NEWSLETTER

July 2019

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AML

CSSF CIRCULAR 19/722 | DECLARATIONS OF FATF

On 1 July 2019 the CSSF published Circular 19/722 relating to recent declarations of the Financial Action Task Force (**“FATF”**).

JURISDICTIONS WITH SUBSTANTIAL AND STRATEGIC DEFICIENCIES

FATF maintained its position that the **Democratic People's Republic of Korea** (DPRK) is a jurisdiction whose anti-money laundering and combating the financing of terrorism regime has substantial and strategic deficiencies. FATF appealed to its members to apply countermeasures and reminded members to take measures to close North Korean bank subsidiaries, branches or representative offices in their respective territories.

The CSSF advised to:

- Consider, with particular attention, the business relations and operations with this jurisdiction;
- apply enhanced due diligence and follow-up measures;
- inform the CSSF in the event of a banking correspondence relationship with a DPRK credit institution;
- maintain strengthened mechanisms for reporting suspicions to the Financial Intelligence Unit.

JURISDICTIONS REQUIRING ENHANCED DUE DILIGENCE

FATF stated that, despite efforts made in this domain, **Iran** is a jurisdiction whose anti-money laundering (AML) and combating the financing of terrorism regime requires the application of enhanced due diligence measures proportionate to the risks arising from such jurisdiction.

FATF decided to maintain the suspension of countermeasures but requires enhanced review and supervision of subsidiaries and branches of financial institutions located in Iran given that there are still gaps in the AML regime.

The CSSF advised to:

- consider with particular attention the business relations and operations with this jurisdiction, including with natural and legal persons of this country;
- apply enhanced due diligence and monitoring measures for business relationships, in particular by increasing the number and timing of controls and by selecting the types of transactions that require further examination, as well as obtaining information on the reasons for proposed transactions;
- maintain strengthened mechanisms for reporting suspicions to the Financial Intelligence Unit.

JURISDICTIONS WHOSE AML REGIME IS UNSATISFACTORY

FATF stated that Bahamas, Botswana, Cambodia, Ethiopia, Ghana, Pakistan, Panama, Sri Lanka, Syria, Trinidad and Tobago, Tunisia and Yemen are jurisdictions whose anti-money laundering and combating the financing of terrorism regime is not satisfactory.

- The CSSF advised to consider the deficiencies identified by FATF in its declarations and the risks resulting from these deficiencies in business relations and transactions with these jurisdictions.
- The CSSF points out that **Serbia** is no longer a jurisdiction subject to FATF's continuous monitoring process, but continues to work with the FATF regional style body.

BANKING & FINANCE

CSSF CIRCULAR 19/716 | THIRD COUNTRY FIRMS PROVIDING INVESTMENT SERVICES OR PERFORMING INVESTMENT ACTIVITIES IN LUXEMBOURG

The different regimes that are applicable to third-country firms (the "**TCF(s)**") that wish to provide investment services or perform investment activities together with ancillary investment services in Luxembourg under the recently added Article 32-1 of the Luxembourg law of 5 April 1993 on the financial sector, as amended (hereinafter the "**Law**") are now clarified by CSSF Circular 19/716 (the "**Circular**") issued on 10 April 2019. The newly added Article 32-1 of the Law implements the provisions of the Directive 2014/65/EU of 15 May 2014 on markets in financial instruments ("**MiFID II**") and Regulation (EU) No. 600/2014 of 15 May 2014 on markets in financial instruments ("**MiFIR**").

The Circular urges TCFs to firstly identify their targeted clientele, as different rules apply in respect to the provision of investment services to retail clients or professional clients on request on the one hand and per se professional clients or eligible counterparties on the other hand. In respect to the former category of clients, the Law is clear that TCFs are required to establish a branch in Luxembourg whereas in relation to the latter type of clients, the Law allows for such TCFs to opt in for either the national regime or the EU regime. In contrast, a TCF is not subject to the provisions of the Law should a client established or situated in the EU initiate, at its own exclusive initiative, the provision of an investment service by such TCF (so called 'reverse solicitation').

TCFs can provide investment services to per se professional clients or eligible counterparties situated within Luxembourg on a cross-border basis as permitted by the national regime only if the European Commission has not yet taken an equivalence decision in respect to a TCF's country of origin or the TCF chooses to benefit from the three-year transitional period pursuant to MiFIR. TCFs can benefit from the national regime as long as the CSSF is satisfied, subsequent to a duly submitted application by the interested TCF to the CSSF, that (i) the TCF is subject to supervision and authorisation rules in its country of origin considered as equivalent to those of the Law (i.e. whether the third country is a signatory party to the IOSCO Multilateral Memorandum of Understanding (MoU) or whether it is subject to adequate AML/CFT laws and supervision (ii) a MoU is in place between the CSSF and the respective TCF's supervisory authority and (iii) the TCF is authorised in its country of origin to provide the investment services it wishes to provide in Luxembourg.

Conversely, a TCF can opt in for the European regime and hence provide investment services on a cross-border basis to per se professional clients and eligible counterparties in Luxembourg where the European Commission has adopted beforehand, an equivalence decision relating to the TCF's country of origin and such TCF is registered in the relevant register kept by ESMA.

TCFs must, whether utilising the national or the European regime, and before offering any investment service, inform their clients that they are not allowed to provide services to clients other than eligible counterparties and per se professional clients and are not subject to supervision in the EU.

Interested TCFs wishing to utilise the national regime can apply to the CSSF and submit the relevant form attached to the Circular, whereas those TCFs opting for the EU regime can apply to ESMA in the manner and form prescribed in Regulation (EU) 2016/2022 of 14 July 2016 with regard to regulatory technical standards concerning the information for registration of third-country firms and the format of information to be provided to the clients.

MIFID II & MiFIR | UPDATE OF ESMA & CSSF Q&A

On 29 May 2019, ESMA updated its Q&A on the Markets in Financial Instruments Directive 2014/65/EU of 15 May 2014 (“**MiFID II**”) and on the markets in Financial Instruments Regulation No. 600/2014 of 15 May 2014 (“**MiFIR**”), and more specifically, its Q&A on investor protection and intermediaries (the “**ESMA Investor Protection Q&A**”);

Furthermore, on 21 May 2019, the CSSF has updated its Q&A on MiFID II and MiFIR to cover four new questions relating to transaction reporting data samples.

We will only focus here on the updates to the ESMA Investor Protection Q&A.

BEST EXECUTION

Article 21 of Directive 2004/39/EC 21 April 2004 on markets in financial instruments (“**MiFID I**”) required firms “*to take **all reasonable steps** to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order*”. On the other hand, Article 27 of MiFID II requires firms “*to take **all sufficient steps** to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order*”.

ESMA has confirmed that firms and competent authorities should understand “all sufficient steps” to be a higher bar for compliance than “all reasonable steps”. ESMA goes on to provide some practical guidance to firms to achieve this through, for example, the monitoring of quality and appropriateness of their execution arrangements and policies on an *ex-ante* and *ex-post* basis to identify where areas need improvement.

INFORMATION ON COSTS AND CHARGES

Four new questions and answers have been added to the section of the ESMA Investor Protection Q&A dealing with best execution.

ESMA has:

- clarified when it is necessary to provide *ex-ante* information about costs and charges in case of clients’ sell orders;
- provided helpful guidance on how to disclose cost information (in good time) to a client who places an order via telephone;
- confirmed that firms may use an assumed investment amount in *ex-ante* costs and charges disclosures, notwithstanding if the services or products have linear or non-linear charging structures, provided the assumed investment amount reflects where, in the charging structure, the specific transaction is assumed to stand;
- confirmed that, in *ex-ante* costs and charges disclosures, firms are not allowed disclose the relevant costs and charges that would be incurred by a client by way of a range or as a maximum amount/percentage.

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CAPITAL MARKETS

NEW LUXEMBOURG PROSPECTUS LAW

On 2 July 2019, the Luxembourg Parliament (*Chambre des Députés*) adopted the final text of the draft law No. 7328 on prospectuses (the "**New Prospectus Law**") for the purposes of implementing Regulation (EU) 2017/1129 of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the "**Prospectus Regulation**").

In our July 2018 Newsletter, we gave a brief overview of the first draft of the New Prospectus Law issued by the Luxembourg Parliament (*Chambre des Députés*); specifically we explained that according to that first draft, the New Prospectus Law was divided into five parts in a similar way to the law of 10 July 2005 on prospectuses (the "**Existing Law**") which it will replace. This remains the case in the final text of the New Prospectus Law.

EXERCISE OF THE OPTION REGARDING THE EXEMPTION THRESHOLD

While the Prospectus Regulation is directly applicable throughout the EU, Member States are given some discretion to set the threshold under which offers of securities to the public shall be exempt from the obligation to publish a prospectus. In this regard, the Luxembourg legislator has opted to fix the threshold at EUR 8,000,000 calculated on a total consideration basis over twelve months, which is the maximum level permitted under the Prospectus Regulation. In case of an offering of securities to the public with a total consideration of at least EUR 5,000,000 but less than EUR 8,000,000, an information note (which does not require any formal approval) is required.

DOMESTIC PROSPECTUS REGIME

The domestic prospectus regime (which applies to those offers of securities made to the public in Luxembourg and admissions to trading of securities on a regulated market, which fall outside the scope of the Prospectus Regulation) has been, for the most part, retained in Part III of the New Prospectus Law, with such offers requiring only an alleviated prospectus similar to the simplified prospectus required under Part III of the Existing Law.

Similar exemption thresholds as those applied by the New Prospectus Law to offers to the public which are within the scope of the Prospectus Regulation, have been applied to offers to the public under the domestic regime in Chapter 1 of Part III of the New Prospectus Law.

WHAT IS NEXT?

The Prospectus Regulation will be fully applicable on 21 July 2019 in all Member States. It is anticipated that the New Prospectus Law will be applicable as from the same date, thereby repealing and replacing the Existing Law.

THE NEW SHAREHOLDERS LAW: IMPLEMENTATION OF THE DRAFT LAW 7402 | GENERAL OVERVIEW

On 10 July 2019 the Luxembourg Parliament (*Chambre des Députés*) adopted the final text of the draft law No. 7402 (the **New Shareholders Rights Law** for the purposes of implementing Directive (EU) 2017/828 amending Directive 2007/36/EC as regards the encouragement of long term shareholder participation (the **Shareholders Rights Directive II**). The New Shareholders' Rights Law will amend the law of 24 May 2011 on the exercise of certain shareholders' rights at general meetings of listed companies (the **2001 Law**).

The 2011 Law related to the protection of the exercise of certain rights of shareholders in listed companies in connection with general meetings; however, the New Shareholders Rights Law introduces a significant conceptual change by imposing obligations on asset

owners and asset managers with respect to their investments in listed Luxembourg companies, the purpose of which is to increase transparency as well as the quality of shareholder's engagement. Consequently, such enhancement of shareholders rights triggers major regulatory changes for asset owners and asset managers.

Intermediaries maintaining securities accounts on behalf of shareholders are equally impacted by the New Shareholders Rights Law; they will indeed be involved in the transmission of information, along the chain of holding, between the issuer and the shareholder to facilitate the exercise of shareholders rights.

Additional information on the new rights and duties will be detailed in an ad hoc article to be followed soon.

EMPLOYMENT

DIRECTIVE ON THE PROTECTION OF PERSONS REPORTING ON BREACHES OF EU LAW

The Luxembourg law of 26 June 2019 on the protection of undisclosed know-how and business information ("**trade secrets**") against their unlawful acquisition, use and disclosure (the "**Law**") has been published in the *Mémorial* on 28 June 2019. The Law seeks to transpose Directive (EU) 2016/943 of 8 June 2016 on the protection of trade secrets against their unlawful acquisition, use and disclosure and to establish a sufficient level of protection of trade secrets. In particular, the Law provides for measures and procedures to take action against the unlawful use or disclosure of such secrets. For more information on the subject, please read our Newsflash.

LAW OF 26 JUNE 2019 ON TRADE SECRETS

The directive on the protection of persons reporting on breaches of EU law (the "**Directive**") was approved by the EU Parliament on 16 April 2019. The Directive has not yet been published to the Official Journal of the EU. In a context where whistle-blowers play a key role in exposing and preventing breaches of the law that are harmful to the public interest, but are often discouraged from reporting their concerns or suspicions for fear of retaliation, the Directive lays down minimum standards aimed at protecting and encouraging reporting of breaches of EU law. For more information on the subject, please read our Newsflash.

INVESTMENT FUNDS

AML/CFT INVESTMENT FUND QUESTIONNAIRE

On 23 May 2019, the CSSF disseminated a press release about the publication of an AML / CFT investment fund questionnaire in relation to money laundering and terrorist financing risks ("**ML/FT risk**").

The purpose of this new questionnaire is to collect standardised key information on the money laundering and terrorist financing risk which entities subject to the supervision of the CSSF are exposed to.

This questionnaire must be completed when sending a licencing application for setting up a SIF, UCI Part II, SICAR or ELTIF. More importantly, the questionnaire should be completed by the AML/CFT Compliance Officer or a person who is responsible for the control of the fight against money laundering and terrorist financing for the relevant fund.

The CSSF must receive this questionnaire by email before it acknowledges receipt of the licensing application file. The AML/CFT questionnaire is available on the CSSF's website under the link entitled "Forms", depending on the type of fund intended to be launched.

In addition to the questionnaire itself, certain additional documents will need to be filed with it such as declarations of beneficial ownership and declarations of honour.

The questionnaire can also be reached directly via the following link:

http://www.cssf.lu/en/supervision/ivm/sif/forms/

PROPOSAL TO AMEND THE PRIIPS REGULATION

BACKGROUND

The EU Parliament and Council issued a proposal to amend the Cross Border Distribution Regulation in order to amend the existing Regulation (EU) 2014/1286 of the European Parliament and of the Council relating to the key information documents for packaged retail and insurance based investment products ("**PRIIPs Regulation**"). The amendment pushes back the UCITS exemption to produce the PRIIPs key information document (KID) to 31 December 2021.

CSSF UPDATED Q&AS.

In light of the above, the CSSF has recently published an updated version of its FAQ on UCITS and FAQ on AIFMs, in order to anticipate the extension of the exemption to produce a PRIIPs KID for UCITS and AIFs which produce a UCITS like KIID (Key Investor Information Document).

According to the existing PRIIPs Regulation, manufacturers of Luxembourg UCITS need to have in place a PRIIPs KID as of 1 January 2020, or later, if the period of exemption provided for in article 32(1) of the PRIIPs Regulation is extended to a later date. Until such date, the Luxembourg UCITS will be exempt from the obligation of the PRIIPs Regulation in conformity with article 32(1) of such regulation.

In addition, said FAQ on UCITS clarifies that the notification of the final form of the PRIIPs KID is not mandatory but may be requested on a case-by-case basis by the CSSF. As stated in the CSSF's FAQ on AIFMs, the same rule applies to Luxembourg AIFs having issued such UCITS like KIIDs.

DIRECTIVE TO FACILITATE CROSS-BORDER DISTRIBUTION OF INVESTMENT FUNDS

On 16 April 2019, the European Parliament adopted legislative resolutions on the proposal for a directive of the European Parliament and of the Council amending directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings (the "**Proposal**"). The Proposal was signed on 20 June 2019 and should be published soon.

The Proposal aims to remove the current regulatory barriers to the cross-border distribution of investment funds in order to make their cross-border distribution simpler, faster and cheaper.

The final draft of the Proposal (the "**Final Draft**") contains the following changes from the last amended proposal dated December 2018 (see our newsletter dated February 2019).

CONCERNING THE AMENDMENT OF THE NOTIFICATIONS RELATED TO THE USE OF THE MARKETING PASSPORT

The Final Draft introduces a new "sanction". Where, pursuant to a change to the information in the notification letter, the UCITS would no longer comply with directive 2009/65/EC and, where the competent authorities of the UCITS home Member State informed the UCITS that it is not allowed to implement that change, the competent authorities of the home Member State of the UCITS shall take all appropriate measures, including, the express prohibition of marketing of the UCITS.

CONCERNING THE PROVISIONS ON PRE-MARKETING

1. *The Final Draft clarifies the exceptions for pre-marketing in the EU by an EU AIFM.* An authorised EU AIFM can't engage in pre-marketing in the EU where the information presented to potential professional investors (a) is sufficient to allow investors to commit to acquiring units or shares of a particular AIF; (b) amounts to subscription forms or similar documents whether in a draft or a final form; or (c) amounts to constitutional documents, a prospectus or offering documents of a not-yet-established AIF in a final form.
2. *The Final Draft requires one more special mention in the draft prospectus.* Draft prospectus shall clearly state that they do not constitute an offer or an invitation to subscribe to units or shares, and, that the information should not be relied upon because it is incomplete and may be subject to change.
3. *The Final Draft imposes formal requirements* upon an AIFM to inform the competent authorities of its home Member State of the start of the pre-marketing: the AIFM should send, within two weeks of it having begun pre-marketing, an informal letter, in paper form or by electronic means.
4. *The Final Draft foresees one more new condition to de-notify arrangements made for the marketing of units or shares of some or all EU AIFs.* The de-notification requires that any contractual arrangements with financial intermediaries or delegates are modified or terminated with effect from the date of de-notification. Thus, (i) as of the date of de-notification, the AIFM shall cease any new or further, direct or indirect, offering or placement of units or shares of the AIF it manages in the Member State and, (ii) for a period of 36 months from the date of de-notification the AIFM shall not engage in pre-marketing of units or shares of the EU AIFs referred to in the notification, or in respect of similar investment strategies or investment ideas, in the Member State identified in the notification.

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DRAFT LAW 7349 CONCERNING ELTIF, EUVECA AND EUSEF AND AMENDING THE RAIF LAW

Draft Law No. 7349 (the "**Draft Law**"), which has been working its way through the Luxembourg parliamentary process since August 2018, implements into domestic law certain provisions of the following regulations:

- Regulation (EU) No. 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds ("**EuVECA Regulation**")
- Regulation (EU) No. 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds ("**EuSEF Regulation**"),
- Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European Long-term Investment Funds ("**ELTIF Regulation**").
- Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on money market funds ("**MMF Regulation**")
- Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisations ("**Securitisation Regulation**")
- The Draft Law explicitly designates the CSSF as the competent authority in respect of the EuVECA, EuSEF, ELTIF and MMF Regulations and sets out the powers of the CSSF and the administrative sanctions that may be applied by the CSSF pursuant to such regulations.

The CSSF is also generally designated as the competent authority pursuant to the Securitisation Regulation provided that the *Commissariat aux Assurances* is the competent authority for ensuring respect of the obligations laid out in articles 6 (risk retention) and 9 (criteria for credit-granting) of the Securitisation Regulation by sponsors, originators and securitisation special purpose entities.

The Draft Law proposes to amend articles 12-3 and 12-5 of the law of 5 April 1993 on the financial sector in order to correct material mistakes and for a better understanding of the law.

Finally it is proposed that the Draft Law amend the law of 23 July 2016 relating to reserved alternative investment funds (the "**RAIF Law**"). It is proposed to amend article 8 to provide that *fonds commun de placement* (FCPs) may be managed by Luxembourg management companies authorised pursuant to chapters 15, 16 or 18 of the law of 17 December 2010 relating to undertakings for collective investment ("**2010 Law**"). The previous wording of the RAIF Law did not allow for management companies fully authorised pursuant to chapter 15 of the 2010 Law to manage FCPs taking the form of reserved alternative investment funds.

It is also proposed to amend article 49 of the RAIF Law to allow for the transformation of FCP RAIFs into SICAV RAIFs.

ESMA PUBLISHES UPDATED AIFMD AND UCITS Q&A

On 4 June 2019, the European Securities and Markets Authority ("**ESMA**") published updated questions and answers documents ("**Q&A**") on the application of the Alternative Investment Fund Managers Directive ("**AIFMD**") and the Undertakings for Collective Investment in Transferable Securities Directive ("**UCITS Directive**").

The updated Q&A includes five new questions relating to the depository function under AIFMD and the UCITS Directive.

The first question clarifies that supporting tasks, which are linked to depository tasks such as administrative or technical functions performed as part of the depository tasks listed under Article 21(7) and (9) of the AIFMD and Article 22(3) and (4) of the UCITS Directive

could be entrusted to third parties where all of the following conditions are met: (i) the execution of the tasks does not involve any discretionary judgement or interpretation of the third party in relation to the depository functions; (ii) the execution of the tasks does not require specific expertise in regard to the depository function; and (iii) the tasks are standardised and pre-defined.

The second question specifies that depositories may entrust tasks to third parties and give them the ability to transfer assets belonging to AIFs and UCITS without requiring the intervention of the depository. However, ESMA provides that these arrangements are subject to the delegation requirements set out in Article 21(11) AIFMD and Article 22a (2) UCITS Directive.

The third question pointed out that the internal allocation of functions between the head office and the branches of a depository should not lead to situations that may represent a circumvention of the establishment requirement under Article 21(5) AIFMD and Article 23 (1) UCITS Directive. Operational infrastructure and internal governance systems of such branches must be adequate to carry out depository functions autonomously from its head office and ensure compliance with national rules implementing the AIFMD and the UCITS Directive.

The fourth question explained that the competent authority of a Member State, where a branch is established, shall be responsible for supervising the activities of the branch with regard to depository functions in relation to AIFs and UCITS. This includes the supervision of the allocation of depository functions from the branch to its head office or vice versa to avoid any possible circumvention of the establishment requirement under Article 21(5) AIFMD and Article 23(1) UCITS Directive.

The final question clarifies that legal entities within the same group of a depository should be considered "third parties" for the purpose of the depository delegation rules under Article 21(11) AIFMD and Article 22a UCITS Directive.

REGULATION TO FACILITATE CROSS-BORDER DISTRIBUTION OF INVESTMENT FUNDS

On 16 April 2019, the European Parliament adopted legislative resolutions on a proposal for a Regulation of the European Parliament and of the Council on facilitating cross-border distribution of collective investment undertakings and amending regulations (EU) No. 345/2013, (EU) No. 346/2013 and (EU) No. 1286/2014 (the "**Regulation**"). The proposal was signed on 20 June 2019 and should be published soon.

The Regulation aims to remove the current regulatory barriers to the cross-border distribution of investment funds in order to make their cross-border distribution simpler, faster and cheaper. It establishes uniform rules on the publication of national provisions concerning marketing requirements for collective investment undertakings and on marketing communications addressed to investors, as well as common principles concerning fees and charges levied on fund managers in relation to their cross-border activities. It also provides for the establishment of a central database on the cross-border marketing of collective investment undertakings.

The Regulation applies to AIFMs, UCITS management companies and self-managed UCITS, EuVECA managers and EuSEF managers (collectively the "**Managers**").

REQUIREMENTS FOR MARKETING COMMUNICATIONS:

- All marketing communications addressed to investors must be identifiable as such and describe the risks and rewards of purchasing units or shares of an alternative investment fund ("**AIF**") or undertaking for collective investment in transferable securities ("**UCITS**") in an equally prominent manner
- All information must be fair clear and not misleading.

- It must be ensured that marketing communications that contain specific information about a UCITS do not contradict or diminish the significance of the information contained in the prospectus or the key investor information
- marketing communications must contain clear information that the Manager may decide to terminate the arrangements made for the marketing of its collective investment undertakings
- AIFMs, EuVECA and EuSEF managers shall ensue that marketing communications do not contradict the information which is to be disclosed to investors in accordance with Directive 2011/61/EU (“**AIFMD**”), Regulation (EU) No. 345/2013 (the “**EuVECA Regulation**”) or Regulation (EU) No. 346/2013 (the “**EuSEF Regulation**”) or diminish its significance.

ESMA should issue guidance within 24 months of the date of entry into force of the Regulation on the application of the requirements for marketing communications.

PUBLICATION OF NATIONAL PROVISIONS CONCERNING MARKETING REQUIREMENTS

National competent authorities (“**NCAs**”) shall publish and maintain on their websites up-to-date and complete information on the applicable laws and regulations governing marketing requirements for AIFs and UCITS and shall notify same to ESMA as well as any changes thereto. ESMA shall publish and maintain a central database containing summaries of such laws and regulations.

EX-ANTE VERIFICATION OF MARKETING COMMUNICATIONS

NCAs may require prior notification of marketing communications which UCITS management companies, and, in respect to marketing to retail investors only, AIFMs, EuVECA or EuSEF managers, intend to use for purposes of verifying compliance with the Regulation.

ESMA will have to report on such ex-ante verifications by March 2021 and every two years thereafter.

COMMON PRINCIPLES CONCERNING FEES OR CHARGES

Where fees or charges are levied by NCAs for carrying out their duties in relation to the cross border activities of the Managers such fees or charges shall be consistent with the overall cost relating to the performance of the functions of the NCA. The NCAs and ESMA shall also publish and maintain up-to-date information on their websites listing such fees or charges.

ESMA CENTRAL DATA BASE

ESMA shall publish within 30 months after the date of entry into force of the Regulation a central database on cross-border marketing of AIFs and UCITS listing all AIFs and UCITS that are marketed in a Member State other than their home Member State, the Member States in which they are marketing and their Manager.

AMENDMENTS TO THE EUVECA REGULATION AND THE EUSEF REGULATION

The Regulation amends the EuVECA and EuSEF Regulations in order to define “pre-marketing” and to set out the rules governing pre-marketing which are similar to the rules applicable to AIFs (see article in this newsletter on the Directive to Facilitate Cross Border Distribution of Investment Funds.

SHAREHOLDERS RIGHTS DIRECTIVE II | IMPACT ON AIFMs AND MANCOs

BACKGROUND

The deadline for transposition of Directive (EU) 2017/828 amending Directive 2007/36/EC as regards the encouragement of long term shareholder participation (the "**Shareholders Rights Directive II**") expired on 10 June 2019. The Shareholder Rights Directive II aims to enhance shareholder participation and equal rights in decision making. It applies to a wider group of market participants including AIFMs and Management Companies. It imposes new obligations on such entities as regards disclosure of how they integrate shareholder engagement in their investment strategy.

NEW OBLIGATIONS

Under the Shareholders Rights Directive II, Management Companies and AIFMs, to the extent that they invest in shares traded on a regulated market on behalf of investor, are obliged *inter alia* to:

(i) develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy. The policy shall describe how they monitor investee companies on relevant matters, capital structure, social and environmental impact, and corporate governance or exercise voting rights and other rights attached to shares;

(ii) on an annual basis, publicly disclose how their engagement policy has been implemented, including a general description of voting behaviour, an explanation of the most significant votes and the use of the services of proxy advisors;

(iii) publicly disclose how they have cast votes in the general meetings of the companies in which they hold shares;

(iv) disclose to institutional investors for whom they invest, either on a discretionary basis or through a collective investment undertaking, on an annual basis, how their investment strategy and implementation thereof complies with the arrangement with the institutional investor and contributes to the medium to long-term performance of the assets of the institutional investor or the managed fund. Such disclosure shall include reporting on the key material medium to long-term risks associated with the investments, on portfolio composition, turnover and turnover costs, or on the use of proxy advisors for the purpose of engagement activities.

TRANSPOSITION

The Shareholders Rights Directive II will be implemented into the Luxembourg legal framework through draft law No. 7402 (the "**Draft Law**"), which has been lodged with Luxembourg Parliament on 4 February 2019 and at the moment of publication of this newsletter is awaiting a second vote in the Luxembourg Parliament (or dispensation from same).

The Draft Law amends the law of 24 May 2011, relating the exercise of shareholders' rights in shareholders' meetings of listed companies and introduces a new chapter III placing on Management Companies and AIFMs those obligations discussed in points (i) to (iv) above.

ESMA QUESTIONNAIRE ON UNDUE SHORT-TERMISM

On 24 June 2019, the European Securities and Markets Authority ("**ESMA**") published a questionnaire, which aims at collecting evidence about what aspects of the financial sector could cause short-term pressure on companies.

ESMA defines "short-termism" as "the focus on short time horizons by both corporate managers and financial markets, prioritising near-term shareholder interests over long-term growth of the firm".

The impact of short-termism forms part of ESMA's work on sustainable finance and

relates to the European Commission’s Action Plan on “Financing Sustainable Growth. Therefore, ESMA invites investors, issuers, UCITS management companies, self-managed UCITS investment companies, AIFMs and the trade associations of financial market participants to respond to the questionnaire.

The questionnaire covers six areas:

- investment strategy and investment horizon;
- disclosure of Environmental, Social and Governance (ESG) factors and the contribution of such disclosure to long-term investment strategies;
- the role of fair value accounting in better investment decision-making;
- institutional investors’ engagement;
- remuneration of fund managers and corporate executives;
- and use of credit default swaps by investment funds.

The questionnaire will be open for five weeks, closing on 29 July 2019. It takes the form of a survey and therefore, it is presented in “**EUSurvey**”, an online survey making tool.

Overall, with this survey ESMA is seeking to collect information on market practices and the views of financial market participants. By responding to the questionnaire, market participants will contribute to ESMA’s advice to the European Commission and as such shape future policy decisions in relation to short-termism in the financial sector. By December 2019, ESMA will deliver a report to the Commission based on its findings, which will present evidence and possibly advice on potential undue short-termism.

TAX

FINAL LOSSES | NEW DECISIONS OF THE ECJ

In two recent cases, the ECJ clarified in which situations holding companies might be entitled to deduct final losses, thus confirming the principles previously established in the Marks & Spencer decision (C-446/03).

In the first decision, Memira Holding (C-607/17) dated 19 June 2019, a Swedish holding company had one German subsidiary, which was operating several ophthalmologic clinics and whose activity was not sustainable, so that the holding company decided to merge and absorb the German subsidiary. The Swedish tax authorities however wanted to deny taking into account the final losses deriving from the activity of the German subsidiary. The ECJ confirmed in this case that even if the jurisdiction of the subsidiary (i.e. Germany) does not allow the transfer of losses to another company liable for corporation tax in the event of a merger, this does not prevent the jurisdiction of the parent company (i.e. Sweden) from taking into account those losses. Indeed, if the parent company can demonstrate that it is impossible for it to deduct those losses in the jurisdiction of the subsidiary, the tax losses should be taken into account in the jurisdiction of the parent company.

In the second decision, Holmen AB (C-608/17), dated 19 June 2019, another Swedish holding company operated various subsidiaries in Spain, which were part of a fiscal unity. The activity was not viable and the entities were thus put into liquidation. The Swedish tax authorities refused to take into account, at the level of the parent company, the losses accumulated at the level of the subsidiaries held indirectly (i.e. sub-subsidiaries). In addition, Spanish law did not authorise the transfer of losses of a liquidated company in the year of liquidation.

In both cases, the ECJ stressed that the parent company carries the burden of proof in demonstrating that its subsidiaries' losses are truly final. The Court seems to construe final losses as losses which cannot be used by a third party, in particular after a sale for a price including the tax value of the losses. Further, the ECJ confirmed that domestic law restrictions on the use of losses in the jurisdiction of the subsidiary are not decisive in determining whether the jurisdiction of the parent company must grant loss relief. As regards losses held by a sub-subsidiary, the ECJ held that the jurisdiction of the parent company may refuse to grant cross-border tax relief for losses held by an indirect subsidiary established in a different Member State than the direct subsidiary. However, if the indirect subsidiary is established in the same jurisdiction as the intermediate subsidiary, the jurisdiction of the parent company must grant cross-border tax relief for losses meeting the conditions set out in the Marks & Spencer decision (i.e. final losses).

In conclusion, the ECJ confirmed its previous conclusions on final losses and even opened the door, under certain conditions, for final losses deriving from indirect subsidiaries to be taken into account.

FOUNDATION'S BOARD MEMBER REMUNERATION IS NOT SUBJECT TO VAT

On 13 June 2019, the ECJ published its judgment in the IO vs *Inspecteur van de rijksbelastiengsdienst* case (C-420/18) and clarified that the member of a foundation's supervisory board does not qualify as a VAT taxable person as he does not independently exercise an economic activity. The foundation's main activity was to provide permanent housing to people in need. IO was a member of the foundation's supervisory board and received an annual lump sum remuneration of EUR 14,912. As such, he submitted a VAT return, which was subsequently contested.

In the appeal proceedings, the 's-Hertogenbosch Court (*Gerechtshof's-Hertogenbosch*) referred a preliminary ruling to the ECJ asking whether the member of a foundation's supervisory board qualifies as an entrepreneur carrying out an independent economic activity within the meaning of Articles 9 and 10 of the VAT Directive (EU) 2006/112 and was consequently subject to VAT. The ECJ confirmed that generally, the members of a foundation's supervisory board are on an independent mandate. The board member's role is to control the board's strategy as well as the foundation's routine business. As such, the members are not hierarchically subordinated to the supervisory or executive board of the foundation. Nonetheless, such activities must be carried out independently by the members, meaning that they cannot be subordinated to the foundation. For this purpose, the board members incur economic risks, act under their own name, on their own account and incur responsibility for any damage caused.

When carrying out his activities, IO however did not fulfil any of those conditions. He did not incur any economic risks as his annual income was neither dependent on his participation in regular meetings nor on a specific number of hours worked at the foundation. IO acted solely under the name and on the account and responsibility of the supervisory board and did not incur any responsibility for damages caused on his behalf. In doing so, IO did not have any particular influence on his own income or expenses. Furthermore, any negligence on behalf of IO did not automatically have, as a consequence, his resignation, but was subject to the commencement of a specific internal procedure. As such, the ECJ decided that IO, as member of the foundation's supervisory board, cannot be considered an entrepreneur independently carrying out an economic activity. Indeed, he was found to be in a subordinate relationship to the foundation due to not incurring any entrepreneurial risks himself. As a result, his remuneration should not have been subject to VAT.

INTERCOMPANY PAYMENTS FOR FUEL CARDS CONSTITUTES VAT EXEMPT FINANCING SERVICES

On 15 May 2019, the ECJ published its judgment in the *Vega International case* (C-235/18) confirming its previous judgment in *Auto Lease Holland* (C-185/01) relating to the VAT treatment of intercompany payments for the use of fuel cards.

The subsidiaries of Vega International transported commercial vehicles from the factories to the customer. The Austrian parent company (Vega International) provided fuel cards to its subsidiaries enabling them to refuel the vehicles they transported. Vega International received invoices from the fuel suppliers for the purchase of fuel with the applicable VAT. Subsequently, the parent company passed on those costs of the fuel supply with a surcharge of 2% to its subsidiaries.

The Polish tax authorities refused to refund the VAT to Vega International relating to the purchase of fuel in Poland arguing that the contract concluded with the Polish subsidiary did not constitute a supply of goods, but a contract to finance the fuel purchase, the latter of which does not allow for VAT reimbursement as financing activities are VAT exempt.

In the appeal proceedings, the Polish Supreme Administrative Court referred a question for preliminary ruling to the ECJ. It asked whether the concept of 'service granting credit' under Article 135(1)(b) of the VAT Directive (EU) 2016/112 includes transactions consisting in the provision of fuel cards by the parent company to its subsidiaries for the purchase of fuel or whether said provision of fuel cards should rather be qualified as a complex transaction the main objective of which is the supply of fuel and thus the supply of goods, in respect of which it is possible to recover VAT paid.

In its ruling, the ECJ confirmed its *Auto Lease Holland* decision of 2003 stating that the 'supply of goods' requires a transfer of the right to dispose of tangible property as its owner, meaning a right to decide how the goods will be used. The ECJ decided that Vega International does not own the purchased fuel as if it was the owner since the parent entity only acted as an intermediary providing the equipment (the fuel cards) to its subsidiary enabling it to purchase the fuel. Instead, the Polish subsidiary was considered to take all decisions regarding the purchase of fuel (quality, quantity, type of fuel) and bearing the costs connected thereto, rendering it the entity having the right to dispose of the fuel.

The surcharge of 2% imposed by Vega International was qualified as a payment for providing financing services entailing the advance payment of fuel for its Polish subsidiary, by which the parent acted as an ordinary credit institution. Intercompany payments for the use of fuel cards do thus not constitute a taxable supply of goods which would allow VAT reimbursement, but a financing service being VAT exempt.

LUXEMBOURG GOVERNMENT COUNCIL APPROVES TRANSPOSITION OF VAT 'QUICK FIXES'

On 24 May 2019, government ministers approved the filing of the draft law providing for a transposition of Directive (EU) 2018/1910 of 4 December 2018 regarding the harmonisation and simplification of certain rules in the value added tax system for the taxation of trade between Member States (the "**Directive**"). The draft legislation introduces changes to the common EU VAT regime. The changes foresee four 'quick fixes' to improve the functioning of the VAT rules:

- call-off stock: Transfers by a taxable person of goods forming part of his business assets to another Member State under call-off stock arrangements shall not be treated as a supply of goods for consideration. This new rule simplifies call-off stock operations as it does away with the inconvenient requirement that the supplier be identified for VAT purposes in the Member State of arrival of the goods.
- VAT identification number: To benefit from a VAT exemption for the intra-EU supply of goods, the VAT identification number of the customer will henceforth constitute a substantive condition, rather than only being a formal requirement.
- recapitulative statements: In addition to the VAT identification number, suppliers must submit a recapitulative statement to benefit from the VAT exemption for the intra-EU supply of goods. This recapitulative statement must identify the persons to whom the goods have been supplied. By way of exception, the exemption will apply despite the supplier's failure to submit recapitulative statements, if the supplier can duly justify his shortcoming to the satisfaction of the competent authorities.
- chain transactions: Where the same goods are supplied successively and those goods are dispatched or transported from one Member State to another Member State directly from the first supplier to the last customer in the chain, the dispatch or transport shall be ascribed only to the supply made to the intermediary operator.

These quick fixes are being introduced ahead of more wide-ranging reforms to the EU's VAT rules. In fact, the European Commission is aiming to create a 'definitive VAT regime' in which goods and services are taxed in the Member State of the recipient, rather than in Member State in which the supplier is situated. According to the European Commission, a reformed VAT regime would mitigate opportunities for VAT fraud.

Member States must transpose the Directive by 1 January 2020. With the Luxembourg Government Council having approved the filing of the draft law, it will soon be subject to vote by the Luxembourg Parliament.

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DECISION OF THE ECJ ON THE ADJUSTMENT OF THE VAT DEDUCTION IN CASE OF SALE AND LEASE BACK (*CESSION-BAIL*) AGREEMENTS

The case concerned Mydibel S.A., a Belgian VAT taxable person, that owned several buildings which it used exclusively for its economic activity and for which it deducted the input VAT paid for its construction in full. In 2009, Mydibel entered into sale and lease-back (*cession-bail*) agreements with two financial institutions. Under these agreements, the financial institutions became owners of the buildings while simultaneously granting Mydibel the use of the buildings for a non-revocable period of 15 years. Since these sale and lease-back transactions were not subject to VAT, the Belgian tax authorities considered that the initial deduction on the construction of the buildings should be adjusted. Mydibel brought an action before the Belgian courts, which in turn referred several questions to the ECJ for a preliminary ruling.

In its judgment, the ECJ first examined whether a sale and lease back transaction could be seen as a trigger for an adjustment of the initial deduction of input VAT. According to the VAT Directive, an adjustment must be made where, after the VAT return is made, some change occurs in the factors used to determine the amount to be deducted. The ECJ considers that this mechanism aims to establish a close and direct relationship between the right to deduct input VAT and the use of the goods or services concerned for taxable output transactions. In the present case, the ECJ considered that Mydibel continued to use the buildings for its activities subject to output VAT so that the relationship between the right to deduct input VAT and the use the goods for taxable output transactions had not been severed.

Secondly, the ECJ examined whether the sale and lease back transaction on the buildings could be covered by the specific rules for the adjustment of VAT deductions as regards capital goods. Under these rules, an adjustment of the initially deducted VAT must be made if the capital good is subject to a VAT exempt supply during the adjustment period (that can be up to 20 years for immovable capital goods). In this respect, the ECJ held that "the supply of goods" should not be understood as a transfer of ownership but rather as the transfer of the right to dispose of the property as an owner. In the present case, the ECJ found that, following the sale and lease back transaction, the financial institutions were not entitled to dispose of the buildings as if they were the owner. The ECJ concluded that Mydibel was not obliged to adjust VAT on buildings which was initially deducted.

In conclusion, the ECJ decision means that sale and lease back transactions can be carried out in VAT neutrality, in cases where these transactions are of a purely financial nature and designed to increase the taxpayer's liquidity, while the buildings at issue remain in the possession of the taxpayer, which continues to use them in an uninterrupted and permanent manner for the purposes of its taxable transactions.

JUDGMENT OF THE HIGHER ADMINISTRATIVE COURT ON THE APPLICABILITY OF ARTICLE 50bis LITL

On 4 June 2019, the Luxembourg Higher Administrative Court (*Cour Administrative*) handed down a judgment on the application of the intellectual property partial exemption regime.

In the case at hand, an individual resident taxpayer holds various patents, including the one at issue in the present litigation (the "**Patent**"). By virtue of a license agreement, the taxpayer made the Patent available to a Belgian company, of which he is also managing director and employee. At the same time, the taxpayer was also an employee and director of a Luxembourg resident company.

The tax issue arose as the taxpayer treated the income from the Patent as income from a self-employed activity benefiting from the 80% exemption, provided for in Article 50bis of the Luxembourg Income Tax Law ("**LITL**"). The tax administration however disagreed with the above treatment and qualified the income as royalties received for the concession of a patent, as it took the position that the patent formed part of the taxpayer's private fortune and not his professional assets maintained by virtue of the self-employed activity. Indeed, it held that being employed as a director would prevent the taxpayer from concurrently exercising a self-employed activity. Both the Director of tax authorities and the lower administrative court (*Tribunal Administratif*) confirmed the tax authorities' position.

In its judgment, the higher administrative court (*Cour Administrative*) reversed the lower administrative court's judgment in that it agreed that the taxpayer had validly exercised a self-employed activity as an inventor and the fact of being a director of the company that exploits the patent is not sufficient to affect the taxpayers independence, which constitutes one of the conditions to undertake a self-employed activity. As a result, the activities of inventor and employee/director can be separated and the patent in question was therefore deemed to be part of the inventor's professional assets, allowing the income derived from it to benefit from the 80% exemption provided for in Article 50bis of the LITL.

ECJ CLARIFIES RIGHT TO DEDUCT INPUT VAT ON MIXED EXPENSES

On 8 May 2019, the ECJ published a judgment (C-566/17 *Związek Gmin Zagłębia Miedziowego w Polkowicach* v *Szef Krajowej Administracji Skarbowej*) clarifying the extent of the right to deduct input Value Added Tax ("**VAT**") incurred on supplies used indissociably for the purpose of economic and non-economic activities. In the case at hand, Polish case law allowed taxable persons, in this instance a local government entity, to fully deduct input VAT in respect of supplies used indissociably both for the purpose of the local government entity's economic and non-economic activities. Polish law at the time did not provide for any rules setting out the methods to apportion input VAT in case of a taxable person engaging in activities falling within the scope of VAT and activities outside the scope of VAT. Following a request for a tax ruling, the Polish tax authority refused to confirm the full deductibility of the input VAT. The local government entity argued that the absence of national laws setting out the apportioning methods for deducting input VAT meant it had the right to deduct in full input VAT incurred on supplies although it performed taxable and exempt activities. Further, according to the local government entity, to hold contrary would run counter to the principle of legality enshrined in the constitutional order of many Member States, including Poland.

First of all, regarding the right to deduct input VAT, the ECJ held that article 168 of the Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "**VAT Directive**") clearly provides that the right to deduct arises only in so far as the goods and services are used for the purpose of taxable transactions. Indeed, the right to deduct input VAT on goods and services applies only when and to the extent that the goods and services are subsequently used for taxable transactions. Thus, the ECJheld that recognising a right to a full deduction in the case at hand, where the goods and services had been used for both economic and non-economic transactions, would be contrary to the basic principles of the EU VAT system.

Second, the ECJ held that the principle of fiscal legality may be considered as a general principle of EU law requiring that the essential elements of the tax be defined in law. In other words, the taxpayer should be able to, based on the law, calculate the amount of tax and determine when it will be due. The ECJ took

the view that Article 168 of the VAT Directive, as implemented into domestic law in the case at hand, defined with sufficient certainty the essential elements of the right to deduct input VAT (i.e. when the right may arise and its scope). As a result, the obligation on the taxpayer to apportion his input VAT incurred on supplies between his economic and non-economic activities is not, even in the absence of national laws precisely determining the technicalities relating to said apportionment, contrary to the principle of legality.

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