 of the AIFMD (ESMA/2013/592)

In addition, on 31 May 2013, ESMA approved centrally-negotiated cooperation arrangements with 34 non-EU securities regulators. The extensive list of the 34 non-EU authorities is available on ESMA's website (ESMA/2013/629). It includes authorities from jurisdictions such as Hong Kong, USA, Singapore and Switzerland.

2. AIFMD EU legislative documents table

The table below gives an overview on all EU AIFMD legislative documents already published and available.

Level 1	**Alternative Investment Fund Managers Directive** 2011/61/EU of 8 June 2011
Level 2	Commission Delegated Regulation (EU) 231/2013 of 19 December 2012 supplementing the AIFMD with regard to **exemptions, general operating conditions, depositaries, leverage, transparency and supervision**
	Commission (EU) AIFMD Q&A published in March 2013
Level 2	Commission Implementing Regulation (EU) 448/2013 of 15 May 2013 establishing a procedure for determining the **Member State of reference of a non-EU AIFM**
	Commission Implementing Regulation (EU) 447/2013 of 15 May 2013 establishing the procedure for AIFMs which choose to **opt in** under Directive 2011/61/EU
Level 2,5	ESMA Final Report of 2 April 2013 on draft regulatory technical standards on **types of AIFM** (ESMA/2013/413)
Level 3	ESMA Guidelines of 11 February 2013 on sound **remuneration** policies under the AIFMD (ESMA/2013/201)
	ESMA Final Report of 24 May 2013 on guidelines on **key concepts** of the AIFMD (ESMA/2013/600)
Consultation(s)	ESMA Consultation Paper of 24 May 2013 - Guidelines on **reporting obligations** under Article 3 and Article 24 of the AIFMD (ESMA/2013/592)
Centrally-negotiated cooperation arrangements	ESMA confirmation of the execution of 34 centrally-negotiated cooperation arrangements – 31 May 2013

3. AIFMD implementation in Luxembourg

3.1. Bill of law implementing the AIFMD

On 24 August 2012, the Bill of law (the "**Bill**") implementing the AIFMD was deposited with the Luxembourg Parliament. Besides transposition of the specific provisions of the AIFMD, the Bill aims to introduce a number of innovations that are designed to facilitate and improve the development of the alternative investment fund industry in Luxembourg.

On 21 May 2013, an amended version of the Bill was published. The new version can be viewed under: http://www.chd.lu/wps/PA_RoleEtendu/FTSByteServingServletImpl/?path=/export/exped/sexpdata/Mag/124/289/122838.pdf

It is currently expected that the law will be adopted in early July.

3.2. CSSF

- CSSF Guidance

On 18 June 2013, the CSSF published information on the procedure to be followed by managers established or to be established in Luxembourg to be authorised by the CSSF as AIFM. Application forms to be used when filing an application for authorisation as AIFM are now available on the CSSF website.

On the same day, the CSSF published a series of questions and answers (FAQs) on the AIFMD.

- Cooperation arrangements

As regards cooperation with third country authorities, the CSSF announced on 31 May 2013 by means of a Press Release that it has signed a Memorandum of Understanding with each of the 34 non-EU authorities mentioned in section 1.

For more information on this topic, see our Newsflash of 18 June 2013.

4. OVER-RELIANCE ON CREDIT RATINGS

On 31 May 2013, the OJEC published Directive 2013/14/UE amending (i) Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision ("**IORPs**"), (ii) Directive 2009/65/EC relating to UCITS and (iii) Directive 2011/61/EU on AIFM in respect of over-reliance on credit ratings.

In order to improve the quality of the investments made by IORPs, UCITS and AIFs and to protect investors in those funds, the Directive considers it appropriate to require IORPs, management and investment companies with regard to UCITS, and AIFMs to avoid relying solely or mechanistically on credit ratings or using them as the only parameter when assessing the risks involved in the investments made by IORPs, UCITS and AIFs. The general principle against over-reliance on credit ratings should therefore be integrated into the risk-management processes and systems of IORPs, management and investment companies with regard to UCITS, and AIFMs, and adapted to their specificities.

5. NEW EU LABEL FOR VENTURE CAPITAL AND SOCIAL ENTREPRENEURSHIP FUNDS

On 17 April 2013, the EU authorities adopted Regulation (EU) 345/2013 on European Venture Capital Fund and Regulation (EU) 346/2013 on European Social Entrepreneurship Funds. The overall objective is to foster the growth of small and medium-sized enterprises (SMEs) by improving their access to finance through the establishment of an EU-wide passport for managers of venture capital funds (EuVECA) and social entrepreneurship funds (EuSEF) relating to the marketing of their funds.

6. CSSF ANNUAL REPORT

On 3 May 2013, the CSSF published its 2012 annual report. This document is currently only available in French and can be viewed under http://www.cssf.lu/fileadmin/files/Publications/Rapports_annuels/Rapport_2012/CSSF-rapport-2012.pdf

BANKING

1. THE CSSF ADMITS CLIENT WAIVER AS ELIGIBLE EXEMPTION FROM BANKING SECRECY OBLIGATIONS

In the context of outsourcing, the CSSF Circular 13/552, as amended, on central administration, internal government and risk management provides that data confidentiality shall be guaranteed at all times, unless explicit consent is given by the customer or the owner of the data on the basis of an informed opinion on the interest of the outsourcing, the specific nature of the final goal, the content of the provided information, the recipient and location of the data as well as of the duration (point 182).

As a consequence, point 193 of this Circular provides for the possibility to outsource management and operation of IT systems where (i) no confidential data is readable or (ii) where clients have given their consent under the conditions as described above. The CSSF even adds that no consent is required for institutional clients, for which it is sufficient that the specifics of the outsourcing are mentioned in the agreement.

The CSSF goes a step further in its 2012 annual report where it describes the concept of client consent as a general rule beyond the scope of outsourcing. Section 2.14 of chapter 3 of this report provides that the client is free to direct the information concerning its person and may therefore waive the protection of banking secrecy by an expression of free and informed consent. The client must have the possibility to cancel its waiver, so that a definitive waiver without any limitations is not allowed. The consent must therefore be specific as described in the first paragraph.

Whereas a written and explicit consent is recommended, verbal and tacit consents may be eligible according to the circumstances.

As a consequence, banks are allowed on a case-by-case or continuous basis, to transfer all client data to operational or IT centres in Luxembourg or abroad as long as these banks have been provided with the clients' consent.

The position of the CSSF stems from a memorandum issued by the committee of legal experts of the CSSF (questioned on the rigidity of the public nature of banking secrecy in relation to the transmission of information that could be made upon consent or request of the protected client), entitled "The Nature and the Scope of Banking Secrecy" and published in the 2003 annual report of the CSSF. It is for the first time that the CSSF has taken an official position on the concepts developed in this memorandum by taking an extensive view of the possibility for clients to waive their protection under the banking secrecy rules. The liberal interpretation made by the CSSF is certainly helpful for the organisation of intergroup relations and synergies. It should be noted, however, that in case of litigation, the concept of banking secrecy will be interpreted by the Courts.

2. CRD IV: COUNCIL ADOPTS NEW BANK AND INVESTMENT FIRM CAPITAL REQUIREMENTS

On 20 June 2013, the Council adopted stricter capital requirements for banks and investment firms (the "**CRD IV package**"). The new rules will apply from 1 January 2014. The CRD IV package is composed of a Regulation establishing prudential requirements that institutions must respect and a Directive governing access to deposit-taking activities.

3. MIFID : REMUNERATION POLICIES (ESMA/2013/606)

On 11 June 2013, ESMA published Guidelines on remuneration policies and practices (MIFID).

These guidelines can be viewed under: http://www.esma.europa.eu/content/Guidelines-remuneration-policies-MiFID

4. BCL REGULATION 2013/15: EUROSYSTEM REFINANCING OPERATIONS AND ELIGIBILITY OF COLLATERAL

On 3 May 2013 , the "*Banque Centrale du Luxembourg*" ("**BCL**") published Regulation 2013/ N°15 of 3 May 2013 implementing the Guideline of the European Central Bank of 20 March 2013 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral and amending Guideline ECB/2007/9. This regulation replaces and abrogates the BCL Regulations N°12, 13 and 14.

This Regulation can be viewed under http://www.bcl.lu/fr/publications/Reglements_de_la_BCL/Regulation_BCL_No15_Implementation_Guideline_ECB_2013_4__EN_.pdf

FINANCE

1. LAW OF 6 APRIL 2013 RELATING TO DEMATERIALISED SECURITIES

The Law, which became effective three days after its publication in the Luxembourg *Mémorial* on 15 April 2013, modernises Luxembourg securities law by introducing the option for Luxembourg capital companies to issue shares in dematerialised form and for all other issuers to issue dematerialised debt securities governed by Luxembourg law.

Prior to the adoption of this law, Luxembourg law only envisaged the issue of bearer securities or registered securities, with certain limited exceptions which were provided in the Law on securitisation of 22 March 2004 and a Grand Ducal Regulation of 2002 regarding state loans. Already prior to the new law, legal doctrine in Luxembourg accepted the possibility to issue dematerialised securities based on the principle of contractual freedom. Practice also accepted dematerialisation of both registered and bearer securities, in each case however after the issue of the securities, at the level of their custody and/or inscription.

The purpose of the new law is to follow the global trend towards dematerialisation of securities. This trend is based on the idea that for a large number of securities, the swiftness and cost efficiency of their circulation are increasingly important factors. Bearer and registered securities are therefore no longer sufficient options.

The law, which is to a large extent inspired by the relevant Belgian Law of 1995, considers dematerialised securities as being a particular category of securities, which co-exist with bearer and registered securities, in relation to which the *de facto* dematerialisation of securities which continues to exist is not affected by the law. In order to protect the rights of investors the law requires that the issue of the dematerialised securities must be done through a professional specifically approved to that effect (i.e. a settlement system within the meaning of the law regarding payment services or a central account holder). The law also provides for the possibility for issuers to convert shares which have been issued in bearer or registered form into dematerialised form. Such a conversion can be mandatory or optional at the issuer's discretion. In order to preserve the same regime between the securities which are subject to the factual dematerialisation and securities which are dematerialised *de jure*, the Law of 1 August 2001 regarding the circulation of securities is amended and extended to dematerialised securities.

The Law of 1 August 2001 on the circulation of securities has been amended *inter alia* to incorporate certain principles of the UNIDROIT convention on intermediated securities signed in Geneva on 9 October 2009.

Other laws have also been amended by the new Law of 6 April 2013, including in particular the Law of 10 August 1915 on commercial companies, as amended, to introduce the new form of dematerialised securities, as well as a number of laws regarding investment funds and the Law of 22 March 2004 relating to securitisation. Generally, the law on dematerialised securities introduces a comprehensive and complete regime covering the issue, conversion, pledging, transmission and conditions required for the issue of dematerialised securities.

The law furthermore amends the Law of 5 April 1993 on the financial sector to introduce the new profession of *teneur de compte central* (i.e. central account holders in dematerialised securities).

2. PRINCIPLES FOR BENCHMARKS – SETTING PROCESSES

On 6 June 2013, ESMA and EBA issued their final report (ESMA/2013/658) on Principles for Benchmark-Setting Processes in the EU ("**Principles**"). Whilst indicating that the Principles would be without binding legal effect, the intention is that the Principles will "bridge the gap" to aid benchmark administrators, calculation agents, publishers and data submitters in working together toward a future legally binding framework. The Principles do not replace and are without prejudice to existing international or EU provisions, such as ESMA's guidelines on Exchange Traded Funds and other UCITS (ESMA/2012/474).

ESMA and EBA intend to review the application of the Principles 18 months after their publication or sooner if warranted by material changes in market practice or if international standards pertaining to benchmarks (such as, but not limited to, IOSCO positions or European Commission legislative proposals such as the revised Market Abuse Directive and Regulation and/or Benchmark Regulation) are adopted in the meantime.

As the Principles have no legal binding effect, the impact on existing benchmarks is expected, in practice, to be limited. The Principles are however an indication of the direction in which the various regulators intend to legislate. Industry participants affected would be well advised already to consider ways to comply with the Principles as they will in all likelihood form the basis of any future binding legislation.

3. DERIVATIVES - EMIR

On 4 June 2013, ESMA updated its Q&A (first version published on 20 March 2013) in order to promote common supervisory approaches and practices in EMIR following the questions posed by the general public, market participants and competent authorities in relation to the practical application of EMIR (ESMA/2013/685).

The Q&A can be viewed under:
http://www.esma.europa.eu/node/65855

COMMERCIAL

LAW ON COMBATING LATE PAYMENT IN COMMERCIAL TRANSACTIONS

The Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011, on combating late payment in commercial transactions, has been implemented in Luxembourg by the Law of 29 March 2013 (the "**Law**"), which modifies the Law of 18 April 2004.

The Law has been applicable since 14 April 2013.

1. Scope

The scope of the Law is limited to (i) commercial transactions between undertakings and (ii) commercial transactions between undertakings and public authorities. This Law does not introduce changes regarding contracts concluded between a seller or a supplier and a consumer. The provisions of the Law of 18 April 2004 governing such a relationship remain applicable.

2. What are the important changes to the Law of 18 April 2004?

2.1. The maximum statutory period of payment

In the case of commercial transactions between undertakings and in the case of commercial transactions between undertakings and public authorities, if the parties have not agreed to a specific period of payment in the contract, the period of payment is 30 calendar days.

There are different starting points for this time limit fixed by Article 3 of the Law. For example, if a procedure of acceptance or verification of the conformity of the goods or services is provided for by statute or in the contract and if the debtor receives the invoice or the equivalent request for payment earlier or on the date on which such acceptance or verification takes place, the 30-day period starts from such date.

2.2. Period of payment agreed upon between the parties

- in the case of commercial transactions between undertakings, the parties may agree on a payment period of up to 60 calendar days. The parties may also stipulate a payment period beyond 60 calendar days, provided such prorogation is objectively justified; and
- in the case of commercial transactions between undertakings and public authorities the parties may stipulate a payment period of up to 60 calendar days. This prorogation of the payment period must be expressly justified in the contract.

Article 6 (1) of the Law provides that a contractual term or a practice relating to the date or period of payment, the rate of interest for late payment or the compensation for recovery costs may be declared unenforceable if the clause is totally unfair to the creditor.

In determining whether a contractual term or a practice is totally unfair to the creditor, all circumstances of the case shall be considered, including:

- any gross deviation from good commercial practices, good faith and fair dealing;
- the nature of the product or the service; and
- whether the debtor has any objective reason to deviate from the statutory rate of interest for late payment, from the payment period or from the lump sum (Article 5 (1) of the Law).

A contractual term or a practice which excludes compensation for recovery costs is presumed to be totally unfair.

2.3. Compensation for late payment

The creditor is entitled to interest for late payment from the day following the end of the period for payment without the necessity of a reminder.

In the case of breach of this maximum period of payment, the interest for late payment is the minimum applicable interest rate. This interest corresponds to the sum of the reference rate (i.e. the interest rate applied by the European Central Bank to its most recent main refinancing operations – on 6 June 2013 was 0,5%) plus 8 percentage points.

2.4. Recovery costs

The creditor is entitled to obtain from the debtor:

- a lump sum of EUR 40, payable without the necessity of a reminder (a clause excluding the payment of the lump sum or the recovering costs is deemed to be abusive); and
- reasonable compensation for any recovery costs incurred due to the debtor's late payment, e.g. lawyer's fees.

2.5. Payment schedule

Article 3 (5) of the Law allows the parties to agree on payment schedules providing for instalments in commercial transaction between undertakings or between undertakings and public authorities.

Where any of the instalments are not paid by the agreed date, interest and compensation are calculated solely on the overdue amounts.

INFORMATION AND COMMUNICATION TECHNOLOGIES

ELECTRONIC ARCHIVING

On 13 February 2013, the Bill of law 6543 regarding electronic archiving (modifying the actual amended Law of 5 April 1993 related to the financial sector) was introduced by the Minister of Economy and Trade to the Chamber of Deputies.

This Bill of law aims to modernise the rules relating to the dematerialisation of original documents. It is also part of the generalised dematerialisation process initiated by the Law of 14 August 2000 regarding electronic signatures which, by recognising the validity of electronic signatures, allows the dematerialisation of entire business processes (such as online sales).

The main feature of this Bill of law is to give digital copies the same legal value as original documents and to set up a legal presumption of conformity to original documents in accordance with certain legal conditions. Thus, it would be incumbent upon the party who challenges the value of a digital copy to demonstrate that this copy does not conform to the original document.

In order to achieve this goal, a digital copy shall be made by a qualified person called "Digitisation and Archiving Service Provider" ("*Prestataire de services de dématérialisation ou de conservation*" ("**PSDC**")) who is entitled to carry out the dematerialisation. To obtain this status, the above-mentioned service provider shall respect the storage and dematerialisation conditions corresponding to high technical and organisational requirements in terms of reliability and durability of the dematerialised documents.

Consequently, this new legal framework should offer sufficient guarantees in order to enhance the confidence of the actors in favour of the dematerialisation process and its digital storage.

The Bill of law should normally be enacted before the end of the year.

TAX

1. TAX TREATIES NEWS

1. Bill of law 6501 voted by the Parliament

In our Newsletter of March 2013 we discussed Bill of law 6501 ratifying the new tax treaties with **Germany** (replacing the current Treaty of 23 August 1958), **Kazakhstan** (including the Protocol of 3 May 2012), **the Lao People's Democratic Republic, the Republic of Macedonia, the Seychelles, the Democratic Socialist Republic of Sri Lanka** and **Tajikistan** and approving the amendments to the existing tax treaties with **Canada, South Korea, Italy, Malta, Poland, Romania, Russia and Switzerland**. The treaties with Canada, Italy, Malta, Romania and Switzerland are aligned with OECD standards (Article 26 of the 2010 OECD Model Convention) with respect to the exchange of information procedure. Details on the key features of the most relevant treaties and protocols can be found in our March 2013 Newsletter.

Bill of law 6501 was adopted by the Parliament on 16 May 2013. Hence, the new double tax treaty with Germany and the Protocol of 21 November 2011 to the treaty with Russia should enter into force as of 1 January 2014, as expected.

2. Taiwan

On 7 March 2013, the Minister of Finances submitted Bill of law 6552 to the Parliament for ratification of the double tax treaty and Protocol signed on 19 December 2011 with Taiwan. The treaty generally follows the OECD Model, with some exceptions (e.g., definitions of permanent establishments and royalties, shipping, pensions, non-discrimination, limitation on benefits).

The maximum withholding tax rates are:

- 10% on dividends, but 15% if the beneficial owner of the dividends is a corporate collective investment vehicle;
- 10% on interest, but 15% if the beneficial owner of the dividends is a corporate collective investment vehicle. 0% if the interest is paid: (i) to the other territory, a political subdivision or a local authority or the Central Bank thereof or any financial institution wholly owned or controlled by the other territory; (ii) in respect of a loan granted, guaranteed or insured or a credit extended, guaranteed or insured by an approved instrumentality of the other territory which aims at promoting export and (iii) on loans between banks; and
- 10% on royalties.

According to the Protocol, a collective investment vehicle which is established in a territory and that is treated as a body corporate for tax purposes in this territory shall be considered as a resident of the territory in which it is established and as the beneficial owner of the income it receives. A SICAV/F should hence be entitled to benefit from the treaty with Taiwan.

3. Czech Republic

The Czech Republic and Luxembourg signed a new double tax treaty on 5 March 2013 in Brussels. Once effective, the new treaty will replace the current double tax treaty of 18 March 1991. The treaty generally follows the OECD Model, with some exceptions (e.g., permanent establishment, 183-day rule, definition of royalties, pensions, no provisions for the collection of taxes).

The maximum withholding tax rates are:

- 0% on interest;
- 10% on royalties, but 0% for royalties on copyrights. Article II of the Protocol contains a most-favoured nation clause under which the rate will be lowered when the Czech Republic signs a treaty with another EU Member State providing for a lower rate; and
- 10% on dividends, but 0% if the receiving company directly holds at least 10% of the

capital of the company paying the dividends for an uninterrupted period of at least one year.

SICAV/Fs may generally benefit from the new treaty with the Czech Republic. This is not the case under the current treaty.

4. Isle of Man

A double tax treaty between Isle of Man and Luxembourg was signed on 8 April 2013. The treaty generally follows the OECD Model, with a few exceptions (e.g., shipping, pensions, artists/sportspersons and no provisions for the collection of taxes).

The maximum rates of withholding tax are:

- 0% on interest and royalties;
- 15% on dividends in general, and 5% if the receiving company (other than a partnership) directly holds at least 10% of the capital of the company paying the dividends.

A collective investment vehicle established in a contracting State, which is not transparent in the country of establishment (such as a SICAV), is regarded as a resident of the State where it is established and as the beneficial owner of any income received. A transparent collective investment vehicle (such as an FCP) will be regarded as an individual resident of the residence state and as the beneficial owner of the income received. However, the other contracting state may tax its residents if they receive income from such a collective investment vehicle.

The double tax treaty does not affect the application of the Savings Agreement signed with the Isle of Man in 2004.

5. Jersey

A double tax treaty was signed between Jersey and Luxembourg on 17 April 2013. The treaty generally follows the OECD Model, with a few exceptions (e.g., shipping, non-discrimination and no provisions for the collection of taxes).

The maximum withholding tax rates are:

- 0% on interest and royalties;
- 15% on dividends in general, and 5% if the receiving company (other than a partnership) directly holds at least 10% of the capital of the company paying the dividends.

A collective investment vehicle established in a contracting State, which is not transparent in the country of establishment (such as a SICAV), is regarded as a resident of the State where it is established and as the beneficial owner of any income received. A transparent collective investment vehicle (such as an FCP) will be regarded as an individual resident of the residence state and as the beneficial owner of the income received.

The double tax treaty does not affect the application of the savings agreement signed with Jersey in 2004.

6. Guernsey

A double tax treaty between Guernsey and Luxembourg was initialled on 10 May 2013. The treaty generally follows the OECD Model, with a few exceptions (e.g., shipping, pensions and no provisions for the collection of taxes).

The maximum rates of withholding tax are:

- 0% on interest and royalties;
- 15% on dividends in general, and 5% if the receiving company (other than a partnership) directly holds at least 10% of the capital of the company paying the dividends.

A collective investment vehicle established in a contracting state, which is not transparent in the country of establishment (such as a SICAV), is regarded as a resident of the State where it is established and as the beneficial owner of any income received. A transparent collective investment vehicle (such as an FCP) will be regarded as an individual resident of the residence state and as the beneficial owner of the income received.

7. Saudi Arabia

On 7 May 2013, Luxembourg and Saudi Arabia signed an income and capital tax treaty. Details of the treaty are not available yet but will be highlighted in a later edition, once available.

8. Hungary

Hungary and Luxembourg have initialled a tax treaty on 16 April 2013. The new treaty will replace the Hungary-Luxembourg income and capital tax Treaty of 1990. Details of the new treaty will be highlighted in a later edition, once available.

9. Serbia

A tax treaty between Luxembourg and Serbia was initialled on 16 May 2013 in Belgrade. Details of the new treaty will be highlighted in a later edition, once available.

10. Andorra

As a result of the recent visit of the Andorra Prime Minister and Minister of Foreign Affairs to Luxembourg, Luxembourg and Andorra signed a memorandum of understanding ("**MoU**") for negotiations to conclude an income and capital tax treaty.

2. ADMINISTRATIVE COOPERATION IN THE FIELD OF TAXATION – LUXEMBOURG TRANSPOSES COUNCIL DIRECTIVE 2011/16/EU INTO NATIONAL LAW

On 15 February 2011, the Council Directive 2011/16/EU on administrative cooperation in the field of taxation was adopted, repealing Directive 77/799/EC. This Directive has been supplemented by the Regulation 1156/2012 of 6 December 2012 laying down detailed rules for implementing certain provisions of the Directive.

The administrative cooperation in the field of taxation covers all taxes of any kind, whether direct or indirect, levied by or on behalf of a Member State. Value added tax, customs duties and excise duties covered by other EU legislation on administrative cooperation are however excluded; the Directive also does not apply to compulsory social security contributions.

As under the former Directive, the new Directive retains three principal types of administrative cooperation:

- the exchange of information on request with respect to information that is foreseeably relevant ; Member States are not at liberty to engage in fishing expeditions or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer;
- the mandatory automatic exchange of information; and
- the spontaneous exchange of information.

According to Article 8 of the new Directive, mandatory automatic exchange of information shall apply to information, regarding taxable periods as from 1 January 2014, that is available concerning residents in another Member State, on the following specific categories of income and capital: (a) income from employment, (b) director's fees, (c) life insurance products, (d) pensions and (e) ownership of and income from immovable property.

In line with Article 26 (exchange of information) of the OECD 2005 Model Convention, the new Directive provides that Member States cannot refuse to supply information solely because this information is held by a bank or other financial institution. As pointed out by former Commissioner Kovács, *"In line with the principle of subsidiarity, the proposal does not ask Member States to give up banking secrecy for their own residents. Domestic banking secrecy is a national matter. Therefore, this proposal does not go beyond what is necessary for the fight against tax evasion at a European level."* (Answer to parliamentary E-1460/2009 question dd. 4 May 2009).

Due to this significant change, Article 18.3, of the Directive includes a transitional rule, under which a Member State may refuse the transmission of the requested information where such information concerns taxable periods prior to 1 January 2011, and where the transmission of such information could have been refused on the basis of Article 8 (1) of Directive 77/799/EC if it had been requested before 11 March 2011. According to the latter provision, a Member State was under no obligation to have enquiries carried out or to provide information if the Member State, which should furnish the information, would be prevented by its laws or administrative practices from carrying out these enquiries, or from collecting, or using, this information for its own purpose.

Member States had to transpose this Directive by 1 January 2013; the transposition date for the mandatory automatic exchange of information provided for under Article 8 has however been extended to 1 January 2015.

On 29 March 2013, the Luxembourg Parliament adopted the law transposing the Directive into national law, with the exception of those provisions relating to the mandatory automatic exchange of information, since this part of the Directive only has to be transposed by 1 January 2015. The law entered into force, as prescribed by the Directive, as from 1 January 2013.

The Law dated 29 March 2013 can be consulted under the following link :
http://www.legilux.public.lu/leg/a/archives/2013/0059/2013A0756A.html?highlight=

3. EU SAVINGS DIRECTIVE – LUXEMBOURG WILL SWITCH FROM WITHHOLDING TAX TO THE EXCHANGE OF INFORMATION AS OF 1 JANUARY 2015

The Savings Taxation Directive was adopted in June 2003, with the aim to tackle cross-border tax evasion through the creation of an automatic exchange of information system, in order to identify individuals who receive savings income in a Member State other than the one of their residence.

Only Belgium, Luxembourg and Austria, were entitled, during a transitional period, to levy a withholding tax, at a rate of, currently, 35%, in place of information exchange.

Against the background of a gradual move towards the application of an automatic exchange of information procedure as an international standard, Belgium switched, in January 2010, to the automatic exchange of information.

Recently, the Luxembourg government announced that it has decided to end the transitional period foreseen in the EU Savings Directive, and to introduce the automatic exchange of information under the Savings Directive, as of 1 January 2015. The date of 1 January 2015 coincides with the date of entry into force of the mandatory automatic exchange of information procedure provided for under Article 8 of the Council Directive 2011/16/EU on administrative cooperation in the field of taxation.

The automatic exchange will, however, be limited to interest income, as defined under Article 6 of the current version of the Savings Directive as implemented in Luxembourg. Luxembourg individual residents receiving interest from a Luxembourg paying agent will remain subject to the 10% withholding tax.

Luxembourg agreed further on a mandate allowing the European Commission to negotiate an agreement with Switzerland, Liechtenstein, Andorra, Monaco and San Marino, in order to extend the scope of the existing agreements, in line with the proposed revision of the Savings Directive. The Commission will negotiate on the basis of the draft Directive amending the Savings Directive.

The statement of the Luxembourg government can be consulted under the following link :
http://www.mf.public.lu/actualites/2013/04/faq_aut_exchange_1004131/index.html

4. FATCA – LUXEMBOURG WILL SIGN A MODEL 1 INTERGOVERNMENTAL AGREEMENT

The Foreign Account Tax Compliance Act ("**FATCA**") was enacted in March 2010 by US Congress to target non-compliance by U.S. taxpayers using foreign accounts. To accomplish this, FATCA requires foreign financial institutions ("**FFIs**") to report to the Internal Revenue Service ("**IRS**"), information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Insofar as an FFI does not comply with these provisions, FATCA imposes a 30% withholding [tax] on US source investment income and the gross proceeds of sales of US stocks and debt instruments held by the FFI.

In order to implement FATCA, the IRS and the US Treasury expect to rely on intergovernmental agreements ("**IGA**") to be signed between the US and foreign countries. To that end the US Treasury released two forms of IGAs (referred to as Model 1, developed in consultation with the G5 countries, or Model 2).

On 21 May 2013 the Luxembourg Minister of Finance announced that Luxembourg will sign a Model 1 IGA. Hence, Luxembourg will join the club of those countries that have already signed a Model 1 agreement with the US, including the UK, Ireland, Singapore and Germany. Switzerland instead, opted for the Model 2.

The most notable difference between the Model 1 and the Model 2 IGA is that, under the Model 1, an FFI will report tax information to the relevant domestic authority, which will then automatically transmit the information to the IRS. FFIs established in jurisdictions that entered into the Model 1 IGA will not need to enter into an FFI agreement with the IRS, in order to be FATCA compliant; registration with the IRS is, however, still required. Under the Model 2, the FFI has to enter into an FFI agreement and must report directly to the IRS.

According to the statement of the Luxembourg Government, *"this decision will put Luxembourg's relations with the US in line with its declaration of 10 April 2013, by which Luxembourg announced that it will introduce, on 1 January 2015, and within the scope of the 2003 EU Savings Directive, the automatic exchange of information within the European Union".*

It should be noted that the Luxembourg IGA is still under negotiation. One of the biggest challenges ahead is the negotiation of the Annex II, which is a list of entities and accounts that are exempt from FATCA reporting, as they represent a low risk of being used by US persons to evade US tax.

It is expected that the Luxembourg IGA will be signed by September 2013.

The statement of the Luxembourg government can be consulted under the following link: http://www.gouvernement.lu/salle_presse/communiques/2013/05-mai/21-fatca/

5. FINANCIAL TRANSACTION TAX – LUXEMBOURG GOVERNMENT OF FINANCE PUBLISHES A FAQ

In September 2011 the European Commission tabled a proposal for an EU-wide financial transaction tax ("**FTT**"). Several Member States opposed the proposal and it became clear that the unanimity required under Article 113 TFEU to adopt the FTT, would not be achieved.

Accordingly 11 Member States, including Germany and France, requested the use of the enhanced cooperation mechanism provided for under Article 20 TEU and Articles 326 to 334 TFEU to proceed with the introduction of a FTT. The Council authorised the enhanced cooperation in January 2013, followed in February by the Commission's proposal for a Council Directive implementing enhanced cooperation in the area of FTT (Com(2013)71 final).

The United Kingdom lodged an application at the European Court of Justice challenging the decision of the Council to establish enhanced cooperation with regard to a European financial transaction tax (case number C-209/13). The United Kingdom argues mainly that the Council decision violates the enhanced cooperation mechanism because it authorises the adoption of an FTT (i) with extra-territorial effects failing to respect the competences, rights and obligations of non-participating states, (ii) for which there is no justification in customary international law and (iii) the implementation of which will inevitably cause costs to be incurred by non-participating states.

Last month, the Luxembourg Ministry of Finance issued a statement detailing Luxembourg's position on the introduction of the FTT:

- Luxembourg is not opposed to the principle of an FTT in order to achieve better coverage of the systemic risk linked to some activities. Such a levy should however be implemented globally, and not regionally, in order to avoid capital flight from the EU to other financial centres and fragmentation of the Single Market.

- The Luxembourg government considers that the FTT, as currently designed, has significant extra-territorial effects which are not acceptable and that penalise those countries, such as Luxembourg, that did not engage in the enhanced cooperation procedure.

According to the explanatory memorandum of the Commission's proposal, in order for a financial transaction to be taxable in a participating Member State, one of the parties to the transaction needs to be established in the territory of a participating Member State (so called "residence principle"). Taxation will take place in the participating Member State in the territory of which the establishment of a financial institution is located, on condition that this institution is party to the transaction. Where the financial institutions are located in the territory of a State which is not a participating Member Sate the transaction is not subject to an FTT in a participating Member State, unless one of the parties to the transaction is established in a participating Member State in which case the financial institution that is not established in a participating Member State will be deemed to be established in that participating Member State and the transaction becomes taxable there.

The current proposal supplements the "residence principle" by an "issue principle", which brings within the scope of the FTT transactions in financial instruments issued in a participating Member State. In the context of the issue principle, the transaction is linked to the participating Member State in which the issuer is located. The persons involved in such a transaction will be deemed to be established in that Member State because of this link, and the financial institution(s) concerned will have to pay FTT in that State.

In brief, financial institutions in non-participating states, such as Luxembourg, could be obliged to pay the FTT, whenever they transact with a party established in the territory of a participating Member State and whenever they transact in securities issued by an entity established in a participating Member State.

In this context, Luxembourg supports the United Kingdom's legal challenge.

The statement of the Luxembourg government (French version only) can be consulted under the following link:
http://www.mf.public.lu/actualites/2013/05/taxe_trans_fin_080513/index.html

6. INCOME TAX ALLOWANCES FOR HIGHLY SKILLED EMPLOYEES COMING TO LUXEMBOURG

The Luxembourg tax authorities issued on 31 December 2010 Tax Circular L.I.R. 95/2 whose purpose is to provide for a special tax regime for highly skilled employees. Given the complexity of the framework put into place, as well as the cumbersome upfront approval procedure, we had at that time expressed doubts as to the efficiency of the framework put into place, even though without doubt the intention was good (www.ehp.lu/uploads/media/EHP_Newsletter_July_2011.pdf).

The 2010 Circular has now been replaced by a new Tax Circular L.I.R. 95/2 of 21 May 2013 that tightens the stiff conditions of the existing framework. The main changes to the eligibility criteria are the following:

- removal of the flux criteria of contribution to the Luxembourg economy;
- decrease of the minimum threshold of the annual base remuneration to EUR 50,000;
- removal of criteria pertaining to diploma of higher education; and
- increase of the maximum percentage of eligible employees for entities established in Luxembourg for at least 10 years from 10% to 30%.

In addition, the previously existing upfront approval procedure with the tax office in charge has also been repealed because since 1 January 2013 the favourable regime applies without prior agreement of the Luxembourg tax authorities.

The only drawback is that under the new regime, a person can only be eligible if he/she has been living at a distance of at least 150 kilometres from Luxembourg. The question arises, however, whether such different treatment of non-residents from the same neighbouring countries that, by the way, have all concluded income tax treaties with Luxembourg that contain OECD-Model-like non-discrimination clauses, could be considered as discriminatory.