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The Single Supervisory Mechanism – Next step towards the Banking Union

On 4 November 2014 the European Central Bank (the "**ECB**") will become the single supervisor of all the banking sector in the Eurozone in the framework of the Single Supervisory Mechanism (the "**SSM**") as part of the Banking Union (the "**Banking Union**").

1. Background – the Banking Union

The Banking Union was launched in June 2012 by a decision of the Euro Area Heads of State or Government after the financial crisis had turned into a sovereign debt crisis of the Eurozone in 2010/11.

The Banking Union's core objective is to break the vicious circle between banks and sovereign debt. As banks are required to maintain higher capital reserves and liquidity, it will make them more robust and reinforce their capability to manage risks. In case a bank fails nevertheless, it will be recovered by a process on European level and not bailed out by the relevant state government. This avoids a weakening of the relevant government's fiscal position, and so avoiding an increase of refinancing costs further weakening the bank and enhancing the crisis.

The Banking Union is composed of the following three pillars:

Single Rulebook

The single rulebook is the foundation of the Banking Union and consists of a collection of legislative texts setting down requirements for all the financial institutions in the EU focusing on capital requirements for banks, depositors' protection and compensation and prevention and management of bank failures.

Single Supervision

The SSM is conceived as a truly European supervision mechanism with the ECB taking over the role of a centralized supervisor for large credit institutions and coordinating the overall supervision, allowing for a more efficient control of the banks' compliance with EU banking requirements.

Single Resolution

A single resolutions mechanism is foreseen for the rare cases where a bank fails despite the stronger capital and liquidity requirements and stronger supervision (the "**Single Resolution Mechanism**"). There are clear rules for decision-making which will allow for an effectively managed and rapid resolution of such failing bank. The single resolution fund will be financed by the banking sector itself.

As the next step towards the Banking Union will be the implementation of the SSM in November 2014 the following overview focuses on the functioning of the SSM.

2. The scope of the SSM

2.1. Purpose

The core objective of the SSM is to strengthen financial supervision through a centralized supervisory system by reducing financial connections and interdependencies between state governments and banks.

The financial crisis has shown how fast problems of one state can spread to another and to what extent the financial problems can have a direct impact on the citizens throughout the Eurozone. These problems shall be reduced by the implementation of a centralized supervisory mechanism on European level restoring trust and confidence in the European banking sector.

2.2. Legal Framework

On 15 October 2013 Council Regulation 1024/2013 (the "**SSM Regulation**") has entered into force specifying the tasks of the ECB for its role as single supervisor as from 4 November 2014.

On 15 May 2014 the Regulation 468/2014 of the ECB (the "**SSM Framework Regulation**") has entered into force, establishing the framework for cooperation within the SSM between the ECB and national authorities.

2.3. Covered credit institutions

All credit institutions of the Eurozone shall be covered by the SSM. The ECB will directly supervise the largest banks and the national supervisory authorities will remain in charge of monitoring the smaller banks. The ECB and the national authorities will work in close cooperation to monitor compliance with EU banking rules, especially the single rulebook while the ECB remains in charge of the overall control and coordination of the supervision. A list of "significant supervised entities" and "less significant institutions" has been published on the website of the ECB in September.

Not only banks from the Eurozone will be supervised by the ECB; other Member States of the EU that are not members of the Eurozone can adhere to the supervision of the ECB on an optional basis (together with the Eurozone Member States the "**Participating Member States**").

2.4. Comprehensive assessment

In order for the ECB to assess the balance sheets of the significant banks and identify the need of potential corrective actions, the ECB is currently conducting comprehensive stress tests of those banks (the "**Stress Tests**").

The Stress Tests cover approximately 85% of the bank assets of 131 banks in the Eurozone and are performed in close cooperation with the national competent authorities.

In order to allow for a real comprehensive assessment, the Stress Tests are a combined assessments consisting of

- Asset Quality Review: The banks' assets and collateral are examined and a check is carried out to assess whether the assets are sufficiently adequate and sound for the business of the banks; and

- Stress Tests: The Stress Tests in the proper sense consist in an examination of how the banks would react to specific "stress" scenarios.

The criteria for the assessment are credit risk, market risk, securitisations held in the portfolio, net interest income and other pre-provision profit.

3. Organization of supervision and tasks of the ECB

3.1. Tasks of the ECB

The ECB will be responsible for the direct supervision of banks holding assets of a value of more than 30 billion Euros or constituting at least 20% of the national gross domestic product and will assume specific tasks relating to the prudential supervision of these credit institutions.

The tasks of the ECB are specified in the SSM Regulation as follows:

- Authorisation of credit institutions and withdrawal of authorisations: validating or objecting provisionally approved applications by the national competent authorities;

- Carrying out the tasks of the competent national authority for the establishment of a branch or provision of cross border services by a credit institution;

- Assessment of notifications of acquisitions and disposal of qualifying holdings: validating or objecting a proposal decision by the national competent authorities;

- Ensure compliance with prudential requirements, such as own funds requirements, securitisation, liquidity and reporting;

- Ensure compliance with requirements for robust governance arrangements, such as risk management

processes, internal control mechanisms, and internal capital adequacy assessment of credit institutions;

- Supervisory reviews of the arrangements, strategies, processes and mechanisms put in place to ensure a sound management and coverage of the risks of the credit institution;

- Supervision of parent companies of credit institutions on a consolidated basis and contribution to supervision of parent companies outside the Participating Member States;

- Participating in the supplementary supervision and coordination of supervision of the credit institutions included in a financial conglomerate; and

- Carrying out supervisory tasks in relation to recovery plans.

Moreover, the ECB will carry out supervisory tasks in relation to the establishment of a branch or provision of cross border services by a credit institutions established in a non-participating Member State, i.e. an EU Member State outside the Eurozone and not participating on a voluntary basis (the "**Non-Participating Member State**").

3.2. Cooperation and Internal Organisation

In carrying out its activities, the ECB will closely cooperate with other authorities both at the EU level and at the national level to ensure consistency of the supervision. At EU level, the ECB will cooperate with entities such as the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). At national level, the ECB will conclude memoranda of understanding with both authorities of Participating Member States and with Non-Participating Member States setting out how they will cooperate with one another.

As regards the internal organizational requirements of the ECB, it will carry out its supervisory tasks in operational separation from its monetary policy tasks and will establish a separate budget line for its supervisory tasks in order to avoid any potential conflict of interest between monetary policy and supervision.

The ECB will be independent in carrying out its supervisory activities, but will be accountable to the European Parliament and subject to regular reporting requirements in order to ensure that it uses its supervisory powers within the boundaries set out in the treaty of the EU

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Latest updates and developments in investment management

CSSF Circular 14/591: Protection of investors in case of a material change to an open-ended undertaking for collective investment

Background

According to a long-standing supervisory practice, the *Commission de Surveillance du Secteur Financier* (the "**CSSF**") requires that, in the event of a material change to investors' interests in an open-ended undertaking for collective investment ("**UCI**") governed by the amended Law of 17 December 2010 relating to UCIs (the "**2010 Law**"), sufficient time be provided for investors to make an informed decision on the envisaged change and, as the case may be, to redeem or convert their holdings free of charge. CSSF Circular 14/591 was issued on 22 July 2014 to formalise this administrative practice and to set forth relevant clarifications in writing.

As prescribed by the 2010 Law, the prospectus of a UCI shall include the information necessary for investors to be able to make an informed judgment of the investment proposed to them. In case of a "material" change (i.e. potentially affecting the investors' interests and impacting the basis on which their existing investment has been made), the CSSF shall assess whether additional measures should be taken to ensure investor protection.

Process

When considering a material change to its structure, organisation or operations, a UCI should examine whether there is "substantial likelihood" that an existing investor would reconsider his/her investment(s) in light of the envisaged change. Before the relevant change becomes effective, the UCI should therefore analyse the impact it may have on current investors (i.e. by comparing their interests/situation before and after the implementation of such change) and submit the proposed change along with appropriate explanations to the CSSF for prior approval.

The CSSF will then determine on a case-by-case basis whether this change should be deemed material and, where appropriate, request that notification be given to investors. According to CSSF's current administrative practice, a minimum notification period of one month should apply before a material change becomes effective. During such notification period, investors have the right to request the redemption, repurchase and/or conversion (if this option is offered by the UCI) of their shares/units free of charge.

Based on a duly supported request for derogation, the CSSF may however agree to waive this notification period along with the possibility for investors to freely redeem or convert their holdings (e.g. if all investors in a given UCI agree to the contemplated change). In the same vein, the CSSF may agree to impose a notification period for informational purposes only but without offering investors the right of free redemption or conversion.

Entry into force

CSSF Circular 14/591 is immediately applicable as from the date of its publication.

CSSF Circular 14/592: Implementation of revised ESMA's guidelines on ETFs and other UCITS issues

Background

On 18 December 2012, the European Securities and Markets Authority ("**ESMA**") published the guidelines on ETFs and other UCITS issues (ref. ESMA/2012/832) (the "**Original Guidelines**") which applied as from 18 February 2013 following their publication on ESMA's website. The transitional provisions of the Original Guidelines ceased to have effect on 18 February 2014. On 24 March 2014, ESMA issued its Final report containing revised collateral diversification rules (i.e. amendments to Paragraphs 43(e) and 48 of the Original Guidelines) in the context of efficient portfolio management ("**EPM**") techniques and over-the-counter ("**OTC**") financial derivatives transactions. The revised ESMA's guidelines on ETFs and other UCITS issues (ref. ESMA/2014/937) (the "**Revised Guidelines**") were published on ESMA's website on 1 August 2014. Following such publication, the CSSF issued Circular 14/592 dated 30 September 2014 ("**CSSF Circular 14/592**") to implement the Revised Guidelines in Luxembourg.

Requirements

Subject to certain requirements being met, the Revised Guidelines introduce greater flexibility in the use of EPM techniques and OTC transactions by allowing an undertaking for collective investment in transferable securities ("**UCITS**") to be fully collateralised in transferable securities and money market instruments issued or guaranteed by a Member State, one or more of its local authorities, a third country, or a public international body to which one or more Member States belong. In terms of diversification, such a UCITS should receive securities from at least six different sovereign issues, provided that securities from any single issue do not account for more than 30% of the UCITS' net asset value.

CSSF Circular 14/592 reiterates that a UCITS intending to use such derogation shall provide adequate transparency in its prospectus and annual report. The CSSF also stresses that the transferable securities and money market instruments received as collateral should be of "high quality" and sufficient liquidity so as to reduce the counterparty risk exposure of UCITS in the framework of EPM techniques and OTC transactions.

As a general principle, the CSSF further reminds UCITS management companies, as well as self-managed SICAVs, that the risks related to collateral management should be identified, managed and mitigated as part of their risk management process (in compliance with CSSF Regulation 10-4 and CSSF Circular 11/512).

Entry into force

CSSF Circular 14/592 implementing the Revised Guidelines entered into force on 1 October 2014 (the "**Application Date**"). As from such date, the transitional provisions set out in Paragraphs 71 and 72 of the Revised Guidelines shall apply as follows:

UCITS that exist before the Application Date are not required to comply with the requirements relating to prospectus transparency on collateral diversification until the earlier of: (i) the first occasion after the Application Date on which their prospectus (having been revised or replaced for another purpose) is published, and (ii) twelve months after the Application Date;

Requirements to publish the relevant information in the report and account of an existing UCITS do not apply in respect of any accounting period that has ended before the Application Date.

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Law dated 16 July 2014 on the immobilisation of shares and corporate units issued in bearer form and on the maintaining of the register of shareholders and of the register of bearer shares

Please be informed that the draft law n°6625 on the immobilisation of shares and corporate units issued in bearer form has been adopted by the Chamber of Deputies on 16 July 2014 (the "**Immobilisation Law**"), published in the Luxembourg official gazette (the *Mémorial*) on 14 August 2014 and entered into force on 18 August 2014 (the "**Effective Date**").

4. Purpose of the Immobilisation Law

The Immobilisation Law provides that the management of companies having issued shares in bearer form shall appoint a professional custodian who will keep a register of bearer shares which must contain the information necessary for the identification of the holders of such bearer shares and record every transfer thereof. The certificates representing the bearer shares will have to be physically handed to this custodian.

5. Entities submitted to the Immobilisation Law

This law applies to:

- public limited liability companies ("*sociétés anonymes*" or "S.A.");
- partnerships limited by shares ("*sociétés en commandite par actions*" or "S.C.A."); and
- the management companies of mutual investment funds (i.e. SICAV, SICAF, SICAR, FIS and FCP) which are admitted to issue bearer shares or units which are not listed on a regulated market.

6. Custodians

The management of companies submitted to the Immobilisation Law shall appoint one of the below professionals as custodian for the registration of their bearer shares:

- credit institutions;
- private portfolio managers;
- distributors of units/shares in UCIs

professionals of the financial sector authorised as Family Office, corporate domiciliation agents, professionals providing company incorporation and management services, registrar agents or professional depositaries of financial instruments;

- lawyers registered with the Luxembourg Bar on list I or IV;
- notaries public;
- independent auditors; and
- chartered accountants.

The custodian has to be based in Luxembourg and must not be a shareholder of the company having issued the bearer shares.

7. Register of bearer shares

The register of bearer shares shall, at least, indicate (i) the precise designation of each shareholder with the number of his/her/its shares, (ii) the date of deposit of the bearer shares and (iii) any transfers of those shares with their date or the conversion of such bearer shares in registered shares, if ever converted.

In comparison with the former regime, any transfer of bearer shares becomes effective as from its registration in the bearer shares register (and no longer by the transfer of the physical certificate) and any pledge over the bearer shares shall be recorded in this register.

8. Transitional period

Companies having issued bearer shares prior to the entry into force of the Immobilisation Law will benefit from a period of 6 months from the Effective Date to appoint a custodian and the holders of the bearer shares issued by such companies will have to hand their bearer shares certificates to the custodian so appointed within this 6 months period. After this period they will have to face the sanctions described below.

9. Sanctions

The holders of bearer shares who would fail to hand their bearer shares certificates to the custodian so appointed after the said 6 months period will be deprived of their voting rights. Should they still not comply with this obligation after 18 months from the Effective Date, the latter will see their shares cancelled and will only perceive, as compensation for the cancellation of their shares, a price equal to the proportion represented by those shares in the shareholders' equity of the issuing company decreased by the costs incurred by the share capital decrease.

The managers/directors who would fail to comply with their obligation to appoint a custodian within the aforesaid 6 months period will be subject to a fine comprised between EUR 5,000.- and EUR 125,000.-.

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The Luxembourg freeport – how it works

On 17 September 2014, Luxembourg has inaugurated its Freeport which is equipped with state-of-the-art technologies and which boasts 22.000 square meters of storage area dedicated to warehousing a broad range of high-value goods such as artworks, wine, gems, precious metals, etc.

The Freeport aims to attract a broad range of customers such as collectors, high-net-worth individuals, or investment funds (to name a few), which may store their goods through a range of licensed operators working under the supervision of the Customs Department of the Luxembourg Customs and Excise Agency, which is itself physically present at the Freeport.

The Freeport's infrastructure was conceived as a "one-stop-shop" and hosts a number of specialized professionals who offer a wide range of value adding services such as the handling of customs formalities, crating, shipping, framing, cataloging, restoration, valuation, insurance, etc. The Freeport's premises include a lobby and private show-rooms which are available for exhibitions and even a scientific laboratory.

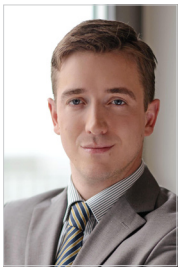
In order to operate, the service providers, as well as the operators, must obtain a business license from the Luxembourg Ministry of Middle Classes, which exercises *a priori* control over their professional integrity and qualification.

The operators have the exclusive right to handle storage area; they must comply with Luxembourg anti-money laundering legislation, keep detailed inventories and ensure the traceability of the goods stored at the Freeport at any time. In order to be licensed as service provider, the applicant must be VAT registered in Luxembourg and established in Luxembourg. In addition, these operators are required to keep ATA carnets for the goods stored within the Freeport. These carnets are international customs documents that can be used for the VAT-free and duty-free exportation of goods to foreign countries that accept carnets, provided that those goods are returned to the Freeport within a certain period depending on the country of destination but not exceeding a year.

The Freeport further enables the importation of non-EU goods under a regime of customs duties and VAT suspension. This regime continues to apply for the sale and acquisition of the goods, for as long as they are stored within the Freeport. Value-adding services rendered with respect to the goods

while in storage (including storage charges) are exempt from VAT. Through the use of ATA carnets, artworks can be lent to museums or art galleries without incurring custom duties or VAT, which leads to increased visibility and thereby value. No custom duties or VAT will become due should the goods be re-exported outside the EU. VAT and customs duties will only become applicable and due by the last owner of the goods if the goods exit the Freeport to be introduced into an EU member country.

Henceforth, the Freeport offers a wide range of new opportunities to high-value goods dealers, specialized funds, foundations, museums, family offices and private collectors.



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