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Asset management and investment funds

- Securitisation Regulation: Impact on investment funds and their managers investing in securitisations
- Non-regulated AIFs: New reporting obligations
- Implementation of Securities Financing Transactions Regulation (SFTR)
- Implementation of MiFID II and other recent publications
- UCITS ESMA Q&A: Update May 2018
- Benchmark ESMA Q&A: Update May 2018

Administrative law

- New Public Procurement Law

Banking and financial services

- MiFID II: Recent publications
- Incompatibility: Chairman of the board and effective director functions

Dispute resolution and commercial

- Competition law exemption for Webtaxi pricing algorithm
- No fine for small supermarket chains' cartel

Tax

- Implementation of Anti-Tax Avoidance Directive (ATAD 1)
- CRS reporting – New list of Reportable Jurisdictions for the reporting year 2017

Securitisation Regulation: Impact on investment funds and their managers investing in securitisations

The new EU securitisation package which was published in the Official Journal of the European Union in December 2017 will become applicable on 1 January 2019.

Regulation (EU) 2017/2402 (i) lays down a general framework for all securitisations (including initial and ongoing due diligence, risk retention and transparency requirements) and (ii) introduces a new securitisation label (with specific conditions to be fulfilled) for simple, transparent and standardised securitisation ("**STS**") with the creation of a specific STS framework ("**Securitisation Regulation**") and **Regulation (EU) 2017/2401** amends the CRD IV Regulation (EU) 575/2013 mainly to introduce the specific features of STS securitisations when such securitisations meet the additional requirements laid down in the Securitisation Regulation.

The Securitisation Regulation will reshape the currently applicable securitisation provisions in sector-specific legislation such as the Alternative Investment Fund Managers Directive 2011/61/EU ("**AIFMD**") and Commission Delegated Regulation (EU) 231/2013.

Alternative investment fund managers ("**AIFM**") (including non-EU AIFMs and so-called below-threshold AIFMs) that manage and/or market alternative investment funds in the European Union, UCITS management companies and internally managed UCITS will be affected by the Securitisation Regulation, in particular, when investing in securitisation positions, including STS securitisations as they qualify as "institutional investors" under the Securitisation Regulation.

Institutional investors are subject to **initial and ongoing due diligence requirements** which also apply when they invest in securitisations where the sponsor, the original lender or the originator (as the case may be) is established in a third country.

As part of their due diligence, institutional investors, amongst others, will need to check whether EU originators, sponsors or original lenders comply with the new direct **risk retention requirement** as well as **criteria for credit granting** laid down by the Securitisation Regulation. Where neither the originator, sponsor nor original lender is established in the European Union, institutional investors have to verify whether the originator, sponsor or original lender meets the risk retention requirements and criteria for credit granting in accordance with Article 5 1. (b) and (d) of the Securitisation Regulation. The Securitisation Regulation foresees some exemptions to the risk retention requirement where the securitised exposures are exposures on or exposures fully, unconditionally and irrevocably guaranteed by certain institutions or governmental bodies such as, for example, central governments or central banks.

The Securitisation Regulation foresees the possibility for an institutional investor to instruct its delegate in charge of the investment management to fulfil the due diligence requirements that would otherwise apply to that institutional investor. According to the Securitisation Regulation, EU Member States are required to ensure that where such a delegate is appointed, any sanctions are applied to that delegate and not to the institutional investor.

The Regulations will apply to securitisation transactions the securities of which are issued on or after 1 January 2019 and to any securitisations that create new securitisation positions on or after 1 January 2019 (subject to certain transitional arrangements). Transitional provisions are detailed in Article 43 of the Securitisation Regulation.

The Securitisation Regulation may well have an impact the eligibility of certain securitisation securities for investment by UCITS and AIFs. In that context, the Securitisation Regulation introduces new provisions into the AIFMD and the UCITS Directive 2009/65/EC which provide that where AIFMs, UCITS management companies or internally managed UCITS are exposed to a securitisation that no longer meets the requirements provided for in the Securitisation Regulation, they shall, in the best interests of the investors in the relevant funds, act and take corrective action, if appropriate.

Non-regulated AIFs: New reporting obligations

The Central Bank of Luxembourg (*Banque Centrale de Luxembourg*, "**BCL**") issued a circular on 18 May 2018 (**BCL 2018/241**) requiring non-regulated AIFs to report information to the BCL upon incorporation, and periodically, on a monthly, quarterly or annual basis. The periodicity of the reporting is determined on the basis of the size of the AIF and the threshold under which the BCL may grant an exemption to provide a monthly or a quarterly reporting is fixed at EUR 500 million of total assets. In this latter case, only an annual reporting is due.

A calendar of remittance dates on which the reports are due is published on the **BCL website**, however, the implementation of the new collection consisted of a two-step process:

- For existing non-regulated AIFs as at the date of the BCL circular, the duly completed BCL form (available on its **website**) and the latest available balance sheet had to be sent by mail to the BCL by 31 may 2018.
- For non-regulated AIFs which are not exempted from the monthly and quarterly reporting, (i) the next quarterly reporting and the monthly report for the September 2018 reference period must be submitted before 26 October 2018, and (ii) the monthly report for the October 2018 reference period must be submitted before 29 November 2018.

Implementation of Securities Financing Transactions Regulation (SFTR)

The Luxembourg Law of 6 June 2018 implementing the Securities Financing Transactions Regulation (EU) 2015/2365 ("**SFT Regulation**") and amending the **UCI Law**[1], the **AIFM Law**[2] as well as the Insurance Sector Law[3] entered into force on 12 June 2018 ("**SFT Law**").

The SFT Law designates the CSSF (*Commission de Surveillance du Secteur Financier*) and CAA (*Commissariat aux assurances*) as competent authorities responsible for the supervision of compliance with the SFT Regulation in the Grand Duchy of Luxembourg and, in this context, gives them the power to impose administrative sanctions and other administrative measures in case of violation of the SFT Regulation.

In particular, the SFT Law amends the UCI Law and the AIFM Law in order to include non-compliance with the transparency obligations provided for by Articles 13 (periodical reports) and 14 (pre-contractual documents, such as UCITS prospectus and AIF disclosure to investors[4]) of the SFT Regulation in the list of cases in which the CSSF may impose administrative sanctions and other administrative measures on, *inter alia*, UCITS management companies or UCITS investment companies, and AIFMs respectively. For AIFMs, the maximum fine is EUR 250,000. In the context of UCITS, the CSSF may impose fines of up to EUR 5 million or 10% of the total annual turnover of the UCITS or the UCITS management company, as appropriate.

Furthermore, the SFT Law gives the CSSF and the CAA the power to impose fines of (i) up to EUR 5 million (or 10% of the total annual turnover) for violations of the relevant counterparty's reporting obligation of securities financing transactions and (ii) up to EUR 15 million (or 10% of the total annual turnover) for violations of the obligation of transparency in case of reuse of financial instruments received under a collateral arrangement, on a counterparty to a securities financing transaction or engaging in reuse within the meaning of the SFT Regulation.

Updated versions of the UCI Law and the AIFM Law are published on our website and accessible via the following links[5]:

- UCI Law (**FR/EN** and **FR/DE**)
- AIFM (**FR/EN** and **FR/DE**)

For more information on the SFT Regulation, please refer to our Article on its key features contained in our **March 2016 Newsletter**.

1. "**UCI Law**" refers to the amended Law of 17 December 2010 on undertakings for collective investment.
2. "**AIFM Law**" refers to the amended Law of 12 July 2013 on alternative investment fund managers.
3. "**Insurance Sector Law**" refers to the amended Law of 7 December 2015 on the insurance sector.
4. i.e., the information to be made available to investors by the AIFM according to Article 23 of **Directive 2011/61/EU**.
5. The original French texts appear in parallel with the English and German translations.

Implementation of MiFID II and other recent publications

The Law of 30 May 2018 implementing the revised EU Markets in Financial Instruments regime (MiFID II) into Luxembourg law ("**MiFID II Law**") entered into force on 4 June 2018.

A Grand-Ducal regulation[1] on the MiFID II requirements as regards safeguarding of financial instruments and funds belonging to clients, product governance, obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits entered into force on the same date.

The key points of the new MiFID II regime are highlighted in the **MiFID II dedicated Newsflash** available on our website.

ESMA has also recently published its final report on the **Guidelines on certain aspects of the MiFID II suitability requirements** and updated its various Q&A on the application of MiFID II, including its **Q&A on MiFID II and MiFIR investor protection and intermediaries topics**. The newly added questions and answers relate to client categorisation, inducements, provision of investment services and activities by third-country firms and the concept of ongoing relationship.

As a reminder, investment funds and their AIFMs/UCITS management companies are out of scope of MiFID II. They are not directly subject to any MiFID II requirements for their service of collective investment management. However, they will be indirectly affected by MiFID II when they rely on MiFID entities for the provision of MiFID services, e.g. distribution, portfolio management, brokerage, (...) or where MiFID entities provide investment services in relation to investment funds to the clients of the

funds (e.g. reception, transmission of orders).

AIFMs and UCITS management companies will also be directly affected if they have an extended licence to provide certain MiFID services. In this case, they will have to comply with specific MiFID II requirements.

> 1. Grand-Ducal Regulation of 30 May 2018 with regard to safeguarding of financial instruments and funds belonging to clients, product governance, obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

UCITS ESMA Q&A: Update May 2018

In May 2018, ESMA added a question on the disclosure of remuneration of delegates in its **Q&A on the application of the UCITS Directive**. In its answer, ESMA takes the same position as the one taken in the case of delegation by an AIFM (see our **Newsletter December 2017**). ESMA clarifies that the remuneration-related disclosure requirements under Article 69(3) (a) of the UCITS Directive also apply to the staff of the delegate of an AIFM to whom portfolio management or risk management activities have been delegated. In line with the approach followed under the UCITS Remuneration Guidelines, ESMA provides for two different ways of complying with this requirement.

Benchmark ESMA Q&A: Update May 2018

In the latest update of its **Q&A on the Benchmark Regulation**, ESMA clarifies its position as regards the need to include a reference in the prospectuses issued under the **UCITS Directive** (2009/65/EC) ("**UCITS Prospectuses**") and the prospectuses issued under the **Prospectus Directive** (2003/71/EC) ("**Other Prospectuses**") to the registration of administrators and benchmarks in the **ESMA register of EU benchmark administrators and third country benchmarks** ("**ESMA Register**").

1. For Prospectus approved on or after 1 January 2018

A reference to the fact that the administrator is listed in the ESMA Register should be added or, if the relevant administrator is not registered in the ESMA Register by the time a prospectus is published, the prospectus should include a statement to that effect.

In the latter case, once the relevant administrator is included in the ESMA Register:

- UCITS Prospectuses should be updated at the first opportunity.
- Other Prospectuses are not, under the Benchmark Regulation, required to be systematically updated once the relevant administrator is included in the ESMA Register. However, this is without prejudice to the obligation provided in the Prospectus Directive for the issuer, the offeror, or the person asking for admission to trading on a regulated market, to make an assessment, on a case-by-case basis, of the significance and/or materiality of the specific situation.

2. For Prospectus approved prior to 1 January 2018

- UCITS Prospectuses should be updated at the first opportunity or at least within 12 months after 1 January 2018. If the administrator is not included in the ESMA Register by 1 January 2019, the prospectus should include a statement to that effect.
- As regards the Other Prospectuses, the position is the same as the one above described in section 1, i.e. they are not required to be systematically updated; however, an assessment on the materiality may have to be made on a case-by-case basis.

Administrative law

New Public Procurement Law

The **Law of 8 April 2018 on public procurement** transposing Directives 2014/24/EU on public procurement and 2014/25/EU on procurement by entities operating in the water, energy, transport and postal services sector was published in the Luxembourg official journal on 16 April 2018 and entered into force on 20 April 2018.

The main improvements under the new Luxembourg procurement rules are:

- contracting authorities will be encouraged to divide contracts into lots, making tenders more accessible to SMEs;
- the turnover required to participate in a tender procedure will be limited, allowing more SMEs and start-ups to participate ;
- the documentation requirements for procurement procedures will be considerably decreased by using The European Single Procurement Document (ESPD) which is a self-declaration form replacing the various different forms used in the past by EU countries for proving that a bidder fulfils the exclusion and selection criteria. Evidence will only have to be provided by the tender winners.

Moreover, to encourage progress towards particular public policy objectives, the new rules also allow for environmental and social considerations, as well as innovation aspects to be taken into account when awarding public contracts.

For further insight into the key features brought by this law, see the newsflash "**Nouvelle législation sur les marchés publics**" on our website.

Banking and financial services

MiFID II: Recent publications

1. MiFID II implementation and CSSF Q&A

The Law of 30 May 2018 implementing the revised EU Markets in Financial Instruments regime (MiFID II) into Luxembourg law ("**MiFID II Law**") entered into force on 4 June 2018.

The MiFID II Law reflects the requirements of both the level 1 MiFID II Directive (Directive 2014/65/EU) and Regulation (Regulation (EU) 2014/600) and the level 2 MiFID II Directive (Directive (EU) 2017/593) and is divided into two parts. Part I includes a new law on markets in financial instruments, repealing the Law of 13 July 2007 on the same topic[1] and Part II amends the 1993 Law on the Financial Sector.

A Grand-Ducal regulation which implements the MiFID II requirements as regards safeguarding of financial instruments and funds belonging to clients, product governance, obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits also entered into force on 4 June 2018.

The key points of the new MiFID II regime are highlighted in the **MiFID II dedicated Newsflash** available on our website.

A **Q&A on the application of MiFID II** in Luxembourg is also available on the CSSF website. This Q&A is updated on a regular basis, the last time being in May 2018.

2. ESMA publications

On 28 May 2018, ESMA published its final report on the **Guidelines on certain aspects of the MiFID II suitability requirements** in the context of investment firms[2] which provide investment advice and/or portfolio management. Those Guidelines are now in the process of being translated into the official EU languages.

ESMA also updated its various Q&A on the application of MiFID II, including its **Q&A on MiFID II and MiFIR investor protection and intermediaries topics**. The newly added questions and answers relate to client categorisation, inducements, provision of investment services and activities by third-country firms and the concept of ongoing relationship.

> **1.** The Law of 13 July 2007 on markets in financial instruments is repealed, except its Article 37 relating to an official listing.
> **2.** These Guidelines shall also apply to management companies and AIFMs which have an extended licence to provide certain MiFID services.

Incompatibility: Chairman of the board and effective director functions

In its **judgment** of 24 April 2018 in joined cases T-133/16 to T-136/16, the General Court of the European Union ("**General Court**") rejected the action for annulment introduced by four regional branches of Crédit Agricole ("**Applicants**") against decisions by which the European Central Bank ("**ECB**"), in its capacity as prudential supervisor of Crédit Agricole, rejected several appointments.

Although the ECB had approved the appointment of the persons proposed by the Applicants as chairmen of their respective boards of directors, it rejected the simultaneous appointment of these persons as "effective directors" by reference to Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV) and, in particular, its Article 88 regarding arrangements ensuring effective and prudent management of a credit

institution.

The ECB considered that, on one hand, the functions enabling a person to be appointed as "effective director" were executive functions, hence different from the supervisory function vested in the chairman of the board of directors, and that, on the other hand, there had to be a separation between the executive and non-executive functions within the management body. The Applicants argued that the ECB did not correctly interpret the concept of "effective director" by limiting it to members of the senior management with executive functions.

In line with the ECB's reasoning and recalling the objective of good governance of credit institutions and the need for checks and balances within their management body, the General Court held that the effectiveness of the supervision by non-executive members of the management body would be jeopardised if the chairman of the board of directors in its supervisory function was also responsible for the effective direction of the business, such as by exercising simultaneously the function of "effective director" of the credit institution.

In Luxembourg, this principle is enshrined in the CSSF Circular 12/552 on central administration, internal governance and risk management.

Dispute resolution and commercial

Competition law exemption for Webtaxi pricing algorithm

Webtaxi S.à.r.l. (previously ProCab) operates a taxi booking platform in Luxembourg, to which Webtaxi affiliates and taxis of competing undertakings (generally through payment of a monthly fee) are linked. When a client makes a booking, an algorithm allocates the taxi closest to the client and calculates the taxi fare, based on predetermined criteria (price per kilometre, length of journey, traffic conditions, pick-up charge, etc.). The fare is non-negotiable and binding on both clients and taxi drivers.

Upon a complaint against the platform received in January 2016 alleging illegal price fixing, the Competition Council ("**Council**") opened an investigation.

In **decision n°2018-FO-01** of 7 June 2018, the Council analysed Webtaxi's activity as that of a platform in a two-sided market for advance booking of taxis which is national in scope. It confirmed the existence of a horizontal price-fixing agreement between competitors on that market in violation of Article 3 of the Law on Competition of 23 October 2011 ("**Law**").

However, after indicating that there are no agreements between undertakings which may not be exempt *per se*, the Council verified whether the exemption conditions of Article 4 of the Law were fulfilled, *i.e.* whether the agreement contributed to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, without imposing restrictions which were not indispensable, or affording the undertakings concerned the possibility to eliminate competition in respect of a substantial part of the services in question.

Referring to the submissions of the parties, the Council took into account the efficiency gains generated by the platform (fewer empty journeys and shorter waiting times) and the benefit for the clients (lower prices and quality gains). It concluded that the price setting by the platform's algorithm was necessary to achieve those efficiency gains and that no viable alternative with the same pro-competitive effects existed. Finally, the Council noted that the platform accounted for 26% of Luxembourg taxis and

therefore did not eliminate all relevant competition.

It must be noted that it is unusual to have an individual exemption for a price-fixing agreement between competitors but the pragmatic approach of the Council based on the impact on the market of the contested practice allowed it to clearly focus on consumer benefit.

No fine for small supermarket chains' cartel

By **decision n°2018-FO-02** of 13 June 2018, the Competition Council ("**Council**") decided not to impose a fine following its own-initiative investigation of a horizontal cooperation agreement between small supermarket chains involving the joint commercialisation of a series of food retail products at common promotional prices through a website and brochures under the common label "Epiceries du Luxembourg".

The promotional actions and prices were determined at joint meetings between the companies involved. The Council found a horizontal price-fixing agreement in violation of Article 3 of the Law on Competition of 23 October 2011 ("**Law**") between the Pall Center group and Shopping Center Massen, whose retail sales of daily consumer goods partially overlap from a geographical perspective.

However, in order to determine the amount of the fine, the Council analysed whether the agreement restricted competition on the market for retail sales of daily consumer goods to an appreciable extent. It concluded that the restriction on competition was very limited both as regards the geographical area of activities affected and with respect to the affected sales volumes. It also considered that the cooperation agreement had pro-competitive effects beneficial to the consumer. According to the Council, these circumstances justified the absence of a fine.

Besides the non-imposition of a fine, a takeaway point is the Council's rigorous analysis of the food retail market on which the parties operate. From a product market point of view, the Council confirmed that service station shops form a separate market considering the reduced nature of the assortment they propose. From a geographical perspective, the Council identified, for each of the parties, the relevant catchment area of their activities allowing it to conclude that there was only a very limited geographical overlap.

Tax

Implementation of Anti-Tax Avoidance Directive (ATAD 1)

On 19 June 2018 the **bill of law 7318** ("**Bill**") was introduced to the Luxembourg parliament relating to the transposition of measures included in EU anti-tax avoidance Directive 2016/1164 ("**ATAD 1**") into national legislation. The Bill contains the ATAD 1 provisions concerning the following measures:

- Interest limitation rules (Art. 4 of ATAD 1)
- Exit taxation (Art. 5 of ATAD 1)
- General anti-abuse rule ("**GAAR**", Art. 6 of ATAD 1)

- Controlled foreign company ("**CFC**") rule (Art. 7 and 8 of ATAD 1);
- Intra-EU anti-hybrid rule (Art. 9 of ATAD 1)

Based on the ATAD 1, these measures have to be implemented by the EU Member States by 31 December 2018.

With the exception of the provisions on exit taxation which should apply as of 1 January 2020, it is expected that the above measures should come into force on 1 January 2019.

The Bill targets taxpayers subject to Luxembourg corporate income tax, with the exception of the GAAR and the exit tax provisions which apply to all taxpayers.

The Bill also includes additional BEPS-related provisions proposing amendments to the Luxembourg domestic tax legislation in relation to the following aspects:

- the tax neutral conversion of debt into shares; and
- the recognition of foreign permanent establishments (PEs) under tax treaties.

The proposed provisions are still subject to amendments before the final vote by the Luxembourg Parliament.

For further insight into the key features brought by this bill of law, see the article "**Implementation of Anti-Tax Avoidance Directive (ATAD 1)**" on our website.

CRS reporting – New list of Reportable Jurisdictions for the reporting year 2017

On 9 July 2018, a Grand Ducal Regulation has been signed in order to amend the list of Reportable Jurisdictions with a retroactive effect for the reporting year 2017.

The updated list excludes the Bahamas and includes now Hong Kong and Macao.

From a practical perspective, and based on the newsletter published by the Luxembourg tax authorities on 19 June 2018, it seems that, for the reporting year 2017, financial institutions will have to report relevant information related to Hong Kong and Macao residents before the 31 August 2018.

By clicking on the following link, you may access to the **Grand Ducal Regulation** dated 9 July 2018 and the **newsletter of the Luxembourg tax authorities** dated 19 June 2018.