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REGULATORY WATCH Luxembourg

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Agenda

Summary of ESMA Report on Greenwashing

Context

The ESMA report titled "Final Report on Greenwashing," published in June 2024, critically examines the issue of misleading environmental claims in financial products and services, offering insights and recommendations to enhance transparency and safeguard investors in the sustainable finance market.

Definition and Scope

Greenwashing refers to the practice of making misleading claims about the environmental benefits of a financial product or service. The report defines it as the act of presenting investments or financial products as more environmentally friendly or sustainable than they actually are, thereby deceiving investors and undermining the integrity of sustainable finance markets.

Key Findings

The report identifies several key issues contributing to greenwashing:

- Lack of Standardization
- Inadequate Disclosures
- Misleading Marketing

Impact on Investors

Greenwashing poses significant risks to investors, including:

- misallocation of Capital: Investors may unintentionally support products that do not align with their sustainability goals, undermining the overall effectiveness of sustainable finance initiatives;
- erosion of Trust: persistent greenwashing can erode trust in financial markets and sustainability claims, making it harder for genuinely sustainable products to stand out.

Recommendations

The report provides several recommendations to combat greenwashing:

- Enhanced Disclosure Requirements
- Stronger Regulatory Oversight
- Increased Transparency
- Education and Awareness

The ESMA report highlights the urgent need to address greenwashing to protect investors and maintain the integrity of the sustainable finance market. By implementing the recommended measures, regulators and financial institutions can work together to ensure that sustainability claims are accurate, transparent, and reliable, thus fostering trust and effectiveness in sustainable investing.

Retail Investment strategy – Update

Definition and Scope

On 12 June 2024, the Council of the European Union reached an agreement on its position for the Retail Investment Strategy (RIS) and the retail investor package (PRIIPs). This proposal, originally introduced by the European Commission in May 2023, was adopted by the European Parliament in April 2024. The RIS brings significant changes to the banking, insurance, and investment management sectors, revising multiple EU regulations to strengthen retail investor protection.

Inducements

The Council chose to keep inducements for execution-only sales but added safeguards to avoid conflicts of interest.

Main provisions include:

- an inducement test ensuring advisors act in clients' best interests;
- increased transparency on inducements, their costs, and effects on returns,
- firms must follow overarching principles to ensure inducements don't unduly affect product recommendations or favor affiliated entities;
- member States may implement stricter rules on inducements;
- the inducement rules will be reviewed five years after implementation.

Value for Money

This concept ensures that retail clients receive fair value from their investment products. Companies must evaluate costs and charges in relation to product performance, benefits, and objectives.

Key points include:

- financial firms are not required to conduct benchmarking exercises but should compare their products to similar ones in the EU;
- benchmarks will remain a supervisory tool. The European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) will develop benchmarks to help national authorities spot products that do not provide value for money;
- firms can use EU supervisory benchmarks for market comparison instead of peer group comparisons;
- the framework will be reviewed seven years after implementation.

Next Steps

This agreement between the European Parliament and the Council opens the door for interinstitutional negotiations to finalize the text. However, with upcoming European Parliament elections and reorganization, the timeline for final adoption remains uncertain.

How Aurexia can help you

- ➢ Drafting regulatory briefs for Retail Investment Strategy and end-users.
- ➢ Regulatory change and revision.
- ➢ Impact analysis on the scope of products and services concerned.

CSSF Reminds Luxembourgish depositaries and AIFs of depositaries' duties regarding ex-ante information collection and control, as required by the AIFMR when it comes to transactions in illiquid assets

This communication from the CSSF comes following the realization that AIF's depositaries in Luxembourg do not all respect their duties regarding the collection of information and control prior to investing in illiquid assets.

These ex-ante control duties include :

- ownership verification: Control of the AIF's ownership right or ownership right of the AIFM is acting on behalf of the AIF;
- record keeping: Register in its records, in the name of the AIF, assets and their respective notional amounts;
- timely settlement of the information: the depositary shall set up a procedure to detect a situation where operations related to the AIF's assets are not remitted to the AIF within the expected time limits. If there is no remediation to this situation, the depositary shall request the restitution of the assets from the counterparty.

To facilitate this exercise, AIFs will have to provide supporting documentation about the transactions they would like to make in illiquid assets, enabling the custodian to identify the structure through which the transaction is being made and verify the existence of the transaction and the relevant assets. The AIF shall also provide supporting documents to identify the third parties. Without this information, the depositary cannot authorize the payment.

that this is a shared responsibility between the AIF and the depositary to respectively provide and control relevant information promptly, as a way to comply with regards to the depositary safekeeping duties regarding ownership verification and record keeping, as required by Article 90(2) of the AIFMR.

New taxes measures proposed - 8414 - ALFI

On July 19th, ALFI (Association Luxembourgeoise des Fonds d'Investissement) welcomes the new tax package aimed at enhancing Luxembourg's competitiveness. This initiative aims to improve the country's attractiveness for investment and support its financial sector. ALFI sees these measures as a means of consolidating Luxembourg's position as an international financial center. Indeed, Luxembourg is Europe's largest fund domicile and a world leader in cross-border fund distribution.

Here is a detailed summary of the new tax measures proposed in Bill No. 8414 on July 17, 2024, welcomed by ALFI:

1. Exemption from subscription tax for active ETFs to encourage asset managers to launch ETFs with active management strategies.

Impact: Opening new distribution channels for investment funds and broadening the range of funds available to investors in Luxembourg, thereby strengthening the country's competitiveness.

Eligibility criteria: Applicable to UCITS of which at least one unit or share class is traded throughout the day on a regulated market or multilateral trading facility with at least one market maker guaranteeing that the market value of the units or shares does not vary significantly from their net asset value.

2. Reduction in the corporate income tax (CIT) rate 17% to 16% from fiscal year 2025 in order reduce the overall income tax rate for Luxembourg tax residents in Luxembourg City from 24.94% to 23.87%.

Impact: Tax relief for resident companies, including Luxembourg management companies and financial sector professionals.

3. Attracting and retaining talent to strengthen Luxembourg's competitiveness and economic growth by attracting highly qualified experts:

- Modification of the inpatriates regime: Tax exemption of 50% of gross annual income (up to 400,000 euros) to make it easier and more effective for companies to attract key talent.
- Modification of the profit-sharing bonus: Increase in the tax-exempt portion of the bonus from 25% to 30% of gross annual remuneration, and adjustment from 5% to 7.5% of the positive result for the operating year that employers can allocate to profit-sharing bonuses.

4. Adjustments in personal taxation:

Reducing the tax burden on individuals, increasing their purchasing power and stimulating the economy.

In short, these measures aim to strengthen Luxembourg's competitiveness by attracting investment and talent and supporting the investment fund industry.

NEWS - 2nd Batch DORA July 2024

On July 17, 2024, the three European Supervisory Authorities (EBA, EIOPA, and ESMA) published the second batch of policy products under the Digital Operational Resilience Act (DORA). This batch includes four final draft Regulatory Technical Standards (RTS), one set of Implementing Technical Standards (ITS), and two guidelines aimed at enhancing the digital operational resilience of the EU financial sector.

The focus of this package is on the reporting framework for ICT-related incidents, threat-led penetration testing, and oversight framework design. Specifically, the RTS address the content, format, and timelines for reporting major ICT incidents and significant cyber threats, as well as requirements for oversight activities and threat-led penetration testing. The guidelines cover the estimation of aggregated costs/losses from major ICT incidents and oversight cooperation.

On July 26, 2024, the ESAs published their final report on the draft RTS for subcontracting ICT services that support critical or important functions under DORA (the remaining RTS from the 17/07 publication). These RTS are designed to improve digital operational resilience by fortifying ICT risk management in subcontracting. They outline requirements for assessing risks during the pre-contractual phase and managing subcontracting arrangements throughout their lifecycle.

The standards mandate financial entities to monitor subcontractors effectively to control risks associated with ICT services supporting critical functions. These standards are based on Article 30 of DORA, which outlines the conditions for subcontracting ICT services.

The ESAs are releasing the following final draft technical standards:

- **JC 2024 33** – 17 July 2024 RTS and ITS on the content, format, templates and timelines for reporting major ICT-related incidents and significant cyber threats;
- **JC 2024 35** – 17 July 2024 RTS on the harmonization of conditions enabling the conduct of the oversight activities;
- **JC 2024 54** – 17 July 2024 RTS specifying the criteria for determining the composition of the joint examination team (JET);
- **JC 2024 29** – 17 July 2024 RTS on threat-led penetration testing (TLPT); and
- **JC 2024 53** – 26 July 2024 RTS on subcontracting under DORA

The set of guidelines include:

- **JC 2024 34** – 17 July 2024 Guidelines on the estimation of aggregated costs/losses caused by major ICT-related incidents;
- **JC 2024 36** – 17 July 2024 Guidelines on oversight cooperation.

Next steps include adoption of the guidelines by the ESA Supervisory Boards, and submission of the final draft technical standards to the European Commission for review and adoption in the coming months.

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