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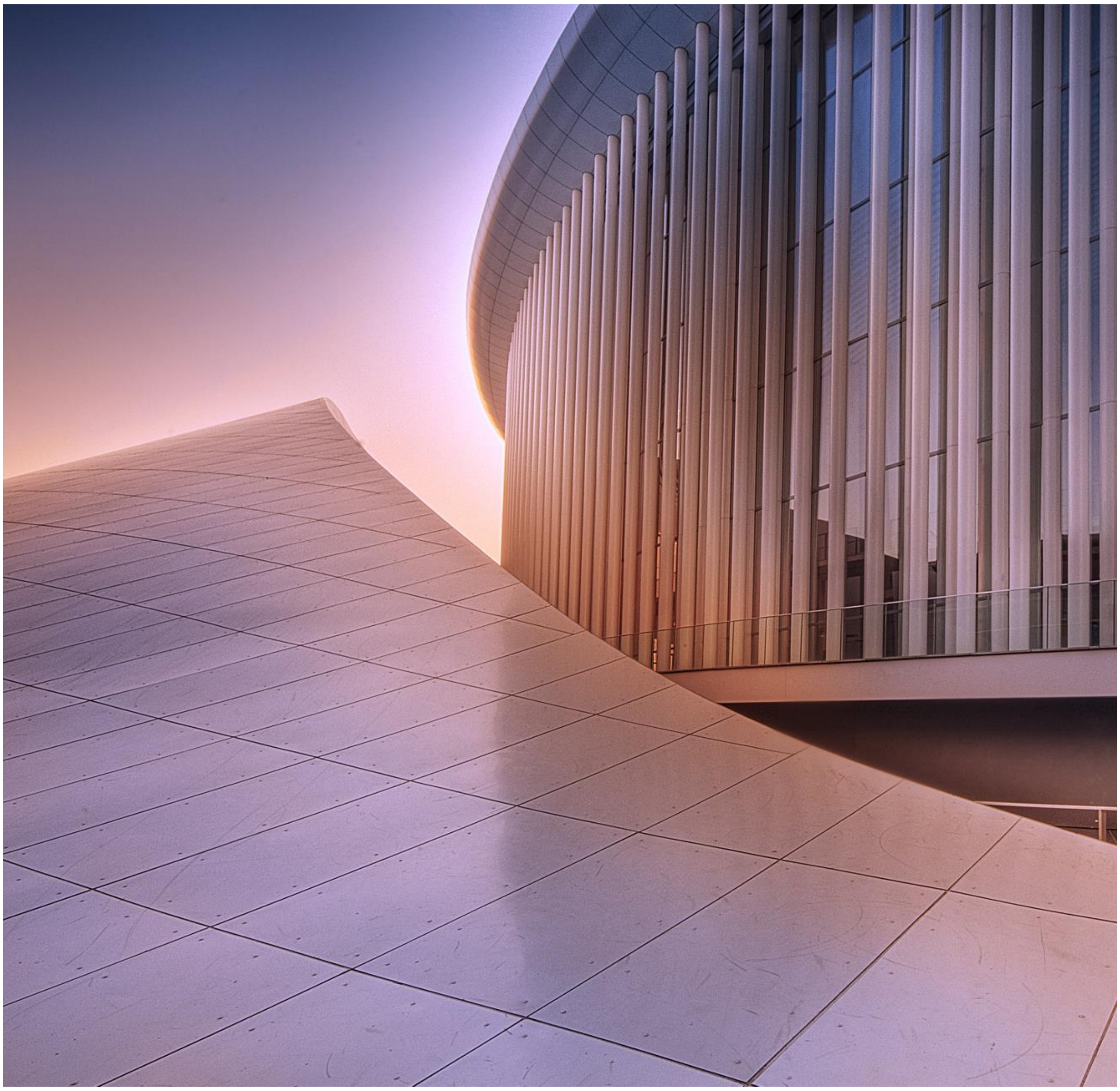

BONN STEICHEN & PARTNERS

NEWSLETTER

DATED

MAY 2017

BONN STEICHEN & PARTNERS
LUXEMBOURG LAW FIRM

SUMMARY

BANKING & FINANCE

MIFID II UPDATES

Since the article on ESMA's Q&As in our January newsletter, the following have been updated:

- Q&A on MiFID II and MiFIR Investor Protection topics (the "Investor Protection Q&A");
- Q&A on MiFID II and MiFIR Market Transparency topics;
- Q&A on MiFID II and MiFIR Market Structure topics;
- Q&A on MiFID II and MiFIR Commodity Derivatives topics;
- Q&A on MiFIR Data Reporting; and
- Q&A relating to the provision of CFDs and other speculative products to retail investors under Directive 2004/39/EC ("MiFID") (the "CFDs Q&A").

We will focus here on just a few of the updates to the Investor Protection Q&A and the CFDs Q&A.

As regards best execution (article 27 MiFID II), ESMA has provided further details regarding the content, timing and means of publication of the RTS 27 and 28 reports. As regards inducements (research) (article 24 MiFID II), ESMA has provided some additional clarity on whether certain services, such as corporate access and macro-economic analysis, should be treated as research that can be paid for from a research payment account ("RPA") and has shed further light on the approach firms should take to ensure that the allocation of the research budget to third party providers is in the best interests of the firm's clients. Finally, ESMA describes how the estimated client research charge, to be paid for out of an RPA, should be disclosed to clients.

The CFDs Q&A does not directly relate to MiFID II and MiFIR, but ESMA notes that the principles and requirements underpinning the content of this document will remain unchanged once the latter two enter into force. This Q&A contains a new section on passporting and the cross-border provision of services by investment firms offering CFDs and other speculative products to retail clients outside the home Member State without the establishment of a branch or tied agents. In particular, ESMA responds to questions on the following:

- the factors a home national competent authority ("NCA") should take into account when assessing whether the investment firm complies with the MiFID provisions on cross border services;
- the factors the home NCA should consider when assessing the use of third parties by investment firms to acquire retail clients under articles 31 and 32 of MiFID;
- examples of poor practice observed by NCAs in respect of the use of third parties by investment firms offering CFDs and other speculative products to acquire retail clients on a cross border basis;
- what cooperation should take place between NCAs; and
- the factors the home NCA should take into account when considering the communication to it by an investment firm which offers CFDs and other speculative products of that firm's intention to provide services in other jurisdictions under Article 31 of MiFID, in order to market speculative products to retail investors across Europe online.

Furthermore, on March 31st 2017, 17 Commission Delegated Regulations supplementing Directive 2014/65/EU ("MiFID II") and 11 Commission Delegated Regulations supplementing Regulation

(EU) 600/2014 ("MiFIR") were published in the Official Journal. These delegated regulations will enter into force 20 days after their publication and, with the exception of a few provisions, will apply from January 3rd 2018.

Finally, a Commission Delegated Directive supplementing MiFID II 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 has also been published and can be found here. This must be transposed into the national law of Member States by July 3rd 2017, and those national law provisions shall apply from January 3rd 2018.

PUBLICATION OF MIFID II AND MIFIR LEVEL 2 LEGISLATION

On March 31st 2017, 17 Commission Delegated Regulations supplementing Directive 2014/65/EU ("MiFID II") and 11 Commission Delegated Regulations supplementing Regulation (EU) 600/2014 ("MiFIR") were published in the Official Journal.

These delegated regulations will enter into force 20 days after their publication in the Official Journal and, with the exception of a few provisions, will apply from January 3rd 2018.

A full list of the Delegated Regulations can be found here.

Furthermore a Commission Delegated Directive supplementing MiFID II 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 has also been published and can be found here.

Member States are required to transpose the provisions of the aforementioned Commission Delegated Directive by July 3rd 2017 at the latest, and those provisions shall apply from January 3rd 2018.

CAPITAL MARKETS

ESMA'S PRACTICAL GUIDE ON MAJOR HOLDINGS NOTIFICATIONS UNDER TRANSPARENCY DIRECTIVE

On February 3rd 2017, ESMA published a practical guide to the national rules on notifications of major holdings ("ESMA's practical guide") under Directive 2004/109/EC of December 15th 2004 (the "Transparency Directive**"**).

The Transparency Directive requires investors to notify issuers of their holdings in securities if and when the investor acquires or disposes of securities which result in a change in voting rights, if the change exceeds certain thresholds. ESMA's practical guide aims to serve as a useful tool for market participants and shareholders who are compelled to make such notifications under national laws implementing the Transparency Directive.

As the implementation of the Transparency Directive very much varies across the various jurisdictions, ESMA's practical guide provides a summary of the implementation in each country of the European Economic Area (EEA), excluding Liechtenstein, including the applicable thresholds, the person responsible for publication of the notification (i.e. issuer or competent authority), the mandatory use of the standard form, the different applicable deadlines, etc. ESMA's practical guide also allows issuers to compare the differences in implementation of the Transparency Directive across the various jurisdictions in the form of tables.

ESMA's practical guide does not introduce any changes to the notification obligations under the national rules transposing the Transparency Directive but merely gives an overview of the status quo.

ESMA's practical guide shall be particularly convenient for multi-jurisdictional investors who may now rely on this unambiguous summary of the applicable requirements under the various national laws facilitating them in complying with their notification of major holdings' obligations. ESMA's practical guide was prepared by ESMA in close cooperation with the competent authorities in the relevant jurisdictions and market participants and will be updated on an ad hoc basis in the future.

MARKET ABUSE

ENTRY INTO FORCE OF ESMA GUIDELINES

On January 17th 2017, ESMA published the translation of its guidelines on information relating to commodity derivatives markets or related spot markets for the purpose of the definition of inside information on commodity derivatives (the "Guidelines"). ESMA was mandated to issue these Guidelines under Article 7(5) of Regulation (EU) No. 596/2014 of 16 April 2014 on market abuse (the "Market Abuse Regulation").

According to Article 7 of the Market Abuse Regulation, inside information shall comprise, in relation to commodity derivatives, information of a precise nature, which has not been made public, relating directly or indirectly to one or more such derivatives or relating directly to the related spot commodity contract, and which, if it were made public, would be likely to have a significant effect on the prices of such derivatives or related spot commodity contracts, and where this is information which is reasonably expected to be disclosed or is required to be disclosed in accordance with legal or regulatory provisions at the Union or national level, market rules, contract, practice, or custom, on the relevant commodity derivatives markets or spot markets.

The Guidelines establish a non-exhaustive indicative list of information which is reasonably expected to be disclosed or is required to be disclosed in accordance with legal or regulatory provisions at the Union or national level, market rules, contract, practice, or custom, on the relevant commodity derivatives markets or spot markets.

The Guidelines were stated to apply two months after their publication. On March 14th 2017, the CSSF published CSSF Circular 16/653 in order to transpose the Guidelines into Luxembourg regulations with immediate effect.

UPDATE OF ESMA Q&A

On January 27th, the European Securities and Markets Authority ("ESMA") published a further update of its Questions and Answers ("Q&A") on Regulation (EU) No. 596/2014 of April 16th 2014 on market abuse (the "Market Abuse Regulation") to include three new questions and answers in Section 3- Investment recommendation and information recommending or suggesting an investment strategy.

All three new questions relate to the application of Commission Delegated Regulation (EU) 2016/958 which sets out technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy ("recommendations").

In answering the new questions, ESMA has confirmed that (i) when a recommendation refers to several issuers independently, the requirements of the delegated regulation apply independently to every such issuer, (ii) when a recommendation relates to several financial instruments independently, the requirements of the delegated regulation apply independently to every such financial instrument, and (iii) when a recommendation relates to a derivative referencing an index of financial instruments, the derivative should be treated as the financial instrument (to which the requirements of the delegated regulation shall apply) and not the individual financial instruments of which the referenced index is comprised.

DATA PROTECTION

DATA PROTECTION – DRAFT LAW ON PROCESSING OF PERSONAL DATA

Pending the entry into force of the EU Regulation 2016/679 of April 27th 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data (the "GDPR"), the Luxembourg Government issued on August 31st 2016 a draft law No. 7049 (the "Draft Law").

The Draft Law aims at modifying the law of August 2nd 2002 on the Protection of Persons with regard to the processing of personal data (the "Law").

The main objective of the Draft Law is to simplify the administrative obligations of the data controllers under the Law and to facilitate the transition to the new regime before the entry into force of the GDPR. The GDPR will abolish the current notification requirements of the data processing or, as the case may be, of a prior authorisation as from May 25th 2018.

The Draft Law proposes that a prior authorisation from the CNPD will no longer be required in the following cases of processing of personal data:

- Supervision at the workplace,
- Supervision in general,
- Processing of personal data regarding the credit status and the solvency of data subjects,
- Interconnection of data.

A mere notification of the processing to the CNPD by data controllers will be sufficient when processing personal data for the above-mentioned purposes.

In addition, the Draft Law provides that in case of a transfer of data to the countries outside the EU that do not provide adequate safeguards with respect to the protection of privacy and fundamental rights and freedoms of individuals, data controllers will be able to rely on the Binding Corporate Rules duly approved by the national data protection authorities of the concerned Member States or on the contracts standard model clauses issued by the European Commission. In such cases, a prior authorisation for international transfer of data from the CNPD will no longer be required.

On October 14th 2016, the CNPD has issued a favourable opinion on the Draft Law stating that it will simplify and improve the current regime allowing the CNPD to focus on the *a posteriori* controls.

On November 16th 2016, the Draft Law was strongly criticized by the Chamber of Employees (*Chambre des Salariés*) who opposes to the reform as it considers that it will adversely affect the fundamental rights and freedom of employees and jeopardize their interests. OGB-L has issued similar criticisms of the Draft Law in its formal statement published on its website on November 24th 2016.

DISPUTE RESOLUTION

THE EU REGULATION 655/2014 ON TRANSACTIONAL SEIZURES ON BANK ACCOUNTS

On January 18th 2017, the Regulation (EU) No 655/2014 of May 15th 2014 establishing a European Account Preservation Order (EAPO) procedure to facilitate cross-border debt recovery in civil and commercial matters entered into force (the "Regulation").

The Regulation aims at facilitating the enforcement of the creditor's claim by authorising the seizure of his debtor's bank accounts in another Member State, without the latter being initially informed. This European procedure is an alternative to, but not a substitute for, national procedures. The Regulation doesn't apply to the United Kingdom and Denmark.

The Regulation applies only to pecuniary claims in civil and commercial matters, excluding specified matters, in cross-border cases, i.e. when the relevant bank account is held in a different Member State to where the EAPO application is made or the creditor is domiciled.

The Regulation doesn't require that the creditor's claim is due at the time of the application, a claim for payment of a determinable amount also qualifies, provided that such a claim can be brought before a court.

The EAPO is only conservative and doesn't authorise the creditor to proceed with the recovery of his debt.

The seizure can be requested before, during or even after the procedure on the merits of the case. In this latter case, the creditor shall initiate such proceedings within the periods of time specified by the Regulation.

The creditor must submit sufficient evidence to convince the court about the urgency of his request.

If the creditor hasn't got any information about the bank accounts held by the debtor in another Member State, but the creditor has reasons to believe that the debtor holds one or more accounts with a bank in a specific Member State, he may request, under certain conditions, the court to which he has submitted his application to ask the authority in charge of obtaining information of the Member State of enforcement to obtain the necessary information for the identification of the bank(s) and the bank account(s) held by the debtor. The Regulation leaves it up to the Member States how they will organize this new disclosure.

The Regulation introduces certain guaranties to prevent abusive application to obtain an EAPO and to insure the indemnification of any prejudice the debtor may suffer from the procedure.

An EAPO issued in a Member State shall be directly recognised in the other Member States without any special procedure being required and shall be enforceable in the other Member States without the need for a declaration of enforceability. Only the amount specified in the EAPO is preserved, any funds in excess shall remain unaffected by the implementation of the EAPO.

The debtor is informed about the procedure only once the EAPO has been implemented.

The Regulation provides for several remedies open to both the creditor and the debtor to revoke or modify the EAPO, or even to challenge the enforcement of the EAPO.

EMPLOYMENT

ECJ JUDGMENTS ON THE WEARING OF AN ISLAMIC HEADSCARF AT WORK

On March 14th 2017, the European Court of Justice ("ECJ") rendered two judgments in the cases of *Achbita v. G4S* (Case C-157/15) and *Bougnaoui v. Micropole SA* (Case C-188/15) on the controversial issue of the wearing of an Islamic headscarf at the workplace.

These cases involved two female employees in Belgium and in France, who were dismissed for refusing to remove their headscarves. Both cases concern the interpretation of the concept of "*genuine and determining occupational requirements*" and discrimination on the grounds of religion or belief contrary to the Directive 78/2000/EC of November 27th 2000 establishing a general framework for equal treatment in employment and occupation (the "Directive").

In the *Achbita* case, the Belgian Supreme Court (*Cour de Cassation*) asked the ECJ whether the prohibition on wearing an Islamic headscarf in the workplace, which arises from a general internal rule of a private undertaking, constitutes direct discrimination in the interpretation of the Directive. In the *Bougnaoui* case, the French Supreme Court (*Cour de Cassation*) queried whether the willingness of an employer to take account of the wishes of a customer no longer to have the employer's services provided by a worker wearing an Islamic headscarf may be considered a "*genuine and determining occupational requirement*" within the meaning of the Directive.

In the first case, the ECJ answered the question in the negative and accepted that the employer's desire to pursue a policy of neutrality in its relations with customers must be considered legitimate; thus, it can justify instances of apparent indirect discrimination on grounds of religion, provided that the measure is proportionate. The ECJ indicated that an employer's wish to project an image of neutrality towards customers relates to the freedom to conduct a business, which is protected under article 16 of the EU Charter of Fundamental Rights. In assessing proportionality, the ECJ considered that "*it is for the referring court to ascertain whether, taking into account the inherent constraints to which the undertaking is subject, and without G4S being required to take on an additional burden, it would have been possible for G4S, faced with [the refusal of Ms Achbita to remove her headscarf] to offer her a post not involving any visual contact with those customers, instead of dismissing her. It is for the referring court, having regard to all the material in the file, to take into account the interests involved in the case and to limit the restrictions on the freedoms concerned to what is strictly necessary*" (para. 43).

In the second case, however, the ECJ stated that in the absence of internal rules, the willingness of an employer to take account of the particular wishes of a customer no longer to have the employer's services provided by a worker wearing the Islamic headscarf (subjective consideration) cannot be considered a "genuine and determining occupational requirement" within the meaning of article 4(1) of the Directive, and hence cannot amount to a justification of discrimination.

FINTECH

EUROPEAN CONSULTATION ON FINTECH

On March 23rd 2017, the European Commission (the "Commission") issued a public consultation document on Fintech (the "Consultation").

CORE PRINCIPLES AND POLICY OBJECTIVES

In the Consultation, the Commission outlines three core regulatory principles which characterise its stance on Fintech and which derive from its priority to establish a connected digital single market with the objective of improving access to digital goods and services and to design rules that foster technological development.

The three core regulatory principles are as follows:

1. **Technology neutrality**: the same activity shall be subject to the same regulation irrespective of the way of delivery.
2. **Proportionality**: any regulation shall take into account the business model, size, systemic significance, complexity, cross-border activity of the regulated entities.
3. **Market integrity**: the technologies for financial services shall be used to promote market transparency benefiting consumers and business without creating unwarranted risks.

The Consultation seeks input on whether the current regulatory and supervisory framework fosters technological innovation in line with these principles. The policy objectives are:

1. fostering access to financial services for consumers and businesses;
2. cutting operational costs while increasing efficiency for the industry;
3. creating lower entry barriers for the single market; and
4. balancing greater data sharing and transparency with data security and protection needs.

LOWERING BARRIERS TO ENTRY

The Commission seeks to simplify market entry of new firms to stimulate effective competition. Stakeholders are asked to identify regulatory requirements or supervisory practices which hinder the implementation of Fintech solutions, or adversely affect the level playing field.

Subject to safeguards of consumer protection and financial stability, unjustified legal and practical barriers hindering Fintech firms across the Single Market must be removed. To achieve this objective, the Commission considers a number of different means:

- Guidelines regarding how certain business models fit under the current regulatory regime.
- New licensing regimes at EU level, such as a 'Fintech' license, provided that the first two core principles are respected.
- Regulating Fintech firms that provide services to regulated firms.
- Introducing rules for supervisors (such as organising stakeholder forums and introducing basic principles for firm support).
- EU support to improve interoperability and standardisation.

As regards financial stability, the Consultation seeks input in order to assess the financial soundness and resilience of non-Fintech firms and the impact of Fintech on such firms.

Regulation of data sharing and transparency

The Commission seeks to balance data sharing and transparency on one hand, and data protection and security on the other. Addressing this issue, the Commission inquires whether service users should be entitled to fair compensation when their data is processed by service providers for commercial purposes beyond their direct relationship.

Exploring data transparency options while addressing data security, the Commission asks whether (a) distributed ledger technology can be used for financial data sharing and (b) additional cybersecurity requirements for financial service providers must be introduced and which penetration and resilience testing rules should be implemented. Finally, the Commission also seeks to improve the access to finance for small and medium enterprises through data sharing.

INVESTMENT FUNDS

UCITS SHARE CLASSES – CSSF ADHERES TO ESMA'S OPINION

On February 13th 2017, the Luxembourg supervisory authority, the *Commission de Surveillance du Secteur Financier* ("CSSF"), published the press release 17/06 adhering to the Opinion on share classes of UCITS (the "Opinion") issued by ESMA on January 30th 2017.

The Opinion is addressed to national regulators in order to ensure a harmonised approach across the European Union with regard to the characteristics of UCITS share classes. In particular, the Opinion sets out the following four high-level principles which UCITS must follow when setting up different share classes:

- common investment objective;
- non-contagion;
- pre-determination; and
- transparency.

Pursuant to the press release, the CSSF takes into account ESMA's position according to which hedging arrangements at share class level are not compatible with the requirement for a fund to have a common investment objective (with the exception of currency risk hedging).

The CSSF requires UCITS to respect the transitional provisions set out in the Opinion, pursuant to which share classes established prior to the issuance of the Opinion and which do not comply with the above principles should be allowed to continue to operate. However, ESMA states that such share classes should be closed for investment by new investors by July 30th 2017 at the latest, and for additional investment by existing investors by July 30th 2018.

As a consequence, the CSSF expects UCITS to take the necessary measures to comply with the transitional provisions set forth in the Opinion. Further, the CSSF provides that new share classes shall comply with the common principles for setting up share classes in UCITS funds.

More information on the content of the Opinion is available in our newsflash of February 14th 2017.

PRIIPS KID: RTS ADOPTED

On March 8th 2017, the European Commission adopted an amended Commission Delegated Regulation ("New Regulatory Technical Standards" or "New RTS") supplementing the Regulation of the European Parliament and of the Council on key information documents ("KID") for packaged retail and insurance-based investment products ("PRIIPS").

The New RTS constitute a revised version of the Delegated Regulation initially adopted by the European Commission on June 31st 2016 and rejected by the European Parliament on September 14th 2016 ("Delegated Regulation").

These New RTS address the concerns expressed by the European Parliament and enhance the standardization of financial products in order to facilitate their comparison by investors.

The text proposes new amendments to the Delegated Regulation with regard to multi-option PRIIPs, performance scenarios, comprehension alert and presentation of administrative costs in relation to biometric components of insurance-based investment as follows:

- **Performance scenarios**: the obligation to include in the KID, in addition to a favourable, a moderate and an unfavourable performance scenario that had already been set out in the document, an extra stress scenario in order to allow investors to better assess the future performance of their investments.

- **Multi-option PRIIPs**: implementation of a specific provision for PRIIPs manufacturers investing in UCITS or non-UCITS funds referred to in Article 32 of Regulation (EU) No. 1286/201. They can use the key investor information document ("KIID") available for these products and drawn-up in accordance with Directive 2009/65/EC (UCITS Directive) to draft the PRIIPS KID and comply with the PRIIPs regulation until December 31st 2019.
- **Comprehension alert**: clarification of the fact that in the cases of simple/understandable financial products the comprehension alert (a disclaimer in the initial section of the KID, relating to the complexity of the product) may be omitted in the KID.
- **Presentation of administrative costs in relation to biometric components of insurance-based investment:** the impact of the biometric risk premium (which refers to premiums paid directly by the retail investor or deducted from the amounts credited to the mathematical provision or from the participation bonus of the insurance policy, that are intended to cover the statistical risk of benefit payments from insurance coverage) on the investment return as well as the impact of the cost of the biometric risk premium shall be disclosed in the KID.

The European Parliament and the European Council approved the revised draft of the New RTS without formulating any objection. The text, which was published in the Official Journal of the EU on April 12th 2017 will enter into force 20 days after its publication and will apply as from January 1st 2018.

Furthermore, the Luxembourg Investment Fund Association (ALFI) published on April 7th 2017 its first Q&A document on PRIIPs KID. The document contains the working group's answers to questions concerning the practical implementation of the New RTS for the Luxembourg fund industry.

The next step is additional guidance through level 3 and 4 measures.

The RTS are available here.

The Q&A is available for members of the ALFI on their website.

SECURITIES FINANCING TRANSACTIONS – DRAFT RTS

On March 31st 2017, ESMA published its final report implementing the Regulation (EU) 2015/2365 of November 25th 2015 on transparency of securities financing transactions ("SFT") and of reuse (the "SFTR"), which aims to increase the transparency of SFT ("Final Report").

The Final Report was published following the consultation process which closed on November 30th 2016 (we refer you to our article of December 1st 2016) and includes final draft regulatory technical standards ("RTS") under various articles of the SFTR.

More specifically, the draft RTS refer to:

(i) the details and the format of the application for registration as a trade repository;

(ii) the format, the frequency and the details to be included in the reports, to be transmitted by firms to trade repositories, relating to the various SFT concluded;

(iii) the operational standards for data collection by trade repositories and aggregation and comparison of data across repositories and the details of aggregate positions to be published and of SFT to which entities shall have access; and

(iv) the details of information to which, and the terms and conditions under which, entities should have access with regard to the procedures and forms for exchange of information on sanctions, measures and investigations under Article 25(1) and (2) of the SFTR.

It is worth mentioning that articles 13 and 14 of the SFTR provide that ESMA may develop draft RTS specifying the content of the disclosure requirements for UCITS and AIFMs set out in the Annex to the SFTR; Section A of the Annex sets out the information to be provided in the UCITS half-yearly and annual reports and the AIF's annual report, while Section B sets out the information to be provided in the UCITS prospectuses and AIF disclosures to investors. In the Final Report, ESMA states that drafting RTS in order to further specify the contents of the Annex would not be the best approach at this stage. However, ESMA added that it will monitor the developments in market practice as well as the quality of reporting data in order to determine whether to work on these empowerments in the future.

ESMA has sent its final draft RTS under SFTR for endorsement to the European Commission, which has three months to decide whether or not to endorse them.

The SFTR implementing measures are expected to enter into force by the end of 2017. Firms would have to start reporting their SFT to trade repositories twelve months after the publication in the Official Journal of the European Union. The reporting obligation itself will be phased-in over nine months.

UCITS - ESMA ISSUES UPDATED Q&A

On April 7th 2017, the European Securities and Markets Authority ("ESMA") issued an updated version of its Q&A on Undertakings for Collective Investment in Transferable Securities Directive ("UCITS Q&A").

An additional sub-question has been issued under the section relating to "Notification of UCITS and UCITS management companies; exchange of information between competent authorities".

The UCITS Q&A clarifies for UCITS management companies that would like to pursue cross-border activities, such as MiFID services or collective portfolio management of UCITS, through the use of the UCITS management company passport defined under articles 16 to 21 of the UCITS Directive, that the notification of these cross-border activities (through the notification letter) does not have to be linked to the identification of a specific UCITS.

The Q&A explains that the competent authorities in the home Member State of the UCITS will however need to be further notified, in accordance with article 20 of the UCITS Directive, once the management company will have identified the specific UCITS that it intends to manage on a cross-border basis.

The updated UCITS Q&A is available here.

AIFMD - ESMA UPDATED Q&A

On April 7th 2017, the European Securities and Markets Authority ("ESMA") issued an updated version of its Q&A on the application of the Alternative Investment Fund Managers Directive ("AIFMD Q&A").

An additional sub-question has been issued under the section relating to "Notifications of AIFs" to clarify the type of investors to which the marketing of AIFs is permitted. Indeed, in several Member States, categories of investors such as "qualifying investor", "informed investor", or "semi-professional investor" have been introduced. However, those definitions share some but not all the concepts of the definition of professional investors defined in Article 4(1)(ag) of AIFMD that is limited to investors which are considered to be professional clients or are treated as professional clients within the meaning of Annex II to Directive 2004/39/EC.

In its Q&A ESMA confirms that the AIF marketing passport defined under Article 32 of AIFMD and which allows for the marketing of units or shares of EU AIFs in Member States other than in the home Member State of the AIF manager may only be used for marketing the relevant AIF to professional investors as this term is defined in Article 4(1)(ag) of AIFMD.

ESMA further clarifies that any other type of cross-border marketing activity to investors that do not qualify as professional investors will have to be notified and carried out according to national legislation applicable in the host Member State of the AIF as it cannot be carried out by way of the AIF marketing passport.

The updated AIFMD Q&A is available here.

EMIR - ESMA OPINION ON PORTFOLIO MARGINING

Following the entry into force on January 4th 2017 of the new regulatory technical standards setting out the rules on collateral (margin) to be exchanged with respect to OTC derivatives not cleared by central counterparties ("CCPs") under the European Market Infrastructure Regulation ("EMIR") (i) Initial Margin requirements started to be phased in from February 4th 2017 (until September 1st 2020) and (ii) Variation Margin requirements entered into force for the largest counterparties by OTC derivative trading volume and now apply for all counterparties since March 1st 2017.

Under article 27 of the Commission Delegated Regulation (EU) No 153/2013 ("RTS"), CCPs can offset or reduce the required margin across instruments, which they clear, if the price risk of one of the instruments is significantly and reliably correlated to the price risk of other financial instruments considered as the same instrument/product. In those cases, CCPs may apply portfolio margining.

The degree of essential elements that need to be in common needed to be further specified in order to ensure a consistent application of Article 27 of the RTS. As such the European Securities and Markets Authority ("ESMA") issued an opinion on April 10th 2017 regarding the implementation of portfolio margining requirements for CCPs.

The opinion states that:

- two contracts which are not covered by the same default fund cannot be considered as the same instrument or product;
- two securities or two contracts in different asset classes cannot be considered as the same instrument or product.

The opinion then considers different asset classes (for securities, equities and bonds (including repurchase agreements) and for derivatives i) Interest Rates; ii) Equity; iii) Credit; iv) FX; v) Commodities for derivatives) and gives examples of situations where two contracts can be considered by the CCP as the same instrument for the purpose of applying the portfolio-margining and acknowledging the full amount of offsets derived from its margin model. For example, two bonds issued by the same entity can be considered as the same instrument; a bond and an equity issued by the same entity should be considered as different instruments.

In all other cases, the CCP will have to limit the reduction in margin requirement and apply the cap on the amount of margin offsets prescribed in Article 27(4) of the RTS.

The opinion then clarifies the situations where, in light of the above distinction, the CCP may apply more than 80% of margin reduction pursuant to Article 27(4) of the RTS (which allows a 100% margin reduction in cases where the CCP is not exposed to any potential risk from the margin reduction).

ESMA considers that if there is a "limited probability" that the losses of the portfolio would go beyond the level of initial margin, the CCPs should be excluded from this benefit. For ESMA, the reference to the lack of exposure "to any potential risk" referred to in Article 27(4) of the RTS should be considered as a reference to the maximum loss that a CCP can experience from a given position, preventing any possibility that the losses of the portfolio would go beyond the level of initial margin. For ESMA, simply relying on back-test results would not be acceptable to justify allowing a reduction in margins beyond 80%.

The RTS is available here.

The opinion is available here.

TAX

ANTI-TAX AVOIDANCE DIRECTIVE II

After publication of a first proposal to amend the Anti-Tax Avoidance Directive (EU) 2016/1164 (hereafter "ATAD I") in October 2016, the EU Presidency compromise was published on February 17th 2017 (hereafter the Anti-Tax Avoidance Directive II or "ATAD II").

The ATAD II provides for new anti-hybrid measures and aims to extend the anti-hybrid rules included in the ATAD I to third countries as of the year 2020. For further details on the ATAD I please refer to our April and July 2016 newsletter.

The ATAD II aims to address mismatches which lead to deductions without a corresponding inclusion or to double deductions. Additionally, it targets so-called reverse hybrid mismatches and tax residency mismatches. It is proposed to solve those mismatches either by way of a refusal of a deduction or the inclusion of the payment in the taxable income of the taxpayer resident in one of the countries involved.

DEDUCTIONS WITHOUT A CORRESPONDING INCLUSION

These mismatches exist, for example, where a payment is qualified as a deductible interest payment at the level of the paying entity and as a tax-exempt dividend income at the level of the receiving entity or where a payment by a permanent establishment to its head office located in another country is deemed to have been made, thus creating a deduction at the level of the permanent establishment without a corresponding inclusion at the level of the head office.

ATAD II foresees that the payer jurisdiction should deny the deduction. If the deduction is, however, allowed by the payer jurisdiction, the payee jurisdiction should include the amount in its taxable basis (fall back provision).

DOUBLE DEDUCTIONS

These situations may appear where differences in the rules governing the allocation of income and expenses between a head office and its permanent establishment lead to a payment being deducted at the level of the head office as well as at the level of the permanent establishment.

ATAD II foresees that the investor jurisdiction, i.e. the jurisdiction of the head office should deny the deduction. If the deduction is, however, allowed, the jurisdiction in which the payment had its source (i.e. the jurisdiction of the permanent establishment) should refuse the deduction (fall back provision).

REVERSE HYBRID MISMATCHES

A reverse hybrid mismatch would, for instance, occur where a European tax transparent company is treated as tax opaque by its non-European shareholder(s), thus leading to a non-taxation in Europe (due to the tax transparency) and to no immediate inclusion of the income at the level of the non-European shareholder(s) (due to the tax opacity of the company according to the domestic rules of the shareholders).

In this scenario, ATAD II provides that the tax transparent entity should be considered as a tax resident and be taxed on its income in the Member State in which it is located, to the extent that the income is not otherwise taxed in any other jurisdiction. In other words the tax transparency of a European company will depend on the tax treatment applied in the country of the shareholder(s). Collective investment vehicles are, however, expressly excluded from this provision.

TAX RESIDENCY MISMATCHES

Where a company is a tax resident in two countries, the payments made by such a company could lead to a tax deduction in each country in which it is deemed to be a tax resident.

ATAD II provides that the double deductions should be denied if it allows to offset an income that is not included in the taxable base in both countries (i.e. a double deduction is used to offset a single income due to discrepancies in the tax laws). In cases where the jurisdictions involved are European Member States, the tie-breaker rule of the double tax treaty entered into between the two Member States shall determine which country has to refuse the deduction.

EU PARENT-SUBSIDIARY DIRECTIVE AND "SUBJECT TO TAX" CONDITION

The ECJ C-448/15 judgment (Belgische Staat v. Wereldhave Belgium Comm. VA *et al.*) published on March 8th 2017 covers the question whether a company that is subject to corporate income taxes at the statutory tax rate, but that can end up paying corporate income tax at a zero rate, provided that all of its profits are paid to its shareholders, should qualify as a "company of a Member State" for the purpose of Article 2 of the Parent Subsidiary Directive (Directive 90/435, as recast by the Council Directive 2011/96/EU and as further amended, hereafter referred to as the "PSD").

Article 2 of the PSD sets forth certain criteria that have to be met by a company in order to qualify as a "company of a Member State". Besides the conditions regarding the corporate form and the tax domicile, the company is also required to "be subject [to one of the taxes listed in the PSD] without the possibility of an option or of being exempt".

In the case at hand, two Dutch resident entities held shares in a Belgian resident entity. The Dutch entities had the fiscal status of Fiscal Investment Institutions (i.e. a type of entity that is subject to regular corporation tax in the Netherlands but that can be entitled to a zero rate of corporate tax, provided that it pays out all its profits to its shareholders, hereafter referred to as "FII"), which led the Belgian State to refuse the application of the Belgian withholding tax exemption regime that derives from the PSD, as it was of the opinion that those companies did not meet the taxation criteria of the PSD (as detailed above).

The Court reasoned that the PSD lays down a positive (being subject to tax) as well as a negative (not being exempt) criterion, that both need to be met cumulatively. While, from a formal point of view, being subject to tax at a zero rate is not equal to being exempt from taxes, the Court reasoned that, not paying taxes, in practice, prevents the company from fulfilling the negative criterion, as not following this logic would render the existence of the negative criterion superfluous. The Court also outlined its understanding of the logic of the PSD, which is intended to limit the powers of taxation of Member States, but only where exercising them would lead to double taxation, which in the present case could not occur due to the zero tax rate at the level of the parent companies.

As a result, the Court ruled that FII as well as other types of companies, which are subject to corporation taxes at a zero rate, provided that all of their profits are distributed to shareholders, cannot fall within the meaning of a "company of a Member State" and thus do not satisfy the conditions of Article 2 of the PSD. A Member State should thus be allowed to refuse the application of the domestic withholding tax exemption regime based on the PSD to those types of companies.

EU MERGER DIRECTIVE - CJEU C14/16: EURO PARK SERVICE

On April 20th 2017, the ECJ ruled that the French legislation (art. 210 C of the French Tax Code), which provides that the deferral of taxation of capital gains related to assets transferred by a French company to a company established in another Member State is subject to a process of prior approval, is not compliant with art. 49 TFEU, because such an approval is not required for a domestic merger.

Indeed, the Court confirmed that the possibility granted to a Member State to refuse or withdraw the benefit of the deferral on capital gains provided by art. 11 (1) (a) had to be interpreted restrictively (regarding tax evasion and tax avoidance).

Context of Case

Upon the merger, in 2005, of a French company (SCI Cairnbulg Nanteuil) into a Luxembourg company (Euro Park Service), the assets (real estate properties located in France) of the French SCI were transferred at the net book value of EUR 9,387,700 to the Luxembourg company. On the same day, the Luxembourg company sold the real estate properties to another French SCI for EUR 15,776,000.

The French tax authorities challenged the use of the special system for mergers, which results from the EU Merger Directive which provides for a non-taxation of assets transferred within the frame of a merger, on the grounds, first, that Cairnbulg had not sought the ministerial approval provided for under Article 210 C of the CGI and, secondly, that that approval would not, in any event, have been granted, since that operation was not justified by commercial reasons but had been carried out for the purpose of tax evasion or avoidance.

In the present case, the Court had to rule about two legal issues :

- Does EU law allow for the assessment of compatibility of national legislation with the provision of primary EU law, when the legislation was adopted to transpose into national law the option provided for in Article 11(1)(a) of the EU Merger Directive?
- Is the French legislation compatible with Article 49 TFEU and the freedom of establishment?

The scope of art. 11 (1) (a) of Directive 90/434

This provision allows Member States to refuse to apply or withdraw the benefit of all or part of the provisions of the directive only where the operation has as its principal objectives tax evasion or tax avoidance.

The Court ruled that the national legislation had to comply with EU primary law and was deemed to respect the principle of proportionality. As a conclusion, the Court ruled that the provision had to be interpreted restrictively.

Restriction to the freedom of establishment

The Court ruled that, based on the fact that domestic situations are not subject to a prior approval, the principle of equivalence was not respected.

Further, because the practice of the French tax authorities is different from the French legislation implementing the EU Merger Directive, the Court considered that the national legislation was not sufficiently precise, clear and foreseeable to enable taxpayers to know precisely their rights in order to ensure that they were able to benefit from tax advantages under the directive and to rely on them, if necessary, before the national courts.

Consequences for the future

Following this decision, the French legislator will either have to remove the prior approval or to extend it to domestic operations.

This decision could be a precedent for similar restrictions existing in other Member States.

The Court did not define the terms "tax evasion" and "tax avoidance" and referred to the directive. In the present case, a clarification would have been helpful as the transfer occurred before the new tax treaty between Luxembourg and France, so the capital gain was neither taxed in France nor in Luxembourg.

TAX LIABILITY OF DIRECTORS – DSK COURT CASE

On April 4th 2017, the Luxembourg Higher Administrative Court overruled the judgment of the Administrative Court ("*Tribunal Administratif*") that previously confirmed the position of the Luxembourg tax authorities who requested the payment by the former IMF chief Dominique Strauss-Kahn ("DSK") of unpaid taxes of an investment company whose board of directors was chaired by DSK from October 2013 until October 2014.

Within the framework of the liquidation of the company LSK (i.e. Leyne, Strauss-Kahn & Partners) the Luxembourg tax authorities ordered Mr. Strauss-Kahn to pay approximatively €75,000 of non-paid withholding taxes on wages due by the company. Under Luxembourg tax law, the tax authorities are authorised to request the directors to pay the taxes of the company they managed ("*Appel en garantie*") provided they failed to carry out their legal duty and this failure is considered as a culpable fault ("*Schuldhafte Verletzung*"). This second criterion is important, since it has been constant in the case-law that a mere failure to pay the taxes due is not sufficient to trigger the *appel en garantie*; this failure should be combined with a culpable fault. In order to assess whether the director has committed a *Schuldhafte Verletzung,* the behaviour of the director is compared to the behaviour of a diligent director who would be in a similar situation.

In the first instance, the Administrative Court confirmed the *appel en garantie* arguing in the sense of a culpable fault of Mr. Strauss-Kahn characterised by a gross and inexcusable negligence in respect to both his legal duty as a director and his duty under the bylaws to supervise the managing director who was in charge of the payment of the taxes.

However, the Higher Administrative Court considered that, on the basis of the information and evidence provided by DSK, he had a role of gullible victim (even too gullible, according to the Court), which should not be qualified as *Schuldhafte Verletzung*. His behaviour has, indeed, not been qualified as a culpable fault considering that he detected the wrongdoing of the managing director late and that he was not authorised to make a bank order in order to process the payment of the taxes due.

Hence, without any material contradictory facts developed by the tax authorities, the Court cancelled the *appel en garantie* issued to Mr. Strauss-Kahn.

VAT STATUS OF SPECIAL LIMITED PARTNERSHIPS (SCSP)

On February 8th 2017, the VAT working group of the Luxembourg Private Equity and Venture Capital Association (the "LPEA") released a communication on the VAT status of Special Limited Partnerships (*sociétés en commandite spéciale*, "SCSp") and their General Partner(s) ("GP").

According to the LPEA, the Luxembourg VAT Authorities (*Administration de l'Enregistrement et des Domaines*) share the position that, although an SCSp has no legal personality, it should be considered as a VAT taxable person on its own, to the extent that the SCSp's activities qualify as economic activities within the meaning of the law of February 12th 1979 regarding value added tax (the "Luxembourg VAT Law"). The position of the tax authorities is hence to differentiate the VAT status of the SCSp and the Common Funds (FCP) which is an undivided collection of assets. The latter and its management company are viewed as single VAT entity.

This approach seems consistent with (i) the broad wording of article 4 of the Luxembourg VAT Law, using the term "anyone" (*quiconque*), and with (ii) the parliamentary documents relating to said provision, which explicitly state that the legal status and/or personality of an entity makes no difference when it comes to assessing whether the entity qualifies as VAT taxable person or not.

As a consequence, the actual activity performed by the SCSp needs to be assessed on a case-by-case basis: an SCSp carrying out economic activities, such as, for example, service provisions, trading activities or the collective investment in transferable securities of capital raised from the public, may be obliged to register for VAT (separately from its GP) and to file its own VAT returns, whereas an SCSp limiting its activities to the mere acquisition and holding of participations or management of private wealth should not be considered as a VAT taxable person.

VAT - IGP EXEMPTION – LUXEMBOURG REGIME NOT IN LINE WITH EU VAT LAW

On May 4th 2017, the European Court of Justice ("ECJ") released its judgement in the *Commission vs. Luxembourg* case (C-274/15). The ECJ followed the European Commission's position and ruled that Luxembourg has failed to fulfil its obligations under Article 132 (1) (f) of Directive 2006/112/EC of November 28th 2006 on the common system of value added tax (the "VAT Directive").

The latter provision provides that Member States should exempt "*the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses*".

Luxembourg's implementation of the VAT exemption of services supplied by independent groups of persons ("IGP") to their members was considered too broad by the ECJ on three counts.

First, the ECJ held that the wording of article 132 (1) (f) of the VAT Directive limits the exemption to the supply of services which are directly necessary for the exercise of the IGP's members' exempt or out of scope activities. Under Luxembourg's IGP regime, members of the IGP were however allowed to carry out taxable activities up to a threshold of 30% of their annual turnover, without losing the benefit of the exemption of services provided to them by the IGP. Even though, according to the ECJ, the IGP regime is not limited to groups whose members exclusively perform non-taxable activities, the judges clarified that the exemption only applies to those supplies of services which are directly necessary to the members' non-taxable activities. General overhead expenses invoiced by the IGP to any member carrying out VAT taxable activities should thus not fall within the scope of the exemption.

Luxembourg's IGP regime has further been declared non-compliant with the VAT Directive by the ECJ because it allowed the members – to the extent of their own input VAT deduction rights – to recover VAT incurred by the IGP on its costs. The ECJ stressed that the IGP itself is to be considered as a taxable person in its own right (separate from its members). As a consequence, the members should not be entitled to recover any VAT borne by the IGP.

Finally, the ECJ held that the allocation to the IGP, by one of its members, of expenses incurred by that member, in its name but on behalf of the IGP, is a transaction which falls within the scope of VAT. Luxembourg was thus not entitled to consider such transactions as out of the scope of VAT.

As a result of the ECJ's judgement, Luxembourg will be required to change its current legislation and administrative practice with respect to IGPs which may have an impact on those taxpayers currently benefiting from the IGP regime.

VAT - IGP EXEMPTION AND THE FINANCIAL SECTOR

On April 5th 2017, Advocate General Melchior Wathelet released his opinion in the case Commission vs. Germany (C-616/15), which gives some interesting guidance on the possible interpretation of the VAT exemption of services supplied by independent groups of persons ("IGP") to their members.

The European Commission argues that, by limiting the availability of the exemption to IGPs, whose members are doctors, exercise paramedical professions or carry out activities in the health care sector, Germany has failed to fulfil its obligations under Article 132 (1) (f) of Directive 2006/112/EC of November 28th 2006 on the common system of value added tax (the "VAT Directive").

In his threefold reasoning, Advocate General Wathelet suggests that the European Court of Justice (the "ECJ") rules in favour of the Commission's view that the IGP exemption should not be limited to the medical sector.

First, from a schematic point of view, the Advocate General notes that an IGP should be considered as transparent (like a VAT group) in the sense that the passing on of the costs incurred by its members is not to be qualified as a supply for consideration, but simply as the provision of resources with costs being allocated among members depending on the use that each of them makes of those resources. Even if the VAT Directive should thus not have provided for an exemption of the supply of services by IGPs, but rather have excluded such transactions from the scope of VAT, any restriction of the exemption to transactions of IGPs active in areas of public interest (or even solely in the health sector) would not be justified.

Secondly, from a teleological point of view, the Advocate General recalls that the objective of the exemption is to avoid that persons grouped in an IGP incur irrecoverable VAT on services provided by that IGP. This undoubtedly justifies an application of the exemption to all IGPs whose members are carrying out activities in relation to which they are not taxable persons or exempt activities, including IGPs in the financial sector.

Finally, the wording of article 132 (1) (f) of the VAT Directive does not contain any limitation to a specific professional sector; the only restriction being that solely services rendered by an IGP to its members are exempt.

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