LUXEMBOURG

Investment rules of the world

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At DLA Piper, we have one of the largest finance and projects teams in the world with more than 600 dedicated lawyers and an established local law firm network. We share knowledge and skills in debt instruments, debt securities, funds, derivatives and portfolios, as well as energy, infrastructure and other projects, across Europe, the Middle East, Africa, Asia Pacific and the Americas.

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With global perspective, we can help you to realize your financial strategy in whichever markets you do business.

Investment Rules of the World

With input from across our global network, this guide covers key legal topics for different financial activities and projects and gives you an overview of the points you may consider when initially looking at financing or investing in particular jurisdictions. Please contact us if you would like to discuss any legal issues or solutions for your business. We also welcome your feedback about this guide via investmentrules@dlapiper.com.

Luxembourg

Last modified 10 December 2019

Capital markets and structured investments

Issuing and investing in debt securities

Are there any restrictions on issuing debt securities?

There are restrictions on offering and selling debt securities under both Luxembourg and EU law.

Unless certain exclusions or exemptions apply, it is unlawful to offer debt securities to the public in Luxembourg or to request that they are admitted to trading on a regulated market operating in Luxembourg unless an approved prospectus has been made available to the public.

Certain forms of companies cannot offer securities.

The International Capital Market Association has published standard form selling restrictions for offers of debt securities in Luxembourg. These restrictions are aimed at preventing a breach of:

- the rules on financial promotion; and
- the rules on accepting deposits in Luxembourg.

Worth noting the creation of the Luxembourg Capital Markets Association in 1st March 2019.

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What are common issuing methods and types of debt securities?

The most common types of debt securities issued in Luxembourg are bonds or notes issued on a stand-alone basis or under a program.

Many different types of debt securities are offered in Luxembourg. Some common forms include:

- debt securities characterized by the type of interest or payment such as fixed-rate securities, floating-rate securities, variable-rate securities, zero-coupon securities and high-yield bonds;
- guaranteed securities, subordinated securities or perpetual debt securities;
- asset-backed securities;
- derivative securities such as securities linked to the value of one or more reference asset including shares, commodities, interest rate, currency rate or index, and credit-linked notes;
- equity-linked securities such as convertible bonds (debt securities convertible into the equity of the issuer, such as the so-called CPECs);

- depositary receipts (a security issued by a depositary conferring on the holders beneficial ownership of certain underlying assets held by the depositary for the holders); and
- warrants (securities giving the holders the option to purchase the equity of the issuer or a related company)

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What are the differences between offering debt securities to institutional / professional or other investors?

The Regulation (EU) 2017/1129 of the European Parliament of 14 June 2017 on the prospectus to be established when securities are offered to the public or admitted to trading on a regulated market, and repealing the Prospectus Directive ("Prospectus Regulation") makes a distinction between professionals (qualified investors) and other investors for the purpose of its disclosure requirements. The obligation to publish a prospectus does not apply to the offers of securities to the public addressed solely to qualified investors. Moreover, this obligation does not apply neither to offers of securities whose denomination per unit amount to at least €100,000.

According to the provisions of the Luxembourg law dated 16 July 2019 on prospectuses for securities ("Prospectus Law"), the obligation to publish a prospectus does not apply to some types of investors, such as qualified investors, which are defined as:

- professional clients listed under Sections 1 to 4 of Annex II of Directive 2014/65/EU on markets in financial instruments ("MIFID II"), such as credit institutions and investment firms; and
- persons or entities that are, on request, treated as professional clients in accordance with Section II of that Annex II of MIFID II, or recognized as eligible counterparties in accordance with article 2430 of MIFID II, unless they have requested to be treated as non-professional clients.

If the denomination of the securities is equal to or above €100,000 (or the equivalent in another currency), the 'wholesale' rules apply. If the denomination is under €100,000, the 'retail' rules apply. Additional disclosure requirements apply for retail securities.

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When is it necessary to prepare a prospectus?

Under the Luxembourg law dated 16 July 2019 on prospectuses for securities , any communication to any person(s), in any form and by any means that contains sufficient information on the terms of the offer and the securities being offered requires a prospectus so as to enable a potential investor to make their decision whether to purchase or subscribe for such securities.

An exemption from publishing a prospectus will apply, *inter alia*, to an offer:

- addressed solely to qualified investors 9as explained below);
- addressed to fewer than 150 individuals or legal entities per EU or European Economic Area member state other than qualified investors, or where the offer is for a total of at least €100,000;
- addressed to investors who acquire securities for a total consideration of at least €100,000 per investor and for each separate offer; or
- involving securities with a total consideration of less than €8 million (such limit shall be calculated over a period of 12 months).

If the offer is deemed not to be made to the public, a prospectus which complies with the Rules and Regulations of the Luxembourg Stock Exchange may still be required if an application is made for the securities to be admitted to trading on a regulated market. An exemption from both the offer to the public and the admission to trading on a regulated market is needed to avoid having published a prospectus.

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What are the main exchanges available?

In Luxembourg, the Luxembourg Stock Exchange operates two different markets for trading debt securities:

- the regulated market qualifies as a European-regulated market as defined in the Directive 2014/65/EU on markets in financial instruments. This market offers a European passport that facilitates listing on other EU-regulated markets through a notification procedure.
- the Euro MTF is a multilateral trading facility. Offering documents are subject to less stringent disclosure and reporting requirements but issued debt securities do not benefit from the European passport.

The Luxembourg Stock Exchange also offers the possibility to list securities on the securities official list (SOL), without any trading.

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Is there a private placement market?

Luxembourg has an active private placement market.

There is no dominant standard for documentation but efforts have been made by the Loan Market Association and International Capital Markets Association to standardize private placement documentation.

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Are there any other notable risks or issues around issuing or investing in debt securities?

Issuing debt securities

Issuers are required to take responsibility for prospectuses for debt securities. Misleading statements in, or omissions from, any applicable offering document can give rise to both civil and criminal liability under Luxembourg law. Luxembourg has various bondholder protection statutory provisions relevant to liability for an inaccurate offering memorandum. In this respect, article 12 of the Luxembourg law dated 16 July 2019 on prospectuses for securities provides that an administrative fine of a maximum amount of €700,000 may be imposed on an issuer providing incomplete or inaccurate information in a prospectus or if it publishes or causes to be published false information in a prospectus or a supplement to the prospectus. There are general fraud statutes and liability may also arise under common law through a civil action for deceit, negligent misstatement or misrepresentation. Criminal penalties (article 13 of the Prospectus Law) and publication of decisions (article 14 of the of the Luxembourg law dated 16 July 2019 on prospectuses for securities) are also possible.

Investing in debt securities

Debt security terms and conditions typically contain provisions which may permit their amendment without the consent of all bondholders, which may be exercised without the consent of bondholders and without regard to the interests of particular bondholders. The conditions also provide for meetings of bondholders to consider matters affecting the bondholders' interests. These provisions typically permit defined majorities to bind all bondholders including bondholders who did not attend and vote at the relevant meeting and bondholders who voted against the majority. Luxembourg law provisions applicable to bondholders' meetings can be excluded. Selling restrictions should also be considered.

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Establishing and investing in debt / hedge funds

Are there any restrictions on establishing a fund?

Generally

Establishing a fund, offering a fund and operating a fund, among other things, are regulated activities and are therefore subject to supervision of the *Commission de Surveillance du Secteur Financier*. Reserved alternative investment funds (RAIF) as well as partnerships (qualifying as alternative investment funds) are exempt from being subject to the supervision of the *Commission de Surveillance du Secteur*

Financier. However, these investment funds will have to appoint an alternative investment fund manager who is in turn subject to the supervision of the *Commission de Surveillance du Secteur Financier*.

Collective investment schemes

The *Commission de Surveillance du Secteur Financier* has set out the following specific restrictions in relation to hedge funds in its Circular 02/80:

- risk diversification rules regarding short sales;
- borrowings;
- restrictions applicable to investments in target Undertakings for Collective Investment; and
- use of derivative financial instruments and other techniques.

There are no other specific restrictions in relation to hedge or debt funds other than those mentioned in the relevant laws.

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What are common fund structures?

Common forms of funds include:

- Specialized Investment Funds which may qualify as Alternative Investment Funds (AIF);
- Undertakings for Collective Investments in Transferable Securities;
- Undertakings for Collective Investments pursuant to part II of the Luxembourg law of 17 December 2010 which may qualify as AIF;
- Reserved Alternative Investment Funds;
- companies investing in risk capital (these companies are not considered to be investment funds as they are not subject to diversification rules); and
- partnerships which may qyalify as AIF.

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What are the differences between offering fund securities to professional / institutional or other investors?

Retail funds

Retail funds, which are mainly Undertakings for Collective Investments in Transferable Securities, are subject to substantial regulatory oversight and restrictions.

Institutional/professional funds

Non-retail funds are Specialized Investment Funds or Reserved Alternative Investment Funds which generally fall into the category of Alternative Investment Funds and will therefore have to appoint an Alternative Investment Fund Manager. As such, certain obligations with respect to marketing arrangements, reporting, governance etc are applicable.

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Are there any other notable risks or issues around establishing and investing in funds?

Establishing funds

Managing investment funds is a regulated activity and therefore subject to authorization and supervision of the *Commission de Surveillance du Secteur Financier*. The establishment of investment funds such as undertakings for collective investments in transferable securities, undertakings for collective investments pursuant to part II of the Luxembourg law of 17 December 2010, specialised investment funds and companies investing in risk capital are always subject to the authorization and supervision of the *Commission de Surveillance du Secteur Financier*.

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Managing and marketing debt / hedge funds

Are there any restrictions on marketing a fund?

Undertakings for Collective Investments in Transferable Securities (UCITS)

Luxembourg Undertakings for Collective Investments in Transferable Securities (UCITs) may be offered for sale in Luxembourg without any restriction (private or public offer, institutional clients or not and whatever their number) as soon as they are registered on the official list of UCITs of the *Commission de Surveillance du Secteur Financier*.

Alternative Investment Funds (AIFs)

Under the Alternative Investment Fund Manager Directive, marketing is defined as a direct or indirect offering or placement at the initiative of the Alternative Investment Fund Manager (AIFM) or on behalf of the AIFM of units or shares in an AIF it manages to or with investors domiciled or with a registered office in the EU.

An AIFM can only market an AIF to EU investors if it is authorized by a relevant EU regulator – registration with one EU regulator opens access, subject to certain further limited conditions, to marketing to professional investors across the EU under a EU passport or if it complies with national private placement regimes (where available).

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Are there any restrictions on managing a fund?

An investment fund will either have to be managed by itself (not very common), by a management company or an Alternative Investment Fund Manager (AIFM) depending on the qualification of the investment fund itself.

The management functions of a management company are defined by the Luxembourg law which cannot be contravened, except if the management company holds the relevant license:

- portfolio management;
- administration, such as:
  - legal and fund management accounting services
  - customer inquiries
  - valuation of the portfolio and pricing of the units (including tax returns)
  - regulatory compliance monitoring
  - maintenance of unitholder register
  - distribution of income
  - unit issue and repurchase
  - contract settlements (including certificate dispatch)

  - record-keeping; and
- marketing.

Investment management functions which an AIFM must at least perform when managing an Alternative Investment Fund (AIF) are:

- portfolio management; and
- risk management.

The additional functions that an AIFM may perform in the course of the collective management of an AIF are restricted to the following:

- administration, such as:
  - legal and fund management accounting services;
  - customer inquiries;
  - valuation and pricing, including tax returns;
  - regulatory compliance monitoring;
  - maintenance of unit-/shareholder register;
  - distribution of income;
  - unit/shares issues and redemptions;
  - contract settlements, including certificate dispatch; and
  - record-keeping;
- marketing; and
- activities related to the assets of AIFs, namely services necessary to meet the fiduciary duties of the AIFM, facilities management, real estate administration activities, advice to undertakings on capital structure, industrial strategy and related matters, advice and services relating to mergers and the purchase of undertakings and other services connected to the management of the AIF and the companies and other assets in which it has invested.

In order to apply for a license to act as a management company, self-managed company or AIFM, the relevant entity will have to submit various documents to the *Commission de Surveillance du Secteur Financier* in order to verify that the relevant company has sufficient technical and human infrastructure, expertise and policies in place.

However, AIFMs based in Luxembourg may be exempt from a full AIFM license and will only have to be registered with the *Commission de Surveillance du Secteur Financier*, in case either of the following is applicable:

- The AIFM is established in Luxembourg and which either directly or indirectly, through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manages portfolios of AIFs whose assets under management, including any assets acquired through use of leverage, in total do not exceed a total threshold of €100 million.
- The AIFM is established in Luxembourg and which either directly or indirectly, through a company with which the AIFM is linked by common management or control, or by a substantive direct or indirect holding, manages portfolios of AIFs whose assets under management in total do not exceed a threshold of €500 million when the portfolios of AIFs consist of AIFs that are unleveraged and have no redemption rights exercisable during a period of five years following the date of initial investment in each AIF.

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Entering into derivatives contracts

Are there any restrictions on entering into derivatives contracts?

Under Luxembourg law, there is no specific restriction for entering into derivative contracts such as:

- options;
- futures;
- contracts for difference; or
- rights to or interests in investments.

However, the European Market Infrastructure Regulation, as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 applies to all derivative transactions and requires transactions to be reported to regulators, for transactions between dealers to be cleared or subject to other risk mitigation techniques such as initial margin and variation margin requirements.

In addition, the provisions of the Luxembourg law dated 15 March 2016 on over-the-counter derivatives, central counterparties and trade repositories, as amended, grant powers to the Luxembourg supervisory authority of the financial sector (*Commission de Surveillance du Secteur Financier*) and the supervisory authority for insurance companies (*Commissariat aux Assurances*) in the context of Regulation 648 /2012/EU (the European Market Infrastructure Regulation) as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 and specifies that the *Commission de Surveillance du Secteur Financier* and the *Commissariat aux Assurances* are vested with powers of supervision, intervention, inspection and investigation to the extent defined in the European Market Infrastructure Regulation as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 and that they may impose certain sanctions.

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What are common types of derivatives?

Derivative contracts are entered into in Luxembourg for a range of reasons including hedging, trading and speculation.

Derivatives may be traded over-the-counter or on an organized exchange.

All of the main types of derivative contract are widely used in Luxembourg:

- forwards;
- futures;
- swaps (such as interest rate or currency swaps); and
- options (call options and put options).

The value of the derivative contracts is based on the value of the underlying assets. The main classes of underlying asset seen in Luxembourg are:

- equity;
- fixed income instruments; and
- foreign currency.

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Are there any other notable risks or issues around entering into derivatives contracts?

Since the global financial crisis in 2007-2008, derivatives and particularly over-the-counter derivatives have attracted significant regulatory attention. The European Commission has sought, in particular, to:

- enhance transparency by requiring the provision of comprehensive information on over-the-counter derivative positions;
- reduce counterparty risk by increasing the use of central counterparty clearing; and
- improve the management of operational risk by increasing the standardization of derivatives contracts.

As a result, the derivatives market has seen and continues to see the introduction of a significant amount of new regulations and this has led to substantial compliance costs for market participants.

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Debt finance

Lending and borrowing

Are there any restrictions on lending and borrowing?

Lending

Lending is a regulated activity in Luxembourg except, generally, in the following instances:

- one-off and ancillary lending activities;
- intra-group loans; or
- loans granted to a 'restricted circle of previously known persons' (*cercle restreint de personnes préalablement connues*), which are not considered as granted to the 'public', which is generally defined as a multitude of non-identifiable persons.

Mortgage and consumer loans are subject to a range of regulatory requirements that do not apply to other loans. For example, for regulated consumer loan contracts:

- the consumer must have at his disposal the information which will enable him to make his decision with full knowledge of the facts;
- before concluding the credit agreement, the credit institutions must assess the consumer's creditworthiness on the basis of a sufficient number of items of information; or
- the consumer is allowed to withdraw from the credit agreement without stating any reason within the period of 14 calendar days after the execution of the credit agreement.

Finally, a public limited liability company or a partnership limited by shares cannot advance monies, grant a loan, guarantee or security for the purchase of its own shares, subject to completing a whitewash procedure.

Borrowing

While borrowers are generally not regulated, borrowers should consider whether either the mortgage or consumer lending regimes apply to their activities, in which case they will benefit from the protections mentioned above.

For legal entities, borrowing should be permitted under its corporate object.

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What are common lending structures?

Loans can either be provided on a bilateral basis (a single lender providing the entire facility) or syndicated basis (multiple lenders each providing parts of the overall facility). Luxembourg law governed loans can be syndicated but are rare.

Syndicated facilities by their nature involve more parties (such as agents and security agents which fulfil certain roles for the finance parties) are more highly structured and involve more complex documentation. Larger financings will typically be done on a syndicated basis with one of the syndicate taking the lead in coordinating and arranging the financing.

Loans will be structured to achieve specific objectives, eg term loans, asset backed loans, working capital loans, equity bridge facilities, project facilities or letter of credit facilities.

Loan durations

The duration of a loan can also vary between:

- a term loan, provided for an agreed period of time but with a short availability period;
- a revolving loan, provided for an agreed period of time with an availability period that extends nearer to maturity of the loan and which may be redrawn if repaid;
- an overdraft, provided on a short-term basis to solve short-term cash flow issues; or
- a standby or a bridging loan, intended to be used in exceptional circumstances when other forms of finance are unavailable and often attracting a higher margin.

Loan security

A loan can either be secured, unsecured or guaranteed. For more information, see Giving and taking guarantees and security.

Loan commitment

A loan can also be:

- committed, meaning that the lender is obliged to provide the loan if certain conditions are fulfilled; or
- uncommitted, meaning that the lender has discretion whether or not to provide the loan.

Loan repayment

A loan can also be repayable on demand, on an amortizing basis (in instalments over the life of the loan) or scheduled (usually meaning the loan is repayable in full at maturity).

Repurchase agreements

Repurchase agreements are also used as a financing tool.

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What are the differences between lending to institutional / professional or other borrowers?

Lending to institutional/professional borrowers is subject to less regulatory oversight.

By contrast, lending in the context of mortgages and to consumers are subject to specific obligations on the lenders set out in the Luxembourg Consumer Code (ie more pre-information of the borrower).

As a more general principle, the Luxembourg courts determination as to whether lender misconduct is serious will be dependent on whether borrower is a professional or not.

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Do the laws recognize the principles of agency and trusts?

Agency

Agency (*mandat*) is recognized by the Luxembourg Civil Code as a contract under which a principal grants to an agent power to act in its name and behalf. However, powers of attorney, mandates (*mandats*) or appointments of agents (including appointments made for security purposes) may terminate by law and without notice upon the occurrence of insolvency proceedings and may be revoked despite being expressed to be irrevocable.

The Law of 5 August 2005, on financial collateral agreements, as amended from time to time (the Collateral Law), provides that financial collaterals may be held by a person designated by the beneficiaries (ie security agents acting for the lender(s)) without owning any secured debt (so no parallel debt mechanism is needed). Security trustee arrangements are also recognized under the Collateral Law.

Trust

The concept of a trust is unknown under Luxembourg law. However, foreign law trust arrangements are recognized in accordance with the Hague convention of 1 July 1985 on the law applicable to trusts and on their recognition (Hague Trusts Convention), ratified by a Luxembourg law dated 27 July 2003 on trusts and fiduciary contracts, as amended from time to time.

Luxembourg law has implemented the concept of fiduciary (*fiducie*), which, however, does not offer the same features of a trust.

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Are there any other notable risks or issues around lending?

Generally

Luxembourg loan agreements and finance documents are subject to general contractual principles. For instance:

- They should be entered into in *bona fide*.
- Penalty clauses (*clauses pénales*), and similar clauses on damages or liquidated damages are allowed to the extent that they provide for a reasonable level of damages.
- Compounding of interests is subject to certain conditions.
- Specific performance may not always be available and may result only in damages.

Specific types of lending

Specific to the area of mortgage lending is the issue of whether a lender falls within the recently formed Luxembourg mortgage loan regime. The Mortgage Credit Directive, implemented in Luxembourg in the Luxembourg Civil Code, aims to prevent the irresponsible lending and borrowing practices that were exposed during the global financial crisis. The Mortgage Credit Directive applies to first and second ranking mortgages. It imposes a number of requirements on lenders including the need to:

- conduct affordability tests before lending;
- provide standard information about the mortgage to enable borrowers to compare products; and
- ensure that staff are suitably trained.

Standard form documentation

Apart from consumer, mortgage or small corporate loans, major loan financings are not typically governed by Luxembourg law. However this may change as credit providers are using more regularly Luxembourg law.

Syndicated finance transactions are governed by documentation based on recommended forms published by the Loan Market Association (LMA). Bilateral finance transactions are more likely to be documented on bank standard form documentation prepared in-house.

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Are there any other notable risks or issues around borrowing?

Borrowers should be aware of the potential implications of the EU's Bank Recovery and Resolution Directive (BRRD), which outlines certain measures for dealing with failing financial institutions, implemented in Luxembourg by the Law of 18 December 2015 on the resolution, reorganization and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes.

The BRRD applies to financial institutions incorporated in the European Economic Area (EEA), but does not apply to EEA branches of non-EEA incorporated entities.

Article 55 of the BRRD gives authorities the power to 'bail in' obligations of failed EEA financial institutions and also postpone the enforcement of early termination rights against the affected institution. 'Bail in' describes a variety of write down and conversion powers, such as the power to convert certain liabilities into shares or cancel debt instruments. In the case of Luxembourg or other EEA law contracts, such powers override what the contracts says. In the case of non-EEA law contracts, there are requirements to incorporate such provisions into the contract, corporate interest and financial assistance matters are to be considered.

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Giving and taking guarantees and security

Are there any restrictions on giving and taking guarantees and security?

Some of the key areas affecting the giving of guarantees and security are as follows.

Capacity

It is important to verify the constitutional documents of an entity giving a guarantee or granting security to ensure it has an express (or ancillary) power to do so and that giving a guarantee or granting security is not a (shareholder) reserved matter. If the provision of a guarantee or security exceeds the corporate object of the entity, it will still be bound to third-parties (*ultra vires*), unless there is evidence that the beneficiary of such act knew that the acts exceeded the corporate object of the entity or could not, in the light of the circumstances, have been unaware of that fact.

Corporate interest

The entry into the guarantee or security must be in the interest of the entity, which is a subjective and factual concept. The corporate interest must be assessed on a case-by-case basis by the board of the entity. The granting of a guarantee or security interest for the obligations of its parent (upstream) or its sister companies or affiliates (cross stream) is often more difficult. The concept of 'group of company' is not recognized as such and the interest of the group is not sufficient to justify the granting of upstream or cross-stream guarantees/security interests. Therefore, the Luxembourg entity giving the cross stream or upstream guarantee/security interest should:

- have some personal interest in granting such assistance (notably through the expected benefits) and act independently from third party considerations;
- take a commensurate risk in regard of the benefit deriving from the operation; and
- not face a financial exposure exceeding its financial means.

It is standard to include a guarantee limitation to address this issue, except for security interests which are deemed to be limited *per se*.

Financial assistance

It is unlawful for certain companies to provide financial assistance for the acquisition of its own shares by a third party. A whitewash procedure is envisaged by the Luxembourg law on commercial companies dated 15 August 1915, as amended from time to time, but it is rarely applied in practice.

Insolvency

Contractual commitments and guarantees are affected by the opening of insolvency proceedings. In case of such opening of insolvency proceedings secured/guaranteed creditors are registered as members of the general body of creditors. The Law of 5 August 2005, on financial collateral agreements, as amended from time to time, institutes however a framework whereby:

- Luxembourg or foreign bankruptcy and pre-bankruptcy rules are excluded in respect of financial collateral arrangements.
- Immunity from annulment risks in bankruptcy proceedings applies to collateral arrangements governed by the Law of 5 August 2005, on financial collateral agreements, as amended from time to time and to similar collateral arrangements governed by foreign law (provided that the collateral provider is established or resident in Luxembourg).
- There is primacy of financial collateral arrangements over (certain) foreclosure measures.

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What are common types of guarantees and security?

Common forms of guarantees

FIRST DEMAND GUARANTEE (*GARANTIE À PREMIÈRE DEMANDE*)

This creates an abstract, autonomous and independent contractual recourse by the beneficiary against the guarantor. The guarantor may not rely on any exception, or exemption, derived from the underlying debt arrangement.

SURETYSHIP (*CAUTIONNEMENT*)

The suretyship is an accessory to the main monetary obligation. The guarantor may rely on exceptions, or exemptions, derived from the underlying debt arrangement.

It is worth noting that Luxembourg law only envisages payment guarantees (and not performance guarantees).

Other contractual arrangements can also be assimilated to a personal guarantee (e.g. "*promesse de porte-fort*", personal commitment letters).

Common forms of security

The most common types of security agreements are:

- pledge agreements over financial instruments and claims (including among others, intragroup or trade receivables and investors commitments);
- assignment for security purposes of financial instruments and claims;
- commercial pledges over assets (other than financial instruments);
- mortgages; or
- repurchase agreements.

It is worth noting that security must be granted on an asset by asset basis, except that pledges over ongoing business concerns are permitted but rarely used in practice.

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Are there any other notable risks or issues around giving and taking guarantees and security?

Giving or taking guarantees

A civil guarantee must be created by an agreement in writing pursuant to the provisions of the Luxembourg Civil Code. Such a guarantee shall contain some handwritten information (eg the amount of the undertaking in letters and figures). Said restrictions do not apply to commercial guarantees.

Giving or taking security and mortgages

Mortgages must be executed as a notarial deed, involving notarial fees, stamp duties and the attendance by each party to the execution of the notarial deed (powers of attorney are permitted).

Once granted, security and mortgages need to be properly perfected before it can be invoked against third parties. Perfection formalities can range from the entry into the agreement, having the pledge registered in the register of shares/shareholders of the company, notices given to third parties or registration in public registers (depending on the asset).

Notarization is not required for pledge agreements under Luxembourg law.

The entry into the guarantee or security must be in the interest of the entity, which is a subjective concept. The corporate interest must be assessed on a case-by-case basis by the board of the entity. The granting of a guarantee or security interest for the obligations of its parent (upstream guarantee) or its sister companies or affiliates (cross stream) may rise some issues. The concept of group of company is not recognized as such and the interest of the group is not sufficient to justify the granting of upstream or cross stream guarantees or security interests.

Therefore, the Luxembourg entity giving the cross stream or upstream guarantee or security interest should:

- have some personal interest in granting such assistance (notably through the expected benefits) and act independently from third party considerations;
- take a commensurate risk in regard of the benefit deriving from the operation; and
- not face a financial exposure exceeding its financial means.

It is standard to include a guarantee limitation to address such an issue, except for security interests which are deemed to be limited per se.

Pledge agreements and, more generally, security interests governed by the Law of 5 August 2005, on financial collateral agreements, as amended from time to time (such as pledges over financial instruments and claims) are bankruptcy remote:

- they are valid even if entered into during the hardening period; and
- they can be enforced even after the opening of a bankruptcy proceeding.

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Financial regulation

Law and regulation

What are the main laws and regulations that apply to entities that are involved in finance and investments generally?

Generally

Law of 5 April 1993 on the financial sector, as amended from time to time

Consumer credit

The Luxembourg Consumer Code

Law of 23 December 2016, (i) transposing Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 and (ii) amending the Luxembourg Consumer Code

Mortgages

Articles 2114 to 2203 of the Luxembourg Civil Code

Mortgage loans are governed by the Luxembourg Consumer Code (please refer to the legislation in the 'Consumer credit' section above)

Companies

Articles 1832 to 1873 of the Luxembourg Civil Code

Law of 10 August 1915 on commercial companies, as amended from time to time

Funds and platforms

Law of 10 August 1915 on commercial companies, as amended from time to time

Law of 13 February 2007 on specialized investment funds

Law of 17 December 2010 on undertakings for collective investment

Law of 12 July 2013 on alternative investment fund managers

Law of 23 July 2016 on reserved alternative investment funds

Law of 15 June 2004 relating to companies investing in risk capital

Grand-ducal regulation of 8 February 2008 regarding Undertakings for Collective Investment in Transferable Securities (UCITS)

CSSF Regulation No. 10-04 regarding organizational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company of UCITS

CSSF Regulation No. 10-05 regarding mergers, master-feeder structures and notification procedures

CSSF Circular 07/283 regarding specialized investment funds

CSSF Circular 08/380 regarding eligible assets for investments by UCITS

CSSF Circular 11/498 regarding undertakings for collective investment

CSSF Circular 18/698 regarding authorisation and organisation of investment fund managers incorporated under Luxembourg law – special provisions on the fight against money laundering and terrorist financing applicable to investment fund managers and entities carrying out the activity of registrar agent

Other key market legislation

Law of 5 August 2005, on financial collateral agreements, as amended from time to time

Law of 18 December 2015 on the resolution, reorganization and winding up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes

Bank Recovery and Resolution Directive (2014/59/EU) (recovery and resolution)

Capital Requirements Regulation (Regulation (EU) 575/2013) (capital requirements)

European Market Infrastructure Regulation (Regulation (EU) 648/2012) (derivatives), as amended by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019

Market Abuse Regulation (Regulation (EU) 596/2014) (market abuse)

Law of 23 December 2016 on market abuse

Markets in Financial Instruments Directive (2004/39/EC) (financial instruments)

Law of 30 May 2018 on markets in financial instruments

LuxSE Rules and Regulations

Law of 8 April 2019 on the measures to be taken in relation to the financial sector in the event of the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union

The law of 22 March 2004 on securitisation

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Regulatory authorization

Who are the regulators?

The Luxembourg Supervision Commission of the Financial Sector (*Commission de Surveillance du Secteur Financier*) is the regulator which supervises the professionals and products of the Luxembourg financial sector.

. It supervises, regulates through regulations and circulars, authorizes, informs, and, where appropriate, carries out on-site inspections (investigation power) and issues sanctions. Moreover, it is in charge of promoting transparency, safety, soundness and fairness in the markets of financial products and services and is responsible for the enforcement of laws on financial consumer protection and on the fight against money laundering and terrorist financing.

The *Commission de Surveillance du Secteur Financier* has 5 main missions: (i) prudential supervision of certain entities, (ii) public oversight of the audit profession, (iii) compliance with professional obligations, (iv) power of sanction and (v) national, European and international cooperation.

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What are the authorization requirements and process?

Depending on the type of vehicle, it must apply to the *Commission de Surveillance du Secteur Financier* for authorization.

The following vehicles must apply for an authorization:

- Banks,
- Payment institutions and electronic money institutions,
- Professionals of the financial sector (**"PFS"**) being either investment firms, specialised PFS or support PFS,
- Investment vehicles and managers governed by the laws, regulations and circulars referred to in the "Law and regulation" section.

The regulator must assess whether the vehicle meets the requirements set out under Luxembourg law to approve the relevant application. According to the Law of 5 April 1993 on the financial sector, as amended from time to time, the *Commission de Surveillance du Secteur Financier* has to respond to an application within six months of receipt of the application or, if the application is incomplete, within six months of receipt of the informed needed. Absent this decision during this time frame, it is deemed equivalent to a notification of refusal. However, the *Commission de Surveillance du Secteur Financier* is usually responsive.

As mentioned above, credit institutions and must be authorized to exercise their financial activities.

Credit institutions

Banks located in Luxembourg must hold a bank license granted by the Minister of Finance.

Credit institutions from the European Economic Area ("EEA") benefit from the passport for banking services and the freedom to provide banking services in Luxembourg.

Non-EEA credit institutions coming occasionally and temporarily to Luxembourg to provide services must hold an authorization granted by the Minister of Finance.

Application forms dealing with the following criteria shall be completed and sent to the *Commission de Surveillance du Secteur Financier* and shall include, *inter alia*, legal form, capital base, central administration and infrastructure, managing body, shareholders, professional standing, knowledge, competences and experience, governance and remuneration policy, external auditing and deposit guarantee and investor compensation.

Professionnels du secteur financier (PFS)

PFS include investment firms referred to in Part I, Chapter 2, Section 2, Subsection 1 of the Law of 5 April 1993 on the financial sector, as amended from time to time (1993 Law).

Specialized PFS are referred to either in Part I, Chapter 2, Section 2, Subsection 2 or in Article 13 of the 1993 Law and which do not belong to the categories of the first and third indent of such definition.

Support PFS are referred to in Part I, Chapter 2, Section 2, Subsection of the 1993 Law.

Application forms dealing with the following criteria should be completed and sent to the *Commission de Surveillance du Secteur Financier* and should include, *inter alia*:

- legal form;
- capital base;
- central administration and infrastructure;
- shareholders;
- professional standing and experience;
- external audit; and
- participation in an authorized investor compensation scheme (only for investment firms).

Procedure

Authorizations are subject to prior examination by the *Commission de Surveillance du Secteur Financier* and final granting by the Minister of Finance.

Fees to be paid to the *Commission de Surveillance du Secteur Financier* depends on the entity, its form and business. The *Commission de Surveillance du Secteur Financier* charges an annual fee as well as a fee for the examination.

Supervised entities are listed on the webpage of the *Commission de Surveillance du Secteur Financier*.

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What are the main ongoing compliance requirements?

All entities under the supervision of the *Commission de Surveillance du Secteur Financier* must comply with all Luxembourg laws and regulations on an ongoing basis.

In respect of credit institutions, banks shall transmit to the *Commission de Surveillance du Secteur Financier* mainly financial and accounting data relating to their activities on a monthly, quarterly, half-yearly or annual basis, depending on the object.

The *Commission de Surveillance du Secteur Financier* must assess whether the application meets the threshold required by Luxembourg law and regulations.

For the instructions relating to the ongoing information to be provided by a PFS, please refer to circulars CSSF 05/187, CSSF 10/433 CSSF 08/364, IML 96/124.

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What are the penalties for failure to be authorized?

A person or company undertaking a regulated activity without being authorized or exempt commits a criminal offence and is liable to imprisonment and fines. Administrative sanctions and nullity of the agreements is also possible.

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Regulated activities

What finance and investment activities require authorization?

Generally

A person must not carry on a regulated activity in Luxembourg unless authorized or exempt (known as the general prohibition).

Any activity dealing with financial matters, advice or money constitutes a financial activity. The existence of a money flow is an important indication to establish whether an activity qualifies as a financial sector activity. However, the *Commission de Surveillance du Secteur Financier* shall decide for each specific activity whether authorization is required.

- Specified activities include accepting deposits, dealing in, managing, arranging and advising on investments, and establishing collective investment schemes.
- Specified investments include deposits, shares, debt instruments, options, futures, units in a collective investment scheme and government and public securities.

Consumer credit

Consumer credit activities, including credit broking, operating an electronic system in relation to lending and entering into a regulated credit agreement as lender are deemed regulated activities.

The granting of consumer loans requires prior authorization unless covered by the exemptions set out in article L. 224-3 of the Luxembourg Consumer Code, including *inter alia* granting of loans for an amount below €200 and above €75,000 and loans granted to acquire or maintain ownership of real estate land, or an existing building or a building to be constructed.

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Are there any possible exemptions?

Regulated activities may be undertaken without authorization if either a general or specific exclusion applies.

General exclusions

General exclusions include:

- one-off and ancillary regulated activities;
- intra-group activities;
- loans granted to a ‘restricted circle of previously known persons’ (*cercle restreint de personnes préalablement connues*), which are not deemed to be granted to the ‘public’, which is generally defined as a multitude of non-identifiable persons; or
- the exercise of a financial sector activity or a connected or ancillary activity, which is not carried out on a regular basis (legal assessment required).

Specific exclusions

A Luxembourg Reserved Alternative Investment Fund (RAIF) is exempt from being authorized by the *Commission de Surveillance du Secteur Financier*. However, a RAIF will have to appoint an alternative investment fund manager, who is in turn authorized and supervised be the *Commission de Surveillance du Secteur Financier*.

Loan origination and loan participation and/or acquisition are permissible activities for Luxembourg entities subject to due compliance by the manager and the Luxembourg entity, where applicable, with the requirements set forth in the *Commission de Surveillance du Secteur Financier* Frequently Asked Questions, version 10, dated 9 June 2016, concerning the Luxembourg Law of 12 July 2013 on alternative investment fund managers. However, a Luxembourg court may still find otherwise based on the law dated 5 April 1993 on the financial sector, as amended from time to time.

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Do any exchange controls or other restrictions on payments apply?

Luxembourg does not operate any foreign currency controls.

For cases of money transferring from non-EU member states, imports of foreign currency may need to be declared in the custom declarations, but there is no legal restriction on moving money in or out of the country.

Compliance with the EU rules on payments (EU Payments Regulation and the Transfer of Funds Regulations) must be ensured.

There may also be anti-money laundering and tax considerations to take into account.

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What are the rules around financial promotions?

Rules

A financial promotion is a communication of an invitation or inducement to engage in a financial activity made by a person in the course of business. Since such communications can influence consumers, a person is restricted from communicating such promotions unless he /she is an authorized person, or the content of the communication has been approved by an authorized person, or the promotion falls within one of the exemptions.

An unauthorized person who communicates a financial promotion may be held liable for carrying out such activity without being licensed.

Exemptions

Promotions are allowed for those persons and entities authorized by the regulator or permitted (ie benefitting from an exemption) to do so.

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Entity establishment

What types of legal entity are generally used to undertake financial or investment activity?

Generally

Credit institutions may only be incorporated as a public-law institution, a *société anonyme* (public limited liability company), a *société en commandite par actions* (partnership limited by shares) or a *société cooperative* (cooperative).

Authorization for any activity involving the management of funds belonging to third parties may only be granted to legal persons having the form of a public entity or a commercial company.

The legal form that a professional of the financial sector (*professionnel du secteur financier* (PFS)) should adopt, as well as the capital base that it must have, depends on the activity that it intends to carry out. The choice of the legal form of the future PFS shall be made while taking into account the general and special legal conditions applicable to the authorization that is sought.

Investment funds may be set up as companies or partnerships.

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Is it possible to conduct lending or investment business through a branch or establishment?

Yes, it is possible to conduct lending or investment activities through a branch in Luxembourg.

Branch means 'a place of business other than the head office which is a part of a credit institution or an investment firm, which has no legal personality and which performs directly, entirely or in part transactions related to the activity of credit institutions or provides investment services and/or activities and which may also perform ancillary services for which the investment firm has been authorized.'

The exercise of these activities by a branch of a credit institution or investment firm authorized in another member state is not subject to authorization by the Luxembourg authorities provided that these activities fulfil the requirements laid down in article 30 of the Law of 5 April 1993 on the financial sector, as amended from time to time.

Credit institutions and investment firms governed by a non-member state and wishing to establish a branch in Luxembourg are subject to the same authorization rules as those applying to credit institutions and other professionals of the financial sector governed by Luxembourg law.

Foreign companies performing activities in Luxembourg, which lead to the creation of a permanent establishment, may be subject to tax on income attributable to such a permanent establishment.

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FinTech

FinTech products and uses

What are the most common technology products and FinTech applications used or being developed in the finance and investment marketplace?

Peer-to-peer funding platforms and marketplace lending

There is no strict definition for marketplace lending given the wide variety of entrants and financing techniques involved. The principal characteristics of new marketplace lenders, however, would include:

- operating from or through a non-bank lending platform established as a specialist corporate or special purpose vehicle (SPV) based structure (which *inter alia* can be set up as a (regulated) securitization vehicle);
- applying technology to leverage and optimize the lending platform and user experience;
- connecting borrowers and lenders through the platform rather than applying funding arising from a wider deposit-based relationship; and
- virtual payment applications (eg using smartphones).

Instead of having a central institution (such as a regulated credit establishment) granting loans, these are made by 'peers' (eg retail or institutional investors, or funds), subject however to certain restrictions as lending activities are regulated activities.

Alternative credit providers involved in FinTech applications are gaining market share, based on a specific framework. In this respect, loan origination and loan participation or acquisition (as these terms are defined in the CSSF Frequently Asked Questions, version 11, dated 6 July 2017 cannot exclude the possibility that a Luxembourg court will find otherwise based on the law dated 5 April 1993 on the financial sector as amended from time-to-time.

Marketplace lending is available to address most forms of traditional bank funding products. Recently products have included:

- virtual credit cards;
- small and medium-sized enterprises (SME) lending; and
- residential property and commercial property mortgage lending.

It is likely that the volume of lending in these product areas as well as further and additional product areas will significantly increase over the coming years, as financing becomes more readily available to support the marketplace lending sector.

HOW ARE MARKETPLACE LENDING PLATFORMS FUNDING THEMSELVES?

Marketplace lending includes peer-to-peer (P2P) type structures often operated through an electronic platform provider as well as crowdfunding and also direct-to-retail financing mechanisms. The increase in demand for credit through these marketplace platforms has also been appealing to larger pools of available capital, such as private equity and venture capital funds as well as institutional sponsors. Funding platforms will now often be backed by institutional finance in addition to, or rather than, individual investors on a traditional P2P basis.

ISSUES FOR STARTUP MARKETPLACE LENDERS

Following the initial incorporation and startup funding for a new marketplace lending business, there will be a need to establish funding lines which can accommodate growth of the ongoing lending activities of the platform. As the startup lender will not have an established track record, the funding structure will often follow the format of a warehouse securitization structure or fund. Origination of new assets will be funded through drawings on a note issuance facility backed by security over the new assets. Each of the new assets will be subject to eligibility criteria determined by reference to the nature of the underlying asset. In order to provide an efficient financing structure the assets will typically be held through a SPV with origination and servicing provided by the marketplace lender. In order to cover expected losses on the asset pool, the senior facility will be subject to the lending platform maintaining sufficient subordinated capital in the form of equity, or a combination of equity and subordinated debt.

While the funding may be structured through a revolving loan or note program, if there is tranching of the debt this will typically result in the platform being treated as a securitization for the purposes of the European Union Capital Requirements Regulation, with the attendant requirements to hold risk retention and provide appropriate reporting and disclosures.

Blockchain, smart contracts and cryptocurrencies

WHAT IS BLOCKCHAIN?

Blockchain provides a new approach to holding and authenticating data. It is a database operating through distributed ledger technology in which data is recorded on computers, by way of a P2P mechanism, based on pre-agreed consensus algorithms in the applicable participating network. It is a form of database where data is stored in the chain in either fixed structures called 'blocks' or algorithm functions called 'hashes'.

Each block includes unique features such as its unique block reference number, the time the block was created and a link back to the previous block. Each block is reviewed by a number of nodes and the block is only added to the database if the node reaches consensus that the block only contains valid transactions. Content includes digital assets and instructions which reflect the transactions and parties to those transactions. The ability to track previous blocks in the chain makes it possible to identify transactions back to the first ever transaction completed, enabling parties to verify and establish the authenticity of the assets in the latest block. This makes blockchain exceptionally accurate and secure.

Specialist users on the system apply advanced computing software to identify time stamped blocks, verify the accuracy of the block using sophisticated algorithms and add the verified block to the chain. As the number of participants increases, the replication of the data over a wider base makes it harder for any person to alter the data in the chain. Any attempted addition or modification to the information on a block needs to be approved by all users in the network and verification of any block can only happen through a 'proof of work' process. This process requires vast amounts of computing power, making it practically impossible to insert fake transactions into a block.

As a result, the data is identified and authenticated in near real-time, providing a permanent and incorruptible database sufficiently robust to operate as a store of value (eg in the case of cryptocurrencies such as bitcoin) or providing an indisputable record, for example relating to securities transfer.

Blockchain is a decentralized system, created and maintained by users of the network rather than being dependent on any central or third party intermediary. It may be public and open ('permissionless' or 'unpermissioned') or structured within a private group ('permissioned').

Permissionless blockchains include bitcoin and ethereum, in which anyone can set up a node that, once authorized, can validate, observe and submit transactions. The identities of the participants are not known (other than the unique and random identities known as an 'address'). Permissioned ledgers restrict participation in the network and only the specific participants are given access and are known within the network. The network is private, and only organizations that have been authorized can participate and view transactions.

WHAT ARE SMART CONTRACTS AND DECENTRALIZED AUTONOMOUS ORGANIZATIONS (DAOS)?

Developments in blockchain are also providing an ability to transfer and rely on instructions verified within the electronic system in the form of so called 'smart contracts'. These contracts have been converted into code and are then executed and enforced by the blockchain network on the occurrence of an event. This reduces the need for intermediaries to collect, store and act on communicated information.

Smart contracts are essentially pre-written computer codes which are stored and replicated on distributed ledger platforms such as blockchain. Execution takes place over the network, eliminating the need for intermediary parties to confirm the transaction, leading to self-executing contractual provisions. These contracts can be as simple as moving a balance from one account to another or advanced, more-complex interactions with the outside world using so called 'Oracles'. With Oracles, the contract code consults with a service outside of the blockchain network to make a decision. This may entail receiving a confirmation that an event has occurred, such as payment, which automatically executes a further step in the contract, such as the transfer of an asset, which might be in digital form or by delivering instructions to a person or warehouse to release the asset for delivery.

DAOs are essentially online, digital entities that operate through the implementation of pre-coded rules. These entities often need minimal to zero input into their operation and they are used to execute smart contracts, recording activity on the blockchain. DAOs can be particularly challenging to regulate depending on their software engine, the nature of transactions they are completing or other unique features. Questions of ownership and responsibility for resulting acts of DAOs can also be brought to question if any technical issues arise with their operation.

WHAT IS A CRYPTOCURRENCY?

The European Central Bank definition of a cryptocurrency is that it is a digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is issued by natural or legal persons as a means of exchange and can be transferred, shared or traded economically. The oldest and best-known cryptocurrency is bitcoin (itself based on the bitcoin platform) although many other cryptocurrencies now exist. For example, the most widely-known alternatives to bitcoin include ether based on the ethereum platform and litecoin (these cryptocurrencies are now actively traded with a large developing infrastructure for holding, pricing and exchanging currency).

The *Commission de Surveillance du Secteur Financier* published a warning on virtual currencies on 14 March 2018 in order to state that virtual currencies are not currencies, are not regulated, not guaranteed by a central bank or a deposit guarantee scheme. Their high volatility bears a number of risks including total loss of investment.

Initial coin offerings and token-based products

WHAT IS AN INITIAL COIN OFFERING (ICO)?

ICOs are a form of digital currency or token using blockchain technology. ICOs are often a means by which funds are raised for a new blockchain or cryptocurrency venture (the market for ICOs is expanding). ICOs come in a wide variety of forms and may be used for a wide range of purposes. Some forms of ICOs may be directed at customers or suppliers as a form of loyalty program or a form of access or purchasing power (preferential or otherwise) in respect of assets of the issuer’s business. Other forms may be more focused on raising initial funding. It is essential to examine the legal and regulatory basis for any ICO as an unauthorized offering of securities is illegal and may result in criminal sanctions in a number of jurisdictions. Legal analysis of the underlying token will determine if it should be treated as a specified investment or form of regulated security or is more appropriately a form of asset that is not itself subject to the regulatory regime.

Typical attributes provided by tokens will include:

- access to the assets or features of a particular project;

- the ability to earn rewards for various forms of participation on the platform; and
- prospective return on the investment.

Key aspects to consider will include the:

- availability and limitations on the total amount of the tokens;
- decision-making process in relation to the rules or ability to change the rules of the scheme;
- nature of the project to which the tokens relate;
- technical milestones applicable to the project;
- basis and security of underlying technology;
- amount of coin or token that is reserved or available to the issuer and its sponsors and the basis of existing rights;
- quality and experience of management; and
- compliance with law and all regulatory requirements.

The nature of the business and the purpose and structure of the token offering will typically be set out in a white paper available to potential purchasers.

The *Commission de Surveillance du Secteur Financier* published a warning on initial coin offerings (ICOs) and tokens on 14 March 2018 in order to state that raising funds from the public in the form of so-called initial coin offerings is not subject to a specific regulation and does not benfit from any guarantee or other form of regulatory protection. ICOs are highly speculative investments that may lead to a total loss of investment.

Artificial intelligence and robo advisory systems

Automated financial advice tools, also known as 'robo advisors' are software tools driven by artificial intelligence (AI) that provide a variety of investment advice services, from portfolio selection to personal finance planning. The systems are generally operated on a platform /personal dashboard basis; a user can input a set of personalized data to be processed by the AI algorithms which produce optimized outcomes around specified parameters. Although generally of application in the asset management sector, AI and automated advice tools also impact in the banking and private wealth advisor sectors; the implications include decreased human involvement, although recent trends have included a growth in popularity of hybrid structures which combine AI and human inputs.

The *Commission de Surveillance du Secteur Financier* published the 27 March 2018 its position on Robo-advice as well as, in December 2018, a White Paper on Artificial Intelligence: Opportunities, risks and recommendations for the financial sector. This White Paper aims at better understand what Artificial Intelligence is and the related risk as well as explain some practical use cases for the financial sector. An analysis of the main risks associated and key recommendations to take into account when implementing Artificial intelligence inside a business process ae also covered.

Data analysis and cloud computing

Cloud computing enables delivery of IT services through internet-based tools and applications, rather than direct connection to a physical server. Cloud-based storage makes it possible to save masses of data to remote servers, accessible through the internet rather than by way of a physical connection. With the vast data processing and storage capabilities offered by cloud computing technology and virtually no infrastructure barriers to entry, there are a number of applications in building and running FinTech businesses and the technology has had a significant impact in recent years.

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Are there any restrictions, specific laws, regulations or procedures that apply to FinTech products?

General financial regulatory regime

The *Commission de Surveillance du Secteur Financier* (CSSF) supervises the professionals and products of the Luxembourg financial sector. It supervises, regulates, authorizes, informs, and, where appropriate, carries out on-site inspections and issues sanctions.

The National Commission for Data Protection (*Commission Nationale pour la Protection des Données* or CNPD), is the Luxembourg independent authority verifying the legality of the processing of personal data and ensuring the respect of personal freedoms and fundamental rights with regard to data protection and privacy. Its mission also extends to ensuring the respect of the Law of 30 May 2005 regarding the specific rules for the protection of privacy in the sector of electronic communications and the Luxembourg law of 1 August 2018 on the organisation of the National Data Protection Commission and the general data protection framework (short title).

GENERAL CSSF POSITIONS

The CSSF was one of the first European regulators to take position on FinTech. On 14 February 2014, the CSSF published a *communique*, with the following points in respect of virtual currencies:

- Virtual currencies are considered as scriptural money (as opposed to cash money in the form of bank notes and coins), since they are accepted as a means of payment for goods and services. The issuing of virtual money is not regulated from a monetary point of view, they are not legal tender and they entail risks.
- No one can be established in Luxembourg to carry out an activity in the financial sector without an authorization by the Minister of Finance and without being subject to the prudential supervision of the CSSF. The potentially interested persons who would like to establish themselves in Luxembourg in order to issue means of payments in the form of virtual currencies, provide payment services using virtual currencies or create a platform to trade virtual currencies, are required to define their business purpose and their activity in a sufficiently concrete and precise manner to allow the CSSF to determine which status they need to receive a ministerial authorization for.

The position of the CSSF in respect of virtual currencies has been confirmed by the European Court of Justice on 22 October 2015.

More generally, the CSSF has a balanced approach toward FinTech companies and applies the existing regulatory framework (ie the current European Union regulatory framework, as implemented in Luxembourg) in a proportionate way. The CSSF has to determine the potential benefits of the submitted innovation and whether there could be regulatory barriers linked to the innovative character of the business model it could address without circumventing the regulatory requirements. One of the main challenges is to identify risks (cyber-risks, fraud and anti-money laundering/combatting the financing of terrorism risks), which have to be properly assessed together with the mitigating measures that can be applied.

The CSSF has established a division dedicated to financial innovation and technology, focused on developing, facilitating and securing FinTech businesses.

The blockchain has also been implemented in Luxembourg law with, inter alia, the law of 1rst March 2019 amending the Luxembourg law of 1rst August 2001 on the circulation of securities introducing a new article 18bis in the law of 1rst August 2001 by specifying that securities may be booked and transferred through secure electronic recording devices, in particular through distributed ledgers such as blockchain, providing an alternative to the dematerialisation processes already known.

Electronic payments platforms, payment services and regulation of peer-to-peer lenders

PAYMENT INSTITUTIONS

The services offered by Payment Institutions (PIs) can vary from the provision of payment infrastructures to customers (eg for services industries) to services enabling payments between individuals. It also includes facilitation of secure credit and debit card transactions, both nationally and internationally.

ELECTRONIC MONEY INSTITUTIONS

Pursuant to article 1 (29) of the Luxembourg law of 10 November 2009 on payment services, on the activity of electronic money institutions (EMIs) and settlement finality in payment and securities settlement systems, as amended (PSL), electronic money (Electronic Money) means a monetary value represented by a claim on the issuer, which is:

- electronically, including magnetically, stored;
- issued on receipt of funds for the purpose of making payment transactions; and

- accepted by a natural or legal person other than the Electronic Money issuer.

EMIs are institutions issuing Electronic Money.

In addition to issuing Electronic Money, EMIs are also permitted to supply all services of PIs, to grant loans (under certain conditions) linked to payment services, to supply operational services and other services closely linked to the issuing of electronic money or to the supply of payment services.

REGULATION OF PAYMENT SERVICES, PAYMENT INSTITUTIONS AND EMIS

PIs and EMIs in Luxembourg are governed by the PSL, deriving from the interpretation of Directive 2015/2366 on payement services in the internal market (the second payment services Directive) ("PSD 2") repealing Directive 2007/64/EC of 13 November 2007 on payments services in the internal market, and of Directive 2009/110/EC of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of EMIs.

Since 2007, many changes in the digitalization of financial services have led to the need for an update of the Directive 2007/64. The PSD 2 aims to tackle the shortcomings of the first directive in the modern era by impacting PIs and EMIs. PSD 2 introduced two new third-party payment service providers: Payment Initiation Services Providers and Account Information Service Providers.

Before taking a formal decision to set up an EMI or PI in Luxembourg, the prospective institutions should be approved by the CSSF and comply with mandatory conditions (eg legal form, capital requirements).

PEER-TO-PEER LENDERS

Under Luxembourg law, there is no specific regulatory framework in respect of peer-to-peer lending. As a result, European regulation, which mainly consists of the following, applies:

- Regulation (EU) 2017/1129 of the European Parliament of 14 June 2017 on the prospectus to be established when securities are offered to the public or admitted to trading on a regulated market;
- Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers; and Directive 2007/64.

Note that the current position of the European Commission is that there is no need for a specific European regulation in respect of marketplace lending activities. Priority will be given to updating the current regulatory framework regulating the marketplace lending activities.

In addition, no one can be established in Luxembourg to carry out an activity of the financial sector without an authorization by the Minister of Finance and without being subject to the prudential supervision of the CSSF. The potentially interested persons who would like to establish themselves in Luxembourg to carry out marketplace lending activities are required to define their business purpose and their activity in a sufficiently concrete and precise manner to allow the CSSF to determine for which status they need to receive a ministerial authorization.

Under Luxembourg law (article 24-8 of the law of 5 April 1993 on the financial sector, as amended (1193 Law)), professionals carrying on lending operations are professionals engaging in the business of granting loans to the public for their own account, are required to be authorized to carry out these activities. The following, in particular, shall be regarded as lending operations for the purposes of this article:

- financial leasing operations involving the leasing of moveable or immoveable property specifically purchased with a view to such leasing by the professional, who remains the owner thereof, where the contract reserves to the lessee the right to acquire, either during the course of or at the end of the term of the lease, ownership of all or any part of the property leased in return for payment of a sum specified in the contract; and
- factoring operations, either with or without recourse, whereby the professional purchases commercial debts and proceeds to collect them for his own account.

This article shall not apply to persons engaging in the granting of consumer credit, including financial leasing operations as defined in paragraph 2(a) of this article, where that activity is incidental to the pursuit of any activity covered by the law dated 2 September 2011 regulating the access to the profession of craftsman, merchant, industrial as well as certain liberal professions.

Article 24-8 of the 1993 Law shall not apply to persons engaging in securitization operations. Also, authorization to act as a professional carrying on lending operations may be granted only to legal persons and shall be conditional on the production of evidence showing the existence of a share capital of not less than €730,000.

Also, applicable regulation will depend on the form of the vehicle used for the purposes of carrying out the marketplace lending activities (eg securitization vehicle or investment fund).

Application of data protection and consumer laws

The European General Data Protection Regulation ("GDPR") regulates the processing of personal data in Luxembourg. Where a business determines the purposes and manner in which any personal data is processed or processes personal data upon instructions and on behalf of a third party, it will be regulated by the GDPR and have certain compliance obligations. For instance, depending on the situation, a business may have to carry out mandatory notifications where a personal data breach occurs, or where it wishes to put in place a system allowing the surveillance of its employees. In any case, businesses will have to abide by the "data protection by design and by default" principles, which include e.g. the provision of transparent information to individuals whose personal data is processed, and the maintenance of extensive internal compliance documentation.

The Luxembourg law of 1 August 2018 on the organisation of the National Data Protection Commission and the general data protection framework (short title).The Luxembourg law of 30 May 2005, laying down specific provisions for the protection of persons with regard to the processing of personal data in the electronic communications sector, regulates unsolicited direct marketing by electronic means.

Cloud computing

On 17 May 2017, the CSSF published the Circular 17/654, as amended by Circular 19/714 (Circular) on IT outsourcing based on a cloud computing infrastructure. The Circular is designed to clarify the regulatory framework for the use of a cloud computing infrastructure supplied by an external service provider. The Circular confirms that CSSF considers that cloud computing is a form of outsourcing. The Circular applies immediately to financial professionals, including credit institutions, investment firms, specialized financial sector professionals (FSPs), support specialized financial sector professionals, as well as PIs, and EMIs.

According to the CSSF, cloud computing is a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (eg networks, servers, storage, applications and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction.

Money laundering regulations

The CSSF is in charge of supervising the anti-money laundering (AML) controls of supervised entities (eg FinTech companies) which have to comply with:

- the law of 12 November 2004 as amended (Title I, coordinated version);
- the Luxembourg law of 27 October 2010 enhancing the AML and counter-terrorist financing legal framework;
- the grand-ducal regulation of 29 October 2010; and
- the CSSF Regulation N°12-02 on the fight against money laundering and terrorist financing.

Generally, where a firm is authorized and supervised by the CSSF it will also be authorized and supervised by the CSSF for complying with AML requirements. Electronic currencies such as bitcoin and other cryptocurrencies tend to represent a higher money-laundering risk.

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What type of funding arrangements and incentives are available to FinTech businesses?

Early stage

SEED INVESTMENT

Initial investment in FinTech businesses may be provided by family and friends of the founders and other high-net-worth individuals (often known as business angels) in return for an equity stake. Such seed investment is often used to fund the establishment and early growth of the business before larger investment is available. The investing individuals may also provide know-how and expertise to assist in the company's development. The seed investors would typically not require the same controls over the business as, for example, venture capital (VC) providers.

For instance, in Luxembourg, the Digital Tech Fund provides seed financing to entrepreneurs running innovative startup companies active in the field of digital technologies. The fund's aim is to foster long-term innovation, support the technology startup ecosystem in Luxembourg and facilitate the transfer of new digital technologies developed at the University of Luxembourg into successful spin-off companies.

CROWDFUNDING

The crowdfunding sector may be appropriate for a FinTech business in the early stages. It involves members of the public investing in a business by pooling their resources through an intermediary platform.

There are two main types of crowdfunding: equity and reward-based.

- Equity crowdfunding involves company shares being given in exchange for investment in the business.
- Reward-based crowdfunding provides investors with a tangible benefit, such as early access to a platform or application that the business is developing.

Crowdfunding offers a large number of private investors an opportunity to make small-scale investments in early-stage businesses to which they may otherwise not have had access.

ACCELERATORS

In Luxembourg, the Luxembourg House of Financial Technology (LHoFT) has been recently created. The LHoFT is a public-private joint venture that drives technology innovation for Luxembourg's financial services industry, connecting the domestic and international FinTech community.

Among other benefits, the LHoFT offers:

- startup incubation;
- co-working spaces; and
- a soft-landing platform.

The LHoFT connects and creates value for the entire Luxembourg FinTech ecosystem: financial institutions, FinTech trailblazers, the IT industry, research and academia as well as regulatory and public authorities.

Venture capital and debt

Venture Capital (VC) funding is a type of equity investment usually targeted at early stage FinTech companies with an established business and some trading history. VC provides a viable alternative to traditional lending given that the business is unlikely to have the tangible asset base or long track record needed to attract traditional debt funding from financial institutions.

Corporate venture capital (CVC) is a type of VC and involves an equity investment by a corporate fund. The benefit of having a CVC as an investor for a FinTech startup is that the fund is able to share its knowledge and expertise of the FinTech sector with the company and act as an advisor.

An additional funding option is venture debt, which is typically structured as a three-year term loan (or series of loans), secured against a company's assets and includes an equity element allowing the debt provider to purchase shares in the company. However, venture debt providers will usually only invest into companies that have already received investment through venture capital.

European Venture Capital Funds (EuVECA) constitute alternative investment schemes that focus on startups and early stage companies such as FinTechs. EuVECA have been implemented by the Regulation n° 345/2013 on European Venture Capital Funds (Regulation 345 /2013). As part of its drive to improve the functioning of Europe's capital markets and to develop alternative sources of finance for small and medium-sized enterprises, including VC, in July 2016 the European Commission announced amendments to Regulation 345/2013 to

encourage more fund managers to establish funds under this regime. A political agreement between the co-legislators was reached on 30 May 2017 and the revised regulation should be formally adopted soon.

Warehouse and platform funding

Warehouse financing may be suitable for FinTech companies which own a portfolio of assets. Funding is often provided by way of a loan from a small number of lenders to a special purpose vehicle (SPV). The loan is secured on the assets acquired by the SPV from the originator. The lenders will only fund a portion of the assets, with the remainder being financed by way of subordinated lending from the originator.

Another alternative form of funding is by way of peer-to-peer (P2P) lending platforms such as Lendix and CrossLend, which bring individual borrowers and lenders together without the involvement of traditional banks.

Senior bank debt and capital markets funding

SENIOR BANK DEBT

Once a FinTech company is established and has a track record, bank debt becomes a more viable source of funding, either on a secured or unsecured basis depending on the creditworthiness and asset base of the business. In contrast to capital markets funding which is often covenant-lite, bank funding will generally involve the imposition of financial covenants and controls that will apply over the life of the facility. Bank finance may be particularly important for working capital, overdraft, accounts management and general liquidity purposes.

CAPITAL MARKETS FUNDING

Luxembourg has both debt and equity capital markets which are accessible to businesses.

A FinTech that has grown to a certain size may finance itself by way of an Initial Public Offering (IPO). An IPO is the initial sale of company shares on a public exchange, such as the Luxembourg Stock Exchange.

Marketplace loan securitizations have been launched in Luxembourg, where loans originated via marketplace lending platforms are packaged together and sold to investors as bonds. For example, in 2015 CrossLend set up a securitization vehicle to carry out P2P lending. The CrossLend subsidiary issuing the bonds decided to be regulated in Luxembourg because of Luxembourg's expertise in securitization, as well as the accessibility and responsiveness of the *Commission de Surveillance du Secteur Financier* (CSSF).

CONVERTIBLE BONDS/LOAN NOTES

A popular funding tool for fast-growing FinTech businesses is to issue convertible bonds or loan notes which are essentially a hybrid between debt and equity. Convertible instruments begin as a loan accruing interest and are convertible into shares in the issuing company at prescribed prices in certain circumstances.

Incentives and reliefs

A range of support initiatives make Luxembourg the ideal place to engage in a FinTech startup. FinTech startups can combine private funding with public funding schemes for research, development and innovation.

Also, FinTech companies can obtain funding from the €150 million Luxembourg Future Fund (which aims to stimulate the diversification and sustainable development of the Luxembourgish economy – ie companies active in the information and communications technology, cleantech and other technology sectors excluding health technologies and life science sectors), as well as the Digital Tech Fund. Meanwhile, incubator and accelerator facilities offer physical space designed to foster business development and provide invaluable networking opportunities.

Different platforms such as the Luxembourg House of Financial Technolgy (LHoFT) exist, bringing together financial institutions, FinTech innovations, research, academia and public authorities, to help drive forward the development of products which meet specific industry needs.

Tax incentives

NEW LUXEMBOURG INTELLECTUAL PROPERTY REGIME

Intellectual property ("IP") rights relating to FinTech may benefit from the new IP regime introduced in Luxembourg law in March 2018. The new article 50ter of the Luxembourg Income Tax Law provides for a partial exemption of 80% on the net income derived from eligible IP assets

Under this law, patents and copyrights on computer software, among others, including those related to FinTech, are eligible assets for the preferential tax treatment. However, assets of marketing nature, such as trademarks, are outside of the scope.

Eligible income that will qualify for preferential tax treatment includes net income from direct use, royalties from the granting of licenses or income from the sale of eligible IP assets.

The proportion of net income qualifying for the preferential tax treatment will be determined based on the nexus ratio, which is the proportion of eligible expenditure to total expenditure. Total expenditure, under the law, basically includes research and development ("R&D") expenses directly related to the IP assets in question.

All costs not directly related to an eligible IP asset (e.g. real estate costs, interest, financing costs and acquisition costs of IP assets) are not eligible and fall outside the scope of the calculation of the tax exempt income.

The eligible expenditure can be uplifted by 30%. This uplift is allowed as long as the eligible expenditure does not exceed the total amount of expenditure.

The IP activity of the company should be properly documented to demonstrate the link between the eligible IP assets and the related expenses. The taxpayer must also be ready to share this information with the Luxembourg tax authorities, if need be.

DEDUCTIBILITY OF INTERESTS

Payments of interest made by a Luxembourg borrower to a lender through a P2P platform are, in principle, exempt from withholding tax.

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Portfolio sales

Loan transfers and portfolio sales

What are common ways of buying and selling loans?

Buying and selling loans is very common.

A loan can be sold on an individual basis or packaged up with other loans and sold as a portfolio pursuant to overarching terms.

The most common ways of selling loans are:

- **Assignment of claims** – Subject to any contractual restrictions, assignment can be done without the consent of the debtor (although it has to be notified in accordance with article 1690 of the Luxembourg Civil Code).
- **Assignment of contract** – Assignment generally require the consent of the debtor (as this right be seen as a novation).
- **Novation** – Under novation contracts, the parties agree to terminate the existing debt and a new debt is created. Novation can only occur in three situations under Luxembourg law:
    - substitution of debt;
    - change of debtor; and
    - change of creditor.

Loan transfers are commonly documented using standard form contracts made available by the Loan Market Association (LMA). For more complex transactions, a more bespoke form of sale and purchase agreement would tend to be used. The form and content of the transfer documentation will depend on the nature of the underlying assets being sold.

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What are the main considerations when transferring a loan and related security?

There are a number of issues to consider before transferring a loan or portfolio of loans. These issues are often covered as part of a due diligence exercise by the legal advisors. Some of the key considerations include:

- **confidentiality** – whether the seller of the loan is allowed to disclose information relating to the loan to a potential purchaser;
- **data protection** – whether there is any personal data or other restricted information in the loan that should not be disclosed to a potential purchaser;
- **lender eligibility** – whether there are any restrictions around the type of entity to which the loan can be transferred;
- **undrawn commitments** – whether there are any continuing obligations for further funding or other material obligations on the part of the lender that may fall on the transferee or reduce claims made by the transferee;
- **transfer mechanics** – whether there are any steps that need to be taken to transfer the loan in accordance with its term;
- **consent** – whether a transfer requires the consent or notification of any other parties; and
- **preservation of security/perfection formalities** – whether the underlying security is preserved in favor of the new lender and whether any perfection formality is needed for the transfer to be enforceable.

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Projects

Financing / investing in energy / infrastructure

To what extent are energy and infrastructure assets publicly or privately owned?

Various industries have been privatized or liberalized in Luxembourg further to the EU liberalization and free-market policy.

In Luxembourg, rail, roads, waste, health, justice/prisons, defense, social housing and education are mostly publicly owned.

Telecoms, space related activities, aviation, energy are mostly privatized, however, the most important companies operating in this field in Luxembourg are owned by the public sector (eg Post, Luxair, Enovos, SES).

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Are there special rules for investing in energy and infrastructure?

There are no overall domestic restrictions, except in relation to certain utilities. Obligations resulting from anti-money laundering legislation and regulations should also be taken into account.

Luxembourg has an open policy towards foreign investments, promoted by means of, *inter alia*, grants of subsides.

Luxembourg is part of the Belgo-Luxembourg Economic Union which mainly aims at supporting, stimulating and protecting investments. It has signed some 100 bilateral investment treaties with various states around the world which generally create a legal and regulatory framework preventing protectionism with respect to foreign investments.

No governmental approvals are required for project finance transactions. However, a business license may be required if the activity in Luxembourg goes beyond the pure financing of the project and involves carrying out commercial activities in Luxembourg. In such case, a business license must be sought from the *Direction Générale PME et Entrepreunariat*.

Public procurements are regulated.

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What is the applicable procurement process?

Contracts with public entities are subject to public bid restrictions imposed by EU law and national laws. These rules impose a public tender process, governed by the public procurement rules implemented by the Luxembourg law dated 8 April 2018 on public procurement, as amended from time to time.

The key principles are that contracts procured by the public sector are awarded fairly, transparently and without discrimination on the grounds of nationality and that all potential bidders are treated equally.

The procurement process is as follows:

Prerequisite

The submission criteria are detailed in the tender documents accompanying the public contract notice or are sent directly to the business (procedure without publication). The following information is provided:

- award criteria, the weighting given to each criterion and the rating system;
- the minimum criteria for participation in case of a public tender;
- deadlines;
- penalties for delays;
- possible bonus for termination of works before the deadline;
- technical description of variants; and
- insurance policies to take out.

Preliminary steps

When the business has identified a potentially interesting public procurement notice or if it has been invited by a contracting authority to tender a bid, it must verify that:

- the means (human, technical, financial etc) at its disposal meet the contract requirements; and
- it can meet the deadlines.

Types of procedures

There are several types of public procurement procedures, amongst others:

- open procedures, which require the procurement contracts to be publicly advertised;
- restricted procedure may be used in the cases mentioned in article 66 of the Luxembourg law dated 8 April 2018 on public procurement;
- exceptional procedures, which depend on the scope of the procurement contract (regarding procurement contract below or above certain thresholds);
- negotiated procedure or restricted procedure without publication;
- negotiated procedure (regarding, *inter alia*, rescue services, police, customs);
- negotiated procedure with or without prior publication (in instances mentioned in article 19 and 20 of the Luxembourg law dated 8 April 2018 on public procurement, as amended from time to time); and
- competitive dialogue (in instances mentioned in article 68 of the Luxembourg law dated 8 April 2018 on public procurement, as amended from time to time).

Preparing the tender

A business must meet all requirements detailed in the tender documents. This document defines the works or services to be carried out, the tendering conditions and the documents requested by the contracting authority.

Bid documents which do not meet the conditions laid down in the tender documents are rejected.

However, since the reason for a rejection will be provided, any business that believes it has been treated unfairly may lodge an appeal. The bid document allows the business to:

- present itself or the members of the group of businesses;
- highlight its experience;
- put forward its financial means and guarantees;
- put forward the advantages it has over the competition; and
- define its project.

The business may, within a reasonable time limit, request clarifications concerning the contract from the contracting authority. Answers are sent to all the participants.

Tendering the bid

To be eligible, a company must meet the deadlines for submission of the application/tender. The tender may be submitted personally in exchange for a receipt or sent by mail with acknowledgement of receipt.

Administrative certificates

Depending on the procedure, the business must also prove that it has fulfilled its professional obligations by attaching the following documents to its tender:

- a non-liability certificate from the Joint Social Security Centre (*Centre Commun de la Sécurité Sociale*);
- a certificate of compliance with respect to value added tax obligations and liability from the Land Registration and Estates Department (*Administration de l'Enregistrement des Domaines et de la TVA*);
- a non-liability certificate from the Luxembourg Inland Revenue (*Administration des Contributions Directes* – (ACD)), delivered on simple request at the competent tax office of the ACD; and
- an extract from the criminal records.

Where applicable, national and foreign subcontractors must also provide these certificates.

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What are the most common forms of funding / investing in energy and infrastructure?

Funding

Sources of financing are mostly provided by leading foreign financial institutions and private investors but also by investment funds offering structured solutions for public projects established within a public-private partnership.

Common forms of funding in energy and infrastructure include:

- loans made on a corporate finance basis (balance sheet debt);
- loans made on a project-finance basis (to a special purpose project company) on medium- to long-term bases – such loans may later be syndicated to other funders;
- bonds; and
- mezzanine debt.

Investing

Common forms of investing in energy and infrastructure include:

- equity investment in special purpose vehicles or entities that may have a portfolio of interests, such as share capital and subordinated sponsor loans; and
- secondary market investment in operational projects (acquisition of equity).

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Restructuring

Enforcement and sanctions

When can there be regulatory investigations?

When the *Commission de Surveillance du Secteur Financier* considers that an authorized firm or regulated individual may have breached the ongoing compliance requirements, it will launch a formal investigation. This may result in regulatory sanctions.

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What regulatory penalties may apply?

When a rule breach has taken place, the *Commission de Surveillance du Secteur Financier* may impose a financial penalty or censure, or withdraw regulated status against the firm and/or regulated individuals. The regulator will publicize these penalties.

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What criminal penalties may apply?

Following formal investigation, the Luxembourg criminal courts have powers to impose criminal penalties in certain cases, including:

- insider dealing and misleading statements and practices;
- breaches of the money laundering regulations; and
- conducting regulated activities when not authorized.

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Tax

Tax issues

Are stamp, registration, transfer or other similar taxes applicable?

Are there stamp, registration, transfer or other similar taxes payable on the advance, transfer or assignment of a loan?

Luxembourg law does not require the lending of funds, transfer or assignment of a loan to be registered with tax authorities. Hence, no registration tax is payable on the lending of funds or the transfer or assignment of a loan.

Registration duties may be payable upon voluntary registration.

No stamp duty, transfer tax or other similar taxes are payable on the lending of funds, transfer or assignment of a loan.

Are there stamp, registration, transfer or other similar taxes payable on the taking, transfer or assignment of a mortgage, debenture or other security?

Luxembourg law does not require the act of taking, transferring or assigning a debenture or other security to be registered. Hence, no registration tax is payable upon the taking, transferring or assigning of a debenture or other security.

The grant, transfer and assignment of a debenture or other security may, however, be registered on a voluntary basis.

The grant and renewal of mortgages, as well as their transfer and assignment, should be registered and should underly registration duties.

No stamp duty, transfer tax or other similar taxes are payable upon the grant, transfer or assignment of a mortgage, debenture or other security.

Are there stamp, registration, transfer or other similar taxes payable on the issue, transfer or assignment of a debt security (e.g. a bond)?

Luxembourg Law does not require the issue, transfer or assignment of debt securities to be registered. Hence, no registration tax is payable upon the issue, transfer or assignment of debt securities.

The issue of debt securities, the transfer of debt securities and the assignment of debt securities may be registered on a voluntary basis.

No stamp duty, transfer tax or other similar taxes are payable upon the issue, transfer or assignment of debt securities.

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Do tax authorities take priority on enforcement?

On the enforcement of security, do tax authorities take priority over secured lenders or secured debt security holders (eg secured bond holders)?

On the enforcement of security, the tax authorities have priority over secured lenders and secured debt security holders.

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Is withholding tax on interest payments applicable?

Interest payments are not subject to withholding tax (WHT) in Luxembourg except in the following cases:

- Interest payments to a silent partner in proportion to the profit realized may be subject to a 15% WHT.
- Interest payments on profit sharing bonds may be subject to a 15% WHT.
- Interest payments can be requalified into dividends and are then subject to a 15% withholding tax where a Luxembourg company is over-indebted in light of thin capitalization rules or where a Luxembourg company does not comply with transfer pricing regulations.
- Interest payments made by Luxembourg resident paying agents to Luxembourg resident individuals are subject to a 20% WHT. There is an exemption from WHT if the amount due does not exceed €250.

- Where interest payments are made or credited by foreign paying agents located in a member state of the EU or in a state of the European Economic Area, the Luxembourg resident taxpayer may opt for a 20% WHT.

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Are foreign lenders and debt security holders subject to tax on interest payments?

Will the lender be taxed on interest payments under a loan in the jurisdiction of the borrower (other than by way of the application of withholding tax (if any)), assuming the lender is not otherwise resident in that jurisdiction for tax purposes (eg by virtue of incorporation, residence or local branch)?

No.

Would the same analysis apply to interest payments under a debt security (eg a bond)?

Yes.

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