Luther.

Luxembourg

Newsletter Q4 2012

Greetings:

The last quarter of 2012 has been busy and exciting for Luther in Luxembourg.

Thank you to our clients and colleagues who made 2012 a successful year. Thank you also for your trust and collaboration!

We take the opportunity to wish you all the best for this year 2013.

This year already appears as challenging. Different topics such as, *inter alia*, the AIFMD implementation process and the creation of the special limited partnership should offer lots of new opportunities to all of us.

Please find below the current and relevant legal and regulatory updates at a high level. We hope that you will find the information beneficial and will contact us should you need any additional information.

Eric Sublon
Managing Partner
Luther Luxembourg

Table of contents

Banking, Finance and Capital Markets Update

Please see below a high-level overview of two interesting changes which have occurred in the Banking, Finance and Capital Markets area.

1. Short selling in Luxembourg

In the context of the European financial crisis, the European Member States enacted national legislations prohibiting and restricting uncovered short position sales. In order to provide the European Union (the “**EU**”) with a common regulatory framework on uncovered short position sales, the European Commission enacted five EU-Commission regulations including the regulation (EU) N° 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps and details on certain practical aspects of notification, disclosure and exemption procedures (the “**Regulation**”).

Please note that the decisions of the CSSF dated 19 and 29 September 2008 regarding the prohibition of uncovered short selling in publicly listed bonds and insurance companies are repealed as of 1 November 2012.

Although the Regulation is binding as of 1 November 2012 in its entirety and directly applicable in Luxembourg, part of its provisions differ from the provisions set out in the Luxembourg law of 13 July 2007 related to the market of financial instruments (the “**MIF**”). The Luxembourg Parliament is therefore examining a new bill related to the application of certain provisions of the Regulation (the “**Bill**”).

The Supervisory Commission of the Financial Sector (*Commission de Surveillance du Secteur Financier*, the “**CSSF**”) completed this framework by a circular dated 30 October 2012 regarding the entry into force of the Regulation (the “**Circular CSSF 12/548**”).

The Circular CSSF 12/548 aims to provide practical guidelines relating to the notification or disclosure of significant net short positions to the CSSF and the application of the provisions of Article 17 of the Regulation with regard to the exemption for market making activities and primary market operations.

The new regulatory framework has two components. It first establishes the regulatory technical standards on notification and disclosure requirements with regard to net short positions and on public disclosure of net positions in shares. It then sets out the standards regulatory requirements with regard to short selling and credit default swaps.

Notification or disclosure of significant net short positions to the CSSF

The CSSF is the competent authority in Luxembourg for receiving any notifications and/or disclosures of positions in relation to the issued share capital of a company and of significant net short positions in relation to issued sovereign debt and uncovered positions in sovereign credit default swaps.

The notification or disclosure is required when a certain notification threshold is reached.

The persons subject to the notification and/or disclosure requirements can be natural as well as legal persons who are domiciled or established within the European Union or in a third country.

The CSSF has developed a web-based platform which shall facilitate the notification and disclosure process.

Exemption for market making activities and primary market operations

The Regulation establishes an exemption for certain entities to notify or disclose with regard to net short positions when the transaction of those entities are carried out in performance of market making activities.

According to the Regulation, "**Market Making Activities**" means the activities of certain entities (investment firm, credit institution, third country entity or a firm) where is deals as principal in a financial instrument, whether traded on or outside a trading venue, in any of the following capacities:

i. by posting firm, simultaneous two way quotes comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market;
ii. as part of its usual business, by fulfilling orders initiated by clients or in response to clients' requests to trade;
iii. by hedging positions arising from the fulfillment of tasks under points (i) and (ii).

The entities aforementioned carrying out transactions in performance of Market Making Activities are furthermore not subject to restrictions on uncovered short sales.
However, a notification with respect to Market Making Activities shall be made to the CSSF.

In this respect the persons required to file their notification of intent to the CSSF are according to Article 2 (1) (i):

i. investment firms as defined in Article 1 (9) of the Luxembourg law of 5 April 1993 on the financial sector (the "**Financial Sector Law**");
ii. credit institutions as defined in Article 1(12) of the Financial Sector Law;
iii. firms as referred to in point (1) of Article 2 (1) of Directive 2004/39/EC where they have their registered office, their head office or their domicile in the Grand Duchy of Luxembourg.

A similar exemption applies to the activities of a natural or legal person where, acting as an authorised primary dealer pursuant to an agreement with a sovereign issuer, it is dealing as a principal in a financial instrument in relation to primary and secondary market operations relating to the sovereign debt. An authorised primary dealer is according to the Regulation a natural or legal person who has signed an agreement with a sovereign issuer or who has been formally recognized as a primary dealer by or on behalf of a sovereign issuer and who, in accordance with that agreement or recognition, has committed to dealing as principal in connection with primary or secondary market operations relating to debt issued by that issuer (the "**Authorised Primary Dealer**").

The persons exempted as Authorised Primary Dealers and carrying transactions in performance of Authorised Primary Dealers activities are not required to notify or disclose on net short positions relating to issued sovereign debt, are not subject to the restriction on uncovered short sales in sovereign debt and are not prohibited to enter into an uncovered sovereign credit default swap transaction.

However, a notification of intent in connection with the exemption for Authorised Primary Dealer activities shall be made to the relevant competent authority in relation to the sovereign debt.

In other words, any notification of intent related to the sovereign debt issued by the Grand Duchy of Luxembourg, the European Investment Bank, the European Financial Stability Facility and the European Stability Mechanism shall be made to the CSSF.

The aforementioned exemptions shall apply only when the natural or legal person has notified in writing to the CSSF its intention to make use of the relevant exemption (the "**Notification of Intent**").

Upon receipt of the Notification of Intent, the CSSF will assess whether the person intending to make use of the exemption complies with all the conditions of the relevant exemption. In the assessment of the exemption's conditions, the CSSF will take into account the guidelines and recommendations published by the European Securities and Markets Authority ("**ESMA**") applying to the specific exemption.

Any prohibition to use the exemption shall be imposed within the 30 calendar day period and be notified to the person concerned by written and justified decision.

Any approval of the use of the exemption shall also be notified to the person in writing.

With regard to the Bill, it aims to give to the CSSF a right to supervise or investigate as it deems necessary to fulfill its duties under the Regulation.

According to the Bill, the CSSF could carry out on-site investigation with prior announcement and approval of the person concerned. The CSSF could also have the capacity to impose warning, blame or administrative penalty towards legal or natural persons who have not been complying with the notification or disclosure requirements set out in the Regulation.

2. Family office

The Luxembourg law relating to family office was adopted on 21 December 2012 and published in the Mémorial A, N°274 dated 28 December 2012 (the "**Law**"). The Law provides for a dedicated regulatory framework applicable to family office activities. The Law covers professional activities of advice or estate related services offered to individuals, families or their investment entities.

According to the Law, only credit institutions, investment advisors, portfolio managers as well as certain other types of professionals of the financial sector or another regulated profession such as lawyers (List I or IV) may use the denomination of family office and carry out the related activity.

A specific license for family office activities has been introduced into the Financial Sector Law.

The Law also sets out family office obligations regarding the fight against money laundering and terrorism financing, professional confidentiality and remuneration transparency.

The CSSF published a circular dated 21 January 2013 concerning the entry into force of the Law. This CSSF circular encompasses the main features of the Law.

Please note that a memorandum on this topic is available on our website at
http://www.luther-lawfirm.lu/download_memos_en/5.pdf.

To receive additional information and details, please contact:

Laurent Massinon, Counsel
Luther Avocats à la Cour, Luxembourg
Phone +352 27484 658
laurent.massinon@luther-lawfirm.com

Agathe Laissus, Associate (juriste)
Luther Avocats à la Cour, Luxembourg
Phone +352 27484 676
agathe.laissus@luther-lawfirm.com

European Commission – Delegated Regulation supplementing the AIFMD

On 19 December 2012, the European Commission published draft implementation measures for the Alternative Investment Fund Managers Directive ("**AIFMD**") in the form of a delegated regulation ("**Delegated Regulation**").

It is subject to a 3-month scrutiny period by the European Parliament and the Council. It will enter into force after this period and upon publication in the Official Journal of the EU.

Please note that the form of a regulation does not need a national transposition and will be directly applicable in all EU Member States.

The Delegated Regulation will create a single rulebook with uniform rules for all AIFMs.

The European Commission aims to adopt the Delegated Regulation before the end of the transposition period for the AIFMD, meaning that both shall apply as from 22 July 2013 (if no co-legislator objects the Delegated Regulation).

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

1. Determination of the Assets under Management of the AIF, the requirement to appoint Alternative Investment Fund Managers ("**AIFMs**") and other general requirements

a) Calculation of leverage

One key point to assess whether an AIF is in the scope of the AIFMD, is the calculation of the assets under management ("**AuM**"). The calculation is based on the portfolio of assets of each AIF managed by the AIFM, including all assets acquired through use of leverage. Exempt are AIFM whose AuM do not exceed the threshold of EUR 100 million (including assets acquired by way of leverage) or EUR 500 million, if no leverage is used and the investors have no redemption rights exercisable during a period of five (5) years following the date of initial investment. The preamble of the AIFMD shows that financings on the level of private equity portfolio companies shall not be regarded as leverage which is confirmed by the Delegated Regulation in stating that for AIF whose core investment policy is to acquire control in non-listed companies, the AIFM shall not include any exposure that exists at the level of such non-listed companies.

The AuM shall be monitored on an on-going basis and if the AuM exceeds the indicated thresholds for more than three (3) months, the AIFM shall lodge an application for authorisation to its competent authority within thirty (30) days.

AIFMs that delegate functions are included in the calculation, whereas AIFMs that manage AIF portfolios as delegate are excluded from the calculation as well as cross-holdings in other AIFs and UCITS managed by the AIFM.

b) Additional own funds and professional indemnity insurance

To cover professional liability risks, which the Delegated Regulation define in a non-exhaustive list, the AIFM shall provide additional own funds at least equal to 0.01% of the value of the portfolios of AIFs managed.

Upon authorisation by the competent home Member State of the AIFM, the additional own funds may be lower, but not less than 0.008% on the basis of historical loss data of the AIFM as recorded over an observation period of at least three (3) years prior to the assessment.

The competent authority of the home Member State of the AIFM may require, stating its reasons, additional own funds higher than the 0.01% referred to above.

The professional indemnity insurance has to cover 0.7% of the value of the portfolios of AIFs managed for an individual claim p.a., and 0.9% for claims in aggregate.

The recalculation of additional own funds will be done annually and, if necessary, accordingly adjusted.

c) Organisation requirements

The Delegated Regulation states detailed rules for:

- general business organisation including internal controls and determination of an internal compliance function and data protection (UCITS Directive and MiFID as role model);
- electronic data processing;
- accounting procedures;
- a permanent internal audit function; and
- senior management.

2. Operating conditions of AIFMs – General principles, conflicts of interest, risk management, liquidity management and investment in securitisation positions

a) General principles

Inspired by the UCITS Directive, the Delegated Regulation states inter alia the following requirements:

- formalised due diligence procedures for the selection and on-going monitoring of investments;
- additional requirements for less liquid assets;
- financial sound, properly supervised and resourced prime brokers or counterparties.

The prime broker must be subject to approval by the AIFM's senior management.

Moreover, the Delegated Regulation entails rules on:

- inducements;
- investor reporting obligations for subscriptions/redemptions;
- handlings of orders; and
- best execution and trading orders aggregation and allocation.

b) Conflicts of interest

The Delegated Regulations provides details on the identification of types of conflicts of interest, the written conflicts of interest policy and measures to prevent, manage, monitor and disclose conflicts of interest. Finally, each AIFM is required to develop adequate and effective strategies for the exercise of voting rights.

c) Risk management

Largely inspired by the UCITS Directive, the Delegated Regulation provides details on the risk management, notably requires a permanent risk management function, which shall be functionally and hierarchically separated from the operating units. Further, the AIFM needs to have an adequate and documented risk management policy for all risks faced by the AIF.

Moreover, the AIFM shall establish and implement quantitative and/or qualitative risk limits, at least those indicated in the Delegated Regulation.

d) Liquidity management

Each AIFM has to:

- maintain an appropriate level of liquidity taking into consideration the investor profile, size of investments and redemption terms;
- monitor the liquidity profile of the AIF's portfolio of assets;
- implement appropriate liquidity measurement arrangements and procedures to assess the quantitative and qualitative risks of the positions/intended investments having a material impact;
- put in place tools and arrangements necessary to manage the liquidity risk of each AIF.

AIFM shall demonstrate their liquidity management policies and procedures and review them on at least an annual basis and, if necessary, update them. An escalation procedure should be included in anticipation or due to current liquidity shortage or other distressed situations.

Finally, each AIFM shall regularly perform stress tests under ordinary and exceptional liquidity conditions.

e) Investment in securitisation positions

The exposure to the credit risk of a securitisation is merely assumed if the originator, sponsor or original lender explicitly disclosed to the AIFM on an on-going basis a material net economic interest not less than 5% of the nominal value of the securitised exposures.

The Delegated Regulation provides:

- a list of scenarios that qualify as “retention of a material net economic interest of not less than 5%” as well as a list of qualitative requirements with regard to sponsors and originators; and
- a list of qualitative requirements due to investment due diligence process, liquidity and risk management, disclosure of securitisations positions and internal reporting.

A grandfathering clause for existing securitisations applies until 31 December 2014. After that date, where new underlying exposures are added or substituted, the above stated rules apply.

3. Conditions for delegation

The delegation model will be assessed by the AIFM’s supervisory authority.

a) The qualitative criteria to assess the extent of the delegation are as follows:

- types of assets the AIF is invested in and importance of the assets managed to risk/reward profile;
- importance of the assets under delegation for the achievement of the investment goals of the AIF;
- geographical/sectorial spread of the AIF’s investments;
- risk profile of the AIF;
- type of investment strategies;
- types of tasks delegated in relation to those retained; and
- configuration of delegates/sub-delegates, geographical sphere of operation and corporate structure including whether the delegation is conferred on an entity belonging to the same corporate group as the AIFM.

b) The delegation of risk management or portfolio management is limited to:

- UCITS management companies;
- MiFID investment firms;
- Credit institutions;
- External AIFM; and
- Authorised third country asset managers.

c) An AIFM shall constitute a letter-box entity in any of the four following situations, i.e. if it has:

1. no longer the necessary expertise and resources to supervise the delegated tasks and manage the risks associated;
2. no longer the power to make decisions under the responsibility of the senior management or perform them with respect to the implementation of the investment management policy/strategy;
3. no longer contractual rights to inquire, inspect, have access or give instructions to its delegates respectively impossibility to exercise such rights;
4. delegated the investment management function to an extent that exceeds by a substantial margin the function performed by the AIFM itself.

The European Commission shall monitor the application of the letter box entity provision in the light of market developments, review the situation after two (2) years and perform, if necessary, appropriate measures to further specify this term.

4. Rules on depositaries

a) Safe-keeping duties; ownership verification and record keeping

Safe-keeping covers the definition of financial instruments to be held in custody, i.e. transferable securities, including those which embed derivatives, money market instruments, shares of units of UCIs which are capable of being registered in a financial instruments account directly/indirectly in the name of the depositary and financial instruments which can be physically delivered to the depositary.

However, financial instruments registered with the issuer or its agent are not considered to be financial instruments that have to be held in custody.

Safe-keeping duties cover:

- assets held in custody, inter alia, requirements regarding segregation, reconciliation, due care, assessment and monitoring of custody risks throughout the custody chain as well as arrangements to minimise risks (e.g. fraud, poor administration, negligence or inadequate registration);
- ownership verification and record keeping, which is only required for assets that do not fall under the definition of financial instruments to be held in custody and should not be relevant for private equity and venture capital funds as their investment policy is usually not concentrated on such financial instruments.

The depositary shall perform a “look-through” control on the basis of the underlying assets held by financial and/or legal structures controlled directly/indirectly by the AIF/AIFM. This shall not apply to fund of funds and master-feeder structures if they have a depositary.

b) Cash flow monitoring duties

The depositary shall monitor all AIF's cash flows on a daily ex-post basis. However, there is the flexibility to perform this duty less frequent, as and when cash flows occur.

c) Liability and discharge

The loss of a financial instrument held in custody is deemed to occur in the following three situations:

1. stated right of ownership of the AIF is demonstrated not to be valid due to its cessation or existence;
2. the AIF has definitively deprived of its ownership right over the financial instrument; or
3. the AIF is definitively unable to directly/indirectly dispose of the financial instrument.

A depositary's liability is not triggered if the event is beyond reasonable control, such as the following external events:

- natural events;
- war;
- riots;
- major upheavals; and
- acts of government.

The depositary is liable for the return of an instrument in custody if the loss is caused by an event in its or the sub-depositary's operational sphere, such as accounting errors, operational failure, fraud, failure to apply the segregation requirements at the level of the depositary or a third party to whom the custody has been delegated.

In order to discharge its liability, the depositary has to demonstrate objective reasons, i.e. that it has no other option but to delegate its duties to a third party. This shall in particular be the case if:

- the law of a third country requires that certain financial instruments are to be held in custody by a local entity that satisfies the AIFMD delegation criteria; or
- the AIFM insists on maintaining an investment in a particular jurisdiction despite warnings by the depositary as to the increased risks this presents.

5. Reporting requirements

The Delegated Regulation provides for two calculation methods, the "Gross" and the "Commitment" method and indicates the respective calculation methodologies. Both calculation methods shall be revised by the European Commission in the light of market developments and no later than 21 July 2015.

6. Transparency, exchange of information and rules for cooperation arrangements

a) Transparency

The Delegated Regulation sets out the elements which have at least to be contained in the annual report of each AIF as well as in the manager report. The annex to the Delegated Regulations includes the relevant reporting templates.

The reporting frequency is based on the AuM. The competent authority of the home Member State of the AIFM may require more frequent reporting.

b) Exchange of information

The Delegated Regulation provides exchange of information clauses:

- between the competent authorities of the home Member States, ESMA and ESRB on potential systemic consequences of the AIFM activity; and
- between competent authorities to the home Member States.

c) Rules for cooperation arrangements

The Delegated Regulation details the scope, form and objectives of cooperation arrangements among the competent supervisory authorities.

7. Valuation

The Delegated Regulations provides a detailed framework on the:

- policies and procedures for asset valuation, to be consistently applied to all assets within an AIF and subject to a periodic review;
- professional guarantees which may be provided by external valuers in written form proving sufficient personnel and technical resources, adequate procedures to ensure an independent and proper valuation, knowledge and understanding of the investment strategy and the assets, and sufficiently good reputation and experience; the professional guarantee of a registered valuer must indicate the name and contact information of its competent authority and the provisions or rules of professional conduct;

In case the AIFM uses models to value assets, they shall be:

- validated by a person with sufficient expertise;
- not involved in the development of that model; and
- subject to prior approval by the AIFM's senior management.

The validation shall be documented.

The net asset value per unit/share shall be calculated at least once a year and be subject to a regular verification. The AIFM shall secure that remedial procedures exist in case of an incorrect calculation of the net asset value per unit/share.

To receive additional information and details, please contact:

Max Welbes, LL.M., Partner
Luther Avocats à la Cour, Luxembourg
Phone +352 27 484 674
max.welbes@luther-lawfirm.com

Marie-Astrid Willems, Associate
Luther Avocats à la Cour, Luxembourg
Phone +352 27 484 663
marie-astrid.willems@luther-lawfirm.com

One-sided dispute resolution clauses

All relationships between the Bank and its customers are governed by Luxembourg law. Any disputes arising between the customer and the bank shall be subject to the exclusive jurisdiction of the Courts of Luxembourg. In the event the Bank does not rely on such jurisdiction the Bank reserves the right to bring an action before the Courts of the customer's domicile or before any other court of competent jurisdiction.

Such jurisdiction clauses are standard practice in international financing agreements but a decision rendered on 26 September 2012 by the French Cour de Cassation may lead the legal advisers to reconsider the way such clauses are drafted.

In the case which resulted in the decision of the Cour de cassation, a French National residing in Spain (the "**Applicant**"), decided to sue its Luxembourg bank (the "**Bank**") for significant losses she had incurred in the value of her portfolio, it being specified that her assets were placed on a Luxembourg bank account originally opened by the French affiliate of the Bank based in Paris.

Whereas the jurisdiction clause (quoted at the beginning of this article) gave exclusive competence to the Luxembourg courts, the Applicant brought her action before the Tribunal de Grande Instance in Paris. Unsurprisingly, the Bank on the basis of the said clause contested the jurisdiction of the French courts.

The French jurisdictions which were successively seized (i.e. first the Tribunal de Grande Instance, then the Cour d'Appel de Paris and finally the Cour de Cassation) discarded the argument considering this clause as potestative (i.e a clause further to which the execution of the agreement by one of the parties is subject to the realisation of an event which is under its full discretionary control) and consequently as void.

The French judges indeed considered that the Bank had a full discretionary right to bring its action before any other competent court whereas the customer had no other choice than to seize the Luxembourg courts and that such clause must always (i) be limited and (ii) be equally applicable to both parties.

A questionable decision …

The doctrine criticized the lack of legal basis of this decision and underlined the fact that only obligations are voidable when considered as potestative, being specified that the jurisdiction clauses create a right for the parties but not an obligation stricto sensu.

The Cour de cassation inferred that the alleged potestative nature of the clause affected the predictability of jurisdiction rules and was thus contrary to the object and the aim of Article 23 (which allows the parties to agree that a court or the courts of a Member State shall have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship) of the Council Regulation (EC) 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters which was adopted to "minimise the possibility of concurrent proceedings and to ensure that irreconcilable judgments will not be given in two Member States"

It is however noteworthy that the Cour de Cassation gave an interpretation of an European Union regulation whereas such an interpretation is of the exclusive jurisdiction of the Court of Justice of the European Union.

… which may nevertheless inspire the Luxembourg courts

Due to the fact that the provisions of the French and Luxembourg Civil Code are quite similar, it is likely that a similar solution would be applied by the Luxembourg courts.
Moreover Luxembourg courts use to assess the potestative nature of any clause by looking at whether they "create an imbalance between the economic forces at hand and if [they] leave the creditor at the mercy of the debtor" may thus legitimately conclude that a fundamental imbalance is created between a bank that may bring its action before any possible court, and a customer bound to sue the bank in a particular jurisdiction

Despite the rather questionable reasoning applied by the Cour de cassation, its decision has certainly opened a door for consumers to bring effective action against their banks.

To receive additional information and details, please contact:

Selim Souissi, Senior Associate
Luther Avocats à la Cour, Luxembourg
Phone 352 27484 683
selim.souissi@luther-lawfirm.com

Patrick Wildgen, Associate (juriste)
Luther Avocats à la Cour, Luxembourg
Phone +352 27484 672
patrick.wildgen@luther-lawfirm.com

If you do not want to receive this service in future, please send an e-mail with the subject "Newsletter Luxembourg" to luxembourg@luther-lawfirm.com.

Imprint

Luther Rechtsanwaltsgesellschaft mbH, Anna-Schneider-Steig 22, 50678 Cologne,
Phone +49 221 9937 0, Fax +49 221 9937 110, contact@luther-lawfirm.com

V.i.S.d.P.: Eric Sublon, Luther, Aerogolf Center, 1B, Heienhaff, L-1736 Senningerberg,
Phone +352 27484 1, Fax +352 27484 690, eric.sublon@luther-lawfirm.com

Luther

Luther Rechtsanwaltsgesellschaft mbH advises in all areas of business law. Our clients include medium-sized companies and large corporations, as well as the public sector. Luther is the German member of Taxand, a worldwide organisation of independent tax advisory firms.

Berlin, Cologne, Dresden, Dusseldorf, Essen, Frankfurt a. M., Hamburg, Hanover, Leipzig, Munich, Stuttgart
Brussels, Budapest, London, Luxembourg, Shanghai, Singapore

Your local contacts can be found on our website www.luther-lawfirm.com

Hits the mark. Luther.