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Late Payments – Less of a Headache

Banking, Finance and Capital Markets Update

Proposal for a regulation European long-term investment funds

Newsletter Q2 2013

Greetings:

Dear Reader,

We hope that the current and relevant legal and regulatory updates that you will find below will help you in your daily activities.

Enjoy your reading,

Eric Sublon
Managing Partner
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Late Payments – Less of a Headache

Clear rights for creditors and simplified procedures for recovering late payments; these are part of the goals pursued by the European Commission and the EU Member States to address the increasing concern of failing SMEs. New rules increase legal certainty for companies in both, national and infra-EU transactions.

The relevant EU Directive 2011/7/EU[1] has recently been implemented by Luxembourg with the law of 29 March 2013 on combating late payments in commercial transactions (the "**Amendment**"). The Amendment modifies an earlier law of 18 April 2004 on payment periods and interest for late payments (the "**2004 Law**") which implemented a first attempt by EU Member States in the early 2000s to harmonise their national rules[2]. The Amendment clarifies the 2004 Law by specifying a number of rights allowing companies and particularly SMEs to recover late payments in a quick and uncomplicated way. However the Amendment only concerns commercial transactions (the "**B2B**") and leaves the current rules under the 2004 Law for transactions with consumers (the "**B2C**") untouched.

Clear Rights and Effective Enforcement

The major innovations under the Amendment are as follows:

- The payment period after which interest for late payment is due, is now capped to 60 days. *Public entities* are bound by this cap, whereas in transactions between *private undertakings* parties may fix longer periods. If they do, parties are however recommended to provide an objective justification in the contract.

- Compensation is threefold:
  - The interest rate for delayed payment is increased to the Central Bank's Policy Rate plus 8 per cent;
  - If interest for delayed payment is due, the creditor has the automatic right to a fixed sum of EUR 40.-;
  - In addition to the interest for delayed payment and the fixed sum, the creditor has the right to recover additional cost, including lawyer fees.

- Compensation is compulsory:
  - Parties are prohibited from excluding interest for late payments by mutual agreement;
  - Parties should not, by mutual agreement, exclude compensation for recovery i.e. the fixed sum of EUR 40.- or the right to additional compensation, without prior legal advice.

- Compensation is automatic:
  - Interest for late payment is due automatically, no reminder or formal notice being required if (i) the creditor has fulfilled all contractual and legal obligations, (ii) the debtor has not yet paid and (iii) bears responsibility for such delay;
  - The right for the fixed sum of EUR 40.- is automatically due with the interest for delayed payment, no reminder or formal notice being required.

- The creditor or a representative professional body may submit terms and conditions for review to a court using an accelerated procedure (*juge des référés*) if such terms and conditions concern (i) the date or period after which interest is due, (ii) the applicable rates and/or (iii) compensation.[3]

- Finally the new rules put a particular stress on transactions between private business and public bodies. The Parliament has underlined that it is essential that rules are strictly followed down to the local level of municipal administration.

[1] Directive 2011/07/EU of 16 February 2011 on combating late payment in commercial transactions, 2011 OJ L 48/1.

[2] Directive 2000/35/EC of 29 June 2000 on combating late payment in commercial transactions, 2000 OJ L 200/35.

[3] In such case the claimant must establish "manifest abuse" which will be assessed by the judge based on guidance given by article 6(1) (a), (b) and (c), 6(2) and (3) of the 2004 Law.

Overview of the Regime for Late Payments

The following table provides an overview of the main rights and obligations of creditors under the 2004 Law and the Amendment.

	B2C *2004 Law*	**B2B** *Amendment*	**B2 Public Entities** *Amendment*
Period **for Payment** (after which interest for late payment is due)	3 months	<u>Default:</u> 30 days <u>By Agreement:</u> (i) Up to 60 days, no justification required, (ii) over 60 days, justification required, legal advice recommended	<u>Default:</u> *See B2B* <u>By Agreement:</u> Maximum 60 days, justification required
Interest **for Late Payment**	3,5% (2013), conditional (see below) +3% if enforced by court decision	8,75% (1st quarter 2013) Deviation only possible based on objective justifications, legal advice recommended	*See B2B*
Compensation	Not regulated, judicial proceedings required	(i) Fixed (EUR 40.-), automatic; <u>AND</u> (ii) Recovery costs. May be determined contractually or asked for in proceedings	*See B2B*
Creditor **Formalities & Conditions**	(i) Invoice to be issued within 1 month; (ii) Reference in invoice to article 12 of 2004 Law required	(i) Creditor: Contractual and legal obligations complete (ii) Debtor: Non-payment at end of payment period <u>UNLESS</u> debtor bear no responsibility for the delay	*See B2B*
Contractual Obligations		Rights to interest and compensation cannot be set aside contractually.	*See B2B;* <u>AND</u> Parties must not agree on the date of receipt of the invoice

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Banking, Finance and Capital Markets Update

The Luxembourg Parliament enacted three different laws, each completing the Banking, Finance and Capital Markets legal framework.

The first law enacted on 6 April 2013 and published in the Memorial A number 71 on 15 April 2013 introduces a new regime on dematerialized securities (the "**Dematerialization Law**"). This new regime has been further described in our first newsletter of the first quarter 2012 available under the following link: Newsletter Luxembourg Q1 2012.

The second law enacted on 12 July 2013 and published in the Memorial A number 126 on 19 July 2013 (the "**Short Selling Law**") implements the European regulation n°236/2012 of the European Parliament and European Council on 14 March 2012 on short selling and certain aspects of credit default swaps directly applicable in Luxembourg since 1 November 2012. The Short Selling Law précises in particular the competence and the extent of the supervisory role of the CSSF in this respect. The provisions of the European regulation and in particular of the Short Selling Law were further described in our newsletter of the fourth quarter 2012 available under the following link: Newsletter Luxembourg Q4 2012.

Finally the third law enacted on 27 June 2013 and published in the Memorial A number 111 on 1 July 2013 amends the regime applicable to mortgage banks and in particular implements the notion of "mortgage bank with limited activity" (the "**Mortgage Bank Law**"). The main amendments to the mortgage banks' regime were further defined in our newsletter of the first quarter 2013 available under the following link: Newsletter Luxembourg Q1 2013.

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Proposal for a regulation European long-term investment funds

In June 2013 the European Commission proposed a new regulatory framework for private European long-term investment funds ("**ELTIFs**") in the form of a regulation of the European Parliament and of the Council ("**Regulation**"). The new form of fund vehicle is designed to meet the needs of investors who wish to lock their monies (so-called 'patient capital') in alternative long-term investments in return for a long term and stable income.

ELTIFs would be open to all types of investors (retail and professional) and only be permitted to invest in companies and projects which need money committed for a prefixed long period of time. ELTIFs are closed-ended in the sense that investors cannot request the redemption of some or all of their shares or units.

The rules on ELTIFs are closely linked to the alternative investment fund managers' directive 2011/61/EU ("**AIFMD**"), with respect to the management and marketing of alternative investment funds ("**AIFs**") in the European Union. ELTIFs hence qualify as an AIF and can only be managed by an AIFM.

It is proposed to set out the rules in a EU regulation being directly applicable in all EU Member States.

Content:

1. General rules and obligations concerning investment policies, eligible investments, qualifying portfolio undertakings, portfolio composition and diversification rules and borrowing of cash
2. Authorisation and use of designation
3. Redemption, trading and issue of ELTIF shares/or units
4. Transparency and supervision
5. Marketing of ELTIFs shares/units
6. Outlook

The most salient features of the Regulation could be summarised as follows:

1. General rules and obligations concerning investment policies, eligible investments, qualifying portfolio undertakings, portfolio composition, diversification rules and borrowing of cash

a) General rules

The Regulation intends to state uniform rules with respect to the authorisation, investment policies and operating conditions of AIFs which are marketed in the Union as ELTIFs.

Undertakings for collective investment in transferable securities ("**UCITS**") and non-EU AIFs would not be eligible. The requirements contained in the Regulation shall be exhaustive, leaving no scope at national level (i.e. gold-plating).

b) Eligible investments

In addition to the assets referred to in article 50(1) of the UCITS Directive, notably transferable securities/money market instruments, units of UCITS, deposits with credit institution and financial derivative instruments, ("**UCITS Eligible Assets**"), the following represent eligible investments for an ELTIF:

- Equity or quasi-equity instruments which have been:
  - (i) issued by a qualifying portfolio undertaking (as defined below) and acquired directly by the ELTIF;
  - (ii) issued by a qualifying portfolio undertaking in exchange for an equity instrument
  - (iii) issued by an undertaking of which the qualifying portfolio undertaking is a majority owned subsidiary, in exchange for an equity instrument acquired in accordance with points (i) and (ii) by the ELTIF from the qualifying portfolio undertaking;
- debt instruments issued by a qualifying portfolio undertaking;
- loans granted by the ELTIF to a qualifying portfolio undertaking;
- units/shares of one or several other ELTIFs, European Venture Capital Funds ("**EuVECAs**") and European Social Entrepreneurship Funds ("**EuSEFs**") provided that those have not themselves invested more than 10% of their capital in ELTIFs; and
- direct holdings of individual real assets under certain conditions.

According to the recitals of the Regulation, quasi-equity instruments should be understood to entail a type of financing instrument, being a combination of equity and debt, where the return on the instrument is linked to the profit or loss of the qualifying portfolio undertaking and where the repayment of the instrument in the event of default is not fully secured.

An ELTIF shall not:

- short-sell assets;
- take direct/indirect exposure to commodities or any other means or instruments that would give an exposure to them;
- perform securities lending/securities borrowing/repurchase agreements or any other agreement that could encumber the assets of the ELTIF; and
- use financial derivative instruments, for purposes other than hedging.

c) Qualifying portfolio undertaking

A qualifying portfolio undertaking shall be a portfolio undertaking other than a collective investment undertaking which meets the following conditions:

- is not a financial undertaking;
- is not admitted to trading
  - (i) on a regulated market as defined in the markets in financial instruments directive ("MiFID");
  - (ii) on a multilateral trading facility as defined in the MiFID;
  - (iii) on organised trading facilities as defined in the Regulation;
- it shall be established in a Member State, or in a third country provided that the third country:
  - (i) is not a high-risk and non-cooperative jurisdiction identified by the Financial Action Task Force ("**FATF**"); and
  - (ii) has signed an agreement with home Member State of the manager of ELTIF and with every other member State in which the units/shares of the ELTIF are intended to be marketed to ensure that the third country fully complies with the standards laid down in article 26 of the OECD Model Tax Convention on Income and Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements.

A qualifying portfolio undertaking may be a financial undertaking, as long as these are dedicated to financing long-term projects, given that financial undertakings may also be necessary to pool and organise the contributions of different investors.

d) Portfolio composition and diversification

An ELTIF shall invest at least 70% of its capital in eligible investments. ELTIFs will have up to five (5) years in order to build its portfolio.

30% of the ELTIFs capital can be invested in eligible assets.

The aggregate value of units/shares of ELTIFs, EuVECA and EuSEF in an ELTIF portfolio shall not exceed 20% of the value of its capital.

The aggregate risk exposure of an ELTIF to a counterparty from over the counter derivative transactions or reverse repurchase agreements shall not exceed 5% of its capital.

In any case, an ELTIF shall invest no more than:

- 10% of its capital in assets issued by a single qualifying portfolio undertaking;
- 10% of its capital in an individual real asset;
- 10% of its capital in units/shares of any single ELTIF, EuVECA or EuSEF;
- 5% of its capital in UCITS eligible assets issued by a single body.

An ELTIF may acquire no more than 25% of the units/shares of a single ELTIF, EuVECA or EuSEF. In relation to UCITS eligible assets, the concentration limits set out in article 56(2) of the UCITS Directive shall apply.

e) Borrowing of cash

To enable an ELTIF manager to raise capital during the ELTIF's life (i) up to 30% of the ELTIFs capital may be borrowed and (ii) in order to eliminate the risk of currency mismatches, the ELTIF should borrow money in the same currency as the assets to be acquired with the borrowed cash. Finally, the borrowing of cash (iii) should aim to acquire a participation in eligible investments assets, (iv) does not hinder the realisation of any asset held in the portfolio of the ELTIF, and (v) does not encumber the assets held in the portfolio of the ELTIF.

2. Authorisation and use of designation

a) Authorisation

Only EU AIFs (i.e. neither non-EU AIFs nor UCITS) are eligible for authorisation as ELTIFs.

The application for authorisation as an ELTIF would include:

- the fund rules or instruments of incorporation ("Rules");
- an information on the identity of the manager;
- an information on the identity of the depositary;
- a description of the information to be made available to its investors; and
- any further information the relevant competent authority of the ELTIF requires to verify compliance with the Regulation's conditions.

The ELTIF and the AIFM shall be informed within two (2) months from lodging a complete application whether authorisation of the ELTIF has been granted.

An AIFM that intends to manage an ELTIF needs the approval of the competent authority of the ELTIF and would have to include in its application:

- written agreement with the depositary;
- information on delegation arrangements with respect to portfolio and risk management and administration; and
- information about the investment strategies, the risk profile and other characteristics of the AIFs that the AIFM is authorised to manage.

ELTIFs authorised pursuant to the Regulation may be marketed in the EU and this authorisation shall be valid for all Member States ("**EU Passport**").

The European Securities and Markets Authority ("**ESMA**") will keep a central register to identify:

- each authorised ELTIF;
- its manager; and
- the competent authority of the ELTIF.

b) Use of designation

The designation "ELTIF" or "long-term investment fund" may only be used if the collective investment undertaking is authorised in accordance with the Regulation. This would imply that an AIFM that envisages managing or marketing funds with long-term assets without using this designation is not obliged to comply with the Regulation.

3. Redemption, trading and issue of ELTIF shares/units

a) Redemption
ELTIFs do not provide for redemption rights before the end of life of the ELTIF. The end of life and procedures for redemption and disposal of assets must be disclosed in the ELTIF's Rules.
Furthermore, the life of the ELTIF should have a time span sufficient to cover the life period of each asset of the ELTIF in accordance with the (i) illiquidity profile and (ii) economic life period of the assets as well as (iii) the indicated investment objective.

Finally, the investor should always have the possibility to be repaid in cash. However, a repayment in kind is possible if:

- the ELTIF Rules provide for this possibility, under the condition of the fair treatment of investors;
- the investors ask for a redemption in kind; and
- no specific rules restrict the transfer of those assets.

b) Trading
An ELTIF may seek admission of its shares/units to a regulated market or a multilateral trading facility as defined in the MiFID or to a defined trading facility as defined in the Regulation.

Shares/units of an ELTIF are freely transferable to third parties.

c) Issue of instruments and preferential subscription right
An ELTIF may issue shares/units pursuant to its Rules, but should not issue new shares/units at a price below its net asset value without granting existing investors a preferential subscription right.

4. Transparency and supervision

a) Transparency
An ELTIF may only market its shares/units in the Union with the prior publication of a prospectus.

In addition, the prior publication of a key information document ("**KID**") is required if the ELTIF is marketed to retail investors.

The Regulation sets out the minimum contents of the prospectus, i.e.:

- a statement setting out the ELTIF's investment objectives and strategy;
- prominent indication of the categories of assets the ELTIF is authorised to invest in;
- information to be disclosed by collective investment undertakings of the closed-ended type in accordance with Directive 2003/71/EC of the European Parliament (prospectus directive) and of the Council and Commission Regulation (EC) No 809/2004;
- information to be disclosed to investors pursuant to article 23 of the AIFMD, if not already covered under the above bullet points;
- any other information considered by the competent authorities to be relevant for the purpose to enable the investors to make an informed judgement regarding the investment proposed to them and, in particular, the risks attached thereto.

The prospectus and the KID and any other marketing document shall prominently notify investors about the illiquid nature of the ELTIF and:

- inform investors about the long-term nature of the ELTIF's investments;
- inform investors about the end of life of the ELTIF;
- state whether the ELTIF is intended to be marketed to retail investors;
- state that investors shall have no right to redeem their investment until the end of life of the ELTIF;
- state the frequency and the timing of any income payments, if any, to the investors during the life of the ELTIF; and
- advise investors that only a small proportion of their overall investment portfolio should be invested in an ELTIF.

The prospectus shall clearly inform investors as to the level of the different costs borne directly or indirectly by the investor and listed in accordance with the Regulation.

The prospectus shall disclose an overall ratio of the costs to the capital of the ELTIF and the KID shall reflect all of the costs outlined in the prospectus, stating the total costs in monetary and percentage terms.

b) Supervision
Compliance with the Regulation will be monitored on an on-going basis by the competent authority of the ELTIF.

The competent authority of the ELTIF shall be responsible for the supervision of the compliance with the requirements (i) set out in the ELTIF's Rules; (ii) indicated in the prospectus; (iii) investment policies; (iv) regarding redemption, trading and issue of ELTIF shares/units and distributions of income; and (v) on transparency.

The competent authority of the ELTIF's manager shall be responsible for supervision of the (i) adequacy of the arrangements and organisation of the manager to comply with the obligations and rules which relate to the constitution

and functioning of all the ELTIFs it manages and (ii) compliance of the ELTIF manager with the Regulation.

The competent authorities of the ELTIF and its manager shall cooperate with each other and ESMA and exchange information to perform their duties under the Regulation.

5. Marketing of ELTIF shares/units

The Regulation requires managers of ELTIFs to put in place facilities in each Member State where they intend to market their ELTIFs. The following additional requirements must be considered if marketing to retail investors is intended:

- ELTIFs Rules provide for equal treatment and no preferential treatment or specific economic benefits are granted to individual investors or groups of investors; and
- ELTIFs are not structured as partnerships; and
- retail investors may, during the subscription period and at least two (2) weeks after the subscription of shares/units of the ELTIF, cancel their subscription and have their money returned without penalty.

Finally, the Regulation refers to the notification procedures in the AIFMD to authorise the manager of ELTIFs to market units/shares to investors in their home and host Member States.

6. Outlook

The European Commission's assessment is that there is an appetite from managers and investors for such a product in terms of an alternative financing source and that ELTIFs together with EuVECAs and EUSEFs will help to contribute to the financing of the European economy. The timeline, however, is uncertain. The Regulation's adoption seems to depend on the prior adoption of the PRIPS KID Regulation, which is expected to come into effect by the end of 2014.

The Regulation hence adds an additional layer of rules and costs for AIF investing in long-terms investments to be able to add European widows and orphans to their investor base. We are not certain that this will arouse the manager's enthusiasm.

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