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Annual accounts of a Luxembourg company: Key legal requirements, recent updates and potential penalties in case of non-compliance

Luxembourg law of 18 December 2015 implementing Directive 2014/59/EU on bank recovery and resolution and Directive 2014/49/EU on deposit guarantee schemes

Luxembourg Developments in Investment Management

A better work-life balance: The Parental Leave Reform

Newsletter Q4 2015

Annual accounts of a Luxembourg company: Key legal requirements, recent updates and potential penalties in case of non-compliance

The beginning of 2016 is the time to address New Year's greetings. It also marks, for companies closing their financial year on December 31st, 2015, the beginning of the process of preparation and approval of the annual accounts.

We take this opportunity to briefly recap (1) this process, (2) the recent amendments of the applicable laws in this field, and (3) the potential penalties in case of non-compliance with this process.

1. Approval and filing process of the annual accounts

The principal applicable laws on this matter are the law of 10 August 1915 on commercial companies, as amended (the "**Company Law**"), and the law of 19 December 2002 relating to the Trade and Companies Register and annual accounts, as amended (the "**RCS Law**").

Step 1: Preparation of the annual accounts

- The management body of the company first has to prepare the annual accounts, and to liaise with its accountant (if any) in this respect.

Step 2: Preparation of the management report

- The management report (through which the directors have to explain and present the prepared annual accounts) is (in principle) required only for companies which fulfil at least two of the three following thresholds in two consecutive financial years (the "**Thresholds**"):
  - Total balance sheet of EUR 4.4M;
  - Total turnover of EUR 8.8M;
  - Average number of 50 full-time employees.
- A SOPARFI company (*i.e.* having a pure holding activity) is thus generally not required to produce such a management report.

Step 3: Supervision of the annual accounts

- The qualification of the individual person or entity in charge of the control of the annual accounts may vary from one company to another:
  - The appointment of a statutory auditor (*commissaire(s) aux comptes*) in a public limited liability company (*société anonyme,* "**S.A.**"), or of a supervisory board (*conseil de surveillance*) in a partnership limited by shares (*société en commandite par actions* "**S.C.A.**") is in principle mandatory, but not (some exceptions exist) in a private limited liablity company (*société à responsabilité limitée*);
  - A Luxembourg company may have to appoint an independent expert auditor (*réviseur d'entreprises agréé*, "**RE**"). It is the case when it fulfils the Thresholds. The requirement of a statutory auditor (or supervisory board) is then no longer needed. The RE may also be appointed on a voluntary basis;
  - Specific conditions of professional qualification, honourability and the registration with the CSSF (*Commission de Surveillance du Secteur Financier*) must be fulfilled to obtain the title of RE, while no specific qualifications are required in order to be appointed as a statutory auditor or a member of a supervisory board. Unlike the RE, the statutory auditor and the supervisory board are corporate bodies of the companies.
- After having communicated its/his conclusions to the management body, the statutory auditor or the RE has to prepare a specific report, following the performance of its/his duties of control of the accounts. The report has to be made available to the shareholders (please see below).

Step 4: Relevant documentation to be made available to the shareholders

- The draft annual accounts and related documentation (including the statutory auditor's or the RE's report) have to be made available to the shareholders at the registered office of the company for a period of at least 15 days before the annual general meeting of the shareholders on the annual accounts (the "**AGM**").
- Upon request, the shareholders may receive copies of these documents.

Step 5: Convening and holding of the annual meeting of the shareholders

- The management body then has to convene the shareholders to the AGM.
- The AGM has to be held within a six month period following the end of the company's financial year.
- The AGM has generally to make a decision on the following matters:
  - Approval of the accounts;
  - Decision of allocation of the results;
  - Granting of a discharge for their duties during the financial year to the members of (i) the management body and (ii) the statutory auditor (if any).
- The decision of the AGM is in principle approved at a simple majority.

Step 6: Filing

- Once the annual accounts are approved, the management body has to proceed to the filing within a month following the date of the AGM. It consists in:
  - Filing the approved accounts with the Trade and Companies Register (the "**RCS**");
  - Publishing by extract the decision of approval to the Luxembourg official gazette (*Mémorial C*).

Points requiring specific attention

- *The **distribution of dividends** is not possible when the net assets of the company would become, following such distribution, lower than the amount of the subscribed share capital plus non distributable reserves.*
- *Specific rules are applicable in case where a S.A. (or S.C.A.) would suffer **losses exceeding 50 % of its share capital**. Directors must then insert an item in the agenda of the meeting of the shareholders, in order for them to decide on the continuation or winding-up of the company, in the presence of at least 50 % of the share capital, by a two third majority vote. In case of losses exceeding 75 % of the share capital, the same rules shall be observed except that the decision to wind-up the company may be approved by only one fourth of the voting cast. Directors may be declared personally and jointly liable toward the company if they do not comply with the above provisions.*
- *A company is required to prepare **consolidated annual accounts** (and related consolidated management report) if it (i) has a majority of the shareholders' or members voting rights in another undertaking, (ii) has the right to appoint or remove a majority of the members of the management body of this undertaking; or (iii) is a shareholder of this undertaking which controls alone a majority of its shareholders' rights. The scope of requirement of consolidated accounts has been recently amended (please see below).*

2. Recent update of the provisions applicable to the annual and consolidated accounts

- The new law of 18 December 2015 on annual accounts and consolidated accounts (the "**Accounting Law**") transposes the provisions of the accounting directive 2013/34/EU.
- It is applicable since 1st January 2016 and only impacts the preparation of the accounts of financial years starting on or after this date.
- It fully restates the applicable rules to annual and consolidated accounts, including the structure and contents of the balance sheet, profit and losses accounts and notes to the accounts, for the purpose of harmonization in the EU.

Your accountant officer or RE will have to advise you and to consider these amendments in the preparation of the accounting documentation of the next financial year.

- From a legal standpoint, two aspects of the Accounting Law (among others amendments) came particularly to our attention:

  - A new obligation has been introduced for small-sized entities (*i.e.* companies below the Thresholds defined above) to disclose information concerning the subsidiary companies in which they hold at least 20 % of the share capital, when such participation is considered as significant (in accordance with the principle of true and fair view of the annual accounts).

  - Thresholds to differentiate middle size and large size companies have been increased which has an impact on the scope of requirement to prepare consolidated accounts. Companies below the thresholds are in principle exempted from preparing consolidated accounts. From now on, the thresholds will be as follows:

    - Total balance sheet of EUR 20M;
    - Total turnover of EUR 40M;
    - Average number of 250 full-time employees.

3. Potential penalties in case of non-compliance with the approval of annual accounts process

3.1. Potential liability of the directors

- Civil liability

  - As the obligation to approve, deposit and publish the accounts on time is provided by the Company Law, the failure (or the delay) of the directors to fulfil their duties in this respect is considered as a breach of law and may trigger their civil liability;

  - The directors are in principle jointly and severally liable for such a breach, towards both the company (represented by the meeting of the shareholders deciding at a simple majority) and any third parties having suffered a prejudice.

- Criminal liability

  - In addition to civil liability, failure by the directors to submit the accounts for approval within the six month period carries a potential fine penalty (payable by each of the directors);

  - A potential fine as well as a prison sentence may also be incurred if the directors fail, with fraudulent intent, to publish the annual or consolidated accounts (or other related documents).

3.2. Potential judicial dissolution of the company

- The Luxembourg Public Prosecutor is entitled to introduce a dissolution proceeding against a company which fails to approve or file its annual accounts on time, since such failure is considered as a serious breach of law.

- Proceedings of judicial dissolution generally concern companies which have not approved nor filed their annual accounts on several financial years.

Point requiring specific attention

- *After the introduction of the petition by the Public Prosecutor, the **possibility to avoid the judicial dissolution** shall be discussed before the Court (even if in the meantime the company has regularized its situation and has approved and filed all its annual accounts).*

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Luxembourg law of 18 December 2015 implementing Directive 2014/59/EU on bank recovery and resolution and Directive 2014/49/EU on deposit guarantee schemes

In the last quarter of 2015, Luxembourg implemented Directive 2014/59/EU of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investments firms ("**BRRD**") and Directive 2014/49/EU of 16 April 2014 on deposit guarantee schemes ("**DGSD**" and together with BRRD, the "**Directives**") by way of adopting the law of 18 December 2015 on resolution, recovery and liquidation measures of credit institutions and some investment firms, on deposit guarantee schemes and indemnification of investors (the "**Law**") which is divided into three parts followed by a final part regrouping amending provisions.

Before considering the scope and the content of the Law, a quick overview of the context of the Law seems to be appropriate.

The Background

The financial crisis which emerged in 2007 made it clear that the regulation and supervision of bank activities needed to be harmonised across the European Union (the "**EU**"). The crisis revealed in particular a misjudgment of risks by the banking sector and hence, in 2012, the European Council agreed to "*break the vicious circle between banks and sovereigns*". One of the EU's responses to correct previous loopholes was to establish the so-called Banking Union.

The Banking Union is based on three pillars. The first pillar on single supervisory mechanism in relation to policies relating to the prudential supervision of credit institutions has already been implemented through the Luxembourg law of 23 July 2015 by transposing into Luxembourg law the Capital Requirements Directive (CRD IV).

Consecutively, the second pillar of the Banking Union on the bank failure management system, called the single resolution mechanism, has now been implemented by the Law transposing the BRRD and the third pillar relating to the deposit guarantee schemes has also been implemented through the Law by the transposition of the DGSD into Luxembourg law.

The financial crisis has shown the need to strengthen the crisis management mechanisms at national level and to set up mechanisms to better manage the failures of pan-European banking groups. Therefore, the Law aims to fill the gaps identified during the last financial crisis through the implementation of the Directives which are arising from the Banking Union's context.

Part I of the Law – Resolution Framework

1. Objectives

The first part governs the resolution of credit institutions and certain investment firms. The resolution is an administrative measure that aims to restructure "gone concern" banks experiencing serious financial difficulties to ensure the continuity of its core activities (i.e. activities relating to deposits or credits) and to avoid any systemic impact.

2. Key provisions

2.1. Resolution planning

The Law distinguishes three stages in the bank recovery and resolution: (i) preparation and prevention, (ii) early intervention and (iii) the resolution tools.

Resolution takes place if the preventive and early intervention measures fail to prevent a further decline of a situation to the point that the bank could default or threaten to default. If it turns out that no further action would avoid the failure of the bank and if the public interest justifies it, the resolution authority will take the control of the financial institution and will agree on the implementation of specific resolution measures.

2.2. Resolution tools

The Law foresees the following resolution tools:

i. Disposal of activities (part or all) of the failing bank by the competent authority without shareholder consent;

ii. Implementation of a "bridge bank" (identification of good assets and essential functions and segregation to create a new bank. Toxic assets and non-core functions are then liquidated under normal insolvency proceedings);

iii. An asset segregation allowing a transfer of toxic assets to a "bad bank"; and

iv. A "bail-in" permitting the recapitalization of the failing bank by cancelling or diluting shares and reducing debts by converting into shares.

The Law creates also a Luxembourg resolution fund (*Fonds de Résolution Luxembourg*) which will finance the implementation of resolution tools, which may be used to, among others, guarantee the assets and liabilities of a credit institution or an investment firm under resolution, make contribution to a bridge institution or pay compensation to shareholders or creditors.

2.3. Luxembourg resolution authority

The CSSF (*Commission de Surveillance du Secteur Financier*) is designated as resolution authority for Luxembourg, with a distinct department within the CSSF, namely "*conseil de resolution*", which will assume the resolution functions.

If needed, the CSSF will collaborate with the European Central Bank and the Luxembourg Ministry of Finance to exercise its resolution powers.

Part II of the Law – Reorganisation and winding up

This second part of the Law gathers the actions regarding the reorganisation and winding-up of credit institutions, investment firms and other professionals of the financial sector managing third parties funds and abrogates part IV of the Luxembourg law of 5 April 1993 on the financial sector (the "**Financial Sector Law**") in order to comply with the provisions of the BRRD.

The Part II of the Law covers the following topics:

- Suspension of payments;
- Voluntary liquidation and judicial liquidation;
- Bankruptcy;
- Withdrawal of authorization and information of creditors following a liquidation procedure;
- Effects on contracts and legal rights following a liquidation procedure; and
- Offsetting procedures.

Part III of the Law – Protection of depositors and investors

The third part of the Law implements notably the provisions of the DGSD in Luxembourg law with the aim to better protect the depositors and investors and to shorten the delay for compensation of depositors.

1. Fonds de Garantie des Dépôts Luxembourg

The Law creates a new public deposit guarantee system under the name of *Fonds de Garantie des Dépôts Luxembourg* (the "**FGDL**") which replaces *Association pour la Garantie des Dépôts Luxembourg*, a funded system governed by a private association of local banks.

The FGDL is covering all eligible deposits for each depositor up to a total amount of EUR 100,000. It should be noted that, deposits are covered per depositor per bank, the limit of EUR 100,000 applies to all aggregated accounts at the same bank. However, some deposits are excluded from the scope of the Law, such as interbank deposits, insurance deposits, UCI's deposits, etc.

Moreover, the reimbursement period for depositors will be reduced from 20 business days to 7 business days.

In terms of financing, the FGDL will in a first stage be funded with contributions of 0,8 % of the total guaranteed deposits no later than 31 December 2018. Thereafter, the institutions will contribute to an additional buffer of 0,8 % of covered deposits within a period of 8 years. It is agreed that the additional buffer will not be included in the mutual European deposit guarantee fund which will be implemented under the third pillar on deposit guarantee schemes of the Banking Union.

2. Système d'Indemnisation des Investisseurs Luxembourg

The Law sets up a new compensation scheme for investors, namely *Système d'indemnisation des investisseurs Luxembourg* (the "**SIIL**"). This system protects investors in Luxembourg credit institutions and investment firms, Luxembourg branches of credit institutions and investment firms having their registered office in a third country.

The SIIL will be financed by ex-post contributions and will cover all investment transactions for each investor up to a total amount of EUR 20,000. However, the Law excludes a list of assets from the protection, such as the receivables of UCIs, insurance companies, pension and retirement funds, etc.

With regard to the repayment deadlines, the investors shall be reimbursed no later than 3 months after the agreement on the eligibility and the amount of debt.

3. Other specific protections

It is worth noting that a high level of protection will be insured to depositors in specific personal circumstances. Depositors will be protected for up to EUR 2.5 million for a period of one year starting from the moment on when the deposits have been made, in case of, for instance, an inheritance, an arrangement due to a divorce or the sale of a building.

Part IV of the Law – Amending, transitional and final provisions

The fourth and final part of the Law amends the Financial Sector Law so as to introduce the BRRD provisions on recovery. These provisions apply to credit institutions, some investment firms and some financial holding companies which will be required to draw up recovery plans and to take steps to better manage recovery. The Law also provides for exemptions and simplified obligations for specific cases.

Moreover, this part of the Law defines the new governance structure of the CSSF, as described above, by inserting it into the law of 23 December 1998 establishing a supervision commission of the financial sector for Luxembourg and the early intervention measures to be implemented by the CSSF (changing management, convening shareholders, appointment of temporary administrators, etc.).

Finally, the Law is a further step in the implementation of the Banking Union which aims to prevent and better manage an eventual financial crisis, by providing for a stronger legal framework for the recovery and resolution for failing or likely fail bank or institutions.

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Luxembourg Developments in Investment Management

I. Reserved Alternative Investment Funds

1. Background

On 14 December 2015, the bill of law introducing a new type of alternative investment fund ("**AIF**") in Luxembourg, the *fonds d'investissement alternatif réservé* (i.e. "reserved alternative investment fund" or "**RAIF**") was submitted to the Luxembourg Parliament and published on its website (the "**Bill**").

The RAIF has the same essential characteristics as the Luxembourg specialised investment fund (the "**SIF**") but will neither be subject to the prior authorisation, nor the ongoing supervision of the *Commission de Surveillance du Secteur Financier* (the "**CSSF**").

In terms of investor protection, the RAIF will have to appoint a duly authorised alternative investment fund manager ("**AIFM**") in Luxembourg or in another EU Member State and will therefore be subject to indirect regulatory supervision, as the AIFM shall be responsible for ensuring that the RAIF under its management complies with applicable product rules. In addition, it will benefit from the European marketing passport.

2. Characteristics

- Similarly to the SIF, the RAIF will be restricted to well-informed investors, meaning institutional investors, professional investors and other investors meeting certain conditions;
- As for SIFs, the Bill does not set out any particular investment rules or minimum diversification requirements for RAIFs and thus CSSF Circular 07/309 regarding risk-spreading in the context of SIF may come to be applied. Consequently, a RAIF could in principle not invest more than 30 % of its assets in securities of the same type issued by the same issuer. Should the RAIF however restrict its investment policy to only invest in qualifying risk capital investments, like a *société d'investissement en capital à risque* ("**SICAR**"), the principle of risk spreading shall not be applicable;
- The RAIF will be subject to the same taxation as the SIF, meaning an annual subscription tax rate of 0.01 % to be levied on the net assets, or alternatively, if the RAIF only invests in qualifying risk capital investments, to the same taxation as the SICAR;
- The structures available for a RAIF are similar to the ones offered under the SIF regime and it may thus be established as either a common fund or as an investment company with variable or fixed capital. The RAIF may also be set up as a single compartment or umbrella fund structure.

Existing regulated funds such as SIFs, as well as unregulated structures or partnerships, may be able to convert into a RAIF, and conversely a RAIF may opt for a regulated regime (e.g. SIF, Part II fund, SICAR) subject to relevant regulatory approvals.

3. Next Steps

The Bill is currently being reviewed by the *Conseil d'Etat* and is expected to enter into force during the second quarter of 2016.

II. CSSF FAQs on UCITS

1. Background

On 8 December 2015, the CSSF published a first version of Frequently Asked Questions (the "**FAQs**") on the Law of 17 December 2010 relating to undertakings for collective investment (the **UCI Law**"). The questions addressed in the FAQs consolidate the existing CSSF practice as regards eligible assets and diversification rules applicable to undertakings for collective investment in transferable securities ("**UCITS**").

2. Eligible Assets

- The CSSF clarified that a UCITS may invest into certain SIFs, SICARs and other regulated open-ended funds provided that such funds comply with Articles 2(2) and 41(1) e) of the UCI Law. In particular, it is important to note that

SIFs and SICARs must also qualify as AIFs in order to be eligible investments.

- Subject to Article 41(1) of the UCI Law, a UCITS may trade transferable securities and money market instruments on certain non-EU OTC bond markets provided that such markets are regulated, operate regularly and are recognised and open to the public. The following bond markets do qualify as “regulated markets”: US OTC Fixed Income Bond Market, the Hong Kong OTC Corporate Bond Market and the China Interbank Bond Market and the OTC bond market organised by the International Capital Market Association (ICMA).

3. Diversification Rules

Regarding the control and holding limits imposed by Article 48 (2) of the UCI Law, the CSSF confirmed that for an umbrella UCITS fund, such limits apply at sub-fund level.

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A better work-life balance: The Parental Leave Reform

On January 15th, 2016, the draft law n° 6935 on the reform of parental leave (the "**Reform**") was submitted to the Chamber of Deputies.

The main objectives of the Reform are: to have a better work-life balance, meet the parents needs' expectations, increase the number of people (especially fathers) who take a parental leave in order to promote equal opportunities, etc.

In order to achieve those objectives, the Reform, which will normally come into force before the end of the year 2016 and be retroactively applied, provides major changes to the current parent leave regime which can be requested by parents in case of birth or adoption of one or more children.

What are the major changes introduced by the Reform?

1. Prerequisites:

According to the Reform, all parents who work at least 10 hours per week will be eligible to a parental leave. And subject to the agreement of all employers, the parent who works at least 10 hours per week for multiple employers will also be able to take parental leave.

Moreover, if the parent changes employer during the 12-month period preceding the request for parental leave or during this leave, the allowance may be allocated to him/her if the new employer gives his consent. Furthermore, the refunding of the allowance which has already been paid will not be requested.

The last modification of the prerequisites is that both parents will have the option to take the parental leave at the same time.

2. Parental leave period:

Regarding the first parental leave, no changes have been introduced by the Reform as this leave must be taken immediately after maternity or adoption leave. However, for the second parent leave, the Reform provides that a parent will be able to benefit from such leave until the age of 6 (instead of 5) of the concerned child (or 12 years in the case of an adoption).

In addition, the first and the second parental leave can be taken either 4 or 6 months for a full-time parental leave (and not only 6 months) or 8 or 12 months for a part-time parental leave (and not only 12 months).

Furthermore, with the prior consent of the employer, parents will be allowed to split the parental leave as follows:

- For parents working full-time: the parent will decide either to reduce his/her weekly working time by 20 % during a maximum period of 20 months, or to take 4-month periods, spread equally over a maximum period of 20 months.

- For parents working part-time and whose working time is at least 20 hours per week: the weekly working hours will be reduced by 50 %.

In those cases, a parental leave plan which aims to indicate the effective period(s) of leave must be concluded by mutual agreement and signed by the parent and the employer at least 4 weeks before the start of the requested period of leave.

As in the current law, employers will be obliged in any case to accept the request for a full-time parental leave, but can object the request for a part-time parental leave or for a split leave proposal. In this case, the employer should propose an alternative to the employee. If the parent refuses such alternative, he/she will nevertheless still be able to benefit from the full-time parental leave.

3. Parental leave allowance:

Finally, the gross monthly parental leave allowances are currently fixed at 1,778.31 € in case of full-time parental leave and at 889.15 € in case of part-time parental leave.

Nevertheless, the Reform provides an important modification as regard the parental leave allowance.

In fact, the parental leave allowance will be linked to the beneficiary's remuneration and will become a real replacement income which amount will be calculated over a 12-month period preceding the request for parental leave. The gross replacement income of the parent who works full-time (i.e. 173 hours per month) will thus be set between 1,922.96 € (minimum social wages for unskilled workers of 18 years and over) and 3,200 € per month.

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